

Sims Metal Management

Trading update

Sims Metal Management (SGM) announced the recent and significant falls in ferrous and non-ferrous prices would have a negative impact on the first half of FY20, and that the result would be materially lower than for the first half of FY19.

Accordingly, Ord Minnett has further reduced its forecasts for FY20 and now expects the worst half-year performance since Sims was loss-making in the first half of FY16. We have lowered our first-half FY20 earnings before interest and tax (EBIT) forecast by 58%, having previously forecast a decline on first-half FY19 profitability, while FY20 EBIT has been reduced by 37%.

A recovery before calendar year end is unlikely, in our view, and a further deterioration in the macro-economic environment cannot be ruled out.

We maintain our Lighten recommendation on Sims and lower our target price to \$9.50 from \$10.50.

- **1H20 downgrade** – Sims announced that the recent and significant falls in ferrous and non-ferrous prices would have a negative impact on 1H20, and that the result would be materially lower than for 1H19.
- **Ferrous pricing (volumes/margins)** – In the release, Sims revealed that steel mills materially reduced both their scrap purchases in early September, as well as their outlook for purchases. The current scrap price results in a buy price that is potentially sub-economic for a number of Sims' suppliers. In our forecasts, we assume a 9% drop in volumes on 1H19.
- **Shipping rates (margins)** – The company also cited a consistent rise in deep sea freight prices over the past month. Normally, Sims has been able to recover increased costs through the buy price, but now has said this was not possible in the present low-price, low-liquidity environment. We have assumed this will result in a US\$7.5/t impact on 1H20. A reduction of that magnitude without Sims's ability to offset through lower buy prices more than halves margins in the North American business, South Africa joint venture and European businesses.
- **Non-ferrous prices** – Declining automobile sales are affecting the price and demand for non-ferrous automobile shred (known as twitch).

Recommendation

Lighten

Risk

Higher

Target price

▼ \$9.50

Previous

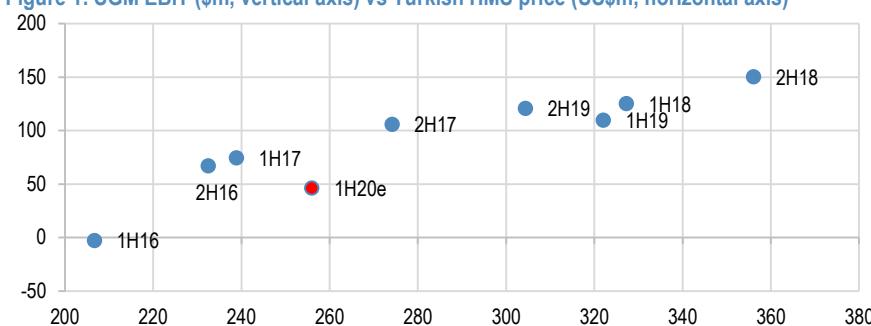
\$10.50

Last price

\$10.90



Figure 1: SGM EBIT (\$m, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

Company Review

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Private Client Research

Price Performance



Company Data

Shares O/S (mn)	205
52-week range (\$)	13.87-8.91
Market cap (\$ mn)	1,537.16
Exchange rate	1.45
Free float(%)	82.9%
3M - Avg daily vol (mn)	1.08
3M - Avg daily val (\$ mn)	8.0
Volatility (90 Day)	44
Index	ASX 100
BBG BUY HOLD SELL	2 3 3

Key Metrics (FYE Jun)

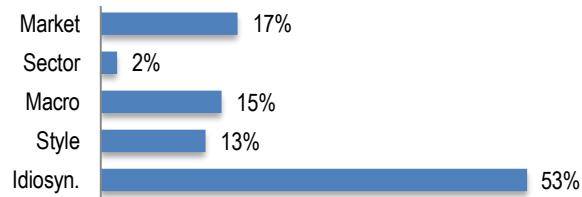
	FY19A	FY20E	FY21E	FY22E
Financial Estimates				
Revenue	6,630	6,369	6,940	6,750
EBITDA	363	292	405	413
Adj. EBITDA	363	292	405	413
Adj. EBIT	230	142	241	236
Adj. net income	162	99	169	164
Net income	153	99	169	164
Adj. EPS	0.79	0.49	0.83	0.81
BBG EPS	0.79	0.86	0.87	-
Net debt	(348)	(61)	35	(21)
Cashflow from operations	360	61	304	331
Investing cashflow	(194)	(293)	(323)	(192)
FCFF	174	(218)	(9)	150
Margins and Growth				
Revenue growth	2.8%	(3.9%)	9.0%	(2.7%)
EBITDA growth	(7.4%)	(19.7%)	38.8%	1.8%
Adj. EPS growth	(14.6%)	(38.1%)	70.2%	(2.9%)
Ratios				
Adj. tax rate	27.6%	26.4%	25.7%	25.8%
Net debt/EBITDA	NM	NM	0.1	NM
ROCE	7.3%	4.2%	6.5%	6.1%
ROE	7.2%	4.3%	7.1%	6.6%
Valuation				
FCFF yield	7.8%	(9.9%)	(0.4%)	6.8%
Dividend yield	3.9%	2.3%	3.9%	3.7%
EV/EBITDA	6.1	8.5	6.4	6.1
Adj. P/E	13.8	22.3	13.1	13.5
P/BV	1.0	0.9	0.9	0.9

Summary Investment Thesis and Valuation

Sims Metal Management is a recycler of ferrous and non-ferrous metals that operates as a purchaser, processor and seller. The company's primary operations are in the U.S., although it also has significant exposure to Europe and Australasia. The company is focusing on internal initiatives (under its control) to generate earnings growth (cost-outs, productivity improvements, supply chain and logistics optimisation).

We are Lighten on the stock noting that the present challenged trading environment is being impacted by US/China trade wars, low Turkish scrap demand and low automobile sales.

Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI Australia	0.23	0.50
Sect: Materials	0.21	0.22
Ind: Materials	0.30	0.23
Macro:		
US Dollar	0.25	0.22
Credit Spread	-0.12	-0.16
TR/CC CRB ER Index	0.19	0.13
Quant Styles:		
Momentum	-0.37	-0.34
LowVol	-0.27	-0.26
Size	-0.26	-0.22

Sources for: Performance Drivers – Bloomberg, Ord Minnett Quantitative and Derivatives Strategy; all other tables are company data and Ord Minnett estimates.

Changes to earnings and valuation

We have updated our modelling to incorporate today's profit warning. Sims did not provide any quantitative guidance for the upcoming half except to say the result would be "materially" lower than 1H19 (EBIT of \$109m). We have assumed 1H20 EBIT of \$46m but factor a 2H20 recovery to \$96m. We reduce our PT to \$9.50/share as a result of the downgrade. We provide further justification for our earnings change below.

Table 1: SGM earnings change table

		FY2020E			FY2021E			FY2022E		
		New	Old	Change	New	Old	Change	New	Old	Change
EBITDA	\$m	292	376	-22%	405	408	-1%	413	415	-1%
EBIT	\$m	142	226	-37%	241	244	-1%	236	239	-1%
Normalised NPAT	\$m	99	162	-39%	169	172	-2%	164	167	-2%

Source: Ord Minnett estimates.

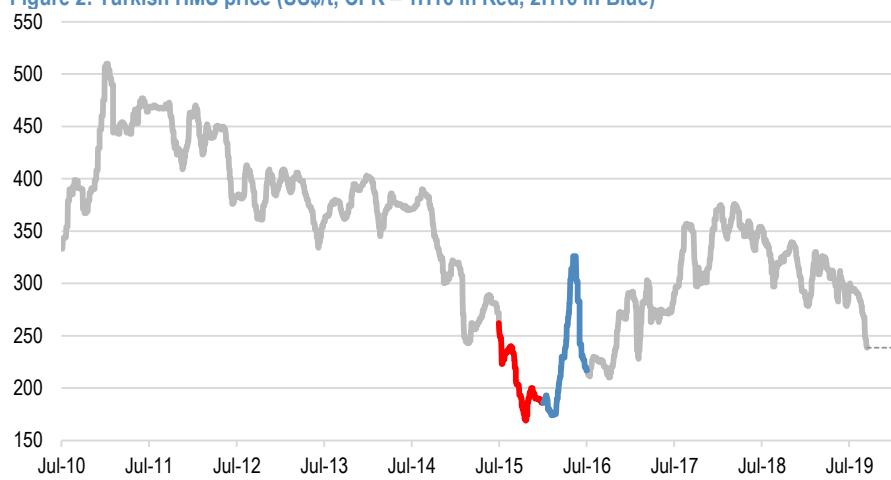
1H20 trading update

The present Turkish HMS scrap price is US\$239/t, a level not seen since FY16 when the company reported a loss making 1H.

Since then, the company has stated that it has delivered ~\$110m of EBIT through internal initiatives (FY17: \$40m, FY18: \$43m, FY19: \$27m).

Offsetting this is a significant deterioration in the non-ferrous segment with the introduction of the Chinese National Sword policy, a US/China trade war as well as impacts on steel trade flows from the US Section 232 tariffs and rising freight costs.

Figure 2: Turkish HMS price (US\$/t, CFR – 1H16 in Red, 2H16 in Blue)



Source: Platts, Ord Minnett estimates.

Table 2: SGM volumes and earnings relative to Turkish HMS scrap price (1H20 assumed spot for remainder of period)

	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20
Turkish HMS price (US\$/t)	207	232	239	274	327	356	322	304	256
SGM EBIT (\$m)	-2.9	66.9	74.3	105.8	125.0	150.1	109.6	120.7	46.1
Sales Volume (kt)	4,299	4,252	4,360	4,340	4,761	5,095	4,951	4,852	4,483

Source: Ord Minnett estimates, Company data, Platts

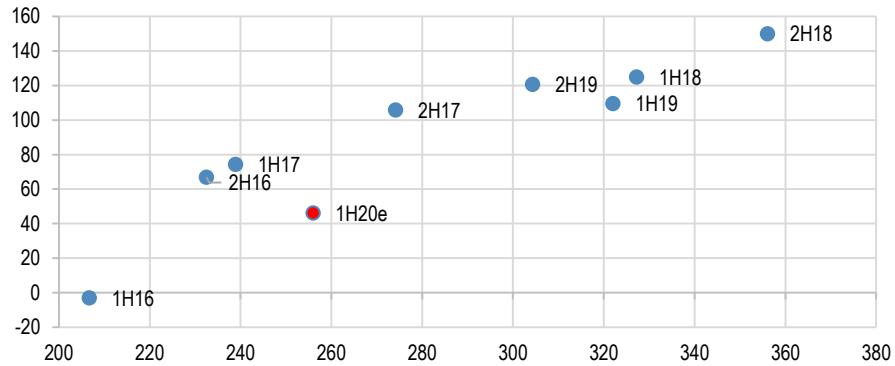
Company Review

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We forecast 1H20 EBIT of \$46m, -58% on the pcp

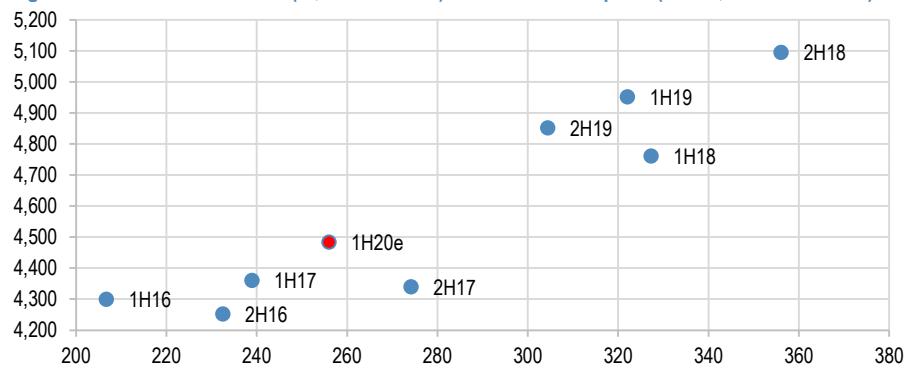
Figure 3: SGM EBIT (\$m, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

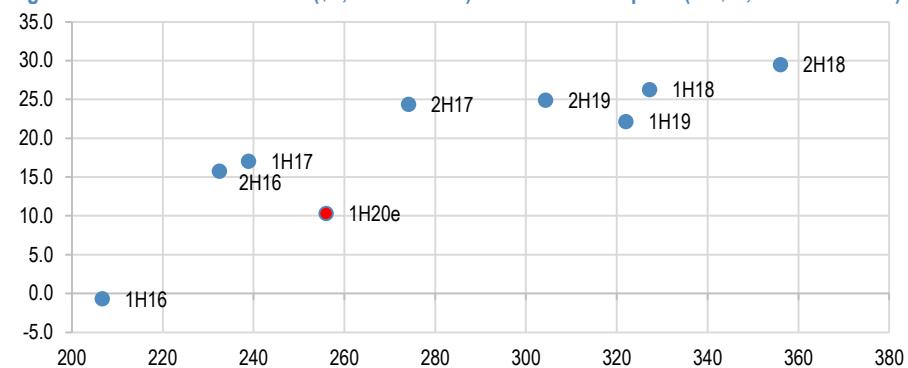
The basis of our \$46m 1H20 EBIT forecast (above) is shown in the charts below. We forecast volumes -9% relative to the pcp but in line with a fall in the scrap prices. We had previously factored in lower margin forecasts but have shaved our expectations on rising freight costs. We have assumed this has a US\$7.5/t impact on 1H20 which unwinds modestly in 2H20. A reduction of that magnitude absent Sims' ability to offset through lower buy prices more than halves margins in the NAM/SAJV and European businesses.

Figure 4: SGM Sales volumes (kt, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

Figure 5: SGM EBIT/sales tonne (\$/t, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

Table 3: SGM segments (excluding the non-trading e-recycling and corporate segments)

		1H19	2H19	1H20e	2H20e
North America					
Sales Volume	kt	2,538	2,405	2,189	2,427
EBIT	\$m	55.3	44.4	16.1	37.2
Margin	\$/t	21.8	18.5	7.4	15.3
EBIT	US\$m	40.0	31.4	10.9	24.3
Margin	US\$/t	15.8	13.0	5.0	10.0
SAJV					
Sales Volume	kt	840	926	843	934
EBIT	\$m	16.8	19.1	6.8	15.0
Margin	\$/t	20.0	20.6	8.1	16.1
EBIT	US\$m	12.2	13.5	4.6	9.8
Margin	US\$/t	14.5	14.6	5.5	10.5
ANZ					
Sales Volume	kt	948	934	851	949
EBIT	\$m	51.8	54.7	38.3	49.9
Margin	\$/t	54.6	58.6	45.0	52.6
EBIT	US\$m	37.5	38.6	26.0	32.6
Margin	US\$/t	39.6	41.4	30.6	34.3
Europe					
Sales Volume	kt	794	810	733	810
EBIT	\$m	6.8	13.5	4.3	11.2
Margin	\$/t	8.6	16.7	5.9	13.8
EBIT	US\$m	4.9	9.5	2.9	7.3
Margin	US\$/t	6.2	11.8	4.0	9.0

Source: Ord Minnett estimates.

Investment Thesis, Valuation and Risks

Sims Metal Management (*Lighten; Price Target: \$9.50*)

Investment Thesis

Sims Metal Management is a recycler of ferrous and non-ferrous metals that operates as a purchaser, processor and seller. The company's primary operations are in the US, although it also has significant exposure to Europe and Australasia. The company is focusing on internal initiatives (under its control) to generate earnings growth (cost-outs, productivity improvements, supply chain and logistics optimisation). We are Lighten on the stock noting that the present challenged trading environment is being impacted by US/China trade wars, low Turkish scrap demand and low automobile sales.

Valuation

Our Jun-20 price target is based on our DCF-based sum-of-parts valuation of \$9.55, using a 9.69% post-tax WACC (beta of 1.29, pre-tax return on debt of 5.8%).

SoP Valuation	A\$m	A\$ps
North America	1,045	5.15
ANZ	1,138	5.61
Europe	317	1.57
Global E-Recycling	65	0.32
Global Trading	(221)	(1.09)
SA Recycling JV	247	1.22
Other	(554)	(2.73)
Enterprise Value	2,036	10.04
Net debt	(61)	(0.30)
Provisions	161	0.80
Equity value	1,935	9.55

Source: Ord Minnett estimates.

Risks to Rating and Price Target

Upside risks to our price target include: the ability to mitigate impacts of changes in the scrap market arising from a Chinese transition away from being a scrap processor; an increase in steel/scrap prices; high economic growth in Turkey, the US, the UK and Australia; and a strengthening of export demand.

Company Review

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Private Client Research

Sims Metal Management

\$ in millions, year end Jun						\$m	ps
Profit And Loss	FY18	FY19	FY20E	FY21E	FY22E	Valuation Summary	
Revenue	6,448	6,630	6,369	6,940	6,750	Current mkt capitalisation	2,234.11 10.90
Revenue growth	26.9%	2.8%	(3.9%)	9.0%	(2.7%)	Price Target	9.50
COGS	(6,134)	(6,312)	(6,109)	(6,587)	(6,388)	Capital growth to price target	(12.8%)
SG&A	-	-	-	-	-		
EBITDA	392	363	292	405	413	Trading Multiples	FY18 FY19 FY20E FY21E FY22E
EBITDA growth	34.2%	(7.4%)	(19.7%)	38.8%	1.8%	PE Pre-abnormals	11.8 13.8 22.3 13.1 13.5
EBITDA margin	6.1%	5.5%	4.6%	5.8%	6.1%	PE Reported	11.1 14.6 22.3 13.1 13.5
Amortisation	(8)	(11)	(12)	(13)	(14)	EV/EBITDA	5.9 6.1 8.5 6.4 6.1
Depreciation	(109)	(122)	(138)	(151)	(162)	EV/EBIT	8.4 9.7 17.5 10.7 10.7
EBIT	275	230	142	241	236		
EBIT growth	52.7%	(16.3%)	(38.4%)	69.6%	(2.0%)	Key Ratios	FY18 FY19 FY20E FY21E FY22E
EBIT margin	4.3%	3.5%	2.2%	3.5%	3.5%	Dividend Yield	4.9% 3.9% 2.3% 3.9% 3.7%
Net Interest	(9)	(7)	(7)	(13)	(15)	Franking	100.0% 100.0% 100.0% 100.0% 100.0%
Pre-Tax Profit	266	224	135	227	221	Return on Assets (%)	6.5% 5.1% 3.0% 4.7% 4.4%
Tax	(74)	(62)	(36)	(58)	(57)	Return on Equity (%)	9.2% 7.2% 4.3% 7.1% 6.6%
Tax Rate	27.8%	27.6%	26.4%	25.7%	25.8%	ROIC (%)	- - - - -
Minorities	-	-	-	-	-		
Abnormals (post tax)	11	(9)	0	0	0	Leverage	FY18 FY19 FY20E FY21E FY22E
Reported NPAT	204	153	99	169	164	Gearing (Net Debt / Equity)	NM NM NM 0.0 NM
Normalised NPAT	192	162	99	169	164	Gearing (ND / (ND + E))	(15.8%) (17.8%) (2.7%) 1.4% (0.8%)
Growth	60.0%	(15.7%)	(38.7%)	70.2%	(2.9%)	Net Debt / EBITDA	NM NM NM 0.1 NM
End of Period Shares	208	205	203	203	203	EBIT Interest Cover (x)	30.9 34.4 20.1 18.0 15.7
EFPOWA	207	205	203	203	203		
Reported EPS	0.98	0.74	0.49	0.83	0.81	Balance Sheet	FY18 FY19 FY20E FY21E FY22E
Normalised EPS	0.93	0.79	0.49	0.83	0.81	Cash	339 383 383 383 383
Growth	55.6%	(15.5%)	(37.9%)	70.2%	(2.9%)	Receivables	462 387 470 479 468
DPS	0.53	0.42	0.25	0.42	0.40	Investments	- - - - -
Growth	6.0%	(20.8%)	(40.5%)	68.0%	(4.8%)	Inventories	567 443 539 545 531
DPS/EPS payout	54.0%	56.4%	51.1%	50.4%	49.5%	Other Current Assets	21 18 18 18 18
						Total Current Assets	1,389 1,230 1,409 1,424 1,400
Cash Flow Statement	FY18	FY19	FY20E	FY21E	FY22E	Net PPE	1,156 1,267 1,410 1,569 1,584
EBITDA	392	363	292	405	413	Total Intangibles	199 194 194 194 194
Net Interest (Paid)/Recd	(7)	(5)	(7)	(13)	(15)	Other Non Current Assets	459 494 505 526 546
Tax Paid	(60)	(61)	(36)	(58)	(57)	Total Non Current Assets	1,813 1,955 2,109 2,289 2,324
(Inc)/Dec in Working Capital	(73)	90	(177)	(9)	11	Total Assets	3,202 3,185 3,519 3,713 3,724
Other Operating Items	4	(16)	(11)	(21)	(20)		
Operating Cash Flow	252	360	61	304	331	Creditors	645 536 539 545 531
Net Capex	(172)	(191)	(284)	(323)	(192)	Current Borrowings	2 0 0 0 0
Net Acquisitions	4	6	0	0	0	Total Current Liabilities	793 659 661 667 654
Other Investing cashflows	(95)	(9)	(9)	0	0	Non Current Borrowings	39 35 322 418 362
Investing Cash Flow	(262)	(194)	(293)	(323)	(192)	Non Current Provisions	75 61 61 61 61
Inc/(Dec) in Borrowings	37	(4)	287	96	(56)	Other Non Current Liabilities	14 14 14 14 14
Equity Issued	35	(18)	0	0	0	Total Non Current Liabilities	219 228 515 611 555
Dividends Paid	(107)	(108)	(55)	(77)	(83)	Total Liabilities	1,012 887 1,176 1,278 1,208
Other Financing Cashflows	(2)	(2)	0	0	0	Equity	2,768 2,750 2,750 2,750 2,750
Financing Cash Flow	(37)	(131)	232	19	(139)	Reserves	148 236 236 236 236
Net Cash Flow	(39)	44	0	0	(0)	Retained Profits	(727) (688) (644) (552) (471)
						Outside Equity Interests	- - - - -
						Total Shareholders Equity	2,189 2,299 2,343 2,435 2,516
						Net Debt	(298) (348) (61) 35 (21)

Source: Company reports and Ord Minnett estimates.

Ord Minnett Private Client Research

Please contact your Ord Minnett Adviser for further information on our document.

Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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