

Skellerup Holdings

Firing on all Cylinders

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OUTPERFORM

Skellerup (SKL) is on track to deliver strong FY21 earnings growth, well ahead of our prior expectations. SKL issued initial FY21 NPAT guidance, with the mid-point of the range implying growth of +12% on the prior year. Although SKL has re-rated meaningfully in the past six months (18x 12 month forward PE ratio), we continue to see value, with its more resilient earnings base justifying the higher valuation multiples, in our opinion. SKL offers investors an attractive dividend yield with a robust pipeline of growth opportunities backed by a low capital growth model. We reiterate our OUTPERFORM rating.

NZX Code	SKL	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.13	NPAT* (NZ\$m)	29.1	33.6	34.2	35.8	PE	21.0	18.1	17.8	17.0
Target price	NZ\$3.50	EPS* (NZc)	14.9	17.3	17.6	18.4	EV/EBIT	15.1	12.9	12.6	12.1
Risk rating	Medium	EPS growth* (%)	0.0	15.7	1.8	4.4	EV/EBITDA	11.6	10.3	10.2	9.9
Issued shares	194.8m	DPS (NZc)	13.0	15.0	16.0	17.0	Price / NTA	4.7	4.5	4.4	4.2
Market cap	NZ\$610m	Imputation (%)	50	50	50	50	Cash div yld (%)	4.2	4.8	5.1	5.4
Avg daily turnover	152.4k (NZ\$347k)	*Based on normalised profits					Gross div yld (%)	5.0	5.7	6.1	6.5

What's changed?

- **Earnings:** FY21E NPAT up +17% to NZ\$34m, FY22E and FY23E NPAT up +15% and +16% to NZ\$34 and NZ\$36m respectively
- **Target price:** Increased +60cps to NZ\$3.50, reflecting earnings changes and higher peer multiples

FY21 guidance ahead of prior expectations

SKL positively surprised the market, issuing initial FY21 NPAT guidance range of NZ\$30m to NZ\$35m, +13% ahead of our prior expectations at the mid-point. We understand performance has been broad based with a number of smaller wins providing incremental gains across the business, rather than any significant individual business wins. The wide guidance range reflects 1) elevated uncertainty from potential COVID-19 outbreaks and the expected weaker economic backdrop, and 2) it is only three months into the financial year.

Earnings growth derived from revenue growth and productivity improvements

Growth in its Agri business has in part been driven by a catch up in international orders, which were deferred in FY20 as the company focussed on fulfilling domestic volumes. In addition, commentary suggests further margin improvement from operational gains at its Wigram plant. The Industrial business is delivering strong growth into the US and Australian markets, with margin improvement from both operational gains and productivity improvements. Productivity at SKL's facilities has returned to pre COVID-19 levels, reversing operating de-leverage experienced in FY20.

Earnings base more resilient than in the past

The Industrial division is expected to be the key driver of growth going forward, both through additional business wins and margin expansion. Management commentary references a healthy pipeline of product development, with a number of projects where customers have already committed capital towards development. The medium-term outlook remains uncertain with a volatile economic backdrop. However, SKL's earnings exposure is more resilient than it has been in the past, with recent Industrial growth driven under SKL's improved operating model and the bulk of its Agri earnings base derived from the sale of quasi-consumable milking products.

Skellerup Holdings (SKL)

Priced as at 29 Oct 2020 (NZ\$) **3.13**

12-month target price (NZ\$)*	3.50
Expected share price return	11.8%
Net dividend yield	4.9%
Estimated 12-month return	16.7%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.10
WACC	7.4%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. DCF	3.21
2. Relative valuation	3.53
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	624
(Net debt)/cash	(29)
Less: Capitalised operating leases	(81)
Value of equity	515

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	245.8	251.4	275.3	286.9	297.3
Normalised EBITDA	48.9	55.3	61.8	62.4	64.4
Depreciation and amortisation	(7.1)	(12.8)	(12.3)	(12.2)	(12.0)
Normalised EBIT	41.8	42.5	49.4	50.3	52.4
Net interest	(1.8)	(2.6)	(2.0)	(2.0)	(2.0)
Associate income	0.0	(0.1)	0	0	0
Tax	(11.0)	(10.8)	(13.8)	(14.0)	(14.6)
Minority interests	0	0	0	0	0
Normalised NPAT	29.1	29.1	33.6	34.2	35.8
Abnormals/other	0	0	0	0	0
Reported NPAT	29.1	29.1	33.6	34.2	35.8
Normalised EPS (cps)	14.9	14.9	17.3	17.6	18.4
DPS (cps)	13.0	13.0	15.0	16.0	17.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	2.2	2.3	9.5	4.2	3.6
EBITDA (%)	3.6	12.9	11.8	1.1	3.2
EBIT (%)	5.1	1.6	16.4	1.7	4.2
Normalised NPAT (%)	6.5	0.0	15.7	1.8	4.4
Normalised EPS (%)	5.5	0.0	15.7	1.8	4.4
Ordinary DPS (%)	18.2	0.0	15.4	6.7	6.3

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	48.9	55.3	61.8	62.4	64.4
Working capital change	(8.5)	4.8	(5.7)	(3.5)	(3.0)
Interest & tax paid	(11.5)	(12.1)	(15.8)	(16.0)	(16.6)
Other	0	0	0	0	0
Operating cash flow	28.9	48.0	40.3	42.9	44.8
Capital expenditure	(4.6)	(4.4)	(5.0)	(5.1)	(5.2)
(Acquisitions)/divestments	(8.2)	(5.8)	0	0	0
Other	0	(4.7)	(4.7)	(4.8)	(4.9)
Funding available/(required)	16.2	33.2	30.6	33.0	34.7
Dividends paid	(24.3)	(25.3)	(28.2)	(31.2)	(27.3)
Equity raised/(returned)	2.4	0	0	0	0
(Increase)/decrease in net debt	(5.7)	7.9	2.4	1.9	7.5

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	76.1	73.7	79.4	82.9	85.8
Fixed assets	91.3	87.8	86.0	84.3	82.9
Intangibles	49.5	54.9	54.9	54.9	54.9
Right of use asset	0	21.8	21.8	21.8	21.8
Other assets	7.6	7.0	7.0	7.0	7.0
Total funds employed	224.4	245.2	249.0	250.9	252.5
Net debt/(cash)	36.6	28.5	26.1	24.3	16.8
Lease liability	0	17.8	20.2	20.8	21.3
Other liabilities	9.5	14.4	12.8	12.8	12.8
Shareholder's funds	178.4	184.6	190.0	193.0	201.5
Minority interests	0	0	0	0	0
Total funding sources	224.4	245.2	249.0	250.9	252.5

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	13.1	11.6	10.3	10.2	9.9
EV/EBIT (x)	15.4	15.1	12.9	12.6	12.1
PE (x)	21.0	21.0	18.1	17.8	17.0
Price/NTA (x)	4.7	4.7	4.5	4.4	4.2
Free cash flow yield (%)	4.0	7.2	5.8	6.2	6.5
Net dividend yield (%)	4.2	4.2	4.8	5.1	5.4
Gross dividend yield (%)	5.0	5.0	5.7	6.1	6.5

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	23.4	16.5	24.2	24.8	26.1
Interest cover EBITDA (x)	27.4	21.4	30.3	30.8	32.1
Net debt/ND+E (%)	17.0	13.4	12.1	11.2	7.7
Net debt/EBITDA (x)	0.7	0.5	0.4	0.4	0.3

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	16.3	15.0	17.0	17.1	17.6
Return on equity (%)	16.3	15.7	17.7	17.7	17.7
Return on funds employed (%)	14.5	14.5	16.4	16.5	17.1
EBITDA margin (%)	19.9	22.0	22.4	21.8	21.7
EBIT margin (%)	17.0	16.9	18.0	17.5	17.6
Capex to sales (%)	1.9	1.7	1.8	1.8	1.7
Capex to depreciation (%)	64	34	41	42	43
Imputation (%)	50	50	50	50	50
Pay-out ratio (%)	87	87	87	91	93

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue by segment					
Agri	88.8	93.6	104.8	108.0	111.2
Industrial	157.2	157.9	170.6	179.1	186.3
Total revenue (incl. eliminations)	245.8	251.4	275.3	286.9	297.3
EBIT by segment					
Agri	22.8	25.4	28.8	28.6	28.9
Industrial	22.9	20.9	24.7	26.0	27.9
Total EBIT (incl. overheads)	41.8	42.5	49.4	50.3	52.4

EBIT margin by segment					
Agri (%)	25.7	27.1	27.5	26.5	26.0
Industrial (%)	14.6	13.2	14.5	14.5	15.0
Total (%)	17.0	16.9	18.0	17.5	17.6

Earnings changes

SKL has issued an initial FY21 NPAT guidance range of NZ\$30m to NZ\$35m.

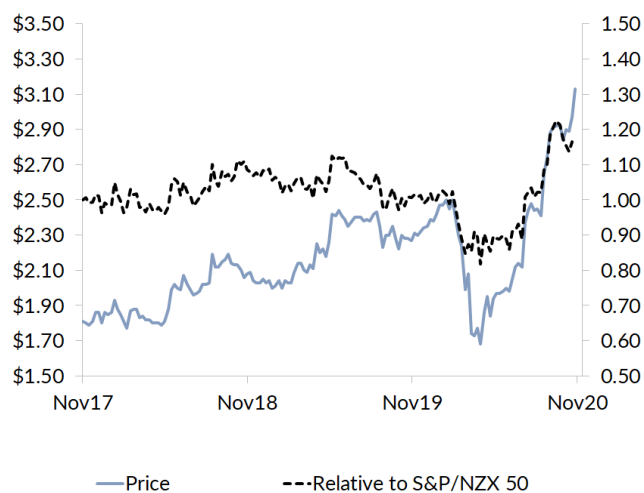
We increase our FY21E NPAT +17% to NZ\$34m, towards the top end of the guidance range. Earnings growth is being driven by a combination of revenue growth from both new and existing customers, and margin expansion as operational gains are realised. We have also lifted our FY22E and FY23E NPAT expectations +15% and +16% respectively, reflecting a higher earnings base. Our low growth assumption in FY22E largely reflects 1) elevated economic uncertainty, and 2) risk of some earnings pull forward occurring in FY21E.

Management commentary suggests a healthy pipeline of growth opportunities, however, the nature of SKL's business and the diverse range of industries it operates in limits visibility on both the quantum and timing of future earnings growth. Execution on significant contracts provides upside to our earnings assumptions.

Figure 1. Forecast changes (NZ\$m)

	FY21E			FY22E			FY23E		
	old	new	% chg	old	new	% chg	old	new	% chg
Revenue	256.4	275.3	7.3%	265.6	286.9	8.0%	272.6	297.3	9.1%
EBIT	42.7	49.4	15.9%	43.9	50.3	14.5%	45.4	52.4	15.4%
Normalised NPAT	28.8	33.6	16.9%	29.7	34.2	15.2%	30.8	35.8	16.2%
EPS (cps)	14.8	17.3	16.9%	15.3	17.6	15.2%	15.8	18.4	16.2%
DPS (cps)	13.5	15.0	11.1%	14.0	16.0	14.3%	14.5	17.0	17.2%

Source: Forsyth Barr analysis

Figure 2. Price performance


Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

Shareholder	Latest Holding
Sir Selwyn John Cushing	6.5%
Forsyth Barr Investment Management	5.0%

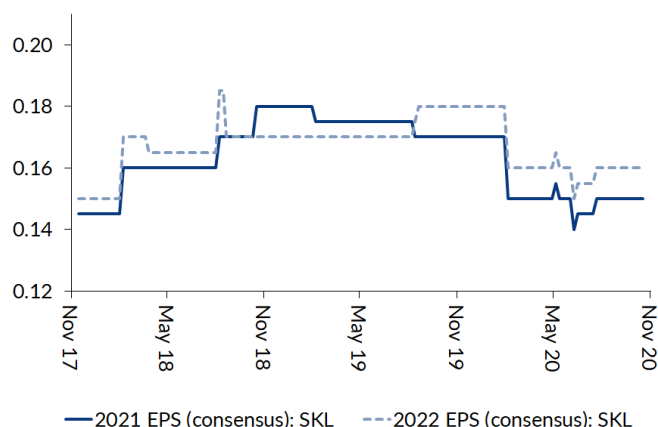
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

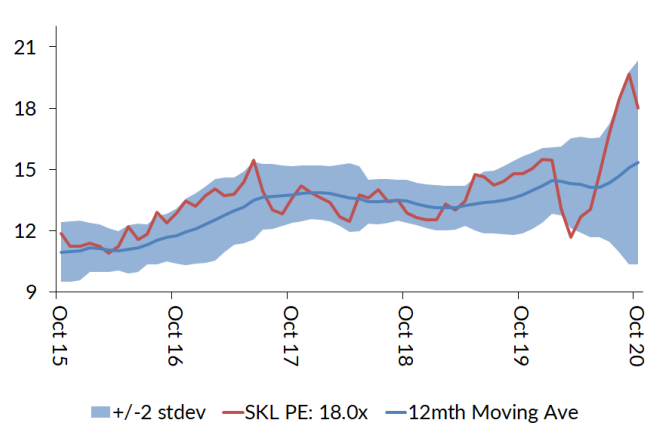
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SKL's balance date - June)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Skellerup Holdings	SKL NZ	NZ\$3.13	NZ\$610	18.1x	17.8x	10.3x	10.2x	12.9x	12.7x	5.1%
AVON RUBBER PLC	AVON LN	£39.35	£1,221	34.0x	29.3x	22.4x	19.7x	25.7x	25.4x	1.1%
TRELLEBORG AB-B SHS	TRELB SS	kr150.30	kr40,742	12.7x	11.1x	8.8x	7.9x	12.4x	10.7x	3.4%
PGG WRIGHTSON *	PGW NZ	NZ\$2.96	NZ\$223	16.2x	14.8x	4.8x	4.7x	10.4x	9.7x	6.1%
NUTRIEN	NTR CN	US\$53.90	US\$30,677	28.7x	23.3x	11.1x	10.3x	22.8x	19.6x	3.5%
METRO PERFORMANCE GLASS	MPG NZ	NZ\$0.37	NZ\$69	17.3x	22.6x	6.0x	6.7x	15.4x	18.0x	0.3%
STEEL & TUBE HOLDINGS *	STU NZ	NZ\$0.62	NZ\$103	30.4x	15.0x	3.6x	3.2x	9.8x	6.8x	4.8%
Compco Average:				23.2x	19.4x	9.5x	8.7x	16.1x	15.0x	3.2%
SKL Relative:				-22%	-8%	9%	17%	-20%	-16%	60%
EV = Current Market Cap + Actual Net Debt										

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Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKL) companies fiscal year end

Figure 5. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)


Source: Forsyth Barr analysis

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