Breaking the cost of capital equipment down to cups of coffee

By Martin Pretty

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Silver Chef — SIV

Last close	$3.00	Net assets	$31.1m
Market cap	$69.6m	NTA	$30.7m
Net debt	$50.5m	Price/book	2.24x
EV	$120.1m	Price/NTA	2.27x
Gearing	42.0%	Year end	Jun 30

Consensus/ historic	FY10a	FY11a/f	FY12f	FY13f
Revenue	49.4	62.9	68.3	75.8
EBITDA	34.6	43.4	46.9	53.0
EPS (adj)	$0.362	$0.385	$0.342	$0.392
DPS	$0.180	$0.200	$0.240	$0.280
EV/revenue	2.43x	1.91x	1.76x	1.59x
EV/EBITDA	3.47x	2.77x	2.56x	2.27x
P/E	8.28x	7.80x	8.77x	7.66x
Yield	6.00%	6.67%	8.00%	9.33%

Silver Chef Limited provides equipment rental finance primarily to the hospitality industry in Australia. It rents and sells various equipment, including beverage, coffee, cooking, display, food preparation, food warming, freezer, refrigeration, washing, cleaning, POS, and vacuum packaging equipment, as well as swift furniture and urns. The company also invests in residential and commercial properties. Silver Chef Limited is based in Milton, Australia.

Source: Capital IQ

We met with Silver Chef (ASX code: SIV) chief executive Charles Gregory this week. SIV has a well established rent/buy model supplying capital equipment to the hospitality industry ($109m of rental assets under management in this division), such as coffee machines and fryers. Typically clients rent for 28 months then buy the equipment outright. The typical value of such an item would be $10,000.

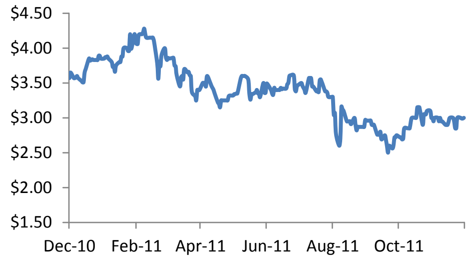
More recently SIV has diversified via its GoGetta business, which leases capital assets to other industries including construction, transport, fitness and baking ($33m of rental assets under management).

SIV's model was established 25 years ago when current chairman Allan English shipped some equipment to Australia only to find his target buyer was not committing. While he turned to the rental model out of necessity, under the business model that has evolved SIV only purchases equipment for which it has a rental deal in place.

SIV's FY12 earnings guidance is for a net profit of $8.3m, up 24% from FY11, translating to EPS of $0.35. This would place it on a prospective P/E of 8.6x.

Earnings growth is tightly linked to asset growth, which requires funding. SIV is talking to its bank about further extending its current $74m facility from CBA but also along the journey requires some additional equity funding and, as such, has at times run an underwritten dividend reinvestment plan (DRP). Current bank covenants are linked to gearing; debt-to-debt + equity; interest cover, total debt remaining less than 8x quarterly EBITDA; and the size of the GoGetta asset pool remaining below a set level relative to whole portfolio.

Share Price



Source: Iress

Key Thoughts

- There are over 400 hospitality dealers nationally and most offer SIV's rental model as an alternative to a sale—a SIV rental deal locks in a sale for the dealer at the full price.
- With rental charged weekly (in advance via direct debit), the cost of the equipment is broken down into bite sizes that can be thought of in terms of "x number of coffees" before it is paid.

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Sell: Valuation < (Share Price X 0.9)
Hold: Valuation > (Share Price X 0.9) < Share Price
Buy: Valuation > Share Price

Speculative (in addition to Buy/Hold/Sell): no history of positive earnings or cash flow; or highly geared; or highly volatile & inherently uncertain earnings

Financial Risk Metrics

General Z-Score: indicator of risk of bankruptcy

- Below 1.1: indicates company could be in financial distress
- Between 1.1 and 2.6: potential warning of financial distress
- Above 2.6: The company may be in good financial shape

Beneish M-Score: indicator of potential earnings manipulation

- A result below –2.22 indicates no apparent manipulation of financial results