

22 February 2011

Silver Chef

Some silver lining

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

SIV delivered a solid underlying result with EBITDA up 22% to A\$19.5m and a 9c fully franked interim dividend. Operating cash flow was strong (up 19.4% yoy) and investment in rental assets was up 40.8% to A\$36.8m which bodes well for the full year. Guidance which was maintained is conservative in our view. Buy maintained.

Chart 1 : Key financial data

Price
A\$3.78

Price Target
A\$4.39

Market Cap
A\$85m

SIV110222

Key Forecasts

	2009A	2010A	2011F	2012F	2013F
EBITDA (A\$m)	23.2	32.1	40.3	48.4	57.4
Net Profit After Tax (A\$m)	3.6	5.5	7.7	9.6	11.9
Net Profit After Tax growth (%)	36.4	53.2	39.9	24.7	24.0
EPS (¢) ¹	22.5	28.0	34.0	40.4	47.4
EPS Growth (%)	47.1	28.6	24.4	21.6	18.8
Dividend Per Share (¢)	14.0	18.0	20.4	24.3	28.5
Dividend Yield (%)	3.7	4.8	5.4	6.4	7.5
Normalised PE (x)	16.8	13.5	11.1	9.3	8.0
PE (x) at price target	19.5	15.6	12.9	10.8	9.2
EV/EBITDA (x)	4.2	3.6	3.2	2.8	2.8
ROIC (%)					

Source: Company data; RBS Morgans estimates

year to Jun, fully diluted

Solid underlying 1H11 result positions SIV well for the 2H11

Revenue of A\$30.1m was up 28.8% on the pcp; EBITDA of A\$19.5m was up 21.8% and operating cashflow was up a similar amount. PBT of A\$4.2m was slightly below expectations and impacted by non-cash costs including a property value decline, interest rate swap and bank fee amortisation. Collectively this accounted for a -A\$750k hit to PBT which when removed indicates double digit underlying growth. NPAT of A\$3.1m was flat on the pcp but up on an underlying basis. EPS declined 22.9% yoy due to capital issued in the 1H11 to fund growth. We expect EPS to grow 24.4% in FY11 as full year earnings growth exceeds dilution. The Board maintained its guidance for FY11 NPAT of A\$6.7-7.0m (+21.8-27.3%). We believe this is conservative and leave our forecast for A\$7.7m NPAT unchanged.

Drivers of growth remain strong

SIV's key earnings driver is the purchase of rental assets which improved a substantial 40.8% yoy (to A\$36.8m) and bodes well for 2H growth. We understand that most of this relates to new customer equipment purchases rather than the replacement of assets damaged in recent floods, fires and cyclones. The core Hospitality business delivered revenue growth of 19.5% while Go Getta delivered a more impressive 82.8% growth off a smaller base (now ~19% of revenue). In an act of good corporate citizenship and following the substantial flood damage incurred in Queensland, SIV provided four weeks of rental relief for affected areas and notes an immaterial impact on earnings.

Investment view – we retain our Buy recommendation

We have made no changes to our forecasts, however our valuation has increase from A\$3.69 to A\$4.38 as we roll forward our valuation. The key risk relates to SIV's ongoing ability to fund expansion. However given refinancing of its banking facility with CBA, SIV is well funded for the medium term. We believe upside risk relates to guidance and the potential for stronger than expected customer demand.

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Results summary

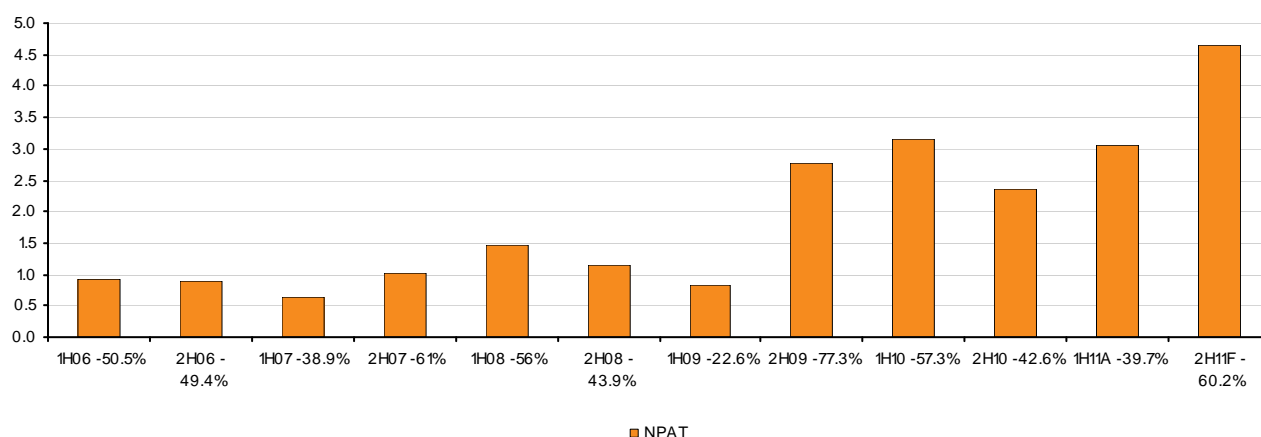
SIV's 1H results were slightly below with our forecast 1H11 NPAT of A\$3.5m. SIV's 1H:2H split has on average been 45:55 but the growing nature of the asset base and several one-offs leaves us comfortable with our 40:60 FY11 split. We forecast NPAT of A\$7.7m which is ahead of guidance for A\$6.7-7.0m in NPAT (which was reiterated at the 1H11 result).

- Revenue of A\$30.2m was up 28.8% on the pcp. Hospitality which accounted for ~80% revenue (e.g. coffee machine rentals) was up 19.5% to A\$23.5m while the more recent Go Getta (e.g. commercial trailers) produced revenue of A\$8.6m (up an impressive 82.8% yoy);
- EBITDA of A\$19.5m was up 22% on the pcp with margins improving;
- Profit before tax was A\$4.2m, flat on the pcp and slightly below guidance due to several non cash/ one-off items;
- NPAT of A\$3.1mm was down 3% on the pcp and EPS were down 22.4% after factoring in a capital raising to help fund growth. On a diluted basis EPS grew ~8%; and
- SIV declared a 9cps dividend (up 12.5% on the pcp) and with a 15 March ex data and 31 March payment date. SIV will maintain its Dividend Reinvestment Plan.

Other

- SIV invested A\$36.8m in PP&E (rental equipment acquisitions) which was up 40.8% yoy. We view this as the leading indicator of SIV's earnings as the acquisition of rental assets is generally followed by rental streams. This 40.8% increase in rental equipment was partially boosted as SIV replaced rental assets damaged in the floods, fires and cyclones of recent times. However we understand the majority of this relates to underlying growth.
- Operating cash flow of A\$20m was up 19.4% yoy while the carrying amount of rental assets (on Balance Sheet) increased a healthy 29.7% to A\$87.5m.
- In an act of good corporate citizenship and following the substantial flood damage incurred in Queensland, SIV provided four weeks of rental relief for affected areas. This leniency is, in our opinion, a good social responsibility and as noted by management will have an immaterial on overall earnings (<4% of revenue).
- We estimate that 36% of SIV's revenue is generated from QLD, 18% from VIC, 28% from NSW and the balance across the rest of Australia. Given the cyclones, floods and fires experienced across Australia, we expect there is further upside to SIV's earnings as customers replace damaged equipment and many who are now cash constrained look to lease business critical assets such as SIV's coffee machines and Go Getta's trailers.
- Net Debt: Equity increased to 180% (from 166% in the pcp). We believe Net Debt: Equipment value is a more appropriate measure and this increased from 55.8% in 1H10 to 56.9% in the 1H11. EBITDA cover and operating cash flow cover (on a full year basis) were comfortable at 1.25x.

Chart 2 : Half yearly NPAT splits and their percentage of the full year result



Source: company data and RBS Morgans estimates

Chart 3 : Results summary table

	1H06	2H06	1H07	2H07	1H08	2H08	1H09	2H09	1H10	2H10	1H11A	2H11F
Revenue	6.9	9.6	9.7	12.1	13.9	15.1	16.3	18.5	23.4	25.9	30.2	31.6
EBITDA	5.0	9.9	6.9	8.5	10.6	10.4	10.8	12.4	16.0	16.2	19.5	20.9
PBT	1.3	5.1	0.9	1.5	2.1	1.7	1.2	2.7	4.2	3.3	4.2	6.8
NPAT	0.9	0.9	0.7	1.0	1.5	1.2	0.8	2.8	3.2	2.3	3.1	4.6
EPS	7.2	7.1	4.5	7.4	10.1	7.4	4.9	17.6	17.8	10.2	13.7	20.3
DPS	3.0	9.0	5.5	5.0	5.0	7.7	0.0	14.0	8.0	10.0	9.0	11.4
Operating cash flow	4.3	-1.9	6.9	-2.0	10.7	2.9	9.7	5.8	16.7	0.9	20.0	0.6
Carrying amount of rental assets	33.5	30.8	37.9	40.5	41.0	41.4	47.0	57.4	67.5	73.5	87.5	7.0
Payments for PP&E	13.0	11.8	15.9	9.2	13.2	10.4	19.2	22.0	26.1	24.7	36.8	25.0

	1H09 vs. 2H08	1H09 vs. 1H08	1H10 vs. 2H09	1H10 vs. 1H09	1H11 vs. 1H10	1H11 vs. 2H10
Growth rates						
Revenue	7.8%	17.2%	26.4%	43.8%	28.8%	16.5%
EBITDA	4.0%	2.8%	29.3%	47.4%	21.8%	20.6%
PBT	-30.4%	-43.3%	53.0%	254.5%	0.7%	28.0%
NPAT	-29.6%	-44.8%	13.8%	287.6%	-3.2%	30.4%
EPS	-32.9%	-51.3%	1.3%	260.1%	-22.9%	34.4%
DPS	-100.0%	-100.0%	-42.9%	n.a.	12.5%	-10.0%
Operating cash flow	231.2%	-9.2%	186.4%	72.9%	19.4%	2147.2%
Carrying amount of rental assets	13.6%	14.6%	17.6%	43.5%	29.7%	19.1%
Payments for PP&E	84.4%	45.7%	19.0%	36.1%	40.8%	49.2%

Source: company data and RBS Morgans estimates

Valuation and forecast changes

We have made no changes to our forecasts. Our DCF based valuation has increased from A\$3.69 to A\$4.38 as we roll forward our valuation.

Key risks relates to liquidity and the risk of customer failure or asset return. However the 13 week rental bond (paid in advance), 29 month average contract life and high rental rates help minimise risk. We believe SIV's risk mitigation process is strong and the companies ability to recycle assets (second hand renting and direct sales) further minimise the risk.

Company overview

SIV is an equipment finance business that was established in 1986 and listed on the ASX in May 2005. It was founded by Allan English and is focussed on providing long term rentals to small-to-medium enterprise. The SilverChef brand is best know for its catering proposition where it provides rental of core business assets to start-up and established restaurants. Management estimate that 70% of all new clients are existing businesses which are growing and therefore need to expand their asset base. More recently SIV launched its GoGetta business which provides equipment financing for commercial purposes e.g. builders renting equipment trailers.

SIV's typical customer is a small to medium business owner/operator. Some of the better known customer brands include: Subway; Dominos Pizza; Eagle Boys Pizza; The Coffee Club; Nandos and Outback Jacks Bar and Grill.

Table 1 : Business lines and customer propositions

Brand	Target Market	Example	Proposition
SilverChef	Start-up and expanding restaurants	Pizza oven rental	Asset renting to minimise cash requirements in start-up business.
GoGetta	Broader commercial equipment market (was ~30% of FY09 AUM)	Trailer and compressor financing	Asset renting to minimise cash requirements in start-up business.

Source: Company data; RBS Morgans

SIV Financial summary

	AIFRS 2009A	AIFRS 2010A	AIFRS 2011F	AIFRS 2012F	AIFRS 2013F	Closing price Valuation metrics	\$3.78	Price target	\$4.39	
Income statement										
Sales revenue	34.8	49.3	61.8	72.1	84.5	Preferred methodology	DCF	Val'n (A\$)	\$4.39	
EBITDA	23.2	32.1	40.3	48.4	57.4	DCF valuation inputs				
Depreciation and amortisation	16.3	21.7	25.4	30.6	35.6	Rf	5.25%	10-year rate	5.25%	
EBIT	7.0	10.4	15.0	17.8	21.8	Rm-Rf	6.00%	Margin	2.0%	
Net interest expense	3.0	2.9	4.0	4.0	4.8	Beta	2.12	Kd	4.73%	
Pre-tax profit	3.9	7.5	11.0	13.8	17.0	CAPM (Rf+Beta(Rm-Rf))	18.0%	Ke	14.0%	
Income tax expense	0.3	2.0	3.3	4.1	5.1	E/EV*Ke+D/EV*Kd(1-t)		NPV cash flow (A\$m)	140.5	
NPAT	3.6	5.5	7.7	9.7	11.9	Equity (E/EV)	20.0%	Minority interest (A\$m)	0.0	
Earnings Per Share (c)	22.5	28.0	34.0	40.7	47.4	Debt (D/EV)	80.0%	Net debt (A\$m)	41.3	
Shares on issue (m)	17.0	19.7	22.6	23.7	25.1	Interest rate	4.73%	Investments (A\$m)	0.0	
Dividend per share (c)	14.0	18.0	20.4	24.4	28.5	Tax rate (t)	30.0%	Equity market value (A\$m)	99.3	
Dividend payout ratio (%)	62.2%	64.3%	59.9%	60.0%	60.1%	WACC	14.4%	Diluted no. of shares (m)	22.6	
						Market Cap	A\$85.5m	DCF valuation	\$4.39	
Cash flow statement	2009A	2010A	2011F	2012F	2013F	Multiples at current share price	2009A	2010A	2011F	2012F
EBITDA	23.2	32.1	40.3	48.4	57.4	Enterprise value (A\$m)	98.5	115.6	128.0	137.6
Change in working capital	1.7	6.6	12.7	6.8	-0.7	EV/Sales (x)	2.8	2.3	2.1	1.9
Net interest (pd)/rec	-2.2	-2.3	-4.0	-4.0	-4.8	EV/EBITDA (x)	4.2	3.6	3.2	2.8
Taxes paid	-2.1	-1.2	-3.3	-4.1	-5.1	EV/EBIT (x)	14.2	11.1	8.6	7.7
Cash flow from ops (1)	20.5	35.3	45.8	47.1	46.8	PE (x)	21.6	13.5	11.1	9.3
Capex (2)	-41.2	-50.8	-61.8	-71.0	-85.8	Yield (%)	3.7	4.8	5.4	6.5
Asset disposals/(acquisitions)(3)	7.4	12.0	16.6	21.0	24.2					
Cash flow from invest (4)	-33.7	-38.8	-45.3	-50.0	-61.6	Multiples at valuation	2009A	2010A	2011F	2012F
Incr/(decr) in equity	-0.3	6.4	1.8	2.5	3.1	EV/EBITDA (x)	5.0	4.0	3.5	3.1
Incr/(decr) in debt	16.2	0.3	10.0	3.0	13.0	EV/EBIT (x)	16.7	12.2	9.5	8.5
Ordinary dividend paid	-1.8	-2.2	-3.6	-5.0	-6.2	PE (pre-goodwill) (x)	19.5	15.7	12.9	10.8
Other financing cash flow	0.0	-0.1	0.0	0.0	0.0					
Cash flow from fin (5)	14.2	4.5	8.2	0.5	9.9	Comparable company data (x)	2009A	2010A	2011F	2012F
Incr/(decr) cash (1+4+5)	1.0	0.9	8.8	-2.4	-4.9	Thorn Group				
Equity FCF (1+2+3)	-13.2	-3.6	0.5	-2.9	-14.8	EV/EBITDA	14.4	10.8	8.5	7.0
						EV/EBIT	15.7	11.4	9.1	7.6
Balance sheet	2009A	2010A	2011F	2012F	2013F	PE	22.3	14.3	13.0	10.8
Cash & deposits	0.5	1.4	10.2	7.8	2.9	EPS growth	13%	56%	11%	20%
Trade debtors	3.1	3.7	4.6	5.3	6.3	ThinkSmart				
Inventory	0.0	0.0	0.0	0.0	0.0	EV/EBITDA	8.4	6.8	5.2	4.4
Investments	6.2	2.3	1.1	0.0	0.0	EV/EBIT	10.8	8.4	6.1	5.0
Intangibles	0.8	0.5	0.5	0.5	0.5	PE	11.1	10.1	8.8	7.8
Fixed assets	57.4	73.5	94.5	115.0	141.1	EPS growth	57%	9%	16%	13%
Other assets	2.1	4.3	4.3	4.3	4.3	Growth ratios	2009A	2010A	2011F	2012F
Total assets	70.0	85.7	115.2	133.0	155.0	Sales growth	20.0%	41.6%	25.3%	16.7%
Short-term borrowings	0.0	0.0	5.3	5.6	6.9	Operating cost growth	44.5%	47.8%	24.9%	10.3%
Trade payables	12.2	15.7	29.4	36.9	37.2	EBITDA growth	10.6%	38.5%	25.5%	20.1%
Long-term borrowings	42.1	42.7	47.4	50.1	61.8	EBIT growth	-5.4%	50.2%	43.3%	18.9%
Provisions	0.5	0.4	0.4	0.4	0.4	NPAT growth	36.4%	53.2%	39.9%	25.5%
Other liabilities	0.1	2.0	2.0	2.0	2.0	EPS growth	28.6%	24.4%	21.6%	19.5%
Total liabilities	54.9	60.8	84.4	95.0	108.2	DPS growth	10.2%	28.6%	13.3%	19.6%
Share capital	9.4	16.9	22.9	30.1	38.9	Operating performance	2009A	2010A	2011F	2012F
Other reserves	0.0	0.0	0.0	0.0	0.0	EBITDA margin (%)	66.7	65.2	65.3	67.2
Retained earnings	5.7	7.9	7.9	7.9	7.9	EBIT margin (%)	20.0	21.2	24.2	24.7
Other equity	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	10.3	11.2	12.5	13.4
Total equity	15.1	24.9	30.8	38.0	46.8	Return on Equity (%)	23.8	22.1	25.0	25.4
						Invested capital	58.4	72.7	86.0	92.7
						ROIC (%)	6.2	7.6	9.0	10.4
Gearing ratios	2009A	2010A	2011F	2012F	2013F					
Net debt (A\$m)	41.6	41.3	42.5	47.9	65.8					
Net debt/ equity (%)	275.3	166.0	138.0	126.1	140.6					
Net debt/ fixed assets (%)	72.5	56.2	45.0	41.6	46.6					
Net debt/ EBITDA (x)	1.8	1.3	1.1	1.0	1.1					
EBIT interest cover (x)	2.3	3.6	3.8	4.5	4.5					

Source: Company data and RBS Morgans estimates; priced at COB 21 February 2011

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SIV: RBS Morgans Corporate Limited was the Underwriter to the Silver Chef Limited dividend reinvestment plan and received fees in this regard.

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Absolute performance, long-term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. The target price is the level the stock should currently trade at if the market accepted the analyst's view of the stock, provided the necessary catalysts are in place to effect the change in perception. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from 'fair' value. Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%; and a Sell less than 5%.

Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

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A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

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