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Elders Ltd (ELD)

Finishing strong

Recommendation
Buy (unchanged)
Price
$4.35
Target (12 months)
$5.01 (previously $4.75)

Expected Return	
Capital growth	15.2%
Dividend yield	0.0%
Total expected return	15.2%

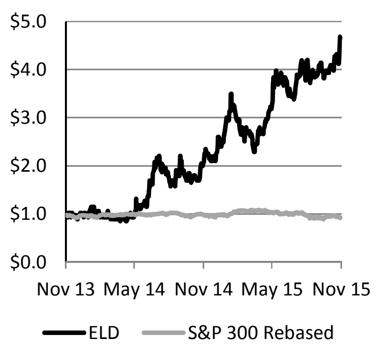
Company Data & Ratios	
Enterprise value	$476.7m
Market cap	$364.2m
Issued capital	83.7m
Free float	100%
Avg. daily val. (52wk)	$1.4m
12 month price range	$1.95-4.77
GICS sector	Food Beverage and Tobacco

Disclosure: Bell Potter Securities acted as Joint Lead Manager in ELD's $57m placement in Oct'14 and received fees for that service.

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	3.99	3.93	2.05
Absolute (%)	16.79	18.58	127.32
Rel market (%)	20.13	26.62	135.57

Absolute Price



SOURCE: IRESS

Strong finish to the year

ELD reported a strong underlying FY15 result, with NPAT 14% ahead of our expectations at $32.6m (BPe $28.7m) and up +258% relative to FY14 levels. Underlying EBIT was 8.8% ahead of expectations with a stronger performance in the retail and agency business of ELD offsetting a weaker than expected result in feed and processing (largely live export). While outlook comments were mixed, the underlying factors which drove the stronger than expected FY15 result, in the form of higher cattle prices and progress on 8PP initiatives, are equally if not more favourable as we commence FY16e.

Low core debt levels create flexibility

Net debt exited the year $39m higher than expected at $136m and largely driven by the stronger finish in the agency and retail businesses. When adjusted for working capital funding, core net debt sat at $15m, a level broadly consistent with FY14 levels ($12m), a reasonable feat given ELD acquired $30m of hybrid equity on market during FY15. With forecast strong underlying cashflows (ex-working capital movements) we would expect further simplification of the capital structure (i.e. buybacks of the hybrid) in the absence of investment initiatives.

Modest upgrades to NPAT

Following a stronger than expected result we have raised our underlying NPAT forecasts by +6.6% in FY16e and +3.2% in FY17e. Our target price lifts to $5.01ps (prev. $4.75ps) reflecting slightly higher earnings, a higher franking balance, faster utilisation of tax loss and higher net debt.

Investment view: Retain Buy rating

ELD operates with favourable tailwinds in the traditional livestock & wool agency businesses (~37% of GP), a strategy in place to lift underlying EBIT to ~$60m by FY17e and has been actively simplifying its capital structure. We retain our Buy rating with an upwardly revised target price of $5.01ps.

Earnings Forecast

Year end September	2015	2016e	2017e	2018e
Sales ($m)	1514.7	1565.0	1699.6	1732.0
EBITDA ($m)	49.3	58.6	65.6	63.5
NPAT (adjusted) ($m)	32.6	40.3	47.6	46.9
NPAT (reported) ($m)	38.3	40.3	47.6	46.9
EPS (adjusted) (cps)	47.9	48.1	56.8	56.0
EPS growth (%)	157.6	0.4	18.2	(1.6)
PER (x)	9.1	9.0	7.7	7.8
FCF Yield (%)	-3.4	5.6	7.1	11.1
EV/EBITDA (x)	9.7	8.1	7.3	7.5
Dividend (¢ps)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	29.5	26.7	24.0	19.1

SOURCE: BELL POTTER SECURITIES ESTIMATES

Strong finish to the year

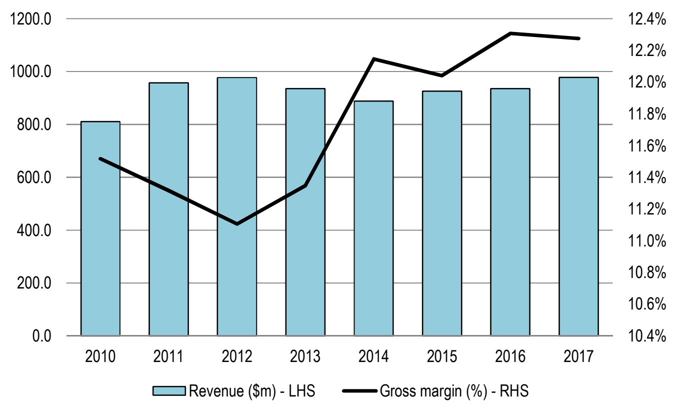
Result: ELD reported a strong underlying FY15 result, with NPAT 14% ahead of our expectations at $32.6m (BPe $28.7m) and up +258% relative to FY14 levels. Underlying EBIT was 8.8% ahead of expectations with a stronger performance in the retail and agency business of ELD offsetting a weaker than expected result in feed and processing (largely live export). An operating cash outflow of $5m was $34m below our expectations and principally driven by a stronger than expected working capital outflow in the period, which in our view is a reasonable sign that activity levels picked up in 4Q15 despite dry conditions. No dividend has been declared as expected.

Figure 1 - ELD FY15 Result overview

Reported revenue	***1657.1***	**702.5**	**729.1**	***1431.6***	**645.5**	**869.2**	***1514.7***	***1510.4***	**0.3%**	
Retail	*106.1*	46.2	61.7	*107.9*	46.5	65.0	*111.5*	*108.8*	2.5%	Sales up 4% despite a 26% fall in fertiliser volumes. Stronger higher margin ag-chem sales filled the gap
Agency	*104.2*	61.4	56.5	*117.9*	67.2	67.5	*134.7*	*128.7*	4.7%	livestock and wool agency GP up +20% YOY on stronger cattle prices and wool volumes
Financial Services	*25.8*	12.7	13.1	*25.8*	12.7	12.7	*25.4*	*26.2*	-3.1%	Management change to driven expected turnaround in the business
Gross contribution	***236.1***	**120.3**	**131.3**	***251.6***	**126.4**	**145.2**	***271.6***	***263.7***	**3.0%**	**Gross profit 3% ahead of expectations**
Overheads	*(220.5)*	(97.0)	(99.5)	*(196.5)*	(96.4)	(99.7)	*(196.1)*	*(202.9)*	-3.4%	Network overhead higher reflecting re-investment. 5-6% headline CPI before cost initiatives
Network	***15.6***	**23.3**	**31.8**	***55.1***	**30.0**	**45.5**	***75.5***	***60.8***	**24.2%**	
Feed & processing	*(23.3)*	5.5	4.5	*10.0*	9.7	4.0	*13.7*	*17.3*	-20.8%	Lower live export volumes and margin per head drove a weaker result in feed and processing
Corporate	*(41.2)*	(15.3)	(22.2)	*(37.5)*	(17.8)	(25.6)	*(43.4)*	*(36.0)*	20.6%	Corporate costs higher reflecting reallocation of charges between divisions
Rural Services EBIT	***(48.9)***	**13.5**	**14.1**	***27.6***	**21.9**	**23.9**	***45.8***	***42.1***	**8.8%**	**Underlying EBIT 9% ahead of expectations**
...Rural Service EBIT Margin (%)	*-3.0%*	1.9%	1.9%	*1.9%*	3.4%	2.7%	*3.0%*	*2.8%*	+20bp	Margin improvement on mix change
Discontinued	*0.0*	0.0	0.0	*0.0*	0.0	0.0	*0.0*	*0.0*	n.a.	
Reported EBIT	***(48.9)***	**13.5**	**14.1**	***27.6***	**21.9**	**23.9**	***45.8***	***42.1***	**8.8%**	
Net Interest expense	*(15.8)*	(7.5)	(8.2)	*(15.7)*	(4.9)	(5.1)	*(10.0)*	*(10.2)*	-2.0%	Lower average net debt through the year on recapitalisation and better working capital management
Profit before tax	***(64.7)***	**6.0**	**5.9**	***11.9***	**17.0**	**18.8**	***35.8***	***31.9***	12.2%	
Tax expense	*(1.8)*	(0.4)	(0.7)	*(1.1)*	(0.3)	(1.1)	*(1.4)*	*(1.9)*	-24.3%	Higher than expected contribution from B&W drove higher tax and outside equity interests.
Minorities	*(2.0)*	(0.6)	(1.1)	*(1.7)*	(0.5)	(1.3)	*(1.8)*	*(1.4)*	29.7%	
NPAT pre-NRI	***(68.5)***	**5.0**	**4.1**	***9.1***	**16.2**	**16.4**	***32.6***	***28.7***	**13.7%**	**Underlying NPAT**
Non-recurring items	*(436.8)*	(15.2)	9.4	*(5.8)*	(0.3)	5.3	*5.7*	*5.0*	14.0%	
Reported NPAT	***(505.3)***	**(10.2)**	**13.5**	***3.3***	**15.9**	**21.7**	***38.3***	***33.7***	13.8%	
Net Debt	*254.8*	236.6	137.6	*137.6*	86.8	136.2	*136.2*	*96.8*	40.7%	Net debt higher than forecasts on larger than expected working capital outflows.

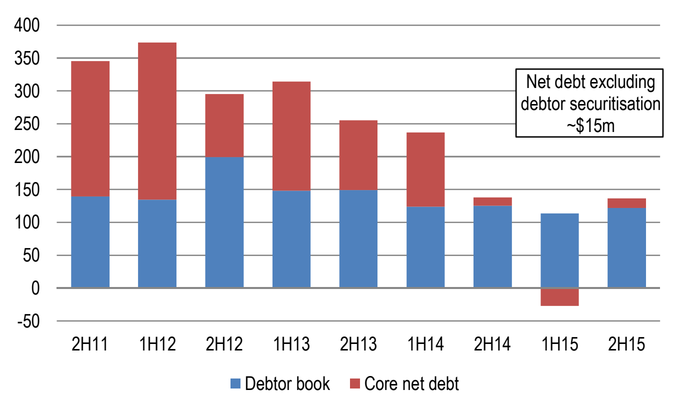
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 2 - Revenue vs. gross margin



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 3 - Core net debt and debtor book



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Net debt: Net Debt exited the year $39m higher than expected with a larger working capital outflow than expected. However, ELD exited the year with core net debt (i.e. ex-working capital financing) of ~$15m. The balance sheet remains in the best shape it has been for several years and in the absence of deploying capital into growth initiatives or acquisition targets we would anticipate further progress on simplifying the capital structure (i.e. further buybacks of the hybrid equity) to continue.

Tailwinds and headwinds: There is no denying the strong tailwinds that were present in the livestock agency business in FY15. However, we continue to see higher cattle prices being sustained (if not elevated) given the declining size of herd and the likelihood of a restocking event at some point over the next 12-18 months. Our base forecasts assume a reduction in saleyard volumes being offset largely by stronger prices (note year end cattle price are ~27% higher than R12m averages), with the overall value of livestock turned over remaining at fairly strong levels.

At the other end of the spectrum FY15 saw a 26% reduction in fertiliser volumes, principally on the east coast, which we estimate would have cost the business ~$6m in gross profit. A return to more favourable seasonal conditions on the east coast would likely see this recovered and potentially grow given the benefit of higher volume rebates following supplier consolidation in FY15.

Outlook and the path to $60m EBIT: On its conference call management commented that independent of market tailwinds they are ahead of schedule on 8PP initiatives; with financial services the one element of the plan lagging expectations. With a range of $44.5-66.5m sustainable EBIT targeted in the initial program we think market tailwinds would have the run rate trajectory towards the upper end of this range and our forecasts reflect this view.

ELD Valuation and risks

COMPANY OVERVIEW

ELD is a leading supplier of fertiliser, agricultural chemicals and animal health products to rural and regional Australia, with strong agency positions in livestock, wool and real estate

INVESTMENT STRATEGY

We rate ELD Buy with a target of $5.01ps. ELD enters FY15e with a recapitalised balance sheet, favourable tailwinds in the livestock and real estate businesses and a strategy in place to more than double underlying EBIT and lift ROIC to a sustainable 20% by FY17e.

VALUATION

Our target price for ELD is $5.01ps, which we derive using our ROIC based valuation model. Our ROIC based valuation assumes looks at FY17e earnings, using an asset beta of 1.0 and market gearing of 41% giving rise to a pre-tax WACC OF 11.8%. From this we derive an EV/EBITDA multiple of 8.9x FY17e EBITDA on our base case estimate. In addition we incorporate an NPV for available tax losses and franking credits which we estimate are worth $1.40ps to investors.

RISKS

risks in an investment in ELD include but are not limited to:

- **Rainfall activity**: A lack of rainfall activity during the winter sowing window of April-July can have a material effect on demand for fertilisers and crop protection products, which make up 40-45% of annual merchandise sales;
- **A deterioration in livestock markets**: The livestock agency and live export business of ELD make up 30-35% of group gross profit. Agency revenues are linked to the value of livestock traded (sheep and cattle) and live export volumes. Over the last ten years there has been ~20% dispersion in the value of livestock traded and any deterioration in volumes and price simultaneously can impact livestock earnings;
- **A deterioration in wool volumes**: ELD is leveraged into domestic wool production and any fall in volumes can impact returns in the agency wool business which operates under a volume based commission model;
- **A deterioration in real estate volumes**: ELD is leveraged into the value of real estate turnover in rural and regional Australia. Any deterioration in land sales values or volumes can impact earnings from the real estate agency business;
- **Changes in commodity prices:** Outside of the direct impact on the livestock agency business, demand for ELD products is linked to farm profitability, with a weakening in commodity prices reducing demand for ELD's core products;
- **Failure to win back lost market share:** A large part of the turnaround for ELD is retaining lost market share on a recapitalised balance sheet. Should this fail to materialise, ELD will have difficulty achieving our forecasts.
- **Failure to control network overheads:** A large part of the ELD internal strategy is to deliver annualised cost savings in excess of inflationary cost pressures. Should this fail to occur, ELD will have difficulty achieving our forecasts; and
- **Capital structure:** ELD management has not dealt with the hybrid equity structure that imposes restrictions around dividend payments and capital management options in the ordinary shares.

Elders Ltd
as at 16 November 2015

Recommendation	Buy
Price	$4.35
Target (12 months)	$5.01

Table 1 - Financial summary

Year end Sep	2012	2013	2014	2015	2016e	2017e	2018e
Profit & Loss (A$m)							
Sales revenue	1813.2	1657.1	1431.5	1514.7	1565.0	1699.6	1732.0
. . . Change	-20.3%	-8.6%	-13.6%	5.8%	3.3%	8.6%	1.9%
EBITDA	23.0	(42.4)	30.8	49.3	58.6	65.6	63.5
Deprec. & amort.	(6.4)	(6.5)	(3.2)	(3.5)	(4.0)	(4.3)	(4.3)
EBIT	16.6	(48.9)	27.6	45.8	54.6	61.3	59.2
Interest expense	(21.5)	(15.8)	(15.7)	(10.0)	(10.4)	(9.5)	(8.0)
Pre-tax profit	(4.9)	(64.7)	11.9	35.8	44.3	51.8	51.2
Tax expense	(2.5)	(1.8)	(1.1)	(1.4)	(2.3)	(2.4)	(2.5)
. . . tax rate	-51%	-3%	9%	4%	5%	5%	5%
Minorities	(3.2)	(2.0)	(1.7)	(1.8)	(1.7)	(1.8)	(1.9)
Net Profit	**(10.6)**	**(68.5)**	**9.1**	**32.6**	**40.3**	**47.6**	**46.9**
Abs. & extras.	(50.0)	(436.8)	(5.8)	5.7	-	-	-
Reported Profit	**(60.6)**	**(505.3)**	**3.3**	**38.3**	**40.3**	**47.6**	**46.9**
Cashflow (A$m)							
EBITDA	23.0	(42.4)	30.8	49.3	58.6	65.6	63.5
Net Interest Expense	(4.6)	(25.0)	(22.6)	(9.9)	(10.2)	(9.9)	(8.8)
Tax Paid	23.9	(1.5)	(1.1)	(1.0)	(2.0)	(2.0)	(2.0)
Change in Wkg Capital	2.8	107.1	60.2	(41.1)	(15.3)	(20.2)	(4.9)
Other	(42.5)	(119.8)	(52.3)	(2.6)	(3.7)	(3.8)	(3.9)
Operating Cash Flow	**2.5**	**(81.6)**	**15.1**	**(5.3)**	**27.5**	**29.7**	**44.0**
Capex	(35.5)	(28.6)	(2.5)	(7.0)	(7.0)	(3.6)	(3.6)
Div Paid (gross of DRP)	-	-	-	-	-	-	-
Free Cash Flow	**(32.9)**	**(110.2)**	**12.6**	**(12.2)**	**20.5**	**26.0**	**40.4**
Acquisitions	(18.1)	(1.5)	-	-	-	-	-
Disposals	105.7	107.3	91.9	0.9	-	-	-
Share Issues (incl DRP)	-	-	9.8	17.0	-	-	-
Other	(3.4)	43.9	2.8	(4.2)	-	-	-
(Inc.) /dec. in net debt	**51.3**	**39.4**	**117.1**	**1.5**	**20.5**	**26.0**	**40.4**
Balance Sheet (A$m)							
Cash & near cash	91.7	39.9	22.5	0.7	5.0	5.0	5.0
Receivables	498.0	340.2	302.1	349.4	359.9	390.9	398.4
Inventories	234.4	153.0	125.9	146.2	156.5	170.0	173.2
Other	91.0	12.6	0.7	0.2	0.2	0.2	0.2
Current assets	**915.1**	**545.7**	**451.3**	**496.5**	**521.6**	**566.1**	**576.8**
Fixed assets	95.7	35.1	25.8	28.7	32.2	31.6	30.9
Intangibles	105.4	5.6	5.6	5.6	5.6	5.6	5.6
Other	393.8	94.5	32.4	46.9	47.3	48.1	48.4
Non current assets	**594.8**	**135.2**	**63.7**	**81.2**	**85.1**	**85.3**	**84.9**
Total assets	**1,509.9**	**680.9**	**515.0**	**577.7**	**606.7**	**651.4**	**661.7**
Creditors	386.6	254.5	249.7	276.2	281.7	305.9	311.8
Borrowings	303.0	268.1	160.0	136.8	120.7	94.6	54.3
Other	124.6	74.1	36.6	43.9	43.2	42.1	40.0
Current liabilities	**814.2**	**596.8**	**446.2**	**456.9**	**445.5**	**442.6**	**406.1**
Borrowings	82.8	26.6	0.1	-	-	-	-
Other	61.0	11.4	11.6	9.3	9.3	9.3	9.3
Non current liabilities	**143.9**	**37.9**	**11.8**	**9.3**	**9.3**	**9.3**	**9.3**
Total liabilities	**958.1**	**634.7**	**458.0**	**466.1**	**454.8**	**451.9**	**415.3**
Net assets	**551.8**	**46.2**	**57.0**	**111.6**	**151.9**	**199.5**	**246.4**
Share capital	1,270.3	1,269.2	1,277.8	1,323.3	1,323.3	1,323.3	1,323.3
Hybrid Equity	145.2	145.2	145.2	107.6	107.6	107.6	107.6
Reserves	(27.3)	(21.8)	(20.1)	(19.3)	(19.3)	(19.3)	(19.3)
Retained earnings	(844.0)	(1,350.5)	(1,347.2)	(1,301.2)	(1,260.9)	(1,213.3)	(1,166.5)
Outside equity Interests	7.6	4.2	1.4	1.3	1.3	1.3	1.3
S/holders' funds	**551.8**	**46.2**	**57.0**	**111.6**	**151.9**	**199.5**	**246.4**
Net Debt (Cash)	294.1	254.8	137.6	136.2	115.7	89.6	49.3

Rating	Buy
Share price ($ps)	$4.35
Target price ($ps)	$5.01
Shares on issue (m)	83.7
Market cap ($m)	364.2
Enterprise Value ($m)	476.7

Year end Sep	2012	2013	2014	2015	2016e	2017e	2018e
Valuation Ratios							
Adjusted EPS (¢ps)	(23.5)	(150.5)	18.6	47.9	48.1	56.8	56.0
Change (%)	n.a.	542%	n.a.	157.6%	0.4%	18.2%	-1.6%
Adjusted PE (x)	(18.5)	(2.9)	23.4	9.1	9.0	7.7	7.8
EV/EBITDA (x)	20.7	(11.2)	15.5	9.7	8.1	7.3	7.5
EV/EBIT (x)	28.7	(9.7)	17.3	10.4	8.7	7.8	8.0
NTA ($ps)	9.81	0.89	0.98	1.27	1.75	2.32	2.88
P/NTA (x)	0.44	4.88	4.43	3.44	2.49	1.88	1.51
Book Value ($ps)	12.13	1.02	1.09	1.33	1.81	2.38	2.94
Price/Book (x)	0.36	4.28	3.99	3.26	2.40	1.83	1.48
DPS (¢)	-	-	-	-	-	-	-
Payout (%)	-	-	-	-	-	-	-
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Performance Ratios							
EBITDA/sales (%)	1.3%	-2.6%	2.2%	3.3%	3.7%	3.9%	3.7%
EBIT/sales (%)	0.9%	-3.0%	1.9%	3.0%	3.5%	3.6%	3.4%
OCF Realisation (%)	-24%	119%	165%	-16%	68%	62%	94%
FCF Realisation (%)	311%	161%	138%	-38%	51%	55%	86%
ROE (%)	-1.9%	-163.3%	16.3%	29.5%	26.7%	24.0%	19.1%
ROIC (%)	1.8%	-8.5%	11.1%	20.7%	21.2%	22.0%	20.3%
Asset turn (years)	3.59	- 6.52	9.51	14.09	14.66	15.35	14.86
Capex/Depn (x)	5.54	4.40	0.76	1.99	1.75	0.85	0.85
Interest cover (x)	0.77	- 3.09	1.76	4.58	5.27	6.43	7.42
Net Debt/EBITDA (x)	12.79	- 6.01	4.46	2.76	1.97	1.37	0.78
Net debt/equity (%)	53%	551%	241%	122%	76%	45%	20%
Segmental operating EBIT (A$m)							
Network			1,111.4	1,175.5	1,197.0	1,286.7	1,296.6
Trading			320.2	339.2	368.0	412.8	435.5
Corporate Charges			-	-	-	-	-
Rural Services	**1,813.2**	**1,657.1**	**1,431.5**	**1,514.7**	**1,565.0**	**1,699.6**	**1,732.0**
Automotive							
Forestry							
Other							
Revenue	**1,813.2**	**1,657.1**	**1,431.5**	**1,514.7**	**1,565.0**	**1,699.6**	**1,732.0**
Network			55.1	75.5	83.8	92.0	89.4
Trading			10.0	13.7	14.2	12.7	13.2
Corporate Charges			(37.5)	(43.4)	(43.4)	(43.4)	(43.4)
Rural Services	**26.6**	**(48.9)**	**27.6**	**45.8**	**54.6**	**61.3**	**59.2**
Automotive							
Forestry							
Other	(10.0)						
EBIT	**16.6**	**(48.9)**	**27.6**	**45.8**	**54.6**	**61.3**	**59.2**
Rural Services Margin (%	1.5%	-3.0%	1.9%	3.0%	3.5%	3.6%	3.4%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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