

13 September 2016

### Pental Limited (PTL)

Building a solid platform for growth

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#### Key Points

- PTL reported EBITDA of \$10.8m for FY16, 5.3% increase on pcp, due to upgraded equipment, and favourable exchange rates. That is in line with our forecasts, initiated in January 2016.
- \$6.1m was spent for equipment upgrades in FY16, we expect the cost base to be reduced by 25% by FY20.
- Cash balance of \$12.3m. PTL is considering the option to buy back Shepparton manufacturing facility to save leasing costs, which is subject to shareholder approval at the AGM.
- We retain our Buy recommendation and a revised price target of \$0.72/share, which represents a 16.1% premium to the current share price.

#### Highlights

- PTL managed to deliver 5.3% yoy EBITDA growth for FY16, albeit in a weak local trading environment.
- The net sales is down 2.4% yoy to ~\$79.2m due to inconsistent performance of old filling equipment and teething issues during commissioning of new equipment. ~\$2m sales was missed.
- A total of ~\$700k worth of bar soaps were shipped to Asia (predominately China) during the 2H, which is ahead of schedule. The Chinese market will be the main revenue driver for PTL in the coming years, PTL has taken a number of initiatives to enter the market (next page for more details). We expect PTL to obtain \$2m sales from the region in FY17 and grow to \$10m in FY20.
- Capex of \$6.1m in FY16 for equipment upgrades. We estimate \$6.3m needed in FY17 to finalise the outstanding projects, and Capex would normalise to ~\$2.6m thereafter.
- The Shepparton manufacturing facility was forced to be sold in 2011 for \$6m, PTL is now under consideration to buy back the facility at an estimated cost of \$7.5m, which is subject to shareholder approval at the AGM. Current lease is ~0.65m p.a.
- A fully franked final dividend of 1.95c/share was declared, combined with 1c/share interim dividend, implying an attractive 4.8% total yield based on current share price vs avg.4.1% for All Ordinaries on consensus.

**View:** The share price has gone up 40% in the past 12 months, vs Small Ordinaries Index returned 26% (outperformed 14%). We believe PTL is now turning into a low cost producer and exporter, we retain our Buy recommendation and a price target of \$0.72/share, which represents a 16.1% premium to the current share price. 10% discount to DCF is due to high regulatory risks in exporting into Asia.

#### Milestones:

**1H'17** – Commission of new bulk filling line and additional Soap cutting & wrapping equipment

**FY'17** – Modernisation of Soap Plant and liquids upgrade

**FY'18** – Accelerated sales into Asia

#### Risks:

- Slow in securing new export contracts
- Delay in equipment replacements/upgrades to meet demand
- Exports are subject to China 'Free Trade Zone' legislations.
- Low share trading volume – liquidity risk

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#### Recommendation

**Buy**

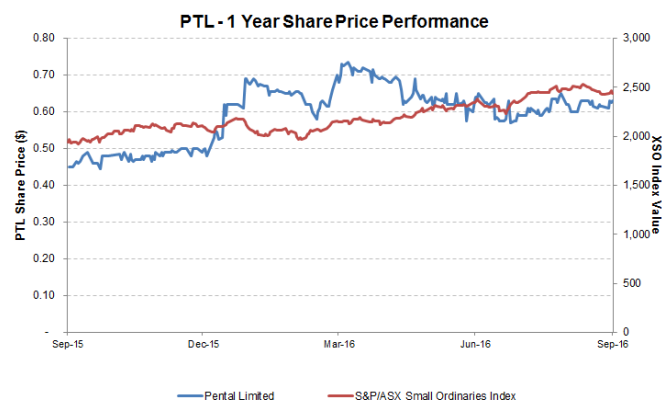
Previous Recommendation	Buy
Risk Rating	Medium
Current Share Price	\$0.62
12 Month Price Target	\$0.72 (previously \$0.84)
Price Target Methodology	10% discount to DCF
Total Return (Capital + Yield)	20.4%
DCF Valuation	0.80
Market Capitalisation	\$84m
Liquidity – Daily Value	\$0.05m

#### Financial Forecasts & Valuation Metrics

Y/e (\$m)	FY16A	FY17F	FY18F	FY19F
Revenue	79.2	82.0	86.0	90.5
EBITDA	10.8	11.8	13.9	15.1
NPAT	5.6	6.0	6.9	7.7
EPS (cps)	4.1	4.4	5.1	5.7
EPS Growth	1.2%	7.1%	14.9%	11.7%
DPS (c)	3	3	3	3
EV / EBITDA (x)	6.8	6.3	5.3	4.9
<b>PER (x)</b>	15.4	14.3	12.5	11.2
Dividend Yield	4.8%	4.3%	4.9%	5.5%
Cash Balance	12.3	10.5	12.6	15.5

Source: PAC Partners estimates

#### Share Price Performance



Source: S&P Capital IQ and PAC Partners

## Solid FY Results with Ahead of Schedule Asian Sales

~\$2m sales were missed due to old equipment

PTL reported gross revenue is \$110m, which is down 1.2% on pcp. mainly due to inconsistent performance of old filling equipment and teething issues during commissioning of new equipment.

However, as a result of cost saving initiatives implemented in FY16, PTL managed to deliver 5.3% EBITDA growth to \$10.8m (vs \$9.3m for FY15)

**Cutting operation expenses:**

- \$1.1m Freight&dist.
- \$0.5m Marketing
- \$90k Finance costs



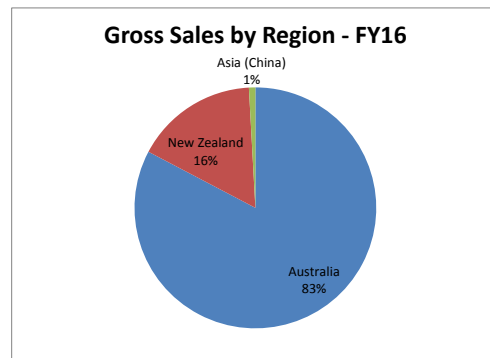
Source: Company Presentation

**Ahead of Schedule Asia sales**

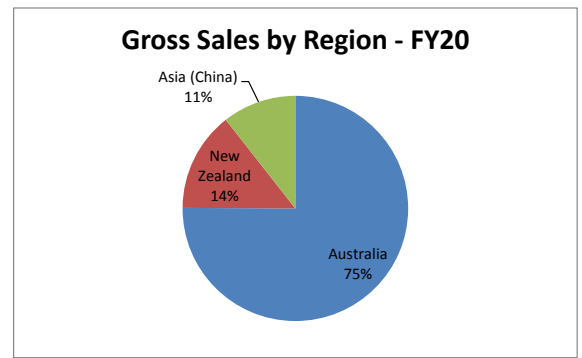
A total of ~\$700k worth of bar soaps were shipped to Asia (predominately China) during the 2H'16, which is ahead of schedule. We expect this number to triple in FY17, and grow at a CAGR of 100% over the next four years and reach \$10m by FY20.

PTL's revenue mix is expected to shift in terms of geographic locations...

...with tremendous growth opportunities in China



Source: Company Report



Source: PAC Partners estimates

Differentiated approach to enter China

Unlike Bellamy's, A2 Milk and some others, who are mainly selling through the well-known 'grey channels' or online platforms, PTL has taken a differentiated approach to enter the Chinese market:

- Build up direct relationship with Chinese retailers and utilise various distribution channels
- Established a warehouse in Shanghai Free Trade Zone (FTZ)
- E-Commerce

In addition, PTL is actively exploring export opportunities in other Asian countries, any material expansion updates may lift our valuation.

**Attractive Dividend Yield**

4.8% dividend yield vs 4.1% for Small Ordinaries







A fully franked final dividend of 1.95c/share was declared, combined with 1c/share interim dividend, implying an attractive 4.8% total yield based on current share price vs avg. 4.1% for All Ordinaries on consensus.

The payout ratio for FY16 is 71.4%. We assume PTL to keep an steady 60% payout ratio moving forward.

## Turning into Low Cost Producer

A total of \$6.1m was spent in FY16 to upgrade/replace old equipment...

...we expect another ~\$6.3m needed to finalise the remaining projects and the cost base to be reduced by 25% by FY20.

Capital Works	Completed	Status	Outcomes
Replacement of Bleach Line A filler	Dec 2015		Reduced waste & improved throughput rate (since March 2016 increased by 15.8%), however "overall" bleach plant downtime needs to be improved
Soap Manufacturing "SWING" plant	Dec 2015		Improve soap quality, increased tallow yields & reduced manning costs
Bleach Line B (Part 1) automated case packer	Aug 2015		Reduced labour costs, however "overall" bleach plant downtime needs to be improved. (Since March 2016 throughputs increased by 26.4%)
Bleach Line B (Part 2) automated filler & Capper	May 2016		Reduced labour costs, however "overall bleach plant downtime" needs to be improved
Firelighter carton palletiser	Mar 2016		Reduced labour costs and achieving targets
Warehouse Consolidation	Mar 2016		Increased operational flexibility and significantly reduced operating costs

Source: Company Presentation

## Valuation

Lowered LGR to 1.5%...

...Lower EBITDA for short term...

...Buy with PT \$0.72/share

We initiated our coverage in January 2016, with a Buy recommendation and price target of \$0.84/share. The FY16 results are largely in line with our estimates. However, due to current low growth environment within the soap industry, we have adjusted our long-term growth rate in our model to 1.5% (from 2%). In addition, we revised our model to reflect slower margin improvement due to delays in equipment upgrades, and hence our DCF valuation dropped 9.5% to \$0.80/share. Our price target is then obtained by applying 10% discount to the DCF valuation due to relatively high political/regulatory risks involved in exporting into Asia. We assume the company will revert back to a steady 60% payout ratio in FY17 and beyond, which imply a 4.3% dividend yield for FY17. We remain confident that PTL is well capitalised to capture more growth avenues from Asian markets by leveraging on the highly regarded Australian owned heritage brands. We retain a Buy recommendation with a price target of \$0.72/share, which represents 16.1% premium to the current share price.

**Pental Limited****NFPOS****136 m****Price \$ 0.62****Market Cap \$84 m**

## PROFIT &amp; LOSS (\$m)

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
<b>Revenue</b>	<b>81.2</b>	<b>79.2</b>	<b>82.0</b>	<b>86.0</b>	<b>90.5</b>	<b>94.5</b>
Adj. EBITDA	10.3	10.8	11.8	13.9	15.1	15.9
Depreciation & Amortisation	2.1	2.6	3.1	3.8	3.8	3.8
<b>Adj. EBIT</b>	<b>8.2</b>	<b>8.3</b>	<b>8.7</b>	<b>10.1</b>	<b>11.2</b>	<b>12.1</b>
Net Interest	(0.2)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Income tax	(1.9)	(2.6)	(2.6)	(3.0)	(3.3)	(3.6)
<b>Adj. NPAT underlying</b>	<b>6.1</b>	<b>5.6</b>	<b>6.0</b>	<b>6.9</b>	<b>7.7</b>	<b>8.3</b>
Less non-controlling Interest	0.0	0.0	0.0	0.0	0.0	0.0
Abnormal items	(1.0)	0.0	0.0	0.0	0.0	0.0
<b>NPAT Reported.</b>	<b>5.1</b>	<b>5.6</b>	<b>6.0</b>	<b>6.9</b>	<b>7.7</b>	<b>8.3</b>

## BALANCE SHEET (\$m)

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Cash	11.0	12.3	10.5	12.6	15.5	19.4
PP&E	15.3	18.9	22.3	21.3	20.3	19.4
Debtors & Inventory	31.5	32.4	33.5	36.0	38.1	40.1
Goodwill	25.1	25.1	25.1	25.1	25.1	25.1
Other Intangibles	15.2	15.1	15.0	14.8	14.5	14.2
Other Assets	0.7	0.3	0.5	0.5	0.5	0.5
<b>Total Assets</b>	<b>98.8</b>	<b>104.2</b>	<b>106.9</b>	<b>110.3</b>	<b>114.0</b>	<b>118.8</b>
Borrowings	0.0	0.0	0.8	5.9	6.1	6.4
Trade Creditors	15.4	16.7	16.7	17.4	17.9	19.4
Other Liabilities	1.7	4.3	2.2	2.3	2.5	2.9
<b>Total Liabilities</b>	<b>17.1</b>	<b>21.0</b>	<b>19.7</b>	<b>25.6</b>	<b>26.5</b>	<b>28.6</b>
<b>NET ASSETS</b>	<b>81.7</b>	<b>83.2</b>	<b>87.2</b>	<b>84.8</b>	<b>87.5</b>	<b>90.2</b>
<b>Issued Capital</b>	<b>90.7</b>	<b>90.7</b>	<b>90.7</b>	<b>90.7</b>	<b>90.7</b>	<b>90.7</b>

## Cash Flow (\$m)

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
<b>Operating EBITDA</b>	<b>9.3</b>	<b>10.8</b>	<b>11.8</b>	<b>13.9</b>	<b>15.1</b>	<b>15.9</b>
Interest & Tax	(2.1)	(2.7)	(2.7)	(3.1)	(3.5)	(3.8)
Change in Working Cap. & Others	2.4	0.4	(1.0)	(1.8)	(1.5)	(0.6)
Others	2.2	2.7	0.0	0.0	0.0	0.0
<b>Operating Cash Flow</b>	<b>11.8</b>	<b>11.3</b>	<b>8.1</b>	<b>8.9</b>	<b>10.1</b>	<b>11.5</b>
Capex	(4.1)	(6.1)	(6.3)	(2.6)	(2.6)	(2.6)
<b>Free Cashflow (FCF)</b>	<b>7.7</b>	<b>5.1</b>	<b>1.8</b>	<b>6.3</b>	<b>7.5</b>	<b>8.9</b>
Asset Sales	0.0	0.0	0.0	0.0	0.0	0.0
Ord Dividends	(3.3)	(4.0)	(3.6)	(4.2)	(4.6)	(5.0)
Equity, (Debt Paydown)	6.7	0.0	0.0	0.0	0.0	0.0
<b>Net Cashflow</b>	<b>11.0</b>	<b>1.1</b>	<b>(1.9)</b>	<b>2.2</b>	<b>2.9</b>	<b>3.9</b>

## DIRECTORS

Peter Robinson	Non-exec Chairman
Mel Sutton	Non-exec Vice Chairman
John Etherington	Non-exec Director
John Rishworth	Non-exec Director
Kimberlee Wells	Non-exec Director

## MAJOR SHAREHOLDERS

	%
Alan Johnstone	21.9%
Allan Gray Australia	13.5%
John Rostyn Homewood	12.6%
Elevation Capital Management	8.1%
<b>Top 20</b>	<b>78.8%</b>

## REGIONAL SUMMARY (\$m)

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
<b>Net Revenue</b>						
Australia	67.3	65.5	66.8	68.2	69.5	70.9
New Zealand	13.9	13.0	13.2	13.3	13.4	13.5
Asia (China)		0.7	2.0	4.5	7.5	10.0
<b>Total</b>	<b>67.3</b>	<b>66.2</b>	<b>68.8</b>	<b>72.7</b>	<b>77.0</b>	<b>80.9</b>

**Pental Limited**

Date:

**13-Sep-16**

Model Updated:

**13-Sep-16**

## KEY RATIOS

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
EBITDA Margin (%)	9.3%	9.9%	10.4%	11.7%	12.3%	12.4%
NPAT Margin (%)	5.5%	5.1%	5.3%	5.9%	6.3%	6.5%
ROA (%) y/e	6.1%	5.4%	5.6%	6.3%	6.8%	7.0%
ROE (%) y/e	7.4%	6.8%	6.9%	8.2%	8.8%	9.2%
ROI (%) y/e	11.6%	11.7%	11.2%	12.9%	14.4%	15.7%
NTA per share (\$)	0.46	0.47	0.49	0.51	0.54	0.58
Eff Tax Rate (%)	24.3%	31.5%	30.0%	30.0%	30.0%	30.0%
Interest Cover (x)	53.1	129.4	126.9	57.1	62.3	65.0
Net Gearing (%)	-13.5%	-14.8%	-11.1%	-7.9%	-10.7%	-14.5%

## VALUATION PARAMETERS

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
EPS (cps)	4.1	4.1	4.4	5.1	5.7	6.1
<b>PE Adj (x)</b>	<b>9.4</b>	<b>15.4</b>	<b>14.3</b>	<b>12.5</b>	<b>11.2</b>	<b>10.4</b>
Enterprise Value (\$m)	45.8	74.1				
EV / EBITDA (x)	4.5	6.8	6.3	5.3	4.9	4.7
EV / EBIT (x)	5.6	8.9	8.5	7.4	6.6	6.1
Price / NTA	1.0	1.3	1.3	1.2	1.1	1.1
DPS (cps)	2.7	3.0	2.7	3.0	3.4	3.7
Dividend Yield (%)	4.3%	4.8%	4.3%	4.9%	5.5%	5.9%
Free Cash / Share (c)	5.6	3.8	1.3	4.6	5.5	6.6
Price / FCF PS (x)	11.0	16.5	48.0	13.4	11.3	9.4

## DCF VALUATION &amp; SENSITIVITY

PV of Cashflows 2016 to 2022	31	Risk Free Rate	3.0%
PV of Term Year Cashflow	66	Equity Risk Premium	8.0%
Net Debt	(12)	Equity Beta	0.90
		Cost of Equity	10.2%
		Terminal Growth	1.5%
		<b>After Tax WACC</b>	<b>10.2%</b>
<b>PV of Equity</b>	<b>109</b>		
PV of Equity per share	<b>\$ 0.80</b>		

## Term. WACC

Term. Growth	12.2%	11.2%	10.2%	9.2%
1.0%	\$ 0.63	\$ 0.70	\$ 0.77	\$ 0.87
1.5%	\$ 0.65	\$ 0.72	<b>\$ 0.80</b>	\$ 0.91
2.0%	\$ 0.67	\$ 0.74	\$ 0.83	\$ 0.95
2.5%	\$ 0.69	\$ 0.77	\$ 0.87	\$ 1.00

## GROWTH PROFILE (YoY)

Y/e Jun	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Sales Revenue	2%	-1%	2%	5%	3%	4%
EBITDA	6%	5%	9%	18%	9%	5%
EBIT	4%	1%	5%	16%	12%	8%
NPAT	23%	-7%	7%	15%	12%	8%
EPS	-20%	1%	7%	15%	12%	8%
DPS		11%	-10%	15%	12%	8%

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## Recommendation Criteria

### Investment View

PAC Partners Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
>20%	20% – 5%	<5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

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