# Civmec Limited

(CVL SP/CIVM.SI)

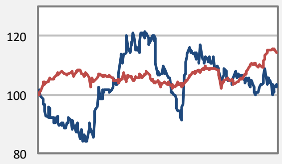
## A value stock with strong fundamentals and growth opportunities

*Megan Choo / 65 6202 1190 / megan.choo@kgi.com*

- **Strong 1H22 financials**. Civmec's top and bottom-line grew 27.4% and 50.4% YoY respectively in 1H22 (YE 30 June 22). Basic and diluted EPS grew 50% YoY to 4.50 Aus Cents in 1H22.
- **Key drivers**. Expansion of Maintenance and Capital Works division which provide recurring income; Increased Australian Infrastructure and Defence budget/spending to provide more opportunities for contract wins; Buoyant commodity demand amidst inflationary market conditions to drive Capex spending from customers.
- While we maintain an **OUTPERFORM** recommendation, we revise our TP down to S$0.79 due to the overall de-rating of valuation multiples across the sector. Our updated TP is now based on 10.0x FY2022F P/E, down from 12.0x we had previously.

**Maintain: Outperform**

| | | | |
|---|---|---|---|
| Price as of 28 Feb 22 (SGD) | 0.64 | **Performance (Absolute)** | |
| 12M TP ($) | 0.79 | 1 Month (%) | 1.6 |
| Previous TP ($) | 0.89 | 3 Month (%) | -4.5 |
| Upside (%) | 23% | 12 Month (%) | 5.8 |
| **Trading data** | | **Perf. vs STI Index (Red)** | |
| Mkt Cap ($mn) | 319 | | |
| Issued Shares (mn) | 502 | | |
| Vol - 3M Daily avg (mn) | 0.1 | | |
| Val - 3M Daily avg ($mn) | 0.1 | | |
| Free Float (%) | 0.5 | | |
| **Major Shareholders** | | **Previous Recommendations** | |
| Finbarr Fitzgerald James | 19.5% | 8-Sep-21 | 0.89 |
| John Tallon Patrick | 19.4% | 12-Aug-21 | 0.86 |




**Financials & Key Operating Statistics**

| YE June (A$'000) | 2020A | 2021A | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| Revenue | 391,868 | 674,186 | 751,374 | 793,347 | 834,600 |
| PATMI | 17,586 | 34,771 | 40,558 | 43,163 | 45,730 |
| EPS (AUD Cents) | 3.5 | 6.9 | 8.1 | 8.6 | 9.1 |
| EPS growth (%) | 189.5% | 97.7% | 16.4% | 6.4% | 5.9% |
| P/E (x) | 18.2x | 9.2x | 7.9x | 7.4x | 7.0x |
| DPS (Sing Cents) | 1.98 | 1.99 | 1.99 | 1.99 | 1.99 |
| Div Yield (%) | 3.1% | 3.1% | 3.1% | 3.1% | 3.1% |
| Net Margin (%) | 4.5% | 5.1% | 5.4% | 5.4% | 5.5% |
| Net Gearing (%) | 13.2% | 4.1% | (3.5%) | (10.2%) | (16.2%) |
| Price P/B (x) | 1.2x | 1.1x | 1.0x | 0.9x | 0.8x |
| ROE (%) | 6.7% | 11.9% | 12.7% | 12.3% | 12.0% |

*Source: Company data, KGI Research*

**1H22 financials: Outstanding results.** Civmec's revenue rose 27.4% YoY to A$389.3mn in 1H22, while net profit after tax jumped 50.4% YoY to A$22.6mn. Even though gross margin declined slightly by 0.5ppts to 10.8% in 1H22, the overall strength in bottom-line was due to prudent cost spending, with admin expenses decreasing slightly by 0.4% to A$9.2mn, and other expenses declining 93% to A$0.1mn in 1H22.

**Growth driver: Maintenance.** Civmec expects its Maintenance and Capital Works division to be a growth driver in the short to medium-term. The company invested substantial resources in this division over the past 2 years to capitalise on growth opportunities geographically within Australia and across a wider range of industries. Revenue from provision of services, which is predominantly realised through maintenance work, grew substantially in 1H22, rising four-fold to A$105.4mn from A$26.2mn in 1H21.

Civmec provides a broad range of maintenance services across Australia and currently has two regional hubs in the East Coast and West Coast, namely Gladstone and Port Hedland respectively. Moving forward, the company plans to further develop this service offering. As the nature of mining sites require repair and maintenance approximately every 6 weeks, the construction of bases will increase worker efficiency as cross-border travelling for employees is minimised.

**Well-positioned to benefit from public infrastructure and defence spending.** Supported by public funds, investment in these sectors is expected to ramp up over the next few years. The Australian Government is investing $110 billion over 10 years from 2021-22 in land transport infrastructure across Australia through its rolling infrastructure pipeline, most of which is under the Infrastructure Investment Program. Since last year's Defence Budget, the estimated Major Capital Investment Program figures across 2020–21 have somewhat reduced, by around a billion dollars each year. However, by 2022–23, the program budget is expected to ramp up to $14.5 billion.

**Commodities demand remain strong.** Amidst the current Russian-Ukraine war, President Joe Biden announced that U.S. will sanction Russian banks, sovereign debt and individuals after the Ukraine 'invasion'. The prospect of a war involving Russia, the largest supplier of gas and oil to Europe, has rattled markets and fuelled fears of higher oil prices. In addition, decarbonisation is becoming a material demand driver for several metals, such as aluminium, copper and lithium as internal combustion engine vehicles are replaced by battery-pack driven electric ones, and clean energy installations (such as wind and solar farms) proliferate.

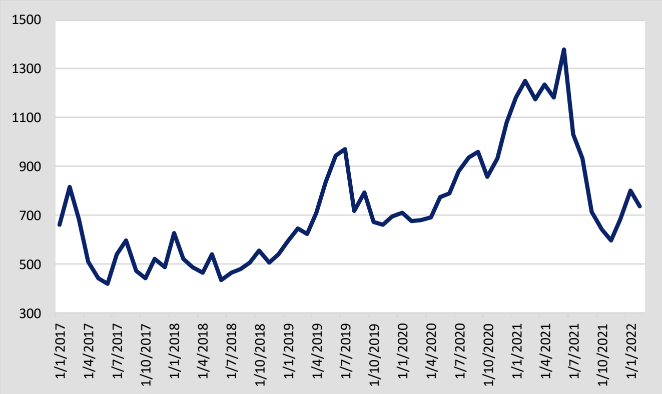
**Valuation & Action:** We maintain Civmec with an Outperform recommendation, but revise our TP down to S$0.79. Our TP is based on 10.0x P/E (previously 12.0x) to FY2022F EPS of S$0.079 (based on 0.97 SGD/AUD).

**Risks:** Rising labour costs in Australia due to labour shortage may result in higher costs; Execution risks.

**Iron ore prices**. Iron ore prices started to gain traction and reversed from its downtrend in November 2021 after almost crossing the $500 mark which was last seen since end 2018. However, its streak was dampened recently after Beijing announced that it wants all purchases of the steel-making material conducted through a single state-backed platform that's under preparation. At the moment, Chinese businesses including steel mills can negotiate spot purchases independently.

Despite iron ore's price correction from its all-time high of $1,387 in June 2021, we expect Capex spending from iron ore miners to be resilient given that their margins remain lucrative. Civmec's largest contribution to the Resources segment comes from iron ore and the company expects activity to remain over the forecast horizon with several large iron ore projects under development.

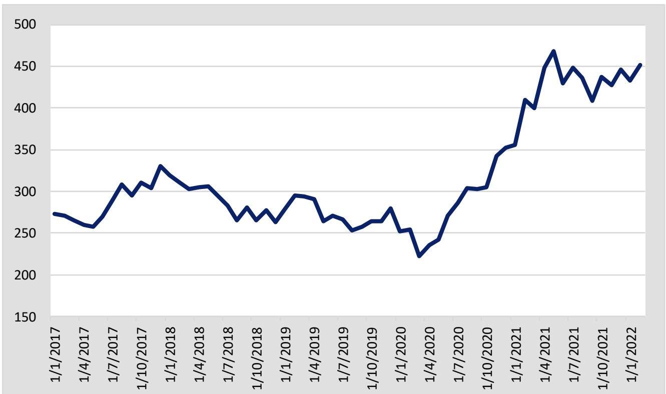
**Figure 1: Generic 1st Iron Ore Prices (IOE1 Comdty)**



*Source: Bloomberg*

**Copper prices.** Besides iron ore, the company expects nickel and copper projects to remain elevated driving strong investments in both capital expansions and new projects. Copper usage is surging with increasing demand for electric vehicles as well as wind farms, solar panels and power grids. Also, the outbreak of civil protests in high producing countries Chile and Peru exacerbates the already tight supply. Copper prices are currently consolidating around US$400 to US$450 and prices are to remain relatively steady given that are demand is expected to remain strong at least in the short to mid-term.

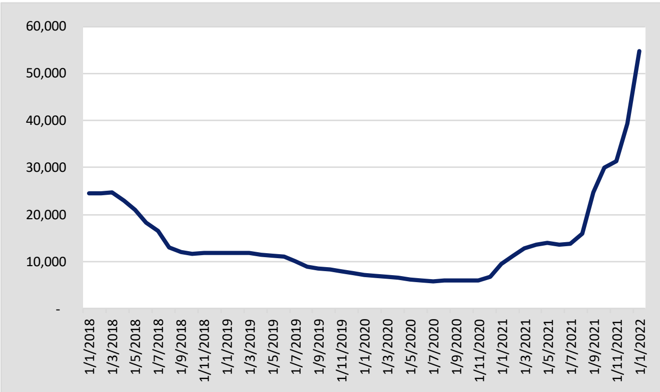
**Figure 2: Generic 1st Copper Prices (HG1 Comdty)**



*Source: Bloomberg*

**Lithium prices.** Lastly, the company also expects further development in the battery minerals space with financial funding approval across a range of rare earths, such as vanadium and lithium projects. Lithium prices have surged to an all-time high of $54,725 as of end January 2022, given the robust demand for the raw material of EV batteries.

**Figure 3: Lithium Carbonate EXW China (Battery Grade)**



*Source: Bloomberg*

**Summary.** As revenue is recognised upon contractual fulfilment, it will be more meaningful to consider outstanding order book. Civmec's order book stood at A$1.19bn as of 1H22, while contract assets rose 25.8% to A$103.9mn. The current strength in commodity prices reflect further potential order book growth moving forward which will translate to revenue in due time.

**Not a pure commodity play.** Revenue coming from Civmec's Defence and Infrastructure segment saw a 80% YoY surge in 1H22. In addition, the Maintenance and Capital Works division grew four-fold in 1H22, suggesting that the company is expanding its steady recurring income growth. Moving forward, the company expects approximately 25% recurring income coming from this division.

Resilient demand for commodities, recurring revenue from maintenance and capital works, as well as the growth in Australian infrastructure and defence spending are key catalysts for the company's growth. Investors should look beyond Civmec as a pure commodity play, but rather a company with solid fundamentals and other potential growth opportunities.

## Forecasts

Due to Civmec's outstanding 1H22 earnings, we adjusted our overall revenue forecast for FY2022F upwards. FY2022F Energy segment revenue annual growth rate was revised from 6% YoY to 25% YoY while Infrastructure and Defence segment growth was revised from 8% YoY to 30% YoY. Resources segment forecast was left unchanged. Gross margin forecast was updated to 10.8%, down 0.5ppts from FY21, after factoring in lower margins in 1H22. Other assumptions within the Income Statement remained unchanged.

There could be upside potential in its Energy segment moving into the second half of the year due to robust oil and gas prices, with WTI Crude futures reaching a 7-year high on 24 February while Brent Crude futures hit US$100 per barrel for the first time since September 2014. Resources segment revenue is expected to register steady growth, given that certain metal prices are on a path to recovery while some are outperforming.  Infrastructure and Defence segment is also expected to outperform, in tandem with an increase in public funding related to these segments. Overall revenue is buoyed by recurring income from the Maintenance and Capital Works division, which is yet another area for expansion moving forward.

**Figure 4: Revised FY2022F forecast**

| Income statement (A$'000) | Previous 2022F | 1H22A | Updated 2022F |
|---|---|---|---|
| Energy | 38,317 | 25,229 | 47,896 |
| Resources | 559,781 | 297,075 | 604,563 |
| Infrastructure & Defense | 76,088 | 67,049 | 98,914 |
| **Total Revenue** | **674,186** | **389,353** | **751,374** |
| Cost of sales | (599,148) | (347,144) | (669,919) |
| **Gross profit** | **75,038** | **42,209** | **81,455** |
| **Profit after tax** | **37,495** | **22,594** | **40,558** |
| **PATMI** | **37,650** | **22,594** | **40,558** |

*Source: Company, KGI Research*

# Financial Summary

| INCOME STATEMENT (A$'000) | 2020A | 2021A | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| **Revenue** | **391,868** | **674,186** | **751,374** | **793,347** | **834,600** |
| Cost of sales | (347,217) | (599,148) | (669,919) | (707,342) | (744,123) |
| **Gross Profit** | **44,651** | **75,038** | **81,455** | **86,005** | **90,477** |
| Admin and other expenses | (21,485) | (20,835) | (23,220) | (24,518) | (25,792) |
| Finance income/(expenses) | (2,323) | (6,481) | (6,251) | (6,141) | (6,023) |
| Other income | 1,722 | 2,572 | 2,866 | 3,027 | 3,184 |
| Shares in profit/(loss) of JV | 201 | -97 | 0 | 0 | 0 |
| **Profit before Tax** | **22,766** | **50,197** | **54,850** | **58,373** | **61,846** |
| Income tax | (5,217) | (15,569) | (14,292) | (15,210) | (16,115) |
| Non-controlling interests | (37) | (143) | – | – | – |
| **PATMI** | **17,586** | **34,771** | **40,558** | **43,163** | **45,730** |

| BALANCE SHEET (A$'000) | 2020A | 2021A | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| Cash and cash equivalents | 27,712 | 48,172 | 71,256 | 95,867 | 121,984 |
| Trade and other receivables | 74,523 | 87,488 | 87,488 | 87,488 | 87,488 |
| Contract assets | 95,118 | 82,642 | 82,642 | 82,642 | 82,642 |
| Other current assets | 2,051 | 1,903 | 1,903 | 1,903 | 1,903 |
| **Current Assets** | **199,404** | **220,205** | **243,289** | **267,900** | **294,017** |
| Property, plant and equipment | 397,804 | 412,030 | 417,336 | 422,939 | 428,834 |
| Intangibles | 10 | 10 | 10 | 10 | 10 |
| Other non-current assets | 2,650 | 4,694 | 4,637 | 4,637 | 4,637 |
| Trade and other receivables | 493 | 0 | 0 | 0 | 0 |
| **Non-current Assets** | **400,957** | **416,734** | **421,983** | **427,586** | **433,481** |
| **Total assets** | **600,361** | **636,939** | **665,272** | **695,487** | **727,498** |
| Trade and other payables | 91,075 | 87,413 | 87,413 | 87,413 | 87,413 |
| Contract liabilities | 83,266 | 80,138 | 80,138 | 80,138 | 80,138 |
| Borrowings (current) | 2,387 | 0 | 0 | 0 | 0 |
| Other current liabilities | 19,687 | 34,313 | 34,313 | 34,313 | 34,313 |
| **Current Liabilities** | **196,415** | **201,864** | **201,864** | **201,864** | **201,864** |
| Borrowings (non-current) | 60,000 | 60,000 | 60,000 | 60,000 | 60,000 |
| Other non-current liabilities | 80,873 | 83,207 | 83,150 | 83,150 | 83,150 |
| **Non-current liabilities** | **140,873** | **143,207** | **143,150** | **143,150** | **143,150** |
| Shareholders equity | 263,188 | 292,126 | 320,516 | 350,731 | 382,742 |
| Non-controlling interests | (115) | (258) | (258) | (258) | (258) |
| **Total Equity** | **263,073** | **291,868** | **320,258** | **350,473** | **382,484** |
| **Total Liabilities and Equity** | **600,361** | **636,939** | **665,272** | **695,487** | **727,498** |

| CASH FLOW STATEMENT (A$'000) | 2020A | 2021A | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| Net income before tax | 22,766 | 50,197 | 54,850 | 58,373 | 61,846 |
| Depreciation & Amortisation | 10,464 | 14,174 | 18,784 | 19,834 | 20,865 |
| Other non-cash adjustments | 9,243 | 9,007 | 6,251 | 6,141 | 6,023 |
| **Operating CF before WC changes** | **42,473** | **73,378** | **79,885** | **84,348** | **88,734** |
| **CF from operating activities** | **95,201** | **58,263** | **59,342** | **62,997** | **66,595** |
| Purchase/Disposal of PPE | (70,039) | (21,616) | (24,091) | (25,437) | (26,759) |
| Other CFI | (245) | 1,213 | 0 | 0 | 0 |
| **CF from investing activities** | **(70,284)** | **(20,403)** | **(24,091)** | **(25,437)** | **(26,759)** |
| Dividends Paid | (3,729) | (10,021) | (12,167) | (12,949) | (13,719) |
| Debt Raised / (Repaid) | (28,135) | (334) | – | – | – |
| Repayment of lease liabilities | (6,003) | (7,045) | – | – | – |
| **CF from financing activities** | **(37,867)** | **(17,400)** | **(12,167)** | **(12,949)** | **(13,719)** |
| Net increase in cash & cash equiv. | (12,950) | 20,460 | 23,084 | 24,611 | 26,117 |
| Beginning Cash | 40,662 | 27,712 | 48,172 | 71,256 | 95,867 |
| **Ending Cash** | **27,712** | **48,172** | **71,256** | **95,867** | **121,984** |

| KEY RATIOS | 2020A | 2021A | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| **Profitability** | | | | | |
| EPS (AUD Cents) | 3.51 | 6.94 | 8.08 | 8.60 | 9.11 |
| EPS Growth (%) | 189.5% | 97.7% | 16.4% | 6.4% | 5.9% |
| DPS (Sing Cents) | 1.98 | 1.99 | 1.99 | 1.99 | 1.99 |
| Dividend Yield (%) | 3.1% | 3.1% | 3.1% | 3.1% | 3.1% |
| | | | | | |
| **Profitability (%)** | | | | | |
| Gross margin | 11.4% | 11.1% | 10.8% | 10.8% | 10.8% |
| Net margin | 4.5% | 5.1% | 5.4% | 5.4% | 5.5% |
| ROE | 6.7% | 11.9% | 12.7% | 12.3% | 12.0% |
| | | | | | |
| **Growth (% YoY)** | | | | | |
| Revenue | -19.8% | 72.0% | 11.4% | 5.6% | 5.2% |
| Net Profit | 149.6% | 97.3% | 17.1% | 6.4% | 5.9% |
| | | | | | |
| **Financial Structure** | | | | | |
| Interest Coverage (x) | 9.9 | 8.7 | 9.5 | 10.0 | 10.5 |
| Net Gearing (%) | 13.2% | 4.1% | -3.5% | -10.2% | -16.2% |

**KGI's Ratings**

| Rating | Definition |
|---|---|
| **Outperform (OP)** | We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon. |
| **Neutral (N)** | We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon. |
| **Underperform (U)** | We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon |
| **Not Rated (NR)** | The stock is not rated by KGI Securities. |
| **Restricted (R)** | KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances. |