EOH – 1H22 Trading Update

Date: 03 February 2022

Evaluating a capital raise

- The key feature of the update is confirmation it's seeking capital market access pre-October 2022 to redeem, in full, its R1.5bn bridge facility that has interest rates ramping up towards 12% in 2H22. Whilst options are being explored, an equity raise is likely be the dominant source of funds post existing asset realisations. The company indicated it would seek to raise equity (from existing and/or new investors), introduce mezzanine debt, a combination of debt and equity or further disposals of assets.
- These are outcomes we discussed in our initiation report (Download Report). We retain the view that raising debt is an option given the support to date from banks, however, it's not ideal as it consumes cash flow required for expansion of its operations and it's coming at a higher cost given rate hikes. Likewise selling assets is not ideal as it diminishes the scale and offering of the group. An equity raise is therefore the most likely scenario. Expanding the shareholder base and incorporating a B-BBEE transaction are add-on options being pursued.
- We previously estimated a potential equity raise of c. R400m. This was based on asset realisations of R830m and debt reduction of R270m from operational cash flow. Non-core asset sales are progressing in line with our expectations. Management's estimate of R750m from non-core asset sales excludes funds from the sale of Afiswitch and Energy Solutions (c. R75m), bringing total funds received in line with the NAV of assets held for sale of R832m in FY21. Operational cash flow has been strong in 1H22E as overdraft facilities have been repaid – management drew down R388m of its R400m facility in FY21. It now has an undrawn R250m overdraft which could be utilised to pay down the bridge facility, in line with our R270m debt reduction forecasts. There is sufficient liquidity in the business for the day to day running of the operations – R722m of cash at 27 January.
- Based on the update we assume R750m from asset sales and R250m from the overdraft facility to reduce the R1.5bn bridge facility to R500m. We expect this to be raised via an equity issue. With the stock having declined c. 22% since the update, the equity raise discount is unlikely to be that significant to entice shareholders to follow rights or accept new capital. We model a further 10% discount from current levels of c. 500c, equating to a 450c issue price.
- On our equity raise assumptions it would result in proforma FY22E HEPS of 52.4c vs our current estimate of 67c, a 22% dilution. Based on scenarios, dilution of 28% occurs at a 400c price and R600m raise and 19% dilution at 500c and R500m.
- Revenue growth remains under pressure and margins have been maintained across the board in 1H22E. We are anticipating modest revenue growth (+2.6%) and a widening of EBITDA margins in FY22E. At this stage we make no changes to our 67c HEPS forecast in FY22E but would note there is downside risk to our estimates.
- Based on our existing mid-range DFCF valuation of 1000c per share, the stock's fair EV is R3.6bn, a 6.6x EV/EBITDA on FY22E estimates. Adjusting for the debt reduction and higher shares in issue, our mid-range fair value reduces to 780c. This declines to 717c for a R600m issue at 400c. We would, however, see upside to these valuations as our current 22.5% Cost of Equity would decline with lower financial leverage and the absence of a stock overhang.

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Price (03/02/2022):	R5.04
Market cap	R852mn
Shares in issue	169mn

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Operating performance

- Operationally, management has stated that revenue growth remains under pressure due to difficult economic conditions and Omicron. We anticipate 2.6% revenue growth in FY22E. Corporate IT appetite has picked up recently but will only flow through in 2H22E as contracts are being finalized. The second half is also historically a stronger half for EOH.
- NEXTEC is reporting improved gross profit and adjusted EBITDA margins in FY22E. These trends are in line with our forecasts given the depressed base in FY21.
- IOCO has produced an operating profit and positive adjusted EBITDA in 1H22E – little color around the magnitude has been given. We are forecasting modest revenue growth of 1.4% in FY22E and EBITDA growth of 14% due to some margin expansion. There is risk to the margin expansion as hardware sales margins are under pressure.
- The group has maintained margins across the board in 1H22E. We are anticipating a widening of EBITDA margins from 6.9% to 7.6% in FY22E. At this stage we make no changes to our 67c HEPS forecast in FY22E but would note there is downside risk to our estimates. Forecast risk remains high given the impact of its restructuring and the supply chain issues.

Equity raise impact on HEPS

Below we calculate the pro-forma FY22E HEPS in the event that debt for the year is reduced by the equivalent value of the equity raise at a 10.25% interest rate. Firstly, we need to calculate the additional shares in issue from an equity raise at different values and different share prices. These are in addition to the current 169m shares in issue. Our base case scenario is highlighted in yellow.

Figure 1 Shares ('m) to be issued given varying equity raise and price scenarios

		Share Price ZAc		
		400	450	500
	500	125	111	100
Equity Value R'm	550	138	122	110
	600	150	133	120

Source: Company data, Chronux Research estimates

Figure 2 Pro-forma HEPS (ZAc) given scenarios around size of equity raise and price

		Share Price ZAc		
		400	450	500
	500	50.0	52.4	54.6
Equity Value R'm	550	49.0	51.6	53.9
	600	48.2	50.8	53.2

Source: Company data, Chronux Research estimates

Figure 3 Dilution to FY22E HEPS post the equity raise

		Share Price ZAc		
		400	450	500
	500	-25%	-22%	-19%
Equity Value R'm	550	-27%	-23%	-20%
	600	-28%	-24%	-21%

Source: Company data, Chronux Research estimates

Disclaimer: