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EQUITY RESEARCH 16 April 2021

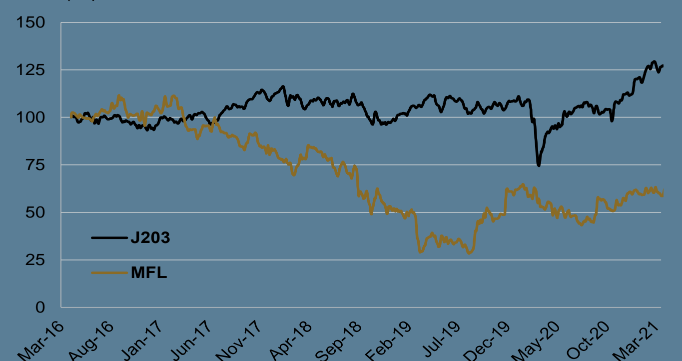
MFL – Metrofile Holdings Limited FY21 Interim Results Equity Update

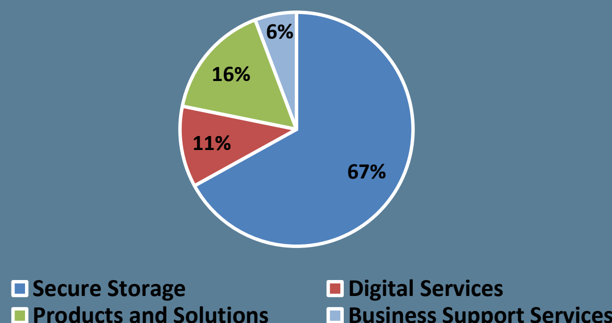
Valuation: Undervalued

MFL released Interim results on 8 March 2021 for the period ended 31 December 2020

Price (R)				**2.87**
PE Fair Value (R)				**3.35**
DCF Value (R)				**3.64**
Upside(Downside) to DCF (%)				26.7%
DY %				4.9%
Price Performance				**Relative**
		Absolute		**to JALSH**
1 month		-1.9%		-3.1%
3 month		0.1%		-12.2%
YTD		5.5%		-6.0%
12 month		**High**		**Low**
(SA Rands)		3.10		1.80
No. of shares (m)	453		Price (R)	2.87
NAV per share	1.14		Mkt cap (Rm)	1295
EV (Rm)	1906		Price/Book (x)	2.41

Financial Year	2019	2020	2021F	2022F
Turnover (Rm)	913	903	926	946
EBITDA	271	302	321	327
EBIT	224	217	239	248
PAT	26	-16	131	143
HEPS (cents)	20.5	24.8	30.3	33.2
Dividend (cents)	10.0	13.0	16.8	22.1
P/E ratio	7.9	9.0	9.6	8.7
EV/EBITDA	4.7	5.4	5.6	5.3
EBITDA margin (%)	29.7%	33.4%	34.7%	34.6%
EBIT margin (%)	24.5%	24.1%	25.8%	26.2%
Net debt/equity	1.07	1.30	0.98	0.79
ROCE (%)	17.6%	17.5%	19.2%	19.5%
ROE (%)	6.4%	-3.1%	24.3%	24.2%





RESULTS COMMENTARYS

MFL had a solid start to the financial year as various restructuring initiatives ensured that despite a reduction in revenue, operating profit continued to improve and cash flow remained healthy.

- Revenue decreased by 3.8% to R455m mainly due to the effects of the lockdown on digital services and business support services.
- Operating profit grew by 5.8% to R144m following a reduction in costs and improvement in operational efficiencies.
- Secure box storage contributes ~67% to Group revenue and grew revenue by ~1% despite net flat volumes. New box intake increased by ~4% from both new and existing clients which was offset by destructions and withdrawals.
- The Housatonic Consortium expressed their commitment to progress with the acquisition of Metrofile (prev. price offer: R3.30) whilst the second international corporation has withdrawn from discussions.
- HEPS increased by 14.7% from 12.9ps to 14.8cps on the back of a reduction in costs and a significant decrease in net finance costs of 24.8%. DPS grew 16.7% to 7c for the interim period.

OUTLOOK FOR NEXT REPORTING PERIOD

MFL's annuity business, in particular the physical storage and related information management services, remained resilient during a harsh period when businesses moved to a work-from-home environment. Box volumes in South Africa reduced by ~1% but the Rest of Africa grew by ~3% and box volume growth in the Middle East was ~19%. Covid-19 had a negative impact on the Digital Services vertical and caused a reduction in digital projects and scanning activities, decreasing the revenue contribution by 18.3%.

Despite Covid-19 affecting revenue streams, the Group was able to increase operating margins from 22.8% to 25.1%, kept buoyant by the successful initiatives to control operating costs. We expect continued growth in operating profit in H2 as they continue to drive cash flow generation while keeping a tight handle on the costs side.

The Housatonic Consortium are still not able to travel to South Africa due to Australian travel restrictions and quarantine requirements. Negotiations have been placed on hold, but management remains confident that the consortium will resume discussions once Australian travel restrictions have been lifted. The Housatonic Consortium will need to see three months of normal trading and revised projections and debt levels before a firm offer package and funding can be finalised.

The original R3.30 per share offer, or ~R1.49bn for MFL, represented a 70.9% premium to the share price at the time the Group announced the first cautionary. If the transaction materialises with the original proposed R3.30 offer price, investors can unlock value of ~14% as the current share price trades at a discount to the offer price. Even if current economic conditions have caused the deal to be revised down or completely cancelled, our valuation reflects potential as a long-term hold. MFL remains very cash generative and relatively defensive against economic downturns. Both our DCF and relative PE valuations point to a higher price than offered by Housatonic. However, while the consortium will still need to re-examine the value of MFL once the virus has run its course, we advise investors to be cautious until more clarity on negotiations and pricing is given.

Debt is slowly improving to a more manageable level but the high debt-to-equity ratio remains concerning at 1.55x, and the share is somewhat expensive on the current price-to-book value of 2.5x. However, MFL has a pleasing interest cover ratio (EBITDA/net finance cost) of 5.96x, above its covenant of no less than 3.5x. Despite this, we will need to see a notable reduction in debt to confirm a bullish long-term view, assuming the buy-out is off the table.

We anticipate improved sales during H2 as management expects more box volume intake as well as a recovery in digital services as most office environments fully reopen. Revenue growth of 2.5% and 2.1% is forecasted for FY21 and FY22, respectively. As a result of good cost reduction measures, we expect an operating profit margin of 25.8% for FY21, above the Group's 5-year average margin of 25.6%, increasing to 26.2% in FY22. HEPS of 30.3cps is achievable in FY21, representing an increase of 22.2%. This is partly driven by lower finance costs as the Group repays its large debt pile.

VALUATION

The Group is focused on refining debt levels and improving cash flow generation to maximise shareholder returns. MFL's high annuity revenue base provides resiliency in tough economic conditions. Operating margins are strong and top-line growth will resume once businesses fully reopen. If the consortium does not proceed with negotiations, shareholders can retain their investment in a well-managed, profitable business with good long-term prospects.

Both our relative P/E valuation and DCF valuation model indicate that the share is currently **Undervalued**.

With reference to the DCF table on the right, we have considered a discounted cash flow analysis with cash flows forecasted to FY23. A terminal growth rate of 6% and a discount rate of 18.4%[1] are used to yield our sensitivity table, which returns a value of R3.64, exceeding the price offered by the consortium.

With reference to the relative PE table on the right, we have compared Metrofile to other IT and storage businesses and believe MFL should be trading on par with the peer group average PE due to its mid-tier size and stable earnings growth. The implied forward PE valuation of 10.3x places Metrofile at a price of R3.35, also exceeding the price offered by the consortium.

	DCF Discount rate				
Growth rate	**14.4%**	**16.4%**	**18.4%**	**20.4%**	**22.4%**
0%	3.45	3.03	2.69	2.43	2.21
2%	3.88	3.34	2.93	2.61	2.36
4%	4.47	3.75	3.23	2.84	2.53
6%	5.35	4.33	**3.64**	3.13	2.76
8%	6.78	5.18	4.19	3.52	3.04
10%	9.52	6.56	5.01	4.06	3.41
12%	16.86	9.20	6.35	4.85	3.93

Merchantec ICT	Price	Mkt cap (m)	1 year fwd PE
Adapt IT	6.50	939	7.3
EOH	8.55	1505	7.0
Mustek	9.91	692	4.8
Alviva	11.90	1472	4.0
Cartrack	48.50	14508	17.5
Stor-Age*	13.24	5715	22.6
Metrofile	2.87	1295	8.8
Average			**10.3**
*consensus forecasts used			-14%
Metrofile	**2.87**	**1295**	**8.8**
Premium (Discount) applied to average:			0%
Metrofile: Implied current gain/(loss):	3.35	17%	**10.3**

Contact us
13th Floor, Illovo Point
68 Melville Road
Sandton
research@merchantec.co.za
www.merchantec.co.za
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Prepared by: The Merchantec Mid Cap Research Team

Contact: Brian Rainier, CFA
Tel: +2721 534 1244
Email: brian@merchantec.co.za

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[1] The discount rate is based on the average implied discount rate obtained from cash flow forecasts for companies with market capitalisations ranging from R301m to R10bn in our research universe