

CAPD LN

9 October 2019

Last price: 60.9p
Target price: 106p

Target Price Increased – 106p (from 91p)

Capital Drilling (LSE: CAPD) this morning announced the signing of binding agreements to provide a full range of mining services at Allied Gold's Bonikro Gold Mine in Côte d'Ivoire alongside a US\$3 million strategic investment. The new contract win marks a strategic move for the company, including for the first time providing load and haul operations, with control of the mine's heavy mining fleet alongside five drill and blast rigs. Capital is working with Bonikro management to refine the mine plan following Allied's recent acquisition, with a view to transitioning the agreement to a five year contract in H1/2020.

Low-risk diversification of service offering and earnings

Capital has the opportunity to move into tendering for load and haul services with a first contract acquiring fleet, management, and employees alongside a US\$3 million equity investment (for ~3% of Allied Gold), US\$4 million capital for new drill and blast rigs, and US\$4 million of ancillary mining fleet. Whilst the specific volumes and rates are being negotiated, revenues for 2020 are expected to be US\$25 – 30 million. The deal appears to represent an ideal way for Capital to enter the contract mining space with limited capex; ordinarily you would expect large balance sheet risk for a contract of this size.

Accretive to earnings, with no dilution to shareholders

Whilst the company has not specifically guided to earnings potential, looking at the listed peer group we feel like a 15% EBITDA margin on the load and haul element of this contract is a reasonable, albeit conservative, assumption. At the mid-point of guidance, we add US\$4.7 million to our 2020 EBITDA estimate (US\$32.3 million), and US\$2.9 million to our 2020 Profit after Tax estimate (US\$12.0 million). On a per share basis, EPS increases 32% to US\$0.09/share from US\$0.07/share.

Sizeable opportunities alongside a new client seeking growth

With few listed mining fleet contractors in West Africa, there is an opportunity for Capital to now tender for clients who require comprehensive services, and expand their service offering to existing clients. The new client, Allied Gold, is a private company which acquired Bonikro this year and is financially backed by private equity group Orion Mine Finance. Bonikro is expected to produce over 120koz Au over the next twelve months and has averaged 100kozpa gold production over the last 10 years.

Revenue underpinned with another long-term production contract

The company's most profitable contracts have historically been their production contracts at established African gold mining operations. At Bonikro, mining is currently taking place at the satellite Hiré pits before ramping up at the main pit over the life of the planned five year contract. This contract win adds another name on the list of stable production contracts (alongside Geita, Sukari, North Mara, Syama, and Tasiast) that should underpin revenue and earnings into the future.

Near term price target upgraded to 106p/share

Recent strong share price performance in challenging market conditions has started to validate our hypothesis that Capital Drilling is structurally undervalued. This contract win and investment is the first step to being able to offer a comprehensive mining services offering and compete for larger contracts. This in turn potentially adds scale and diversity to earnings and cashflow, thereby attracting a higher valuation multiple. The deal appears to represent an ideal way for Capital to enter the contract mining space with limited capex, with the company having assumed responsibility for Bonikro's existing mining fleet.

We value Capital Drilling at 106p/share, representing 5x 2020 EV/EBITDA inclusive of the announced Bonikro contract win, which is a 1.7x multiple on the current share price.

Summary

Last price:	60.9p
Target price	106.0p
Projected return (%)	74%

Share Data

Shares o/s (mm)	135.8
52 week high/low (£)	0.670 / 0.335
3-mth avg. daily vol (k)	105.6
3-mth avg. daily val (£k)	59.7
Market cap (US\$m)	101.2
Cash (US\$m)	15.5
Net cash/(debt) (US\$m)	8.5
Enterprise value (US\$m)	92.7

Financial Data	2018A	2019E	2020E
Revenue (US\$m)	116.0	112.9	144.5
EBITDA (US\$m)	28.3	26.3	32.3
EBIT (US\$m)	14.8	15.5	18.1
PBT (US\$m)	12.6	14.9	17.5
PAT (US\$m)	7.7	9.9	12.0
EPS	0.06	0.07	0.09
Operating CFPS	0.17	0.14	0.16
Dividend (US\$/sh)	0.02	0.02	0.02
Dividend yield	2.4%	2.8%	2.8%
P/E	13.1x	10.2x	8.5x
EV/EBITDA	3.3x	3.5x	2.9x

Share Price Performance



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Impact of New Contract Win

The announced new diversified mining service contract has a material positive impact on our near term earnings forecasts, whilst maintaining a strong balance sheet.

We assume the US\$8 million capital required for the contract will be allocated in 2019, with an increase in 2020 reflecting working capital buildup and increased sustaining capital expenditure. This does not include investments made by Capital under the 'drill for equity program'. We note that Capital still has US\$5 million of headroom on its US\$12 million revolving credit facility with Standard Bank, providing liquidity support if required.

The new contract win is expected to have an immediate uplift on the key financial metrics. Our 2020 revenue forecast at the midpoint of guidance for the new contract increases 23% to US\$144.5 million, increasing our EBITDA forecast 17% to US\$32.3 million. We forecast Profit after Tax to increase 32% to US\$12.0 million for the year, or US\$0.09/share.

We note that whilst the five year schedule of rates contract is still to be agreed, should it be confirmed then revenues are expected to ramp up over the life of mine and have a further positive impact on the financials and ratios. We will revisit our forecasts once the company provides an update on the signing of the long term contract and agreed mine plan.

Figure 1 – Key Financials

US\$m	Tamesis 2019E		Δ		Tamesis 2020E		Δ	
	Previous	Updated	US\$m	%	Previous	Updated	US\$m	%
Key Financials								
Revenue	112.9	112.9	-	-	117.3	144.5	27.2	23%
EBITDA	26.8	26.8	-	-	27.6	32.3	4.7	17%
Profit before Tax	15.1	14.9	(0.2)	(1%)	13.8	17.5	3.7	27%
Profit after Tax	10.1	9.9	(0.2)	(2%)	9.1	12.0	2.9	32%
Per Share Ratios								
Earnings per Share (US\$/sh)	0.07	0.07		(2%)	0.07	0.09		32%
Operating Cashflow (US\$/sh)	0.17	0.14		(19%)	0.17	0.16		(7%)
Free Cash Flow (US\$/sh)	0.07	0.02		(70%)	0.10	0.06		(44%)
Multiples								
P/E	10.0x	10.2x		(2%)	11.2x	8.7x		22%
EV/EBITDA	3.5x	3.5x		-	3.4x	2.9x		15%
Balance Sheet								
Capex	11.8	19.8	8.0	68%	10.9	14.3	3.4	31%
Net Cash/(Debt)	11.7	5.0	(6.7)	(57%)	21.5	9.4	(12.1)	(56%)
Cash at the end of the Period	18.8	12.0	(6.7)	(36%)	28.6	16.5	(12.1)	(42%)

Source: Tamesis

Allied Gold and Bonikro

Allied Gold

Allied Gold is a private gold company looking to grow by acquisition and the development of its existing assets. In addition to the Bonikro Gold Mine, other assets include the Dish Mountain project in Ethiopia with feasibility work ongoing and a stated resource of 1.9Moz.

The company is led by CEO Justin Dibb, a co-founder of Dominion Petroleum (acquired by Ophir Energy), supported by a technical team including several former members of the Equinox Minerals (acquired by Barrick) technical team – of which Capital has a relationship dating back to 2006.

Allied has secured US\$75 million of financing from the leading private equity group Orion Mine Finance. This bodes well for the execution of their growth strategy, which could lead to further opportunities for Capital as an early investor and partner.

Bonikro Gold Mine

Producing c.100kozpa since 2008, Bonikro was acquired from Equigold (ASX: EQX), as part of a takeover from Lihir Gold (ASX: LGL), which was subsequently taken over by Newcrest (ASX: NCM) in 2010. Newcrest divested the mine to private company Afrique Gold in 2018, before Allied's acquisition in 2019.

Since Newcrest's divestment, the mine life has been extended to 8+ years by completing a study to restart mining at the Bonikro pit, with opportunities for further resource conversion and underground mining. Mining currently takes place at the satellite pits at Hiré, approximately 15km via haulage road.

Long Term Incentive Plan

The company has also announced the implementation of a Long Term Incentive Plan. The awards, representing ~1.5% of the issued share capital, are scheduled to vest in December 31, 2019 on a straight line basis if the company achieves compounded annualised growth of either earnings per share growth (50% of the awards) or total shareholder returns (remaining 50%) of between 8% and 18%.

Given the performance nature of the awards we currently are not including the awards in our share capital calculation – however the underlying company and share price performance needed to trigger the awards would well outweigh any potential dilution.

Capital Drilling

CAPD
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As at 08-Oct-19

Share Price (GBP)	0.609	Target Price (GBP)	106
Ordinary Shares (M)	135.8	Market Cap (US\$m)	\$101.7
Options + Notes (M)	2.4	Enterprise Value (US\$m)	\$93.2

ASSUMPTIONS

	2017A	2018A	2019E	2020E	2021E
Average Fleet Size	93	93	95	96	96
Fleet Utilisation	53%	51%	53%	52%	52%
Average Revenue per Operating Rig (US\$)	194,500	194,000	186,500	190,000	190,000

FINANCIAL SUMMARY

	2017A	2018A	2019E	2020E	2021E
Revenue	119.4	116.0	112.9	144.5	144.5
EBITDA	24.3	28.3	26.8	32.3	32.3
Profit before Tax	9.7	12.6	14.9	17.5	16.6
Profit after Tax	5.2	7.7	9.9	12.0	11.1
Earnings per Share (USc)	0.04	0.06	0.07	0.09	0.08
Operating Cashflow per share (USc)	0.15	0.17	0.14	0.16	0.24
Free Cash Flow (unlevered) per Share (USc)	0.15	0.04	0.02	0.06	0.09
P/E	19.5x	13.2x	10.2x	8.5x	9.2x
EV/EBITDA	3.8x	3.3x	3.5x	2.9x	2.9x
Price / Operating Cash Flow	4.2x	3.6x	3.8x	3.1x	3.1x
Price / unlevered FCF	5.1x	17.5x	35.7x	13.3x	7.9x

PROFIT AND LOSS STATEMENT - US\$M

	2017A	2018A	2019E	2020E	2021E
Sales Revenue	119.4	116.0	112.9	144.5	144.5
Operating Costs	(80.2)	(70.7)	(68.9)	(94.2)	(94.2)
Gross Profit	39.3	45.3	44.0	50.3	50.3
Administration Costs	(14.9)	(17.0)	(17.3)	(18.0)	(18.0)
EBITDA	24.3	28.3	26.8	32.3	32.3
Depreciation	(12.6)	(13.5)	(11.3)	(14.3)	(15.3)
EBIT	11.7	14.8	15.4	18.0	17.0
Finance Charges and Other	(5.0)	(3.7)	(2.3)	(3.1)	(3.4)
Pre-Tax Profits	9.7	12.6	14.9	17.5	16.6
Less Tax	(4.5)	(4.9)	(4.9)	(5.5)	(5.5)
NPAT	5.2	7.7	9.9	12.0	11.1

CASH FLOW ANALYSIS - US\$M

	2017A	2018A	2019E	2020E	2021E
Cash Flows From Operating Activities					
Cash from Operations	23.8	26.7	27.7	32.4	32.5
Working Capital inflow/(outflow)	1.4	1.5	(3.9)	(4.9)	(1.0)
Net Interest	(1.0)	(0.7)	(0.4)	(0.5)	(0.4)
Tax	(3.5)	(5.1)	(4.6)	(5.5)	(5.5)
Cash Flows From Investing Activities					
Acq. of Property, Plant and Equip.	(10.8)	(11.9)	(19.8)	(14.3)	(12.9)
Other	(3.9)	(2.2)	(1.7)	-	-
Cash Flows From Financing Activities					
Net Change in Borrowings	-	(3.0)	(2.0)	-	-
Dividends Paid	(2.0)	(2.4)	(2.8)	(2.8)	(2.8)
Other	-	-	-	-	-
Net Increase In Cash Held	4.2	2.9	(7.9)	4.4	9.8
Cash At End of Year	16.9	19.9	12.0	16.4	26.3

BALANCE SHEET ANALYSIS - US\$M

	2017A	2018A	2019E	2020E	2021E
Current Assets					
Cash and Liquids	16.9	19.9	12.0	16.5	26.3
Inventory	21.7	19.8	19.4	27.8	25.8
Prepaid and Recievables	19.4	15.8	22.2	26.0	26.0
Investments	3.3	5.9	10.7	10.7	10.7
Other	0.1	0.1	0.3	0.3	0.3
Non-Current Assets					
Fixed Assets	41.4	43.5	47.1	47.1	44.7
Other	0.0	0.0	0.0	0.0	0.0
Current Liabilities					
Borrowings	0.1	0.1	0.1	0.1	0.1
Creditors	19.7	18.1	18.4	25.8	22.8
Other	0.4	0.4	0.4	0.4	0.4
Non-Current Liabilities					
Borrowings	12.0	9.0	7.0	7.0	7.0
Other	-	-	0.0	0.0	0.0
Equity	70.1	79.8	84.2	96.2	107.3
Net Cash/(Debt)	4.9	10.9	5.0	9.4	19.3

VALUATION

EBITDA Multiples Basis	
2020E EBITDA	32.3
Multiple	5.0x
Valuation (US\$m)	162
Plus net cash/debt	8.5
Plus investments	7.7
Valuation (US\$m)	178
Target Price (US\$)	1.31
Target Price (GBP)	1.06

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