

Supply Network Limited

Trucking on

Supply Network Ltd (SNL) provided a trading update and guidance for its FY23 result. Sales are expected to increase c. 26% in FY23 to \$250m. Underlying NPAT is expected to increase 33% to \$26.5m. Its financial performance was well above our forecast. As such we upgrade our earnings by c. 14% for the next two years. We upgrade to Buy from Accumulate, with a price target of \$15.40.

FY23 guidance is well above our expectations

- Supply Network provided a positive trading update, with an exceptionally strong 2H23 financial performance expected. SNL expects to achieve FY23 sales of \$250m, up 26% on the pcp and 7% above our \$234.1m forecast. The company expects to report an FY23 NPAT of \$26.5m, up 33% on the pcp and 11% ahead of our \$23.9m forecast. Sales have accelerated in 2H23, with 2H23 sales up 28.1%, versus 23.6% in 1H23. SNL's earnings guidance implies a 2H23 operating margin of 15.8%, only 10 basis points lower than the record 15.9% achieved in 1H23.

Near term outlook remains positive

- In terms of outlook, strong demand from commercial vehicle customers for parts continues to be driven by industry tailwinds such as an ageing vehicle fleet, increasing freight task and the increasing complexity of vehicles. Management expects growth "will remain above the long-term trend for at least the next year". As such, SNL is bringing forward capacity-related investments, which include the doubling of capacity at its new Victorian Distribution Centre and branch at Truganina in Victoria. SNL also plans the opening of a new branch in Yatala, Southeast Queensland. While both projects have experienced delays, it has had little effect on performance.

Investment view

- The outlook for SNL remains positive with market demand robust, supported by strong activity in all regions. SNL's future earnings growth will continue to be driven by a combination of robust underlying industry growth supported by further investment into the company's branch network. We upgrade to Buy, from Accumulate, with a 12-month target of \$15.40, up from \$12.90 previously.

Year-end June (\$)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (\$m)	162.6	198.5	250.0	293.5	325.7
EBITDA (\$m)	27.4	36.6	46.5	52.1	56.3
EBIT (\$m)	21.5	29.9	39.5	44.9	48.9
Reported NPAT (\$m)	13.9	20.0	26.5	28.9	31.7
Reported EPS (c)	34.1	48.4	64.2	70.2	76.9
Normalised NPAT (\$m)	13.9	20.0	26.5	28.9	31.7
Normalised EPS (c)	34.1	48.4	64.2	70.2	76.9
EPS Growth (%)	45.9	41.9	32.5	9.3	9.5
Dividend (c)	20.0	32.0	45.0	47.0	52.0
Net Yield (%)	1.5	2.4	3.4	3.5	3.9
Franking (%)	100	100	100	100	100
EV/EBITDA (X)	20.9	16.1	12.6	11.3	10.4
Normalised P/E (x)	38.9	27.4	20.7	18.9	17.3
Normalised ROE (%)	30.4	36.8	39.9	37.0	35.7

Source: OML, Iress, Supply Network Limited

Last Price

A\$13.29

Target Price

A\$15.40 (Previously A\$12.90)

Recommendation

Buy (Previously Accumulate)

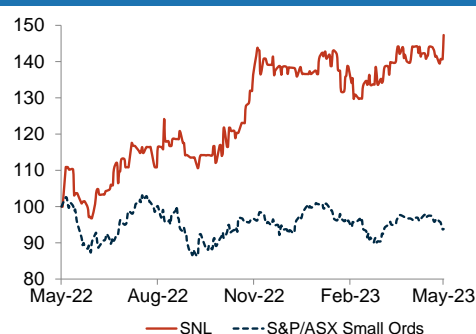
Risk

Higher

Auto Parts and Equipment

ASX Code	SNL
52 Week Range (\$)	8.73 - 13.29
Market Cap (\$m)	548.6
Shares Outstanding (m)	41.3
Av Daily Turnover (\$m)	0.1
3 Month Total Return (%)	6.3
12 Month Total Return (%)	47.3
Benchmark 12 Month Return (%)	-6.2
NTA FY23E (¢ per share)	179.7
Net Debt FY23E (\$m)	40.8

Relative Price Performance



Source: FactSet

Consensus Earnings

	FY23E	FY24E
NPAT (C) (\$m)	-	-
NPAT (OM) (\$m)	26.5	28.9
EPS (C) (c)	-	-
EPS (OM) (c)	64.2	70.2

Source: OML, Iress, Supply Network Limited

James Casey

Senior Research Analyst

03 9602 9265

jamescasey@ords.com.au

Dylan Jones, CFA

Research Associate

03 9608 4104

djones@ords.com.au

Strong FY23 result expected.

Above-average growth continues

- Supply Network provided a strong trading update, with an exceptionally strong 2H23 financial performance expected. The company anticipates FY23 sales of \$250 million, a 26% increase over the pcg and 7% more than our forecast of \$234.1 million.
- Additionally, the company anticipates reporting an FY23 NPAT of \$26.5 million, 11% more than our \$23.9 million forecast and up 33% on the pcg.
- Based on the guidance, sales increased faster in the second half of the year than in the first, by 28.1% against 23.6%. According to SNL's profit projection, the operating margin for 2H23 would be 15.8%, which is just 10 basis points less than the record 15.9% realised in 1H23.
- Demand for commercial vehicle parts and accessories remains robust driven by industry tailwinds including increased vehicle complexity, an ageing truck fleet, an increase in the number of registered commercial vehicles in Australia and increasing demand for road freight transport.

Figure 1: Supply Network: FY23 result guidance

Profit and Loss (A\$m)	1H22	2H22	FY22	1H23	2H23	FY23	Change 1H	Change 2H	Change FY23
Revenue									
Total Revenue	96.4	102.1	198.5	119.2	130.8	250.0	23.6%	28.1%	25.9%
EBITDA	17.4	19.2	36.6	22.4	24.1	46.5	29.1%	25.7%	27.3%
Depreciation and Amortisation	3.2	3.5	6.7	3.5	3.5	7.0	9.6%	1.2%	5.2%
EBIT	14.2	15.7	29.9	18.9	20.6	39.5	33.5%	31.2%	32.3%
Net Interest Expense	0.7	0.7	1.5	0.8	0.9	1.7	11.9%	25.6%	18.7%
Profit Before Tax	13.5	15.0	28.4	18.1	19.7	37.8	34.7%	31.4%	33.0%
Tax	4.0	4.4	8.4	5.4	5.9	11.3	34.4%	34.2%	34.3%
Adjusted NPAT	9.4	10.6	20.0	12.7	13.8	26.5	34.8%	30.2%	32.4%
Earnings per share (cps)	22.8	25.6	48.4	30.8	33.4	64.2	35.0%	30.4%	32.5%
Dividend (cps)	12.0	20.0	32.0	20.0	25.0	45.0	66.7%	25.0%	40.6%
Key Margins									
EBITDA Margin (%)	18.0%	18.8%	18.4%	18.8%	18.4%	18.6%			
EBIT Margin (%)	14.7%	15.4%	15.1%	15.9%	15.8%	15.8%			

Source: Company reports, Ord Minnett Limited estimates

Earnings changes and outlook

- The outlook for SNL remains positive with market demand robust, supported by strong activity in all regions. We upgrade our earnings by 11% in FY23, 13% in FY24 and 15% in FY25.

Figure 2: Earnings changes

	FY23 Old	FY23 New	% Change	FY24 Old	FY24 New	% Change	FY25 Old	FY25 New	% Change
Sales	234	250	6.8%	263	293	11.4%	287	326	13.5%
EBIT	35.9	39.5	10.0%	40.0	44.9	12.2%	43.1	48.9	13.5%
NPAT	23.9	26.5	10.5%	25.5	28.9	13.3%	27.7	31.7	14.6%
EPS	58.1	64.2	10.5%	62.0	70.2	13.3%	67.1	76.9	14.6%
Dividend	40.5	45.0	11.1%	41.5	47.0	13.3%	44.5	52.0	16.9%

Source: Ord Minnett Limited estimates

Investment thesis, valuation, and risks

Investment thesis

- Supply Network Ltd (SNL) has a solid track record of earnings growth coupled with high returns on invested capital. The commercial vehicle automotive aftermarket industry is fragmented, and we believe there is scope for further market share gains and consolidation. Market demand is robust, supported by strong economic activity in key regions, and with a current network of 20 branches in Australia and five in New Zealand, we see a meaningful opportunity for expansion in SNL's operations. We expect sales to continue to grow at above-average levels, driven by: 1) continued growth in demand for bus and truck parts in the commercial automotive aftermarket; 2) further expansion of the SNL branch network in Australia and New Zealand; and 3) market share gains in a fragmented market.

Valuation

- In terms of single-period valuation measures, SNL is currently trading on an FY25 PER multiple of 17x (OMLe), and based on FY25 EV/EBIT multiples, SNL is currently trading on a multiple of 12.0x (OMLe).
- Our 12-month price target of \$15.40 implies an FY25 PER of 20.0x, in line with its longer-term averages. Our \$15.40 price target implies an FY25 EV/EBIT multiple of 13.7x.

Key investment risks

- Increased competition:** The Australian automotive aftermarket parts distribution industry may face increased competition from existing competitors through further consolidation of existing players, or from new entrants into the market. Increased competition could have an adverse effect on the financial performance of the company, growth prospects and industry returns.
- Pricing pressure:** SNL relies on access to a wide range of automotive parts, most of which are foreign-sourced. An increase in pricing pressure from suppliers may force the company to either absorb the price increases or pass on price increases to its customers. Higher prices may result in a decreased demand for products or lead to a decrease in profitability.
- Unable to find sites for new branches:** A key part of SNL's growth strategy is to expand its branch network in appropriate locations. If suitable sites are not able to be identified, this may limit future expansion and revenue growth opportunities.
- Unfavourable vehicle trends:** Demand for automotive parts can be negatively affected by unfavourable vehicle trends. A rise in the number of registered heavy vehicles or decline in freight activity could impact the demand for automotive aftermarket parts.
- Increased competition from online competitors:** While SNL has invested in technology for its customer base, there is potential for the emergence of new players using online capabilities to meet existing requirements.

Supply Network Limited

PROFIT & LOSS (A\$m)	2021A	2022A	2023E	2024E	2025E
Revenue	162.6	198.5	250.0	293.5	325.7
Operating costs	(135.3)	(162.0)	(203.5)	(241.6)	(270.0)
Operating EBITDA	27.4	36.6	46.5	52.1	56.3
D&A	(5.9)	(6.7)	(7.0)	(7.2)	(7.4)
EBIT	21.5	29.9	39.5	44.9	48.9
Net interest	(1.5)	(1.5)	(1.7)	(3.6)	(3.6)
Pre-tax profit	20.0	28.4	37.8	41.3	45.3
Net tax (expense) / benefit	(6.0)	(8.4)	(11.3)	(12.4)	(13.6)
Normalised NPAT	13.9	20.0	26.5	28.9	31.7
Reported NPAT	13.9	20.0	26.5	28.9	31.7
Normalised dil. EPS (cps)	34.1	48.4	64.2	70.2	76.9
Reported EPS (cps)	34.1	48.4	64.2	70.2	76.9
Effective tax rate (%)	29.9	29.7	30.0	30.0	30.0
DPS (cps)	20.0	32.0	45.0	47.0	52.0
Dividend yield (%)	1.5	2.4	3.4	3.5	3.9
Payout ratio (%)	58.6	66.1	70.1	66.9	67.6
Franking (%)	100.0	100.0	100.0	100.0	100.0
Diluted # of shares (m)	40.8	41.3	41.2	41.2	41.2

CASH FLOW (A\$m)	2021A	2022A	2023E	2024E	2025E
EBITDA incl. adjustments	27.4	36.6	46.5	52.1	56.3
Change in working capital	(4.3)	(8.5)	(16.3)	(13.4)	(9.3)
Net Interest (paid)/received	0.3	0.3	1.1	3.6	3.6
Income tax paid	(5.1)	(8.5)	(9.2)	(9.3)	(10.6)
Other operating items	(1.7)	(1.8)	(2.8)	(7.1)	(7.1)
Operating Cash Flow	16.6	18.1	19.3	25.8	32.8
Capex	(1.4)	(3.0)	(3.5)	(7.2)	(5.5)
Acquisitions	-	-	-	-	-
Other investing items	0.0	0.0	-	-	-
Investing Cash Flow	(1.4)	(3.0)	(3.5)	(7.2)	(5.5)
Inc/(Dec) in equity	-	-	-	-	-
Inc/(Dec) in borrowings	0.5	0.4	(0.6)	9.0	1.5
Dividends paid	(6.9)	(9.8)	(13.1)	(19.4)	(20.4)
Other financing items	(3.8)	(4.3)	(4.1)	(4.5)	(6.9)
Financing Cash Flow	(10.2)	(13.7)	(17.8)	(14.9)	(25.8)
FX adjustment	(0.0)	(0.0)	-	-	-
Net Inc/(Dec) in Cash	5.0	1.4	0.0	8.0	7.0

BALANCE SHEET (A\$m)	2021A	2022A	2023E	2024E	2025E
Cash	5.6	6.9	7.0	15.0	22.0
Receivables	17.6	21.4	26.9	31.6	35.0
Inventory	-	63.3	79.7	93.6	103.9
Other current assets	0.4	0.3	0.5	0.5	0.6
PP & E	36.7	43.6	44.6	44.6	42.7
Investments	-	-	-	-	-
Financial Assets	-	-	-	-	-
Intangibles	-	-	-	-	-
Other non-current assets	2.9	3.1	3.1	3.0	3.0
Total Assets	63.1	138.5	161.7	188.3	207.2
Short term debt	0.5	5.2	5.8	7.8	8.0
Payables	25.0	29.5	35.1	40.3	44.7
Other current liabilities	6.7	3.1	4.2	4.7	5.3
Long term debt	35.2	41.1	42.0	49.0	50.3
Other non-current liabilities	0.4	0.3	0.5	0.5	0.6
Total Liabilities	67.8	79.2	87.7	102.3	108.9
Total Equity	49.3	59.3	73.5	83.0	94.3
Net debt (cash)	30.1	39.3	40.8	41.8	36.3

Buy

DIVISIONS	2021A	2022A	2023E	2024E	2025E
Revenue (A\$m)					
Supply Network Ltd	162.6	198.5	250.0	293.5	325.7
EBITDA (A\$m)					
Supply Network Ltd	21.5	29.9	39.5	44.9	48.9

KEY METRICS (%)	2021A	2022A	2023E	2024E	2025E
Revenue growth	18.8	22.1	25.9	17.4	11.0
EBITDA growth	30.6	33.3	27.3	11.9	8.0
EBIT growth	40.5	39.1	32.3	13.5	8.8
Normalised EPS growth	45.9	41.9	32.5	9.3	9.5
EBITDA margin	16.9	18.4	18.6	17.8	17.3
OCF / EBITDA	84.4	76.9	64.9	74.2	83.4
EBIT margin	13.2	15.1	15.8	15.3	15.0
Return on assets	17.8	20.9	18.4	18.0	17.3
Return on equity	30.4	36.8	39.9	37.0	35.7

VALUATION RATIOS (x)	2021A	2022A	2023E	2024E	2025E
Reported P/E	38.9	27.4	20.7	18.9	17.3
Normalised P/E	38.9	27.4	20.7	18.9	17.3
Price To Free Cash Flow	25.4	18.5	14.8	12.6	12.3
Price To NTA	-	9.3	7.4	6.4	5.6
EV / EBITDA	20.9	16.1	12.6	11.3	10.4
EV / EBIT	26.6	19.7	14.9	13.1	12.0

LEVERAGE	2021A	2022A	2023E	2024E	2025E
ND / (ND + Equity) (%)	37.9	39.9	35.7	33.5	27.8
Net Debt / EBITDA (%)	109.9	107.7	87.7	80.2	64.6
EBIT Interest Cover (x)	14.2	20.5	22.9	12.6	13.7
EBITDA Interest Cover (x)	18.1	25.1	26.9	14.7	15.8

SUBSTANTIAL HOLDERS	m	%
Harry Forsyth	12.6	30.4%
Peter McKenzie	4.5	10.8%
J. E. Davies	3.8	9.2%

VALUATION	
Multiples valuation method	FY25 PE
Multiples	20.0
Multiples valuation	15.40
Multiples valuation method	FY25 EV/EBIT
Multiples	13.7
Multiples valuation	15.40
Target Price Method	FY24 PE & EV/EBITDA
Target Price (\$)	15.40
Valuation disc. / (prem.) to share price (%)	15.9

Institutional Research

Alastair Hunter	Head of Institutional Research	+61 3 9608 4168	ahunter@ords.com.au
Malcolm Wood	Macro Strategy Analyst	+61 2 8216 6777	mwood@ords.com.au
Nicolas Burgess	Senior Research Analyst	+61 3 9602 9379	nburgess@ords.com.au
James Casey	Senior Research Analyst	+61 3 9602 9265	jamescasey@ords.com.au
Phillip Chippindale	Senior Research Analyst	+61 2 8216 6346	pchippindale@ords.com.au
Tom Godfrey	Senior Research Analyst	+61 7 3214 5587	tgodfrey@ords.com.au
Paul Kaner	Senior Research Analyst	+61 7 3214 5514	pkaner@ords.com.au
Ian Munro	Senior Research Analyst	+61 3 9608 4127	ian.munro@ords.com.au
John O'Shea	Senior Research Analyst	+61 3 9608 4146	joshea@ords.com.au
Leanne Truong	Senior Research Analyst	+61 2 8216 6367	ltruong@ords.com.au
Rushil Paiva	Research Analyst	+61 3 9608 4155	rpaiva@ords.com.au
Tim Elder	Research Associate	+61 7 3214 5565	telder @ords.com.au
Milo Ferris	Research Associate	+61 2 8216 6691	mferris@ords.com.au
Dylan Jones	Research Associate	+61 3 9608 4104	djones@ords.com.au
William Thurlow	Research Associate	+61 2 8216 6623	wthurlow@ords.com.au
Benjamin Yun	Research Associate	+61 2 8216 6646	byun@ords.com.au
Oliver Burston	Research Associate	+61 3 9608 4166	oburston@ords.com.au

Institutional Sales (Australia)

Angus Esslemont	Head of Institutional Equities	+61 2 8216 6363	aesslemont@ords.com.au
Jim Bromley	Institutional Equities Sales	+61 2 8216 6343	jbromley@ords.com.au
Stephen Jolly	Institutional Equities Sales	+61 2 8216 6424	sjolly@ords.com.au
Isaac Morris	Institutional Equities Sales	+61 2 8216 6370	imorris@ords.com.au
Scott Ramsay	Institutional Equities Sales	+61 3 9608 4100	sramsay@ords.com.au
Matt White	Institutional Equities Sales	+61 3 9608 4133	mwhite@ords.com.au
Zac Whitehead	Institutional Equities Sales	+61 2 8216 6350	zwhitehead@ords.com.au
Trent Stewart	Institutional Derivatives Sales	+61 2 8216 6622	trent.stewart@ords.com.au
Brendan Sweeney	Operator	+61 2 8216 6781	bsweeney@ords.com.au

Institutional Sales (Hong Kong)

Chris Moore	Institutional Equities Sales	+61 2 8216 6362	cmoore@ords.com.hk
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Ord Minnett Offices

Adelaide
Level 5
100 Pirie Street
Adelaide SA 5000
Tel: (08) 8203 2500

Canberra
101 Northbourne Avenue
Canberra ACT 2600
Tel: (02) 6206 1700

Hobart
Ground Floor
85 Macquarie Street
Hobart TAS 7000
Tel: (03) 6161 9300

Melbourne
Level 22
35 Collins Street
Melbourne VIC 3000
Tel: (03) 9608 4111

Head Office
Sydney
Level 18, Grosvenor Place
225 George Street
Sydney NSW 2000
Tel: (02) 8216 6300
www.ords.com.au

Brisbane
Level 34
71 Eagle Street
Brisbane QLD 4000
Tel: (07) 3214 5555

Geelong
Office 3, Suite 4
200 Malop Street
Geelong VIC 3220
Tel: (03) 4210 0200

Mackay
45 Gordon Street
Mackay QLD 4740
Tel: (07) 4969 4888

Newcastle
426 King Street
Newcastle NSW 2300
Tel: (02) 4910 2400

Buderim (Sunshine Coast)
1/99 Burnett Street
Buderim QLD 4556
Tel: (07) 5430 4444

Gold Coast
Level 7
50 Appel Street
Surfers Paradise QLD 4217
Tel: (07) 5557 3333

Mildura
128 Lime Avenue
Mildura VIC 3500
Tel: (03) 9608 4111

Perth
Level 27
108 St Georges Terrace
Perth WA 6000
Tel: (02) 4910 2400

International
Hong Kong
1801 Ruttonjee House
11 Duddell Street
Central, Hong Kong
Tel: +852 2912 8980
www.ords.com.hk

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Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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