BELL POTTER

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Southern Cross Electrical Engineering (SXE)

Contract award momentum continues

Recommendation
Buy (unchanged)
Price
$1.43
Target (12 months)
$2.25 (unchanged)

Sector

Commercial Services and Suppliers

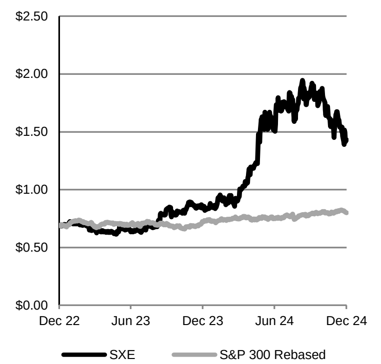
Expected Return	
Capital growth	**57.3%**
Dividend yield	**4.9%**
Total expected return	**62.2%**

Company Data & Ratios	
Enterprise value	**$302m**
Market cap	**$378m**
Issued capital	**264m**
Free float	**77.8%**
Avg. daily val. (52wk)	**$1.0m**
12 month price range	**$0.815-1.965**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.57	1.84	0.87
Absolute (%)	-8.6	-22.1	64.4
Rel market (%)	-8.4	-25.0	50.5

Absolute Price



SOURCE: IRESS

Contracts flowing from multiple sectors

SXE has provided two contract award updates within a week, with new contracts awarded across multiple sectors and by repeat clients totalling >$225m. We are pleased to see further contract awards in the Data Centre sector and an additional Healthcare work package to be delivered in the Illawarra region. Key points

Orderbook bolstered: Excluding the ~$50m Collie BESS Project Switchyard construction package awarded on 5 July 2024, SXE has announced >$225m of new contract awards in FY25-to-date, including purchase orders at Trivantage Manufacturing. These orders compare with >$140m of contracts awarded in the PcP and ~$470m in FY24 (including $210m of work packages for the Collie BESS project and switchyard). We expect SXE to deliver a 1H FY25 orderbook that is consistent with the record $720m reported at FY24, accounting for increased project delivery in 1H FY25, with revenue to lift 23% YoY to $314m.

FY25 EBITDA guidance: SXE continue to anticipate FY25 EBITDA of at least $53.0m (BPe $54.2m, implying >21% YoY growth). While FY25-to-date contract awards are encouraging for expected activity growth across the Group, we do anticipate a high level of work replenishment as contracts complete over FY25, maintaining an elevated EBITDA run-rate into FY26 (vs FY24: $40.1m). We see upside to our forecasts should FY25-to-date contract award momentum continue in 2H FY25.

EPS changes reflect a more optimistic medium-term view of Infrastructure project delivery: nc in FY25-26; and +7% in FY27.

Investment thesis: Buy; TP$2.25/sh (unchanged)

SXE brings key small cap exposure to several emerging and structural themes, including the proliferation of data centre construction across Australia, decarbonisation of the Australian economy, electrification of industries and the build-out of large-scale critical infrastructure. SXE's blue-chip clientele and high proportion of recurring work (33% of FY24 Group revenue) provides some stability to operations and financials and reduced counterparty risk.

Earnings Forecast

Year ending 30 June	**2024a**	**2025e**	**2026e**	**2027e**
Sales ($m)	552	679	720	731
EBITDA ($m)	40	54	58	59
NPAT (reported) ($m)	22	31	33	35
NPAT (adjusted) ($m)	22	31	33	35
EPS (adjusted) (¢ps)	8.3	11.9	12.6	13.3
EPS growth (%)	8.4%	42.4%	5.9%	5.7%
PER (x)	17.1x	12.0x	11.4x	10.8x
FCF Yield (%)	5.8%	2.1%	10.7%	8.9%
EV/EBITDA (x)	7.5x	5.6x	5.2x	5.2x
Dividend (¢ps)	6.0	7.0	8.0	9.0
Yield (%)	4.2%	4.9%	5.6%	6.3%
Franking (%)	100%	100%	100%	100%
ROE (%)	12%	16%	15%	15%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings & valuation changes

Earnings changes

We make no material changes to financial forecasts in FY25-26. In FY27, we have raised revenue forecasts modestly to reflect a more optimistic medium-term view of Infrastructure project delivery.

Table 1 - Changes to earnings estimates

	Previous			New			Change		
Year ending 30 June	**FY25**	**FY26**	**FY27**	**FY25**	**FY26**	**FY27**	**FY25**	**FY26**	**FY27**
Revenue $m	679	720	703	**679**	**720**	**731**	0%	0%	4%
EBITDA (underlying) $m	54.2	57.9	55.0	**54.2**	**57.9**	**58.5**	0%	0%	6%
NPAT (underlying) $m	31.3	33.1	32.7	**31.3**	**33.1**	**35.0**	0%	0%	7%
EPS (underlying) cps	11.9	12.6	12.4	**11.9**	**12.6**	**13.3**	0%	0%	7%
DPS cps	7.0	8.0	9.0	**7.0**	**8.0**	**9.0**	0%	0%	0%
Valuation $/sh	2.27			**2.29**			1%		

SOURCE: BELL POTTER SECURITIES ESTIMATES

Valuation summary

We maintain our Target Price of $2.25/sh and Buy recommendation.

Table 2 - SXE valuation summary

Valuation methodology mix	Weighting (%)	Valuation ($/sh)
Discounted cash flow	50%	0.99
ROIC	50%	1.30
Final valuation	**100%**	**2.29**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Southern Cross Electrical Engineering (SXE)

Company description

Southern Cross Electrical Engineering (SXE) is a leading Group of companies that provides electrical, instrumentation, communications, security and maintenance services to a diverse mix of customers. The SXE companies include: Southern Cross Electrical; Datatel; Heyday Group; SJ Electric; SEME Solutions; Trivantage Manufacturing; and MDE Group. SXE generates a significant portion of its revenue from blue-chip customers, including Woolworths Group (WOW; not rated); Coles (COL; not rated); BHP Group (BHP; not rated); Rio Tinto (RIO; not rated); Multiplex and CPB Contractors.

Investment thesis: Buy; TP$2.25/sh (unchanged)

SXE brings key small cap exposure to several emerging and structural themes, including the proliferation of data centre construction across Australia, decarbonisation of the Australian economy, electrification of industries and the build-out of large-scale critical infrastructure. SXE's blue-chip clientele and high proportion of recurring work (33% of FY24 Group revenue) provides some stability to operations and financials and reduced counterparty risk.

Valuation methodology

Our SXE valuation is based on a 50% / 50% blend of discounted cash flow and ROIC-based valuation methods. A nominal WACC of 10.4% and a terminal growth rate of 3.0% have been applied in our valuation determination.

Investment risks

Risk to investment thesis

Key risks to SXE include, although are not limited to:

Construction risk: The construction industry is inherently risky, and particularly so when fixed-price / lump-sum contracts are involved. This is exacerbated by the general fixed cost nature of construction contracts. Any unforeseen project costs and delays will thus be borne by the contractor. Construction contracting generally is fraught with examples of major contract disputes which can impact profitability, cash flow and ongoing viability. While SXE appears to have a solid track record of achieving profits, there always remains a risk that materially negative project cash outflows may occur.

Contract completion risk: There is always a risk that unforeseen issues prevent SXE from completing a contract as initially intended, or that a disagreement arises with the party that awarded the contract. This risk has grown as project developers have attempted to shift a greater proportion of risks onto contractors, and is particularly pertinent with fixed-price / lump-sum contracts, where contractors are responsible for project delivery.

Contract renewal / replenishment risk: In order to maintain revenue, SXE needs to continually win new projects from clients to replace revenue from other projects as they are completed. The amount of work available for tender varies significantly across periods of time as a result of the cyclical nature of client industries and capital expenditures. During times of low construction activity there is a heightened risk that SXE will not be able to replace completed projects with new work. During times of low project activity, margins are also more likely to come under pressure as engineering & construction companies aggressively tender for a smaller supply of opportunities.

Contract mispricing risk: In addition to customer disputes, SXE could misprice projects for which it tenders. This could result in SXE winning work on uneconomic terms, which may result in SXE recording large losses on some projects that were not originally anticipated. Mispricing could occur as a result of not factoring into account for unforeseen costs, time constraints and project risks. A push into larger sized projects increases this risk, as the potential for larger cost overruns and disputes is greater. A cost inflationary environment can increase this risk, particularly when combined with fixed price contracts.

Occupational Health & Safety risk: Electrical and construction activity carries with it significant health and safety risks. If not properly mitigated by sufficient safety procedures, there is a risk that employees may suffer serious harm. A lack of proper safety procedures and a proper safety culture would damage employee morale, impact the ability to hire and retain staff, potentially cause litigation risks, impact a company's social licence, and leads to loss of clients.

Commodity price / macroeconomic risk: Given that SXE provides a portion of its services on mining projects, any sustained fall in commodity prices is likely to lead to a reduction in opportunities, and the demand for SXE's services.

Bad debt risk: Given that SXE is not paid entirely upfront for its contracts, there is a risk that a customer(s) will not be able to fully pay SXE for its services in the event that they suffer cash flow issues. This risk is somewhat mitigated when project works are with large companies like BHP Group, Rio Tinto and Multiplex. SXE's trade credit insurance policies provide protection against bad debt risk.

Availability and cost of employees / subcontractors risk: During times of an upturn in construction activity, there is a possibility that staff shortages can occur. This may impact SXE's ability to source adequate staff to tender for new projects and increase its revenue. Even if staff are able to be secured, it may require SXE to pay substantially higher rates to both current and newly hired employees/subcontractors in order to secure their services.

Southern Cross Electrical Engineering
as at 16 December 2024

Recommendation	Buy
Price	$1.43
Target (12 months)	$2.25

Table 3 - Financial summary

Date		16/12/24
Price	$/sh	1.43
Target price	$/sh	2.25

Bell Potter Securities
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PROFIT AND LOSS

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
Revenue	**$m**	**465**	**552**	**679**	**720**	**731**
Other income	$m	2	1	1	1	1
Expenses	$m	(428)	(513)	(626)	(664)	(673)
Underlying EBITDA	**$m**	**38**	**40**	**54**	**58**	**59**
Depreciation	$m	(4)	(3)	(5)	(5)	(5)
Amortisation	$m	(5)	(5)	(5)	(5)	(3)
Underlying EBIT	**$m**	**30**	**33**	**45**	**47**	**50**
Net interest expense	$m	(1)	(1)	0	(0)	(0)
Underlying profit before tax	**$m**	**29**	**32**	**45**	**47**	**50**
Tax expense	$m	(9)	(10)	(13)	(14)	(15)
Underlying NPAT	**$m**	**20**	**22**	**31**	**33**	**35**
Adjustments (post-tax)	$m	-	-	-	-	-
Reported NPAT	**$m**	**20**	**22**	**31**	**33**	**35**
Customer relationship amort. (post-tax)	$m	(1)	(1)	(2)	(2)	(0)
Underlying NPATA	**$m**	**22**	**23**	**33**	**35**	**35**

CASH FLOW STATEMENT

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
OPERATING CASH FLOW						
Receipts from customers	$m	557	590	642	746	718
Payments to suppliers and employees	$m	(502)	(536)	(614)	(685)	(663)
Tax paid	$m	(6)	(17)	(13)	(14)	(15)
Net interest	$m	(0)	1	0	(0)	(0)
Other	$m	-	-	0	0	(0)
Operating cash flow	**$m**	**48**	**38**	**15**	**47**	**41**
INVESTING CASH FLOW						
Capital expenditures	$m	(3)	(4)	(5)	(5)	(5)
Payments for acquisitions	$m	(6)	(12)	(1)	(2)	(2)
Disposal of assets	$m	1	0	-	-	-
Other	$m	-	-	(1)	-	-
Investing cash flow	**$m**	**(8)**	**(16)**	**(7)**	**(7)**	**(7)**
Free cash flow	***$m***	***40***	***22***	***8***	***40***	***34***
FINANCING CASH FLOW						
Proceeds from share issues (net)	$m	-	-	-	-	-
Debt proceeds / (repayments)	$m	-	-	-	-	-
Dividends paid	$m	(13)	(13)	(16)	(18)	(21)
Other	$m	(3)	(3)	(3)	(3)	(4)
Financing cash flow	**$m**	**(16)**	**(15)**	**(19)**	**(22)**	**(25)**
Change in cash	**$m**	**25**	**6**	**(11)**	**18**	**9**

BALANCE SHEET

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
ASSETS						
Cash	$m	78	84	73	92	100
Receivables	$m	39	50	66	55	60
Contract assets	$m	65	88	109	96	104
Inventories	$m	5	3	3	3	3
Capital assets	$m	10	11	11	10	10
Intangibles	$m	8	5	4	2	1
Goodwill	$m	103	111	111	111	111
Other assets	$m	11	13	14	15	16
Total assets	**$m**	**318**	**365**	**391**	**383**	**406**
LIABILITIES						
Payables	$m	49	80	87	75	82
Contract liabilities	$m	37	49	54	44	48
Borrowings	$m	-	-	-	-	-
Provisions	$m	19	23	23	23	23
Leases	$m	10	8	9	9	9
Other liabilities	$m	21	13	12	10	8
Total liabilities	**$m**	**136**	**174**	**184**	**162**	**171**
NET ASSETS						
Share capital	$m	117	118	118	118	118
Reserves	$m	1	0	0	0	0
Retained earnings	$m	65	73	89	104	117
SHAREHOLDER EQUITY	**$m**	**182**	**191**	**207**	**221**	**235**
Weighted average shares	m	261	263	263	263	263

FINANCIAL RATIOS

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
VALUATION						
EPS (underlying)	c/sh	7.7	8.3	11.9	12.6	13.3
EPS growth	%	14.4%	8.4%	42.4%	5.9%	5.7%
PER	x	18.6x	17.1x	12.0x	11.4x	10.8x
DPS	c/sh	5.0	6.0	7.0	8.0	9.0
Franking	%	100%	100%	100%	100%	100%
Yield	%	3.5%	4.2%	4.9%	5.6%	6.3%
FCF/share	c/sh	15.4	8.3	3.1	15.3	12.7
FCF yield	%	10.7%	5.8%	2.1%	10.7%	8.9%
EV/EBITDA	x	7.9x	7.5x	5.6x	5.2x	5.2x
NTA	$/sh	0.27	0.29	0.35	0.41	0.47
P/NTA	x	5.2x	5.0x	4.1x	3.5x	3.1x
LIQUIDITY & LEVERAGE						
Net debt / (cash)	$m	(67)	(76)	(65)	(83)	(91)
Net debt / Equity	%	-36.9%	-39.8%	-31.3%	-37.3%	-38.7%
Net debt / Net debt + Equity	%	-58.5%	-66.0%	-45.6%	-59.5%	-63.1%
Net debt / EBITDA	x	-1.8x	-1.9x	-1.2x	-1.4x	-1.6x
EBITDA / net interest expense	x	57.3x	32.4x	-838.9x	368.0x	10556.8x
PROFITABILITY RATIOS						
EBITDA margin	%	8.2%	7.3%	8.0%	8.0%	8.0%
EBIT margin	%	6.4%	5.9%	6.6%	6.6%	6.8%
Return on assets	%	6.1%	6.4%	8.3%	8.5%	8.9%
Return on equity	%	11.3%	11.7%	15.7%	15.5%	15.3%
Return on capital employed	%	15.2%	16.3%	20.9%	21.0%	21.0%
Return on invested capital	%	26.2%	29.3%	36.0%	35.2%	35.5%

HALF YEARLY ASSUMPTIONS

Year ending 30 June	Unit	1H 2023a	1H 2024a	1H 2025e	1H 2026e	1H 2027e
Revenue	**$m**	**255**	**256**	**314**	**379**	**358**
Other income	$m	1	0	1	1	1
Expenses	$m	(237)	(239)	(291)	(349)	(330)
Underlying EBITDA	**$m**	**19**	**17**	**24**	**30**	**28**
Depreciation	$m	(2)	(1)	(2)	(3)	(3)
Amortisation	$m	(3)	(2)	(2)	(2)	(2)
Underlying EBIT	**$m**	**14**	**13**	**20**	**25**	**24**
Net interest expense	$m	(0)	1	0	(0)	(0)
Underlying profit before tax	**$m**	**14**	**14**	**20**	**25**	**24**
Tax expense	$m	(4)	(4)	(6)	(7)	(7)
Underlying NPAT	**$m**	**10**	**10**	**14**	**17**	**17**
Adjustments (post-tax)	$m	-	-	-	-	-
Reported NPAT	**$m**	**10**	**10**	**14**	**17**	**17**
Customer relationship amort. (post-tax)	$m	(1)	(1)	(1)	(1)	(0)
Underlying NPATA	**$m**	**10**	**10**	**15**	**18**	**17**

VALUATION SUMMARY

12-month valuation

Valuation method	**Weight (%)**	**Val. ($m)**
DCF	50%	0.99
ROIC	50%	1.30
Blended equity valuation	**100%**	**2.29**
Current share price $/sh		1.43
Upside to current share price %		60%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

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