

Action Summary – 8 June 2023

Analyst Theodore R. O'Neill – F2Q23 EPS miss on higher revenue due to mix – Reiterate Buy and \$10 target.

- **Unfavorable mix in F2Q23.** ESOA reported F2Q23 revenue and an EPS loss of \$53.7MM and \$0.11, respectively versus our estimate of \$44.4MM and an EPS gain of \$0.06, respectively. There is no consensus. The \$0.17 unfavorable EPS variance was primarily due to a higher mix of maintenance work, in the Electrical, Mechanical & General construction services segment, higher expenses due to its recent acquisition and an increase in staff, higher interest expense (for which we have more comments) partially offset by higher revenue in all segments except transmission, where projects started later than last year.
- **Restatement of results related to PPP loan forgiveness.** The government is reviewing the company's previously announced loan forgiveness. All PPP loans are subject to a six-year window for audit. Because there is a small chance that part of the loan may not be forgiven, the company has had to restate this year and last. This impacts the interest expense in other income. This has no operational impact.
- **Adjusting estimates.** We are adjusting our estimates to reflect F2Q23 results by raising FY23 revenue to \$237MM from \$222.5MM and EPS declines to \$0.05 from \$0.24. For 2024, we are raising revenue to \$245.5MM from \$230.1MM and EPS to \$0.36 from \$0.34. This reflects our outlook for construction.
- **Attractive Valuation.** Based on our discounted future earnings model, the value of all future earnings is \$10/share. Looking at comparables, the market awards a higher valuation as the market cap grows. A simple regression analysis of Market Cap/Sales run against Market Cap shows an R² of 47%, *but if the stock were merely trading at a multiple driven by its size, it would already be 100% above where it is today.* This broadly confirms our view that, along with our discounted earnings model, the shares are undervalued.

6/7 Closing price: \$2.16 USD	Market cap: \$36 million	Multiple of book: 1.4x	EV/2024 Sales: 0.30
Diluted shares outstanding: 16.7 million	Insider ownership: 42%	3-mo avg. daily trading volume: 35,000	Special Dividend 2023 /Yield: \$0.05/2%

GAAP estimates (EPS in USD – Revenue in USD millions)

Period	EPS	Revenue	Op Margin
1Q22A	\$0.07	\$42.7	
2Q22A	(\$0.04)	\$35.4	
3Q22A	\$0.10	\$51.2	
4Q22A	<u>\$0.10</u>	<u>\$68.3</u>	
FY22A	<u>\$0.24</u>	<u>\$197.6</u>	<u>3.3%</u>
1Q23A	\$0.01	\$60.0	
2Q23A	(\$0.11)	\$53.6	
3Q23E	\$0.07	\$53.3	
4Q23E	<u>\$0.09</u>	<u>\$70.0</u>	
FY23E	<u>\$0.05</u>	<u>\$237.0</u>	<u>1.0%</u>
1Q24E	\$0.09	\$59.5	
2Q24E	\$0.07	\$49.0	
3Q24E	\$0.09	\$63.0	
4Q24E	<u>\$0.11</u>	<u>\$74.0</u>	
FY24E	<u>\$0.36</u>	<u>\$245.5</u>	<u>3.5%</u>

Note: Numbers may not add due to rounding. See our full model at the back of this report.

Cash balance (in USD millions)

• 2021A	• \$8.2
• 2022A	• \$7.3
• 2023E	• \$5.1
• 2024E	• \$5.1

Adj. EBITDA (in USD millions)

• 2021A	• \$3.8
• 2022A	• \$12.1
• 2023E	• \$8.4
• 2024E	• \$15.1

Risks/Valuation

- Risks: competitive marketplace, weather
- Our \$10 price target is derived from our discounted future earnings model.

Company description: Energy Services of America Corporation is a contractor and service company that operates primarily in the mid-Atlantic and Central regions of the United States and provides services to customers in the natural gas, petroleum, water distribution, automotive, chemical, and power industries. Energy Services employs 1,000+ employees regularly. The Company's core values are safety, quality, and production.

Figure 1 – Energy Services of America Corporation – One-Year Trading snapshot



Source: FactSet

Quarterly Results

ESOA reported F2Q23 revenue and an EPS loss of \$53.7MM and \$0.11, respectively versus our estimate of \$44.4MM and an EPS gain of \$0.06, respectively. There is no consensus. The \$0.17 unfavorable EPS variance was primarily due to a higher mix of maintenance work, in the Electrical, Mechanical & General construction services segment, higher expenses due to its recent acquisition and an increase in staff, higher interest expense (for which we have more comments) partially offset by higher revenue in all segments except transmission, where projects started later than last year.

Figure 2 –Energy Services of America Corporation – Quarterly Variance Analysis (\$000)

			Better/(worse) than forecast
	FY23 Q2E	FY23 Q2A	
Income Statement			
Total Revenue	\$44,438	\$53,673	\$9,235
Total cost of products sold	39,550	49,773	(10,223)
Total Gross Profit	4,888	3,901	(988)
Operating expenses:			
SG&A	3,555	5,888	(2,333)
Total Expenses	3,555	5,888	(2,333)
Earnings (loss) from Operations	1,333	(1,987)	(3,320)
Adj. EBITDA			
Total Other income/(expense)	0	(537)	(537)
Earnings before taxes	1,333	(2,524)	(3,857)
Tax expense/(benefit)	400	(650)	(1,050)
Net income	\$933	(\$1,874)	(\$2,807)
EPS	\$0.06	(\$0.11)	(\$0.17)
Diluted common shares	16,500	16,667	

Source: Company filings and Litchfield Hills Research LLC

Valuation and Price Target

Valuation Methodology

We believe ESOA is undervalued, and we support that belief with two valuation techniques. To determine our price target, we use a discounted future earnings model, which we then compare its valuation relative to peers.

Discounted Future Earnings – Basis for Price Target

Our 12-month price target of \$10 is based on a discounted earnings model. For valuation purposes, we sum up all future earnings on a GAAP basis and discount them at 8%. We assume earnings grow in double digits until 2027 before growth eventually slows to GDP. Our valuation model is shown in Figure 3 below. Note, this model understates future new services and growth through acquisitions and probably understates the tax benefits, but offsetting that, the earnings never have a down year. The implied share price is \$10.02 which we round to \$10.00.

Figure 3 – Energy Services of America Corporation – Price Target Calculation

Discounted future earnings		\$10.02
Years	EPS	Discounted EPS
FY23	\$0.05	\$0.05
1	\$0.36	\$0.34
2	\$0.40	\$0.34
3	\$0.48	\$0.38
4	\$0.55	\$0.40
5	\$0.60	\$0.41
	Terminal Value	\$8.10

Source: Litchfield Hills Research LLC

Valuation Relative to Peers

Figure 4 is a summary of our ESOA peer comparison. While the comparable companies are all larger and the market awards a higher valuation as the market cap grows. A simple regression analysis of Market Cap/Sales run against Market Cap shows an R^2 of 47%, *but if this were destiny, the stock would be trading 100% above where it is today*. The shares are also trading at a 67% - 81% discount to their peers, as shown in Figure 4. These broadly confirm our view that, along with our discounted earnings model, the shares are undervalued.

Figure 4 – Energy Services of America Corporation – Valuation of Peers

FactSet Ticker	Company Name	Closing Price	Market Cap \$MM	EV \$MM	2024 Consensus Multiples	
					Market Cap / Sales	EV /Sales
PWR-US	Quanta Services Inc	\$181.62	26,367	31,167	1.29	1.52
J-US	Jacobs Solutions Inc.	\$116.37	14,762	18,503	0.87	1.09
ACM-US	AECOM	\$83.06	11,545	13,685	1.64	1.95
MTZ-US	MasTec Inc	\$107.42	8,471	11,629	0.60	0.82
KBR-US	KBR Inc.	\$61.94	8,407	11,109	1.00	1.33
EME-US	EMCOR Group, Inc.	\$174.65	8,304	8,596	0.65	0.68
FLR-US	Fluor Corp.	\$30.25	4,333	3,167	0.26	0.20
DY-US	Dycom Industries Inc	\$107.88	3,164	4,033	0.73	0.93
MYRG-US	MYR Group Inc.	\$136.55	2,281	2,309	0.66	0.67
GVA-US	Granite Construction	\$39.32	1,725	1,862	0.49	0.58
STRL-US	Sterling Infrastructure, Inc.	\$51.68	1,591	1,852	0.79	0.91
PRIM-US	Primoris Services Corp.	\$28.97	1,544	2,793	0.27	0.48
IESC-US	IES Holdings Inc	\$51.98	1,049	1,162		
AGX-US	Argan Inc.	\$43.56	585	297	0.89	0.46
	AVERAGE				<u>0.78</u>	<u>0.89</u>
ESOA-US	Energy Services of America Corp.	\$2.15	36	70	0.15	0.30
	ESOA Discount to peers:				-81%	-67%

Source: Litchfield Hills Research LLC and FactSet

Figure 5 – Energy Services of America Corporation – Income Statement (\$'000 except per share)

September ending year	2021A	2022A				2022A	2023E				2023E	2024E				2024E
	Year	Q1A	Q2A	Q3A	Q4A	Year	Q1A	Q2A	Q3E	Q4E	Year	Q1E	Q2E	Q3E	Q4E	Year
Total revenue	\$122,466	\$42,659	\$35,393	\$51,172	\$68,366	\$197,590	\$60,043	\$53,673	\$53,326	\$70,000	\$237,042	\$59,500	\$49,000	\$63,000	\$74,000	\$245,500
<i>Growth</i>	56%	33%	38%	102%	73%	61%	41%	52%	4%	2%	20%	-1%	-9%	18%	6%	4%
Cost of Goods	109,545	37,351	32,527	44,754	60,587	175,219	54,056	49,773	47,460	62,300	213,589	52,658	43,365	55,755	65,490	217,268
Gross Profit	12,921	5,308	2,866	6,418	7,779	22,371	5,986	3,901	5,866	7,700	23,453	6,843	5,635	7,245	8,510	28,233
Gross Margin	10.6%	12.4%	8.1%	12.5%	11.4%	11.3%	10.0%	7.3%	11.0%	11.0%	9.9%	11.5%	11.5%	11.5%	11.5%	11.5%
SG&A	\$14,044	\$3,633	\$3,417	\$3,821	\$5,007	\$15,878	\$5,316	\$5,888	\$4,266	\$5,600	\$21,070	\$4,760	\$3,920	\$5,040	\$5,920	\$19,640
Total Operating Expenses	14,044	3,633	3,417	3,821	5,007	15,878	5,316	5,888	4,266	5,600	21,070	4,760	3,920	5,040	5,920	19,640
Operating Income	(1,123)	1,676	(551)	2,597	2,772	6,493	670	(1,987)	1,600	2,100	2,383	2,083	1,715	2,205	2,590	8,593
Operating Margin	-0.9%	3.9%	-1.6%	5.1%	4.1%	3.3%	1.1%	-3.7%	3.0%	3.0%	1.0%	3.5%	3.5%	3.5%	3.5%	3.5%
Adj. EBITDA	\$3,823					\$12,062					\$8,383					\$15,093
Total Other Items	9,907	(36)	(259)	(323)	138	(480)	(611)	(537)	0	0	(1,148)	0	0	0	0	0
Pre-Tax Income	8,784	1,640	(811)	2,274	2,910	6,013	59	(2,524)	1,600	2,100	1,235	2,083	1,715	2,205	2,590	8,593
Pre-Tax Margin	7.2%	3.8%	-2.3%	4.4%	4.3%	3.0%	0.1%	-4.7%	3.0%	3.0%	0.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Taxes (benefit)	(29)	494	(200)	651	1,317	2,263	(80)	(650)	480	630	380	625	515	662	777	2,578
Tax Rate	-0.3%	30.1%	24.7%	28.7%	45.3%	37.6%	-135.5%	25.8%	30.0%	30.0%	30.8%	30.0%	30.0%	30.0%	30.0%	30.0%
Net Income (loss)	8,813	1,146	(610)	1,622	1,593	3,750	138	(1,874)	1,120	1,470	855	1,458	1,201	1,544	1,813	6,015
Net Margin	7.2%	2.7%	-1.7%	3.2%	2.3%	1.9%	0.2%	-3.5%	2.1%	2.1%	0.4%	2.5%	2.5%	2.5%	2.5%	2.5%
EPS, as reported	0.52	0.07	(0.04)	0.10	0.10	0.23	0.01	(0.11)	0.07	0.09	0.05	0.09	0.07	0.09	0.11	0.36
Diluted Shares Outstanding	16,988	16,248	16,248	16,450	16,500	16,324	16,667	16,667	16,700	16,700	16,683	16,700	16,700	16,700	16,700	16,700

Source: Company reports and Litchfield Hills Research LLC

Figure 6 – Energy Services of America Corporation – Balance Sheet (\$000)

September ending year	FY2024E	FY2023E	FY2022A	FY2021A
Balance sheet				
Current Assets				
Cash and S.T.I.	\$5,095	\$5,080	\$7,328	\$8,227
Accounts receivable	47,000	44,000	42,909	22,483
Contract assets	18,000	17,000	16,110	8,730
Other assets	5,000	4,000	3,946	3,541
Total Current Assets	75,095	70,080	70,293	42,981
Net PP&E	38,000	35,000	32,662	22,950
Other non-current	10,000	10,000	9,573	4,240
Total Assets	\$123,095	\$115,080	\$112,527	\$70,171
Current Liabilities				
Notes & Accounts payable	\$24,000	\$22,000	\$20,314	\$7,285
Accrued expenses	\$13,000	\$12,000	\$11,266	\$5,600
Current debt & liabilities	\$16,000	\$17,000	\$17,729	\$8,442
Other current liabilities	\$7,000	\$6,000	\$6,028	\$3,153
Total current liabilities	60,000	57,000	55,337	24,480
Deferred income tax liability	5,000	5,000	4,455	2,033
Other non-current	13,000	14,000	14,510	9,021
Total Liabilities	78,000	76,000	74,302	35,534
Stockholders' Equity				
Preferred stock				
Total stockholders' equity	45,095	39,080	38,225	34,637
Total Liabilities and equity	\$123,095	\$115,080	\$112,527	\$70,171

Source: Company reports and Litchfield Hills Research LLC

Figure 7 – Energy Services of America Corporation – Cash Flow (\$000)

	2024E	2023E	2022A
Net Income	\$6,015	\$855	\$3,750
Accounts receivable	(3,000)	(1,091)	(20,426)
Contract assets	(1,000)	(890)	(7,379)
Other assets	(1,000)	(54)	(405)
Net PP&E	(3,000)	(2,338)	(9,712)
Other non-current	0	(427)	(5,332)
Notes & Accounts payable	2,000	1,686	13,029
Accrued expenses	1,000	734	5,666
Current debt & liabilities	(1,000)	(729)	9,287
Other current liabilities	1,000	(28)	2,874
Deferred income tax liability	0	545	2,422
Other non-current	(1,000)	(510)	5,489
Common stock	0	0	0
Additional paid-in capital	0	0	(162)
Accumulated other comp. income	0	0	0
Treasury stock	0	0	0
Employ. stock purch. plan and rest. stock	0	0	0
Total Cash Flow	\$15	(\$2,248)	(\$899)

Source: Litchfield Hills Research LLC

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