8 SEPTEMBER 2020

Stocks Down Under

> *"My logisticians are a humorless lot … they know if my campaign fails, they are the first ones I will slay."*
>
> **- Alexander the Great (356 BC-323 BC), king of the ancient Greek kingdom of Macedon**

QUBE HOLDINGS

Logistics truly make today's world go round

MARLEY SPOON AG

A meal to savour

LAYBUY GROUP

Like Afterpay, but with a Kiwi accent

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Stocks Down Under rating: ★★★

ASX: QUB
Market cap: A$ 5.1BN
Dividend yield: 1.9%

52-week range: A$1.70 / A$3.63
Share price: A$ 2.67

In the era of COVID-19 and the sharp retraction of globalisation as we have known it, Qube Holdings stands alone in the rain to remind us that the world has not screeched to a halt. Qube Holdings is Australia's largest integrated provider of import and export logistic services, and despite being headquartered in Sydney, the company has over 130 locations in Australia, New Zealand and South-East Asia. During COVID-19 Qube Holdings has suffered some unavoidable hits, but all-in-all the company has faired extremely well, despite remaining off its pre-COVID-19 highs.

READ MORE

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Market cap: A$ 533M

52-week range: A$0.18 / A$3.80
Share price: A$ 2.92

Marley Spoon provides a kit-based weekly meal subscription plan that operates in three primary regions, the United States, Australia and Europe. Founded in 2014 and based in Berlin, Germany, Marley Spoon has not historically been EBITDA profitable. However, as of Q2 2020, due in large part to the expansion of its United States operation, Marley Spoon reached EBITDA profitability for the first time. While COVID-19 has been the bane for most companies, for Marley Spoon, it has brought it to profitability.

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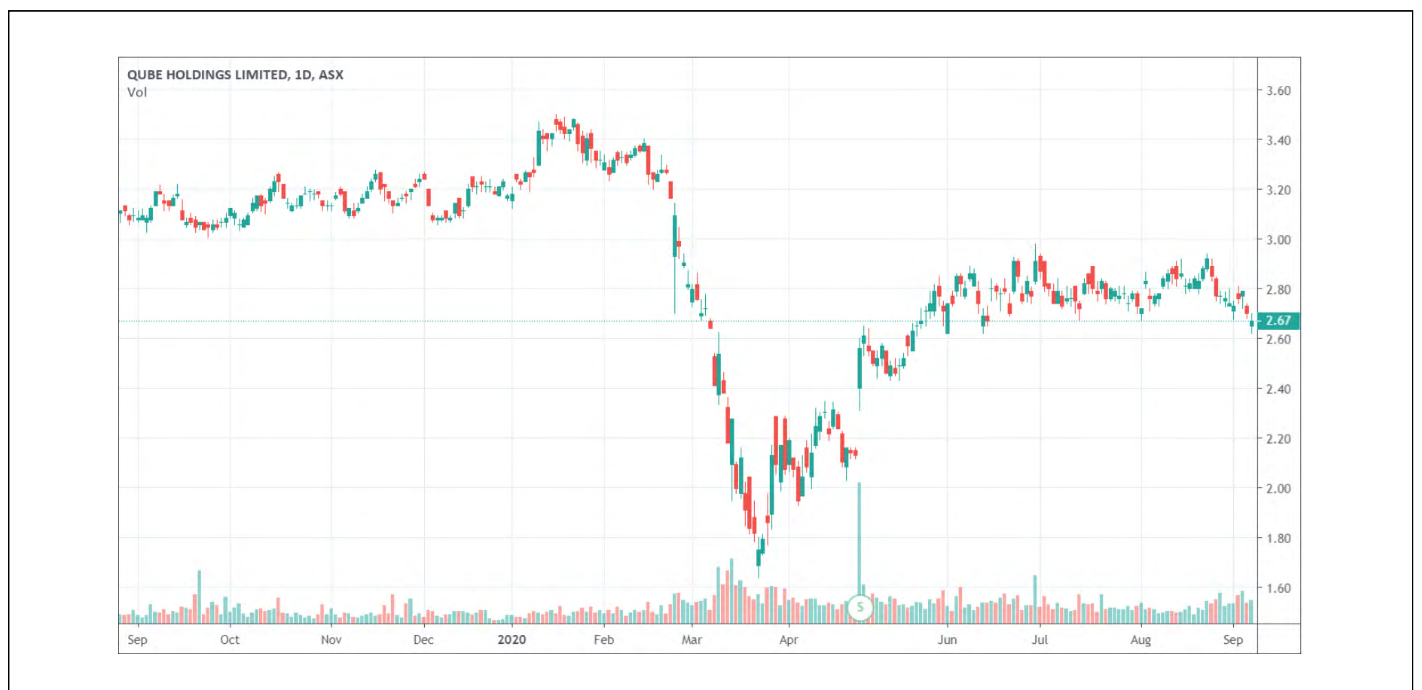
Share price chart



Source: Tradingview

The unsung heroes of the modern world: logistics

If there is one thing COVID-19 and Qube Holdings remind us of, it's a line from Max Brooks' book World War Z:

Ingredients: molasses from the United States, anise from Spain, licorice from France, vanilla (bourbon) from Madagascar, cinnamon from Sri Lanka, cloves from Indonesia, wintergreen from China, pimento berry oil from Jamaica, balsam oil from Peru and that's just for a bottle of peacetime root beer. We're not even talking about something like a desktop PC or a nuclear-powered aircraft carrier.

While COVID-19 is no zombie apocalypse, the message is clear. Society, as we know it, cannot function without effective and consistently functional global trade. As Australia expands, and even as it shifts away from a being heavily focused on resource extraction and export, the growing needs and demands of our population will cause ever-increasing demands on Australia's global logistics network. The fact that anyone of us could walk into a pub and order a glass of Japanese whiskey as soon as lockdown ended was really a minor miracle that we mostly took for granted. However, Qube Holdings did not, and despite all COVID-19 had to throw at it, the company still experienced EBITDA growth of approximately 1%.

Breaking apart the operation

Qube Holdings operates out of three main divisions as well as a 50% ownership in Patrick Terminals; the ports, bulk and logistics division, the infrastructure and property division and the strategic assets division.

The ports, bulk and logistics division consists of Qube Ports, Qube Bulk and Qube Logistics, which function as the operating division of Qube Holdings. Qube Ports provides bulk and general handling facilities in approximately 40 Australian, New Zealand and South-East Asian ports. Qube Bulk offers a range of bulk material transport services with a focus on road and rail transport, stockpile management and bulk shiploads. Qube Logistics operates services for road and rail transport, warehousing and distribution, container parks and related services and intermodal logistics hubs, like rail terminals and international freight forwarding.

The 1% growth in EBITDA was exclusively due to the ports, bulk and logistics division, which reported underlying revenue growth of 9.9% year-over-year. The standout of the bunch was Qube Logistics, which saw revenue growth of 15.7% year-over-year, compared to 5.4% year-over-year growth in Qube Ports and Qube Bulk. Since Qube Holdings top ten customers only account for around 21% of the operating division's annual revenue as well as the geographical diversity of its customers, the ports, bulk and logistics division was not only to weather COVID-19 but grow.

The infrastructure and property division is usually combined with the strategic assets division in the annual reports. These two divisions handle the expansion, investments, properties and joint ventures undertaken by Qube Holdings. Starting in FY21, however, the infrastructure and property division will be renamed the property division due to restructuring as well as the sale of some of the division's assets like Minto Properties. Minto Properties was sold for approximately $207m on 15 July 2020 with an expected close date in September 2020. The remaining assets in these two divisions include the Moorebank Logistics Park Project and ATT as well as joint ventures Quattro Grain Trust and TQ Holdings Pty Limited. These two divisions saw the largest volume decrease due to COVID-19 and the massive bushfires and saw an underlying revenue decline of around 5.6%. However, the underlying Earnings Before Interest and Taxes declined 48.5% year-over-year due to the fixed nature of many of these divisions' costs.

Qube Holdings owns a 50% interest in Patrick, a national container stevedoring services operator facilitating clients in the four largest container terminal ports in Australia. Underlying Net Profit After Tax declined 13.3% year-over-year. However, Patrick maintained its 45% market share across the four ports it operates in, Port Botany, Fisherman Island, Melbourne and Fremantle.

Its all comes down to the cost in the end

While Qube Holdings does not have the best balance sheet, it is stable enough for us to be comfortable for now. However, depending on how the rest of FY21 plays out, we would not rule out another equity raising and, therefore, shareholder dilution.

The shares are currently trading at an estimated FY21 EV/EBITDA ratio of approximately 23x. With the current uncertainty surrounding the Australian and global economy as well as continual COVID-19 concerns, we believe that is a too high and not warranted by this year's expected 5.9% EBITDA growth, or next year's 15.6% EBITDA growth for that matter. However, Qube Holdings is a solid company paying 1.9% dividend and we would recommend investors look out for any significant pullback. Until then, however, we give Qube Holdings three stars.

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Share price chart

Source: Tradingview

COVID-19 = profitability: Wait, what?

Marley Spoon operates on a calendar year basis rather than a financial year basis. The company has been trending towards profitability for the last couple of years. However, until COVID-19 hit the world, this prospect was still a few years off. While the Australian division became EBITDA profitable starting in 2Q19 due to the increase in efficacy and margins from new manufacturing technology, the consolidated company only reached EBITDA profitability during 2Q20 once the United States division reached EBITDA profitability as well.

There were two reasons for this division achieving EBITDA profitability during the past quarter: the 94% increase in active customers and the 300% increase in its manufacturing footprint in the United States. While Europe has not achieved EBITDA profitability yet, its expansion is ongoing and we remain confident in the company's ability to achieve EBITDA profitability in Europe within a year.

Marley Spoon's margins have been steadily increasing over the last couple of years. However, this is not due to a decrease in marketing spend, but rather the growth in revenue significantly outpacing the growth in marketing expense. During 1HY20, marketing expenses increased 65% year-over-year while dropping to a

historical low of 13% of total revenue. Overall, total margin growth still has a long way to go if the Australian division is any indication. At the end of 2Q20, Australia's global contribution margin had increased to 37% compared to the United States' 28% and Europe's 25%.

Vidi, Veni, Vici: I came, I saw, I conquered

During 1HY20 Marley Spoon has made some significant expansion moves, especially in Europe. The Europe division launched into Sweden and brought its brand Dinnerly into Germany, a first for Europe. While Europe is Marley Spoon's smallest division, it has been operating with the largest growth in contribution margin with 2Q20 seeing a 0.1% increase as the company continues its efficiency improvements. The United States growth is based on acquiring new active customers instead of bringing the product into new markets as the company's reach currently spans approximately 98% of the United States' population. Therefore, the 300% increase in manufacturing ability, with plans for a 4th manufacturing centre to open during 2021, bodes well for the global contribution margin of the United States division.

The latest guidance for the remainder of 2020 puts year-over-year revenue growth between 80% and 100%. While this is due to COVID-19, it is important to note that as of 30 June 2020, 91% of Marley Spoon's revenue is recurring with 50% coming from customers who have ordered at least 11 times before. We believe one of the biggest drivers of Marley Spoon's top line growth is its ability to keep its customers coming back. The number of customers who have ordered more than 11 times has continued to increase each quarter. This indicates a strong possibility that, once COVID-19 is finished, it will be able to keep most of its active customers.

Strong cash flow, solid balance sheet, but still equity dilution

EBITDA profitability during 2Q20 was not the only positive news announced in Marley Spoon's 1HY20 results. While 1HY20 EBITDA may have still seen a loss of €2m (€4.5m profit in 2Q20), cash flow from operating activities was a positive €8.1m, a first for Marley Spoon. This led the cash position to increase for the first time not due to debt or equity issues. Cash and cash equivalent outstanding as of 30 June 2020 was €18.4m compared to total debt outstanding of €11m.

However, equity dilution is still a significant concern for two main reasons: Marley Spoon continues to issue convertible debt and has a large amount outstanding. As of 30 June 2020, total convertible notes outstanding stood at €93.4m and on 29 July 2020, the company issued an additional US$2.5m worth of three-year convertible debt. To compare this convertible debt to Marley Spoon's market cap of $533m as of 7 September 2020, the Australian dollar equivalent of the current total convertible notes outstanding is approximately $155m or about 29% of the current market cap. This will likely cause significant equity dilution in the future and is a risk investors must take into account. Management may limit issuing convertible debt now that operating cash flow is positive.

Pre-COVID-19 we had concerns, but now we believe

Before COVID-19, we had significant concerns around Marley Spoon, least of them being that the company would have to issue significantly more equity to last until it achieved profitability. However, in this new, EBITDA positive world Marley Spoon operates in we are confident in the future of this company. If we assume a continuing EBITDA margin as was shown during 2Q20, i.e. 7.1%, and take the low end of management's revenue growth projections for 2020, i.e. 80%, then we calculate a FY20 EV/EBITDA multiple of 21.9x. Please be aware we had to convert Euros to Australian dollars with the exchange rate as of 7 September 2020. Taking into account the equity dilution down the line, we believe this valuation doesn't accurately reflect Marley Spoon's growth potential. Therefore, we issue a four star rating.

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Share price chart

Source: Tradingview

One of the things that has impressed us about Buy Now Pay Later is the speed with which leading companies have grown as consumers everywhere embrace the concept. Laybuy Group is a case in point. CEO Gary Rohloff and his family only started this operation in New Zealand in May 2017, but they still managed to enjoy NZ$1.9m in revenue in the year to March 2018. In the two years since, Laybuy has moved beyond New Zealand and launched in Australia and the UK. Revenue in the March 2020 year was a cool NZ$13.7m. The recently completed IPO, which raised A$40m in new money at $1.41 per share, valued the company at A$246m. Yesterday's share price close of $2.05 raised that to $358m. Not bad for a bit over three years' work.

Buy Now and Pay Later in the currency you want

By now you know the drill with Buy Now Pay Later – the customer gets the goods (or services) now and pays them off in instalments. It works seamlessly for both merchant and customer because it's app-based. There's no interest, but there is a fee if the customer misses a payment. And the BNPL provider makes money mainly by the percentage of Gross Merchandise Value (GMV) that it charges the merchants, 3.5% to 4.5% in Laybuy's case. However, each BNPL provider is subtly different in a way that allows them to enjoy some competitive advantage.

Laybuy Group's payment period is six weekly equal-sized payments. However, it tweaks that with Laybuy Boost where, if you're buying one item that is more than your transaction limit, the excess over that limit is your first payment and the next five payments complete the sale. Another important differentiator is Laybuy Global, which allows customers to Buy Now and Pay Later from overseas merchants, but in the customer's local currency. With so much e-Commerce being international these days, that's a big deal and almost guarantees that the Laybuy platform can expand the world over.

One important reason to back Laybuy Group in a field that has attracted many 'fast followers' to Afterpay (ASX:APT) is that the company managed to stake out New Zealand before Afterpay got there in a serious way. New Zealand may be a small country of only 5 million people, but it's a high income one, with GDP per capita of US$39,000 and the retail sector of the New Zealand economy is fairly innovative. The willingness of Kiwis to say 'put in on Laybuy' the way Aussies would say 'put it on Afterpay' means a pretty loyal core customer base that has allowed Laybuy Group to grow so quickly.

Mastercard likes what it sees

An important part of the growth of BNPL as a sector will be how other, more traditional, payment companies respond. We noted when we wrote about Splitit (ASX:SPT) on 23 April that Visa is collaborating with that company on a global rollout. In February of this year, Laybuy announced a similar partnership with Mastercard where that global payments giant will issue digital cards to Laybuy customers allowing a 'tap and go' service where the merchant offers contactless payments.

The rapid growth Laybuy Group has experienced since 2017 shows no sign of slowing down in mid-2020 in spite of the pandemic and its associated lockdowns. There are now about 6,000 active merchants that use the Laybuy platform and close to half a million customers. In the June 2020 quarter the annualised GMV of traffic through the platform was NZ$460m, but by August that had already reached NZ$520m.

A modestly-priced IPO

We see two big risks for Laybuy right now. One is the entrance of PayPal into the BNPL space, which might spook folks into thinking that the American giant will spoil everyone's party with its new 'Pay in 4' product. We think there's plenty of room for a number of players in this space, including PayPal, but others might take a different view, and that could impact sentiment. Also, with the potential to impact sentiment is the fact that Gary Rohloff and his early backers at Pioneer Capital sold $40m worth of existing stock into this IPO, suggesting (to some) that the smart money is now taking its money off the table.

Balanced against the pessimism of the previous paragraph is the pricing of the IPO. Laybuy didn't make any FY21 forecasts in the IPO prospectus. However, let's just assume that F21 sees comparable growth to FY20 so that FY21's revenue is NZ$26.4m, which is A$21.3m. That would mean, given Laybuy's Enterprise Value at the IPO price is A$200m, that the business is on an EV/Revenue of 7.6x. At yesterday's close that's 12.2x, You can currently get Afterpay for 24x and Zip Co at 12.7x forecast FY21 revenue. That tells us there is upside in this one.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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