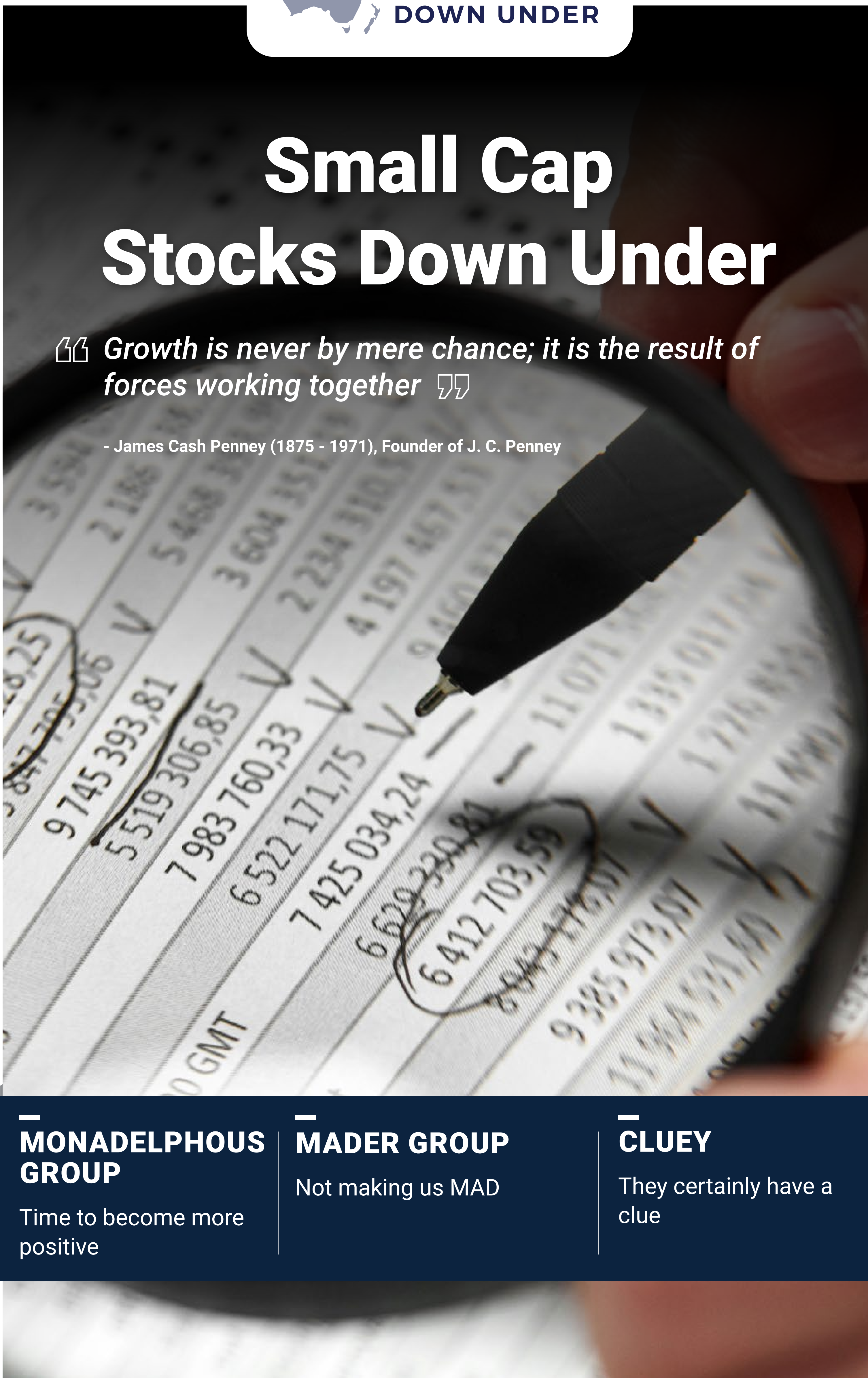
STOCKS DOWN UNDER

19 MARCH 2021

Small Cap Stocks Down Under

> *Growth is never by mere chance; it is the result of forces working together*
>
> **- James Cash Penney (1875 - 1971), Founder of J. C. Penney**



MONADELPHOUS GROUP
Time to become more positive

MADER GROUP
Not making us MAD

CLUEY
They certainly have a clue

MONADELPHOUS GROUP

Time to become more positive

Stocks Down Under rating: ★★★★

ASX: MND
Market cap: A$ 1B
Dividend yield: 3.7%

52-week range: A$7.77 / A$15.55
Share price: A$ 11.01

Perth-based Monadelphous group provides construction, engineering and maintenance services to the energy, resources and infrastructure markets in Australian and six other countries. Project delays and reductions associated with COVID-19 have had a crippling effect on the company's business and financial performance last year, but things appear to be on the upswing. New contract wins in both the construction and maintenance units point to an improving workload as the economy rebounds. Longer term, we believe Monadelphous Group has solid growth prospects related to clean energy and infrastructure activity. Back in April 2020 we started coverage of MND with a two-star, Covid-driven, rating. But we believe now's the time to load up on this one.

READ MORE

MADER GROUP

Not making us MAD

Stocks Down Under rating: ★★★★

ASX: MAD
Market cap: A$ 180M
Dividend yield: 3.4% (100% Franked)

52-week range: A$0.62 / A$1.07
Share price: A$ 0.90

The Mader Group, headquartered in Perth, is a one-stop-shop for mobile and fixed plant equipment maintenance for the mining and civil engineering sectors. Specifically, it provides the skilled contractors required to maintain and fix the equipment that keep mining operations and civil works from grinding to a halt. The continued focus on mining as an essential part of the worldwide COVID-19 recovery means that companies like Mader Group could be in the spotlight for some time to come.

READ MORE

CLUEY

They certainly have a clue

Stocks Down Under rating: ★★★★

ASX: CLU
Market cap: A$ 102M

52-week range: A$0.97 / A$1.48
Share price: A$ 1.24

Sydney-based Cluey offers clients tutoring for primary and secondary school subjects and classes made for seniors seven days a week between 7am and 10pm. The goal of this organisation is to provide tutoring to fit the schedules of all families. The company listed on the ASX on 9 December 2020 at $1.20. With tutoring becoming increasingly popular before COVID-19, is this company a 'smart' investment?

READ MORE

MONADELPHOUS GROUP

Time to become more positive

Stocks Down Under rating: ★★★★

ASX: MND
Market cap: A$ 1B
Dividend yield: 3.7%

52-week range: A$7.77 / A$15.55
Share price: A$ 11.01

Perth-based Monadelphous group provides construction, engineering and maintenance services to the energy, resources and infrastructure markets in Australian and six other countries. Project delays and reductions associated with COVID-19 have had a crippling effect on the company's business and financial performance last year, but things appear to be on the upswing. New contract wins in both the construction and maintenance units point to an improving workload as the economy rebounds. Longer term, we believe Monadelphous Group has solid growth prospects related to clean energy and infrastructure activity. Back in April 2020 we started coverage of MND with a two-star, Covid-driven, rating. But we believe now's the time to load up on this one.

Share price chart

Source: Tradingview

COVID-19 and water underperformance weigh on results

In the early stages of COVID-19 Monadelphous Group's operations were significantly impacted. Many of its projects were suspended and deferred while some were pared back from their original scope. The Engineering Construction division faced supply chain issues which compounded the effects of government and industry restrictions. Things were just as grim in the larger Maintenance segment, which saw a significant reduction in activity as customers eliminated non-essential work.

The company's water infrastructure business was also a problem. Stemming from issues that arose even before the pandemic, several water projects faced contract disputes and showed poor profitability. To address the situation, management performed a strategic review of its Australian and New Zealand water infrastructure businesses. In the end, it chose to discontinue the New Zealand operations and combine its east coast engineering construction operations into a single Eastern Australian business. Although this entailed a $14m provision for the underperformance and restructure, it was a good move for the long run, in our view.

Absent revenue guidance from Monadelphous management, the market wasn't quite sure what to expect in terms of 2020 performance. We suspected sharply lower margins and the fiscal year indeed ended on a sour note.

Latest results reflect improved trading conditions

For the year ended 30 June 2020, Monadelphous Group had $1.65bn in revenue, which was a modest 2.6% above the prior year. The Maintenance & Industrial Services business managed to eke out growth while the Engineering Construction business contracted. Weighed down by a weak second half performance tied to COVID-19 and the water underperformance, net profit after tax (NPAT) fell 28% to $36.5m.

Since then, operating conditions have improved somewhat and Monadelphous Group's share price has trended higher. The group entered fiscal 2021 with a more robust workload despite the ongoing pandemic uncertainty. Maintenance activity began to pick up and some key construction projects resumed.

1HY21 results reflected a healthier trading environment as revenue increased 11% from the previous interim period and 19% sequentially from 2HY20, to $947.8m. It was a tale of two operating divisions. Engineering Construction sales rebounded 68% due to progression of resource construction projects while Maintenance & Industrial Services experienced a 16% drop in revenue.

Monadelphous got a boost from the resumption of deferred work especially within the iron ore market. The establishment of Chinese industrial company SinoStruct's fabrication facility in Tianjin was among the significant milestones of the period. Meanwhile, a major ongoing revenue source is East Perth engineering group Mondium's $400m engineering, procurement and construction (EPC) contract with U.K. mining powerhouse Rio Tinto, which has entered the construction phase.

New contract wins are encouraging

Monadelphous Group has been able to expand its project pipeline alongside the pickup in global economic activity. It secured $360m of new contracts in the first half split roughly evenly between its two business units. We believe this bodes well for more balanced growth moving forward.

It inked a pair of new contracts with Melbourne-based miner BHP, one related to the Western Australia Iron Ore (WAIO) panel agreement and the other involving the Olympic Dam mine, the world's largest known source of uranium. Its Zenviron business was awarded an engineering contract for the Stage II of the Murra Warra Wind Farm, which at completion is expected to consist of almost 100 wind turbines to power Victoria and displace greenhouse gas emissions.

The Maintenance side of the business was also awarded new contracts under BHP WAIO panel agreements as well as a three-year master services contract with Rio Tinto. Beyond these core customers, the Buildtek business received a significant liquid natural gas (LNG) contract. This may have favourable implications for future LNG contract wins if Monadelphous can continue to grab a piece of the action in what's expected to be a fast-growing LNG export market.

Switching from 2 to 4 stars

As Monadelphous Group serves the energy, infrastructure and resources industries in seven countries it does have diversified growth opportunities as the global economy recovers, especially in its main maintenance business and with renewable energy projects.

And following the share price decline from the $15.55 high in December to the important $11 level last week, we think it is time to pick up some Monadelphous stock. At an EV/EBITDA multiple of 7.4x for FY22, which starts in less than four months, we believe MDN presents good value given its expected 14% EBITDA growth next year. For this reason we're switching our previous 2-star rating to four stars.

MADER GROUP

Not making us MAD

Stocks Down Under rating: ★★★★

ASX: MAD
Market cap: A$ 180M
Dividend yield: 3.4% (100% Franked)

52-week range: A$0.62 / A$1.07
Share price: A$ 0.90

The Mader Group, headquartered in Perth, is a one-stop-shop for mobile and fixed plant equipment maintenance for the mining and civil engineering sectors. Specifically, it provides the skilled contractors required to maintain and fix the equipment that keep mining operations and civil works from grinding to a halt. The continued focus on mining as an essential part of the worldwide COVID-19 recovery means that companies like Mader Group could be in the spotlight for some time to come.

Share price chart

Source: Tradingview

Mining is not known for its cleanliness

In today's automated mining world, it can truly be said that a mine is only as effective as its equipment. By its very nature, mining kicks up a lot of dirt, dust, debris, etc., and without constant preventative maintenance, a mining operation will be going nowhere fast.

Here at Stocks Down Under, we believe the world is entering a new commodity supercycle, which will give infrastructure spending a shot in the arm with an incredible amount of stimulus and incentives. And we are not the only ones who believe this. An Australian government report published in December 2020 states that investment in Australian mineral projects has entered a new growth cycle. The report takes a two-year outlook in its analysis featuring an overview of all resources extracted in Australia. Does this mean that the Mader Group killed it during 1HY21? The answer is no. Let's find out why not.

Australia's fully MAD

The Mader Group is a profitable entity generating $16m in EBITDA during 1HY21 on $141m in revenue. For the sake of our analysis, however, we are going to focus on revenue generated. The company saw EBITDA margins grow strongly during 2QY21 to 12.6%, but we want to focus on the company's ability to snap up new opportunities coming onto the Australian market.

With Australia generating 90% of both its pre-COVID-19 revenue and its 1HY21 revenue, the Mader Group is truly an Australian company. Unfortunately, with slightly over 200 customers across 350 sites, the Australian market did not see any considerable growth during 1HY21. We view this with some caution, but we also realise that a mining operation only needs the Mader Group's services after it has purchased additional equipment, not before. This leads to a lag in demand for the company's maintenance, repair and upkeep contractors. The Mader Group has the connections, experience and skilled workforce required to take advantage of the new demand coming online. However, without proper guidance from management we are a bit cautious, especially given the low revenue growth of only 6.4% during 1HY21.

The Mader Group derives revenue from two other geographic divisions: North America (7% of revenues) and the rest of the world (3% of revenues). Despite the small nature of the North American division, it accounts for a highly significant portion of 1HY21's growth and, we believe, its future growth. Its revenue is mostly derived from Canadian contracts and we expect this to continue in the future, especially with the Canadian government's renewed focus on mineral exploration.

During 1HY21, North America's revenue saw an increase of $7.3m resulting in 166% year-over-year growth. We believe a combination of mining's new growth cycle and the Canadian government's renewed focus will create a highly favourable mining investment atmosphere. This, in turn, increases the likelihood of the Mader Group securing new clients.

Don't get MAD

Its touch to predict the Mader Group's future earnings potential for two main reasons. The first is due to the nature of the company's operations, specialists maintaining and repairing equipment. Since we are just entering a new mining investment cycle, there is a delay between when a client's investment in equipment is made and when the Mader Group wins the maintenance contract for that equipment. The second is the lack of guidance. Like most companies listed on the ASX, Mader management is not currently issuing guidance and the company is not well-covered by analysts. Based on the new stage the mining investment cycle is in, the lack of proper earnings guidance makes us believe there is a strong likelihood of an earnings surprise during FY21.

With this in mind, we are moving onto Mader Group's valuation. The market is currently expecting 10% year-over-year EBITDA growth during FY21. This follows only 1.9% EBITDA growth during 1HY21. But with the previously mentioned new mining investment cycle, 2HY21 is supposed to pick up the majority of FY21's growth. If it was not clear before, we believe this is highly likely to occur. However, there is always the risk that this growth will not materialise during 2HY21, which is why FY21's EV/EBITDA ratio is currently only 5.7x.

The Mader Group is an out of the box way to invest in the new mining supercycle. With 1,400 highly trained contractors worldwide, the company has the expertise and experience to win the contracts we expect to become available during 2HY21 in Australia and Canada. However, due to a disappointing 1HY21 EBITDA result, the company is currently trading at what we perceive to be a slight risk-adjusted discount for FY21's full-year results.

There is certainly the risk of a FY21 earnings miss. However, we believe its current, modest, valuation limits the downside risk. Given the highly favourable macroeconomic conditions for Mader Group, this stock gets a four-star rating from us.

CLUEY

They certainly have a clue

Stocks Down Under rating: ★★★★

ASX: CLU
Market cap: A$ 102M

52-week range: A$0.97 / A$1.48
Share price: A$ 1.24

Sydney-based Cluey offers clients tutoring for primary and secondary school subjects and classes made for seniors seven days a week between 7am and 10pm. The goal of this organisation is to provide tutoring to fit the schedules of all families. The company listed on the ASX on 9 December 2020 at $1.20. With tutoring becoming increasingly popular before COVID-19, is this company a 'smart' investment?

Share price chart

Source: Tradingview

Get that kid a tutor!

As the academic demands on children become greater, tutors have been increasingly used to give that extra boost in learning potential. According to an Australia Financial Review article on 31 October 2020, one in seven Australian students receive tutoring. This number rises to 50% when looking at some of the larger big-city schools.

The demand schedule for the Australian tutoring industry is rather predictable. According to the Australian Tutoring Association's Chief Executive Mohan Dhall, demand tends to spike ahead of NAPLAN testing and the high school admission exams administered to Year 6 students. These take place at different times with the NSW NAPLAN test window in 2021 from 22 March through 24 May. For 2022 Year 7 admissions in NSW, the opportunity class placement test is on 21 July 2021 and the selective high school placement test is on 11 March 2021.

A clue about Cluey

Cluey caters to three separate groups of students across three distinct subjects: primary school (English and maths), secondary school (English and maths) and year 11 and 12 (English, maths and chemistry). The company's web-based platform allows for either one-on-one tutoring or group sessions with qualified teachers, high ATAR achievers or subject matter experts. For those not familiar with the ATAR test, it stands for the Australian Tertiary Admission Rank. This test's score is used to determine university admissions.

Cluey is somewhat dirrerent from its competitors as tutors are not required to have any form of formal training or qualification in Australia and often don't. Another selling point for Cluey is its web-based platform. The platform uses video, audio and a virtual whiteboard to allow for a truly interactive session with students. We mentioned above how vital transitioning to online tutoring was for the industry and we believe Cluey's web-based platform puts its service ahead of its competition.

Despite this, Cluey still has plenty of room to grow. According to the Australian Bureau of Statistics' 2020 census data, there are currently 4m students enrolled in Australian schools through Year 12. If we take the one-in-seven statistic we mentioned earlier, that gives us a potential market of more than half a million students. As of 1HY21, Cluey increased its active students from 3,174 (1HY20) to 10,311 or 2% of the potential Australian market. Additionally, student sessions per active student have seen a sharp increase from approximately 8.2 as of 1HY20 to 9.8 as of 1HY21. Since Cluey charges per session, we believe this indicates that growth can come from both organic student signups and from creating greater demand from its current population of active students.

Why IPO now?

First of all, Cluey is not yet profitable. Far from it although FY21 is expected to generate a 218% increase in revenue. During 1HY21, the company generated $29m in net loss after tax, a 277% increase year-over-year. However, 1HY21's results were strong, in our view, because $22.5m of the loss was from non-recurring, non-cash accounting charges. Due to a combination of fair value changes to its convertible debt and interest paid as these notes were converted to shares, the company recorded a charge of $20.4m.

The IPO itself had additional non-recurring charges of approximately $2.2m as well. Excluding all of these IPO-related, non-recurring charges, Cluey generated a $6.6m loss for 1HY21, a year-over-year decrease in its total loss of 14%. Remember, Cluey IPO-ed on 9 December 2020, right at the end of 1HY21.

During Cluey's 9 December 2020 IPO, the company raised $30m and planned to spend 36.3% on sales and marketing and 19.5% on further website and systems development. The focus on sales and marketing is an important one. During 1HY21, the company increased its marketing expenses by 29% to $2.7m and achieved active student growth of 225%. With schools reopening, we believe this increase in spending will help Cluey keep its existing customers and acquire new ones.

We believe the funds dedicated to improving its website and systems will provide the most significant long-term benefit. Cluey's service was 100% online even before COVID-19. The company's web-based platform offers both parents and students significant advantages over the traditional face-to-face system. But the company's AI and recording ability are two other highly interesting product features. That's right, Cluey uses AI to analyse its student interactions on an individual and overall level. AI analysis allows the company to ensure each student is matched with the best tutor. The platform also automatically records every session, allowing parents to easily check-in on the sessions at their convenience. Students can also go over everything that was taught and discussed without relying on inaccurate or incomplete notes. The continued development of its platform and systems is what we believe will allow Cluey to continue to thrive in the post-COVID-19 learning environment.

Online is here to stay

We believe Cluey is a disruptor in the tutoring space and has truly developed a better system. Its platform takes the best aspects of in-person tutoring and combines it with an online session's greatest advantages.

The company is forecasting FY21 revenue will reach $15.5m through year-over-year growth of 218%. Based on this projection, Cluey is currently valued at an FY21 EV/Revenue ratio of 6.5x, which wee believe is quite reasonable for a company growing at more than 200%. Also, Cluey currently only has a 2% market share in a fast-growing industry. So for us this is a four-star opportunity in the Small Cap space.

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.

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document