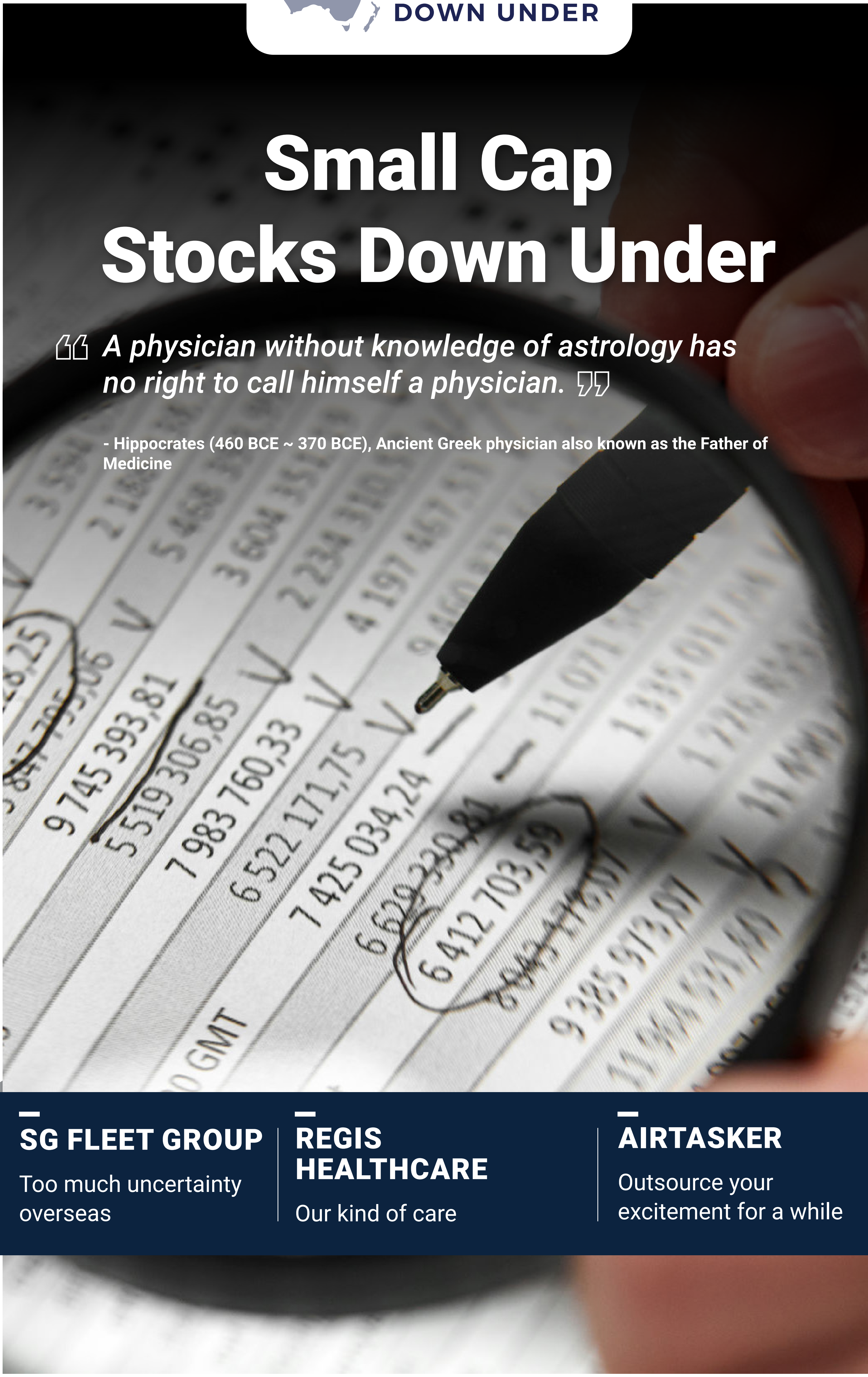
STOCKS DOWN UNDER

16 APRIL 2021



Small Cap Stocks Down Under

"A physician without knowledge of astrology has no right to call himself a physician."

- Hippocrates (460 BCE ~ 370 BCE), Ancient Greek physician also known as the Father of Medicine

SG FLEET GROUP
Too much uncertainty overseas

REGIS HEALTHCARE
Our kind of care

AIRTASKER
Outsource your excitement for a while

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Stocks Down Under rating: ★★★

ASX: SGF
Market cap: A$ 822M
Dividend yield: 3.6% (100% Franked)

52-week range: A$1.14 / A$2.90
Share price: A$ 2.86

Headquartered in Pymble, New South Wales, the SG Fleet Group has 30-years of experience supplying fleet management services and leasing options for corporations and government organisations throughout Australia, New Zealand and the United Kingdom. The company's long-term shareholders had an understandably tough time during the year of COVID-19, 2020. In fact, the stock ended the year down approximately 6% and as of yesterday's close, was still down 7.9%.

READ MORE

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ASX: REG
Market cap: A$ 713M
Dividend yield: 2.2% (50% Franked)

52-week range: A$0.925 / A$2.40
Share price: A$ 2.31

Headquartered in Victoria is one of Australia's largest providers of aged care services. The company currently operates in all states and the Northern Territory, serving over 6,000 Australians. The company had a tough 1HY21, but the stock offered strong returns of 131% since mid-October. Let's find out what is going on.

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When Tim Fung had to move apartments and didn't want to bother his family or friends with the menial task, the result was Airtasker. This Sydney-based online and mobile marketplace allows people to outsource almost any service imaginable. From writing a groom's speech for $50 to legal services for over $1,000, if someone needs something done, there will be a person on Airtasker willing to help for the right price. With over 4.3m registered users, we believe Airtasker has a great business model, but it's just a little expensive right now.

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Share price chart

Source: Tradingview

It's all about Australia

We have written about Australian leasing companies before, specifically the Eclipx Group (ASX: ECX). In fact, the Eclipx Group is currently on 'Marc and Stuart's Top Picks' list. While SG Fleet and Eclipx's businesses are not exactly the same, there is a strong overlap.

SG Fleet offers its clients three different types of services: operating leases, finance leases and fleet management. Operational leasing allows a company to build a vehicle fleet without the massive upfront costs of purchasing them outright. Under this product offering, company's pay SG Fleet a monthly fee for the right to have exclusive use of SG Fleet's vehicles. As of December 2020, 28% of the company's vehicles were used under this type of contract.

The finance offering allows companies and governmental organisations to take out a loan in order to purchase the vehicles managed by SG Fleet. As of December 2020, 29% of SG Fleet's vehicles operated under this arrangement. Last but not least are the vehicles owned by other companies but maintained, managed and looked after by SG Fleet Group for its clients. This service is known as fleet management and accounts for the bulk of the company's managed vehicles at 43% as of December 2020.

These three divisions generated $241m in revenue and $47.4m in EBITDA during 1HY21, a decline of 3.7% and 2.4% year-over-year, respectively. The vast majority of this revenue, 73%, was generated by the company's Australian clientele. Specifically, $176.6m in revenue was generated in Australia, $7.3m in New Zealand, and $56.8m in the United Kingdom.

While 27% is still a large amount of revenue left to be generated in the company's other geographies, i.e., New Zealand and the United Kingdom, SG Fleet's results are still effectively determined by Australia.

The United Kingdom presents substantial risks

The United Kingdom generates 24% of the company's total revenue. We view this as the company's largest risk at the moment. The United Kingdom is still having a very hard time with COVID-19 and Brexit has caused significant problems for the private sector such as delays in getting goods into the United Kingdom and lockdowns. With the delay in the country's vaccine rollout and exposure to the European Union causing continued risk of reinfection across the country, we are pessimistic about SG Fleet's short- and medium-term prospects in the United Kingdom.

Too much risk for us

Australia is certainly well on the road to a full recovery and we are bullish about SG Fleet's business operations domestically. The same can be said for New Zealand. However, since New Zealand only generated $7.3m in revenue during 1HY21, these operations can largely be considered irrelevant to SG Fleet in the near term. As explained, our concerns centre around the UK operations. The market seems to agree with us as it is not expecting significant EBITDA growth in FY21 and FY22. The current market consensus has EBITDA growing 4% year-over-year during FY21 and 20% during FY22. Despite this low rate of expected growth during FY21, the company's stock is still trading at EV/EBITDA ratios of 8.2x for FY21, which we think is high given the EBITDA growth you're getting. Both us and the market are not convinced of the current consensuses EBITDA growth rate for FY22 and this is why its trading at 6.9x. In fact, the FY22 growth rate is only due to a new report placing FY22 EBITDA at a high $126m. We believe the low estimate of $104.7m is far more likely and comes out to approximately 4% EBITDA growth. In conclusion, we think we'll stay away from SG Fleet for now, so three stars from us.

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Share price chart

Source: Tradingview

Australia is getting older

The world is getting older. According to the United Nations Department of Economic and Social Affairs World Population Ageing report, the world is steadily getting older. No, we are not talking about the age of the planet, but rather the portion of the world's population over the age of 65-years old. In 2019, the report found that one in eleven people globally is over the age of 65. This is predicted to increase drastically to one in six by 2050.

Moving onto Australia, the situation is already a lot closer to this six to one ratio. According to the Australian Government's Institute of Health and Welfare, in 2017 (the latest statistics available) one out of seven people in Australia were over the age of 65. Unlike many other parts of the world, life expectancy for the country's older population is rather high. The report found that between 2014 and 2016, Australian men aged 65 and older could expect to live another 20 years while women could assume they had another 22 years to live on average.

Quality of life is a profitable business

Regis Healthcare provides residential aged care in all states and the Northern Territories of Australia. This care is provided in the form of aged care homes, retirement villages and home care. As of 1HY21, the number of homes and facilities owned and managed by the company stands at 64, with an average occupancy rate of 88.3%, compared to 87.9% during 1HY20.

Unfortunately, EBITDA for 1HY21 declined by 1.2% year-over-year to $42.6m, but this really was no surprise. The company was forced to book direct COVID-19 costs of $9.7m during the period. When you compare this to the company's total EBITDA, these costs amount to 23% of total costs. Therefore, once we consider the increase in revenue of 6.3% year-over-year (to $353.1m during 1HY21), we believe the EBITDA result is actually very strong. With COVID-19 virtually eradicated in Australia and the vaccine roll out underway, we believe these costs are likely to decline towards the end of 1HY22 and the beginning of 2HY22. Yes, Australia's vaccine program has had some serious setbacks in the form of European Union protectionism. However, the first wave of vaccines is targeted at the elderly and frontline workers. Therefore, we believe this industry will see protection and the ability to reduce costs in the medium term. This means that during FY22 and FY23, we can expect to see EBITDA increase strongly as costs come down.

It's cyber security ducks in a row

Before we move on to Regis' valuation, there are three other things we need to discuss. Firstly, a lawsuit filed by Oneview Healthcare in the Supreme Court of Victoria for an alleged breach of contract. The amount in damages sought by Oneview is $21.4m. Taking FY20's total EBITDA of $143.9m, the damages come to approximately 14.8% of EBITDA. Therefore, we believe that if the court finds against Regis the cost will likely be significant enough to cause a bit of a share price shock. Unfortunately, it is not clear at this time the chances either company has of winning the case.

Then there was a cyber-attack on 3 August 2020. Like many in the healthcare industry during COVID-19, Regis was the target of a cyber-attack. However, unlike many other organisations, the company proved that it was well-prepared for this. It was able to successfully implement its backups and other security systems, thereby avoiding any substantial damage, breach or interruption of services. The fact that the company was breached was unfortunate, but for investors it's good to know the company has its cyber security ducks in a row.

Lastly, on 30 September 2020 Washington H. Soul Pattinson (ASX: SOL) proposed to acquire Regis for $1.65 per share. This was rejected by Regis' board, leading SOL to increase its offer to $1.85 per share. On 20 January 2021 the board also rejected this offer. It is encouraging to see the board's faith in the value of its company, especially with Regis' stock currently trading at $2.29 per share, proving the board right to reject the take-over offers.

Undervalued and underestimated

As we mentioned above, we are highly optimistic about the company's EBITDA growth during FY22 and FY23, largely due to the expectation that COVID-19 costs will be eliminated by that time. Looking at the current market estimates, we can see that there is no consensus among analysts. There are currently four analysts providing EBITDA forecasts for FY23 and the lowest estimate is $135m, while the highest is $182m, i.e., the range is very wide. We believe the higher estimate is the more realistic one as it considers both revenue growth and the elimination of $9.7m in COVID-19 costs. Using the high EBITDA prediction for FY23, Regis' current EV/EBITDA ratio is 4.5x, compared to an estimated annual growth rate of approximately 11%. Considering all of this as well as the macro trend, its four stars from us.

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Share price chart

Source: Tradingview

Mr Fung teaches his son a lesson

Freelancing started early for Tim Fung. The Airtasker co-founder is now about 37, but when he was ten years old, his father offered him 3 cents for every white hair he pulled from his head. After negotiating the price up to 10 cents little Tim earned $25 and gained an abiding interest in outsourcing.

Airtasker was launched in 2012 by Fung, a fourth-generation Australian from Sydney, and co-founder Jonathan Lui, a serial entrepreneur. It's become the platform that Tim's Dad would now go to if he needed his hair pulled. Customers are offered a nearly infinite range of services with negotiable prices and times. Taskers, which is what the company calls people on its platform prepared to pull hair or do whatever (within reason), can flexibly deliver those services.

Airtasker's revenue comes from a service and booking fee charged to Taskers and customers as a percentage of the task value agreed by parties. You start out paying 20%, but that decreases as you generate more revenue. The more you use Airtasker, the more you benefit. And there is no glass ceiling. The top Tasker in 2020 earned $250,000!

Growth has been exponential for Airtasker. They started in Australia, but they've now expanded into the UK (2018), Ireland (2020) and more recently New Zealand and Singapore. In FY20, revenue sat at $19.3m, 38% growth from the previous year, and the EBITDA loss was only $3.9m. The forecast for FY21 is a revenue of $24.5m and EBITDA of minus $4.2m. Now, the budgeted Advertising and Marketing figure for FY21 is expected to increase to $4.2m so the company could be profitable this year if it weren't investing in its future growth. And who cares if they are profitable now…remember, it took a long-time for Amazon to be profitable and look where that reinvestment got Jeff Bezos.

Dating a nice girl call Gig

Love it or hate it, the Gig Economy is growing. The Gig Economy is the entire ecosystem of freelancers and the people they ostensibly work for. It's virtually synonymous with the online services industry since most freelancers connect with their clients online. This industry was valued at $52 billion in 2019 and, as a nice side effect of COVID-19, 2020 has seen the trend of flexibility and outsourcing accelerate strongly. Airtasker leveraged this trend to achieve 950,000 customers and 150,000 Taskers by December 2020.

Most of Australia has used the online labour marketplace somewhere. Uber can help transport you anywhere on roads. Deliveroo can bring food to your door and Freelancer can help you out with professional services. Airtasker can also help you with any of these. But Airtasker can also help you with everything else as well. If you've ever tried to set up IKEA furniture and thought, "My time is better spent elsewhere," someone on Airtasker has anticipated your needs.

The Network Effect

The more people using Airtasker, the more dominance it will have in the market. Economists call it the Network Effect. Launching the group back in 2012 posed the challenge of creating scale for the platform. Airtasker solved this by paying a recently laid-off truck driver $1,000 to camp outside the Apple store in Sydney for four days to get his hands on the first iPad 3 ever sold Down Under. This was a genius publicity stunt. The truckie did TAFE work the whole time he waited in line and received a nice check at the end. The move generated interest and activity for Airtasker.

The possibility for growth at Airtasker is almost unlimited. With close to a million active users already, new customers or Taskers will find an established demand and supply network. Airtasker doesn't offer standardised services like most platforms. Instead, they bring two unique needs together. They provide ratings, reliability scores, reviews and places to display qualifications, skills and licenses. These measures prevent scamming and reward skilled and loyal workers.

Too big for its boots?

Airtasker listed on the ASX on 23 March at an IPO price of 65 cents. at the first trade was done at 88 cents and the shares reached a high of $1.97 the next day before coming back down to $1.40. That volatility should have investors a little concerned. Currently, Airtasker has a market capitalisation of $503m and roughly $28.5m in cash. That's an Enterprise Value of $488m, which represents roughly 19.9x forecast FY21 revenue. Frankly, we think that's too much.

Remember, in this IPO the existing shareholders took the opportunity to cash in 105.6m existing shares, which was 27% of the entire share register post-IPO. It's also worth noting that Airtasker may be growing its top line strongly, but it's not doubling its revenue like some other high growth businesses you can get on ASX.

So, while we like the Airtasker business model and we think it's got a bright future, we'd wait until Mr Market offered it to you at a less ambitious revenue multiple. For now, Airtasker is two stars.

Pitt Street Research Pty Ltd

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