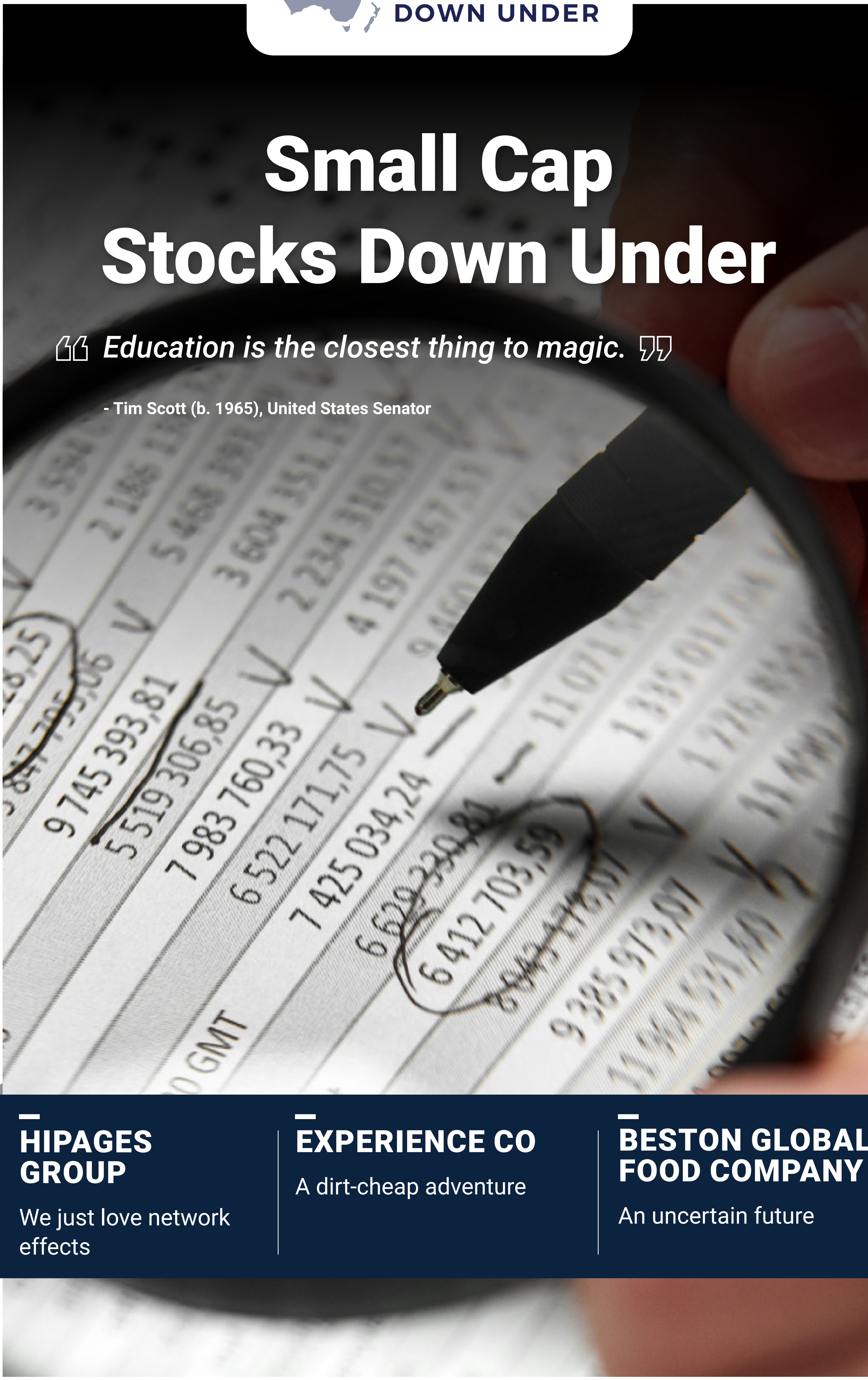
STOCKS DOWN UNDER

7 MAY 2021



Small Cap Stocks Down Under

Education is the closest thing to magic.

- Tim Scott (b. 1965), United States Senator

HIPAGES GROUP

We just love network effects

EXPERIENCE CO

A dirt-cheap adventure

BESTON GLOBAL FOOD COMPANY

An uncertain future

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Stocks Down Under rating: ★★★★

ASX: HPG
Market cap: A$ 311M

52-week range: A$1.93 / A$2.85
Share price: A$ 2.37

Headquartered in Sydney, the Hipages Group knocked it out of the park with its 3Q21 report, causing its share price to jump 14.3% in the following two days. As Australia continues to come out swinging from COVID-19's economic hardships, we expect this tradie for hire platform to continue building into the next Australian success story.

READ MORE

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ASX: EXP
Market cap: A$ 153M

52-week range: A$0.095 / A$0.29
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Headquartered in Sydney, Experience Co is all about living life to its fullest. The company currently offers skydiving, Great Barrier Reef and rainforest tours as well as island day trips in both Australia and New Zealand. Despite the trials and tribulations the tourism industry experienced during 2020, 1HY21 still saw the company generate an EBITDA profit. While EBITDA is forecast to drop during FY21 as a whole as government COVID-19 grants end, FY22 and FY23 are expected to see strong growth. This is one experience we think you should have.

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52-week range: A$0.044 / A$0.119
Share price: A$ 0.086

Headquartered in Adelaide, the Beston Global Food Company is on a mission to become Australia's premier producer of healthy and sustainable agricultural products. So far, management's eyes have been bigger than their plate with EBITDA losses mounting and shareholders starting to show signs their patience is at an end. We are worried management's global goals are running into both shareholder and revenue growth resistance.

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Share price chart

Source: Tradingview

Why is it always a garage?

We are not sure what is so magical about garages, but they seem to be the perfect incubators for brilliant technological innovations. So, it should come as no surprise that Hipages was created in a Sydney garage in 2004 by Roby Sharon-Zipser and David Vitek. Fast forward to 2011 and Home Improvement Pages was transformed into Hipages, expanding its functionality to make it easier for homeowners to post their jobs directions and allowing direct communication with qualified tradies. Two years later, Hipages launched its mobile application, the same year the iPhone 5 was released.

The next significant evolution of Hipages came in February 2019 with the acquisition of workflow management tool Call of Service. This acquisition drastically expanded Hipages' tradie side of the business as Call of Service specialised in workflow and lead management software. On 12 November 2020, Hipages finally began trading on the ASX after raising $100m at $2.45 per share.

The first nine months of FY21 were strong

After listing on the ASX, shareholders were not in for a pleasant ride as Hipages' share price quickly dropped below its IPO price and stayed down. In the company's prospectus, management estimated EBITDA before significant items, such as IPO costs, would increase 62% year-over-year to $9.9m during FY21. But it seemed the market was too excited about the post-COVID-19 housing boom or investors thought this projection was too conservative, because 1HY21's strong results failed to impress.

During 1HY21, EBITDA increased from a loss of $100,000 during 1HY20 to a profit of $6.9m before significant items. Recurring revenue was up 26% to $25.3m and jobs from repeat customers climbed seven percentage points to 64% of total jobs. Recurring revenue is generated mostly from the subscriptions purchased by tradies to use Hipages and accounted for 95% of total revenue. All-in-all, it seemed to be a strong showing for the newly listed company, even at an FY21 EV/EBITDA ratio of 29x (at the IPO price). With brand awareness on the rise and demand for tradies increasing as people start to work on their homes again, 2HY21 seemed primed for a strong showing from Hipages. If we had written about this stock at the time, we are confident we would have given it a four-star rating.

Unfortunately for shareholders who purchased shares during the IPO, Hipages' price only rebounded 10% over the next month to around $2.20 per share. That is, until the company released its 3Q21's results. Recurring revenue for the period jumped 23% year-over-year to $13.5m during 3Q21 on the back of solid user and job volume growth. Since this growth had a lot to do with management's success in expanding Hipages' brand recognition and strategic advertising rather than a massive wall-to-wall advertising blitz, the company was also able to increase its FY21 guidance. Without going into all the details, the main points are EBITDA margin increasing eight percentage-points to 21% instead of the earlier announced 18% and recurring revenue reaching $52.6m, a year-over-year increase of 25% instead of the 20% the company was expecting previously.

A network effect in the making

Looking at Hipages' EBITDA projection for the full year, excluding one-off costs, gives us an estimated EBITDA growth rate of 88% for FY22. Obviously, 88% EBITDA growth is not sustainable as most of the post-COVID-19 housing boom will likely dissipate after FY22. The current market consensus places FY23 and FY24's EBITDA growth rate at a much more down-to-earth 30% and 36%, respectively. Given the EV/EBITDA valuations for FY22, FY23 and FY24 of 20.1x, 15.4x and 11.3x, respectively, we believe Hipages is attractively valued right now.

Furthermore, we believe Hipages has a product that will continue to meet a consumer need far after the COVID-19 housing boom has ended. Its product not only makes checking out and hiring for a job easier for the consumer, but it also helps tradies to manage their business, jobs and their overall operations more efficiently. This should simultaneously drive demand from the consumer side and the tradie side, creating a network effect. The more tradies join Hipages, the more consumers will use it and vice versa. Four stars from us.

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Share price chart

Source: Tradingview

You only live once

If there is one ASX-listed company that embodies the YOLO attitude (You Only Live Once), it is Experience Co. The company offers tourists and adventure seekers skydiving, Great Barrier Reef and rainforest tours as well as island day trips in Australia and New Zealand through its ten different brands. Due to the proximity of its island day trips and rainforest tours to the Great Barrier Reef, management has decided to combine these three operations into one division: GBR. Since Experience Co was founded as a skydiving company, this division is represented separately.

During 1HY21, GBR generated $10.7m in revenue, but received substantial government grants bringing other revenue to $5m, from $703,000 during 1HY20. Without these government grants, this division would certainly have operated at an EBITDA loss, although the $2.2m in EBITDA still represented a decline of 33.3% year-over-year. Despite the lockdowns that are occasionally forced onto an Australian capital city every once in a while, we believe it is likely that domestic tourism will continue to increase during 2HY21 and 1HY22. While we don't think this will allow GBR to recover to 1HY20's revenue level, the company should start to stand on its own two feet again in the absence of government grants.

The skydiving division generated $17m in revenue during 1HY21. While this division did receive government grants bringing other revenue to $2.6m from $141,000 during 1HY20, it would have generated an EBITDA profit without these grants. Including the grant, the skydiving division generated $4.1m in EBITDA, a decline of 57% year-over-year. The three skydiving drop zones in Victoria only reopened in late November 2020, so obviously the division's performance in the first half of the financial year was heavily distorted. Despite this, all Australian drop zones saw 42% of 1HY20's volume during 1HY21. We suspect this number has continued to improve in 2021.

A new kind of experience

We mentioned that Experience Co operates through ten brands, but that has expanded to 12 as of 20 April 2021 when the company announced the acquisition of Wild Bush Luxury and The Maria Island Walk. Because the company realised it had a hole in its product offering, i.e. premium adventures, management decided to shell out $4.3m in cash and an additional $1m subject to earn-outs through April 2023. We believe the timing of this acquisition is perfect as it shows management is looking past the international lockdown and preparing for the likely influx of international tourists once things go back to some kind of 'new normal.' At Stocks Down Under we believe Australia's international travel ban will likely stay in place for at least another year, but this gives Experience Co plenty of time to fully incorporate the new venture. Plus, if things were to suddenly improve, the company is ready to go. In the meantime, Experience Co has shown that it can still generate an EBITDA profit from domestic tourism alone.

Dirt cheap in our book

We believe Experience Co's 1HY21 results and 20 April 2021 announcement show a strong, forward-looking management team. Looking at 1HY21's results, we believe it's no mean feat for any management team to navigate the current macro-environment. We also think the company's new premium adventures are likely to play exceptionally well with both domestic and international tourists, i.e. as soon as Australia reopens to overseas tourists. Unfortunately, therein lies the rub.

Before the recent Indian outbreak, it seemed like the Australian Government was loosening its international grip somewhat, but that has quickly been slapped down. While we hope for significant international restriction loosening by mid-FY22, there is certainly a risk that it will be delayed beyond that point.

However, when we look at Experience Co's current valuation, we believe the risk of a later than anticipated reopening is exaggerated. Following an 18% decline in EBITDA this year, current market forecasts show an FY22 EBITDA growth of 99% compared to FY21. And for FY23 the market consensus is EBITDA growth of 58%. Pretty healthy if you ask us.

Yet, the company's FY22 and FY23 EV/EBITDA ratios currently stand at 13.9x and 8.8x, respectively. In other words, Experience Co is dirt cheap, assuming the market consensus for FY22 and FY23 is not too far off the mark. Based on the potential for recovery of the domestic market and the overall strength of Experience Co's management, we believe the market is exaggerating the risks and is mispricing this one. Four stars.

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Share price chart

Source: Tradingview

All about the cow

When it comes to Beston, it's all about getting the most out of every cow. The company generates revenue through its own branded dairy products and also sells meat, generating $53m in total revenue during 1HY21. However, the Australian meat division should be considered supplementary more than anything else with revenues of only $4.3m during 1HY21. The vast majority of annual revenue is generated through the Australian dairy division ($48.5m in 1HY21), which comprises three important products: cheese, lactoferrin and other milk products. Unfortunately, management does not breakout these revenues into individual product lines.

Cheese production was initially focused on cheddar. However, during FY18 management shifted production to mostly mozzarella. Not only does mozzarella offer significantly higher margins, but for every tonne of mozzarella, Beston is also able to produce 175 litres of cream, 480kg of whey powder and 1,300 grams of lactoferrin. During the production of one tonne of cheddar, one the other hand, only 480kg of whey powder is created as a by-product.

While the sale of cream and whey powder products are nice addons, the dairy division's future growth should come from mozzarella and lactoferrin. Mozzarella production grew 108% during FY20 to 9.1kt and is estimated to grow around 50% during FY21 to between 12.6kt and 14.7kt. While cheddar is still being produced, 97% of cheese production is slated to be mozzarella going forward.

The market likes lactoferrin

Lactoferrin is an iron-bonding protein present in milk that has been scientifically proven to provide a number of health benefits. According to an Italian academic study published on 27 September 2016, lactoferrin's main benefit is non-immune protection, including antimicrobial and immunomodulatory responses, and it even has modest responses against certain cancers. The global lactoferrin industry only generated US$110m in revenue during 2020, according to a 25 March 2021 report published by Global Market Insights. Despite its relatively small size, the market is expected to achieve attractive growth over the next seven years, exceeding US$315m by 2027 (7% annual growth).

With stage two production slated to produce 5% of global supply, lactoferrin is estimated to generate 25 tonnes per annum (tpa) for Beston, starting in March 2022, generating an estimated $37.5m in revenue annually. During 1HY21, production was in the exploratory phase and, therefore, capacity was only 3tpa resulting in revenue of $4.5m annually. Shortly after 1HY21, Beston completed stage one of its production expansion plans and is now generating $18m annually on 12tpa.

Vive la shareholder résistance

Despite the recent positive news out of Beston, shareholders seem to be in almost open revolt after the 29 January 2021 AGM. Following the AGM, Chairman Dr. Sexton stated, "we are extremely pleased with the voting support received from shareholders at today's AGM." This attitude is both incorrect and concerning, in our view. Yes, a spill resolution failed, but 44% voted in favour of the spill, 6% shy of the required 50%. While we understand that management has to stay confident, the company could have at least paid minor lip service and should have acknowledged investors' discontent.

Unfortunately, this discontent can have some serious consequences, as the January 2021 $15.6m Entitlement Offer showed. This offered shareholders the right to buy one new share for every 2.5 shares held at $0.065 per new share. Unsurprisingly, the offer fell far short of its goal, with Beston only raising $9.2m, leading to a shortfall of $6.4m. Accordingly, the sub-underwriters were forced to take up the remaining shares.

Guidance is hard to believe

Management issued revenue guidance for FY21 of $130m to $145m, generated from 12.6kt to 14.7kt of mozzarella and 4t to 6t of lactoferrin production. While this would represent a generally reasonable 33% year-over-year increase in revenue, 1HY21 saw production problems. The Jervois dairy factory's essential machines suffered significant breakdowns during 1HY21, causing production to take a nose-drive. The dairy business went from being on track to report a $1m profit during 1HY21 to generating a $6m loss. While the company has replaced the faulty equipment and management is confident they can make up the production during 2HY21, we are not so sure.

Two recent announcements have made our initial uncertainty around management's projections turn into outright scepticism. The first was the 9 April 2021 lactoferrin update. While mostly positive, it mentioned that the production facility will be shut down for seven or eight days due to required maintenance on its gas supply pipeline. This was initially scheduled for FY22 but was recently moved up to 12 April 2021. The second is the unfortunate news that Beston's CEO, Jonathan Hicks, will need three months of Compassionate Leave for a private family matter, which started 20 April 2021. While we are sorry to hear about this, it leaves the company with a temporary transition issue during part of 2HY21, a time when the company needs to make up a lot of lost ground from 1HY21.

Beston certainly has a compelling bullish argument around its expanding mozzarella and lactoferrin production. However, there is also significant risk around the FY21 earnings. We are concerned that, especially with Beston's recent share price rally, failure to meet FY21 guidance would result in a broad-based selloff. The risk is just too high at the moment, so it's three stars from us. However, we'll keep a close eye on Beston to see if the company can manage the turnaround it's hoping to make.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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