STOCKS DOWN UNDER

9 JULY 2021

Small Cap Stocks Down Under

"In a mad world, only the mad are sane."

- Akira Kurosawa (1910 - 1998), Japanese filmmaker and painter

MAAS GROUP
Building a future

DALRYMPLE BAY INFRASTRUCTURE
Completely misunderstood

PEOPLE INFRASTRUCTURE
Building value

MAAS GROUP

Building a future

Stocks Down Under rating: ★★★★

ASX: MGH
Market cap: A$1BN
Dividend yield: 0.3% (100% Franked)

52-week range: A$2.30 / A$6.32
Share price: A$5.05

Headquartered in Dubbo, New South Wales, is a new edition to the ASX, the MAAS Group. This construction materials, equipment and service provider has strong exposure across all major Australian industries. Since listing on 4 December 2020 at $2.00 per share, it has become clear the IPO was severely under-priced. So far, MAAS has jumped 153%, but when we factor in the new macro realities, we think this ride is far from over.

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Market cap: A$1BN
Dividend yield: 2.1% (0% Franked)

52-week range: A$1.87 / A$2.44
Share price: A$2.09

If you ever thought to yourself, I wish my lease was just a little longer, perhaps it's time you take a look at Sydney-based Dalrymple Bay Infrastructure. Dalrymple owns a 99-year lease on the Dalrymple Bay Terminal, expiring in 2100. This port facilitates the export of 27% of the Australia's metallurgical (met) coal exports and is currently in the process of a massive capacity expansion. The company had an unsurprisingly rough FY20, but based on the current valuation and the take-or-pay nature of its contacts, we think this company has some solid short-term upside.

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Market cap: A$397M
Dividend yield: 1% (100% Franked)

52-week range: A$1.83 / A$4.88
Share price: A$4.40

Founded in 1996 and headquartered in Albion Queensland, People Infrastructure is a workforce management and staffing company with offices across Australia and New Zealand. The company's focus is primarily healthcare and information technology. However, it also provides specialist and general staffing services. People Infrastructure's specialisation in healthcare and information technology places them in a unique position. Both industries are estimated to grow faster than average while also facing significant skill shortages in Australia and New Zealand, as discussed in a recent Insights article on the Stocks Down Under website. While these projections were made pre-COVID-19, the increase in cybersecurity risk and the continual demands on the healthcare system should keep these trends relatively stable.

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Share price chart

Source: Tradingview

We all start somewhere

The founder of the MAAS Group, Wes Maas, started the business at the age of 22 after purchasing a single bobcat and tipper truck. Using these two vehicles, he began winning contracts for small civil jobs starting back in 2002. Through hard work, perseverance, smarts and reinvestments into the business, Wes Maas has grown this company into a force to be reckoned with over 760 pieces of machinery. What is so interesting about MAAS, is how long it took for this company to list on the ASX. It's not common for growth companies, like MAAS, to be added to the MSCI Global Small Cap Australia Index less than six months after listing. Needless to say, it is hard not to be impressed by all Mr. Maas has accomplished. The fact that he has stayed on as CEO post-listing certainly inspires confidence that a steady hand is on the wheel.

Constructing value

Over the last 18 years, MAAS has expanded its operations into four main activities: construction materials, civil construction and hire, real estate, and underground equipment and services. During 1HY21, MAAS

generated $126.2m in revenue and EBITDA of $28.9m, implying an EBITDA margin of 22.6%.

Unfortunately, MAAS' EBITDA margin has fallen victim to the rising prices of raw materials in the post-COVID-19 period. This is extremely clear when you look at the various expenses, changes in inventories, including purchases of raw materials and consumables used. Off the back of a 42.4% increase in total revenue, inventories increased by 79.8% to $67.8m. At Stocks Down Under we believe raw material prices are likely to remain high, and to possibly go higher, until at least 2022, 2023. So, MAAS is not suited to investors looking to capitalise on EBITDA margin growth due to a decline in raw material prices.

Time to dig

During 1HY21, MAAS experienced revenue growth across all divisions, except for equipment and underground services. This division saw a revenue decline of 16.7%, accounting for 14.8% of 1HY21's total revenue. However, we believe there are signs this division may see a strong comeback during 2HY21 and FY22.

The Australian Bureau of Statistics regularly releases a slew of data about the mineral exploration industry in Australia. We looked at its December 2020 release on expenditure and metres drilled and found that during 1HY21, total metres drilled in new deposits in Australia totalled 2,073.5m, resulting in the biggest half (1H and 2H) since the ABS began releasing this data in 2003. When we combine this with the fact that 1HY21 saw the second-largest number of total metres drilled on record and combine this with the fundamentally backed raw materials boom, we believe drilling is likely to result in record-breaking figures during 2HY21 and FY22. Therefore, we believe the decline the equipment and underground services division experienced in 1HY21 is likely due to order lag and will strongly recover going forward.

Building towards the future

The current market consensus places MAAS' FY22 and FY23's EBITDA growth at 34.9% and 10.2%, respectively. However, we believe there is risk that higher commodity prices will continue to hurt MAAS' EBITDA margin. On balance, we believe the company's four core divisions are perfectly placed to take full advantage of the current mining and property boom.

Additionally, when we look to FY23, we believe the boom is likely to continue, although not at the strength of FY22. Looking at the equipment and underground services and civil construction and hire divisions, we believe these will likely combine to drive growth significantly higher than the 10.2% the market is currently forecasting for FY23. We are basing this belief on the slate of civil projects currently under discussion and the current commodity supply/demand imbalances.

When we combine this with our belief that the construction materials and real estate divisions are unlikely to experience a decline during the next two years, we believe MAAS is well placed to beat market consensus in the next two years. With EV/EBITDA multiples for FY22 and FY23 at 12x and 10.9x, respectively, we believe MAAS is not expensive given the market's expected EBITDA growth rate for those years. However, since we expect these forecasts to be on the low side, we are putting a four star rating on MAAS.

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Share price chart

Source: Tradingview

Long-term lease the same as ownership?

Dalrymple Bay Infrastructure (Dalrymple) is rather aptly named as its only asset is its 99-year lease on the Dalrymple Bay Terminal (Terminal), ending in 2100. This might seem like an unusual situation, but when it comes to public-private-partnerships on major assets like ports, these types of leases are the norm. While there are many reasons why leases are used, one of the major reasons is simple economics. Outside of these long-term leases, the companies would have no incentive to make major investments, improvements, or even general maintenance. In fact, Dalrymple has two main expansion plans in place slated to cost the company $4.8bn in total, bringing the Terminal's total capacity to 135.7 Million tons per annum (Mtpa) from its current capacity of 84.2Mtpa.

While we stated that Dalrymple has a 99-year lease on the Terminal, that's not the whole story. The lease was initiated in 2001 and is structured in two parts, a 50-year lease and an option to extend the contract. The option can be exercised at Dalrymple's discretion anytime between September 2045 and September 2047, extending the lease until 2100. Since this extension is solely up to Dalrymple, the company has chosen to footnote the exact details of its lease terms and state that its lease expires during 2100.

Contacts heavily favour Dalrymple

Dalrymple currently has 100% of its capacity contracted out until 2028 under a shockingly favourable system to the company. Under the contracts signed by the Terminal's clients, even if they refuse to use the port, they have to pay 100% of the fees agreed when they reserved the port capacity. This contact type is called 'take-or-pay'.

At first brush, Dalrymple's 2020 EBITDA result was rather catastrophic after it generated a loss of $118.4m. However, upon closer inspection, even after COVID-19 issues, results outperformed prospectus (8 December 2020) estimates, excluding IPO costs. The prospectus estimated total revenues of $38.1m and EBITDA of negative $113.4m, while actual results were $23.4m and negative $118.4m.

Revenue underperformed expectations by $14.6m due to COVID-19 delays and costs, but non-IPO costs were significantly lower as well, totalling $12.5m versus $26.3m projected. While cost controls did play a small part in the drastic outperformance of non-IPO expenses, the main reason is directly linked to the decrease in revenue. Handling costs are a passthrough charge, compensating Dalrymple for its maintenance costs. Due to COVID-19, large scale maintenance was delayed until 1HY21.

The listing costs and the cost of refinancing saw a minor overrun during 2020, resulting in costs of $129.3m versus $125.2m projected. Due to these IPO cost overruns, EBITDA was $5m lower than the prospectus forecast. These costs were one-off charges, and we fully expect Dalrymple to be profitable going forward. Excluding the IPO costs, EBITDA would have resulted in $10.9m versus $11.8m projected in the prospectus.

It's time to buy back

Management has been far from happy with Dalrymple's share price since IPO. The buy back announcement coincided with its release of 2020's results and announced that it was proceeding to buy back up to 10% of its current shares outstanding. Since this announcement, management has been rather aggressive with its buy backs, purchasing 3m shares since 26 February 2021. Over this 62—day period, the company bought back an average of 26,925 shares per day, compared to the total average daily volume traded over the last three months of 390,000.

We believe management will likely continue this buy back strategy for the foreseeable future, potentially putting a floor under the share price. It is important to note that buy backs this early in its listing history is highly unusual.

Long-term prospects are far from certain

While we are bullish on Dalrymple over the next few years from a valuation and dividend perspective, we believe investors need to be aware of two main risks facing the Terminal over the next ten years. The Terminal's only export is metallurgical coal, one of the essential ingredients in conventional steel manufacturing. In fact, at the Terminal's current capacity levels, it exports 15% of the world's annual supply. However, over the next ten years, we believe this method of conventional steel manufacturing is likely to come under threat from the emergence of hydrogen.

Unfortunately, we don't have room to go into this in detail. However, the main point is that it is currently possible to use hydrogen to produce steel instead of metallurgical coal, although it is not economical just yet. At Stocks Down Under, we are quite bullish on hydrogen over the next ten years. As it becomes exceedingly cheaper, we believe hydrogen is likely to become just as economical as met coal by around 2030.

However, in the short-term, we believe Dalrymple represents an attractive dividend play based on an implied dividend yield of 4.2%. Its EV/EBITDA valuation for FY22 and FY23 is 15.6x and 15.1x respectively, which is not very cheap when we look at the projected EBITDA growth of 9.2% between FY22 and FY23. Combined with the current buy-back program, though, we believe Dalrymple represents a four-star opportunity over the next couple of years.

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Share price chart

Source: Tradingview

Where are all the workers?

Australia has a massive shortage of workers. According to the AFR's 6 April 2021 publication, the number of jobs advertised in Australia has hit a 12-year high, 23% higher than before COVID-19. This follows closely with the Australian Bureau of Statistics, that recorded job vacancies at 26.8% higher levels than pre-COVID-19 in February. Despite the end of JobKeeper, employers are still experiencing serious difficulties in finding staff and based on the Coalition's budget commentary, it seems likely this situation will continue to worsen until at least the middle of 2022.

While this is bad for Australia, it is certainly positive for recruitment companies. People Infrastructure is active in the workforce management and staffing industry. We predict that companies are likely to hire recruiters at an increasing rate as they struggle to attract skilled and even unskilled candidates.

Boosting an existing trend

Prior to COVID-19, People Infrastructure was always more of a niche player compared to many of its peers. Based on FY19's earnings, information technology and health and community services (generated 21% and 42% of total profit, respectively. The company is also exposed to the general job market, generating 37% of FY19's profit. This niche focus has worked out well for the company, long before the current market situation. Between FY15 and FY19, People Infrastructure's revenue grew at an average rate of 22.5%, of which approximately 10% was organic revenue growth. We believe this is an important point to highlight, because even after the current, COVID-induced, employment gap is closed, we believe investors are unlikely to find themselves holding a company unable to execute in a normal economy.

Looking at the past financial year, closed last week, People Infrastructure had a surprisingly strong 1HY21 result. And the total Group Billed Hours shot up to approximately 170,000 per week during January 2021 from around 130,000 during February 2020 and 145,000 in December 2020. Importantly, 1HY21 showed how business has mostly rebounded to pre-COVID-19 levels. Revenue and EBITDA, excluding JobKeeper payments, declined 3.8% and 51.6% compared to 1HY20, respectively. However, EBITDA guidance is still between $21.2m and $23.2m, excluding JobKeeper payments. This represents a year-over-year increase between 46% and 60%. The job market has certainly recovered, but it only did so towards the end of 1HY21. We expect things truly kick off in 2HY21, which we'll find out when the company reports it's full year numbers.

How to Value People Infrastructure

People Infrastructure is currently trading near its all-time high from mid-June. However, that doesn't mean the company is overvalued, in our view. We mentioned management's FY21 EBITDA guidance, but People Infrastructure has not updated it since it announced two acquisitions. Therefore, we believe the market consensus of $26.4m for FY21 EBITDA is likely to be more accurate. This means the market is expecting EBITDA to rise from $7.1m during 1HY21 to around $19.3m during 2HY21. Based on our expectation that many companies have a strong need to hire recruiters in this challenging job market, we believe the market's expectations are more than reasonable.

So, where does this leave People Infrastructure's current valuation? The market is currently forecasting EBITDA to rise to $36.7m in FY22 (28% growth) and $41.4m (12.8% growth) in FY23. Despite this, the market currently values the stock at only FY22 and FY23 EV/EBITDA ratios of 9.8x and 9x.

The absence of international travel until at least the middle of 2022 is bad news for the majority of Australia's industries, especially on the hiring front. And yet, for companies like People Infrastructure, with niche skills and a historical track record featuring strong execution, we believe this will cause a wave of demand for their services. The company's stock might be at an all-time high, but we believe there is still a lot of value to be had. So, it's four stars from us.

Pitt Street Research Pty Ltd

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