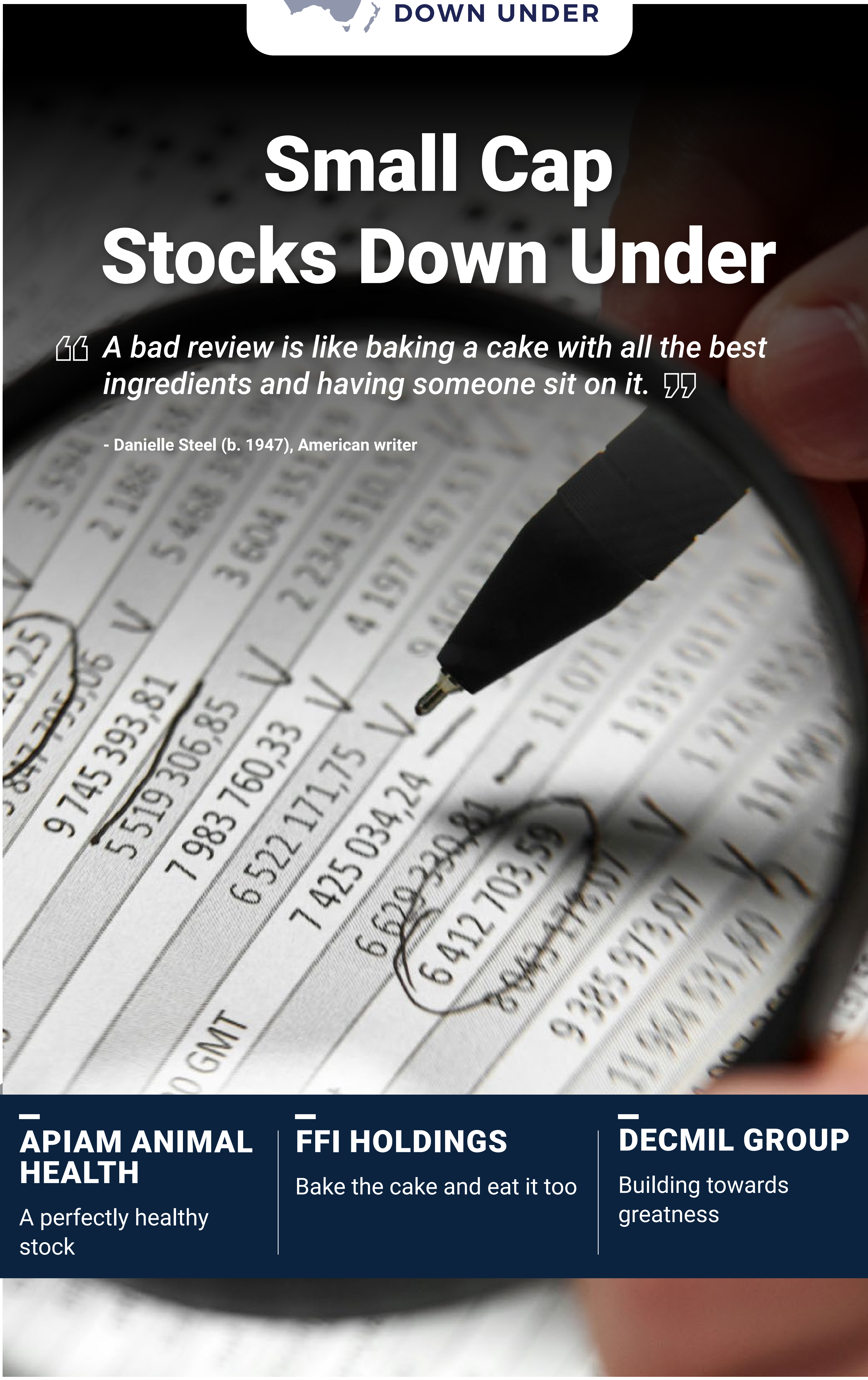
STOCKS DOWN UNDER

23 JULY 2021



Small Cap Stocks Down Under

"A bad review is like baking a cake with all the best ingredients and having someone sit on it."

- Danielle Steel (b. 1947), American writer

APIAM ANIMAL HEALTH

A perfectly healthy stock

FFI HOLDINGS

Bake the cake and eat it too

DECMIL GROUP

Building towards greatness

APIAM ANIMAL HEALTH

A perfectly healthy stock

Stocks Down Under rating: ★★★

ASX: AHX
Market cap: A$ 127M
Dividend yield: 2.5% (100% Franked)

52-week range: A$0.46 / A$0.98
Share price: A$ 0.98

Do you have a pet? If you do, just how far would you go to take care of them? If you're like the majority of pet owners, the answer is as far as you need to go, no matter the cost. But animal ownership goes much farther than just pets, the farming industry is in constant need of feed and veterinary services. This is where Sydney-based Apiam Animal Health comes in and while farming is making a comeback in Australia, we think this stock is perfectly healthy.

READ MORE

FFI HOLDINGS

Bake the cake and eat it too

Stocks Down Under rating: ★★★★

ASX: FFI
Market cap: A$ 76.4M
Dividend yield: 3.5% (100% Franked)

52-week range: A$4.70 / A$7.30
Share price: A$ 7.10

Headquartered in Jandakot, Western Australia is FFI Holdings, one of Australia's specialised food manufacturers. The company services all of Australia and a few South-East Asian markets with Australian-produced fresh and extended shelf-life food products. COVID-19 had a minimal impact on FFI's operations with EBITDA increasing 15% year-over-year in 1HY21. Despite this good result, trading volumes in FFI's shares is exceedingly low causing the stock to be undervalued. For investors willing to put up with the liquidity risk, this company is worth a punt.

READ MORE

DECMIL GROUP

Building towards greatness

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ASX: DCG
Market cap: A$ 55.4M

52-week range: A$0.42 / A$0.78
Share price: A$ 0.43

Headquartered in Osborne Park, Western Australia, the Decmil Group provides construction and engineering solutions across four main sectors: infrastructure, resources, energy and general (non-residential) construction. Recently, the company has been a contract winning machine, but you would not know that from looking at its stock price. Between 1 July 2020 and yesterday's close, the company's share price has declined 28%. However, with a trailing 12-month EV/Revenue ratio of 0.2x, a new industry outlook and a plan to capitalise on it all, we believe Decmil is ready to rock.

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Share price chart

Source: Tradingview

Farm animals need care too

Australian farms have been struggling over the past few years. A perfect storm of a flush international market and consistent drought-like conditions have sent prices plummeting while costs rose. Granted, there have been bright spots, like the wool market, but overall, Australian farms of all sizes have been suffering. And yet, the health of your animals is all-important and remains a priority expense, no matter a farmer's troubles. However, we believe it would be naive to think that Apiam is immune to Australia's farmer troubles. Veterinarian services are important, but reduced yields, higher expenses and lower prices can impact Apiam through reduced herd size and falling check-up frequency. Therefore, while mostly immune to drought conditions, shareholders are still exposed.

Apiam Animal Health describes itself as a provider of veterinary services and animal health products. And while that is not wrong, you might get the wrong idea at first glance. While Apiam does provide services for domestic pets, the company indicates that the majority of its business is based around farm animals, specifically pigs, feedlots and dairy-producing animals. However, it does not provide a profit breakdown, unfortunately.

A results check-up

Slow and steady seems to be the catchphrase for Apiam's earnings growth. Between FY19 and FY20, EBITDA increased 19.4% to $11.1m on a 6% rise in revenue ($118.3m). The main reason for this relatively strong EBITDA growth was the low increase in costs. With supply issues stemming from COVID-19 causing general price increases as well as costs relating to increased biosecurity, we don't expect a similar boost in EBITDA on such a limited revenue growth number.

One bit of good news is that on 30 June 2021, Apiam announced the acquisition of Scenic Rim Veterinary Service and Boonah Veterinary Hospital for $16m. These clinics offer state of the art facilities and fit nicely with the company's existing portfolio. For example, Scenic Rim operates an equine clinic in QLD that covers a large portion of the state's demand. This will be the third equine clinic operated by Apiam and, therefore, we believe this acquisition is likely to offer strong operational expansion with limited consolidation risk. The acquisition is expected to add $6.9m in FY21 proforma revenue and is expected to be profitable after year one.

A perfect check-up

We believe Apiam is a solid company, offering stable growth in a market where demand is constant. The company is exposed to the troubles of Australia's farmers, but we believe in a limited capacity only, and likely on a delayed basis due to the time it takes for herds to be reduced. Despite the positives, we believe the market has priced Apiam appropriately at FY22 and FY23 EV/EBITDA multiples of 10.6x and 9.7x, respectively. These ratios are based on expected EBITDA growth of 12.5% for FY22 and 9.5% for FY23.

While we believe Apiam is a strong company, we see that the market has already fully recognised the expected earnings growth for the next two years. Therefore, we believe at this time Apiam is a three-star stock.

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Share price chart

Source: Tradingview

We don't know how to bake a cake

Here at Stocks Down Under, we specialise in financial analysis, not bakery. Therefore, it should come as no surprise that when it comes to baking, our skills would be classified as poor, to say the least. But let's say we came up with the best cake recipe ever, how could we profit off our discovery with our poor baking skills? We would likely hire a specialised food manufacturer like FFI Holdings.

FFI specialises in mass-producing food products for its clients as well as its own brand through four main divisions: Chocolate Products of Australia, Nemar Cake Toppings, prepacked and Fresh Food Industries. It is important to note that even FFI's products are not available for sale directly to the public. Instead, the company produces products like jams and fruit fillings for bakers or private label chocolate products.

Additionally, the company provides contract packaging services for 'home cooked' products. However, the FFI's main focus is on dessert supplies (cake toppings, pie fillings, etc.) and the actual desert production, all under private label or sold to other businesses.

Expanding more than our stomachs

Operations can be broken down into two segments: bakery and investment property. The bakery division represents the vast majority of revenue, growth and profit. In 1HY21, revenue for this division expanded 7.9% year-over-year to $19.2m, resulting in net profit before tax of $2.5m (4.2% growth) for this segment.

What is interesting about this division is its future growth prospects. Truthfully, 7.9% revenue growth is nothing to be excited about. However, during 1HY21, FFI completed “major extensions to the chocolate factory”, increasing capacity and efficiency. Most importantly, the expansion of the factory allowed management to install a new chocolate block production line. Everything should have come online before the end of June.

Unusually, FFI has a REIT component to it with $20.5m of its total assets of $49.5m resulting from its investment property. Rental income increased 2.8% year-over-year to $593,168.

FFI was forced to sell 11,600 square metres of its land by Main Roads of Western Australia by the government. Unfortunately, this has caused significant disruption to operations and on 19 April 2021 the company announced that it had settled for $9.95m in total compensation, including a $5.44m prepayment made during FY20. Management advises that this will generate a contribution to profit before interest and tax of approximately $1.6m during FY21 after accounting for new building costs.

Low liquidity causing a low valuation

FFI is currently trading at a trailing EV/EBITDA ratio of 11.9x, with a book value for its investment properties of $1.90 per share. When we remove this value from the EV/EBITDA calculation, the ratio drops to 8.3x on 10.4% growth in EBITDA over the last 12 months. This valuation seems low to us when we factor in the stable 3.9% dividend and expansion to the bakery division.

Unfortunately, the reason for FFI’s low valuation is rather clear as the company has next to no trading liquidity. Looking at the last three months’ average daily volume, we see that only 1,900 shares were traded each day on average. This is a very low volume, even for a $68.8m market cap company. It’s clear that FFI is not very well-known to the market.

Despite the low liquidity, we believe FFI presents an interesting value story with a clear pathway to growth. Therefore, for investors able to handle the risk the low volume presents, we believe FFI represents a solid investment opportunity. Four stars.

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Share price chart

Source: Tradingview

It's time to build

Australia is in building mode. In the Federal Government's 2021-2022 Budget alone, $15.2bn is slated to be invested in new building projects. The resource sector is also ploughing full steam ahead with $300bn to $373bn across 335 different projects in the investment pipeline as of 31 October 2020, according to the Australian Government Resources and Energy Major Projects 2020 report. The list goes on and on, but the moral of the story is Australian companies involved in the construction and engineering industries will have their hands full bidding on new contracts for the foreseeable future.

The C and E that make the bread and butter

The Decmil Group provides construction and engineering services across four main Australian sectors: infrastructure, resources, energy and general (non-residential) construction. The infrastructure division focuses on transportation and infrastructure projects like bridges, roads, railroads and airports.

Resources include the usual excavation, site preparation and bulk earthworks and also features industrial buildings, workshops, piping, etc. Across a similar vein (pun intended), energy features wellhead installation, control room and associated facility construction, and engineering and project management services. Lastly, the general (non-residential) construction division focuses on schools, medical centres, facilities, etc. for government and local councils as well as industrial and commercial building construction services.

In Decmil's Board we trust

Unfortunately for shareholders, FY20 saw a disastrous result as revenue dived 18.2% to $451.3m on the back of pre-COIVD-19 issues compounded by the pandemic. In a strong showing of board transparency and accountability, the resulting $44.7m EBITDA loss was not a surprise to shareholders. Although, a decline from a profit of $14.8m to a $44.7m loss will always hurt, no matter how much fair warning you get.

In response to this disaster, the Board took swift and drastic action taking a number of major steps to prevent a repetition of this result. Specifically, the decision to consolidate operations in Australia by closing down its New Zealand operations.

Despite the poor result, we are rather impressed by the Board's reaction to the result. They took full responsibility and took immediate and appropriately drastic steps to fix the problem, while maintaining a high degree of transparency. Remember, 2020 was also the year many ASX-listed companies' boards made bad choices while attempting to reveal as little information as possible to shareholders. The accountability of Decmil's Board is a major plus in our analysis of the likelihood of a successful turnaround.

How low can the margins go?

Decmil operates on razor thin margins. During FY19, prior to any difficulties, the company's gross margin was only 8.6%. While 1HY21 saw EBITDA return to a profit of $5.6m, gross margin remained low at 11.5%. Due to the nature of Decmil's business, we don't expect the company's gross margin to remain this low going forward.

All I do is win, win, win

Revenue continued its decline during 1HY21, when the company generated $165.1m versus $236.9m during 1HY20. However, we are not concerned as the infrastructure boom we discussed above only truly started during the second half of 1HY21, into 2HY21. In fact, Decmil won two major contracts in March alone; the Gippsland Rail Upgrade, with the company's share at $120m, and the $25m Bruce Highway contract. In total, this brings the latest update of Decmil's contracted order book to $575m as of 18 March 2021.

We expect Decmil to continue to win contracts over the next 12 months, causing its contracted and preferred order book to expand drastically. While it is impossible to predict the size of these contract wins, the number of projects up for grabs makes it highly unlikely that the Gippsland Rail Upgrade will be the last sizable contract in this period. In fact, we believe FY21's EBITDA result will likely be in line with FY19's $14.8m due to the company's recovery and ability to work mostly unhindered by COVID-19. This would require EBITDA in 2HY21 to grow to $9.8m.

Using our projected EBITDA result of $14.8m, Decmil would be trading at an FY21 EV/EBITDA multiple of 25.5x. When we compare this valuation to the current industry outlook, quality of the Board and strong recovery outlook, we believe Decmil earns four stars.

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