STOCKS DOWN UNDER

30 JULY 2021

Small Cap Stocks Down Under

All empires fall, eventually. It's not for lack of power. Their power lulls them into comfort.

- Max Barry (b. 1973), American writer

AINSWORTH GAME TECHNOLOGY

Down but not out

SUNLAND GROUP

Get while the getting's good

MY FOOD BAG

When Private Equity is selling, be weary

AINSWORTH GAME TECHNOLOGY

Down but not out

Stocks Down Under rating: ★★★★

ASX: AGI
Market cap: A$357M

52-week range: A$0.27 / A$1.30
Share price: A$1.05

Ainsworth Game Technology is a Sydney-based manufacturer of gaming machines. The company is involved in the design, manufacture, distribution and servicing of the machines. The company has suffered from dwindling profits in recent years, but is looking to bounce back through lucrative partnerships and expansion into new territories.

READ MORE

SUNLAND GROUP

Get while the getting's good

Stocks Down Under rating: ★★★★

ASX: SDG
Market cap: A$352M
Dividend yield: 15.6% (100% Franked)

52-week range: A$1.16 / A$2.70
Share price: A$2.70

Based in Brisbane, Sunland Group is a fairly conventional real-estate company designing and constructing residential buildings in Australia. The company sees architecture as an art form and is constantly innovating in how it designs residential spaces that encourage community interaction. Creating integrated housing developments, apartment buildings and retail areas, Sunland has historically traded at a considerable discount to its book value. Management is on the case and has enacted a strategy that we believe will bring its market cap more in line with Sunland's book value.

READ MORE

MY FOOD BAG

When Private Equity is selling, be weary

Stocks Down Under rating: ★★★

ASX: MFB
Market cap: A$303M

52-week range: A$1.25 / A$1.67
Share price: A$1.25

Through its My Food Bag, Fresh Start and Bargain Box brands, Auckland-based My Food Bag offers consumers a plethora of online delivery meal-kit options. The online food delivery business exploded amid the COVID-19 pandemic as restrictions were imposed all over the world. As the delta strain changes the pandemic dynamic, we believe there is enough upside potential for this recently listed company, given its expanding addressable market and the multiple secular tailwinds.

READ MORE

AINSWORTH GAME TECHNOLOGY

Down but not out

Stocks Down Under rating: ★★★★

ASX: AGI
Market cap: A$357M

52-week range: A$0.27 / A$1.30
Share price: A$1.05

Ainsworth Game Technology is a Sydney-based manufacturer of gaming machines. The company is involved in the design, manufacture, distribution and servicing of the machines. The company has suffered from dwindling profits in recent years, but is looking to bounce back through lucrative partnerships and expansion into new territories.

Share price chart

Source: Tradingview

A slowdown in fortunes

Ainsworth's business model is simple. It creates gaming machines for the gaming industry. These machines are regulated as Class II (games of chance like Bingo) and III (Blackjack, slot machines, etc.) gaming systems.

Throughout the 2010s, Ainsworth enjoyed increasing revenues, going as high as $285m in 2016 and a stable dividend. By expanding into the North and Latin American markets, Ainsworth was able to fuel its growth.

By the end of FY16, North and Latin America accounted for 65% of Ainsworth's revenue. This revenue share was supplemented by the acquisition of Nova Technologies, an American manufacturer of Class II gaming systems. Class II gaming systems are subject to less regulation than Class III systems.

FY17 was the year when the company began to experience a long series of setbacks. With no major acquisitions during the year, the company's revenue was stagnant relative to FY16. Following an increase in operating costs, net income fell by 32% to $38m. Little did management know, this was only the beginning.

Successive failures

During this time, Ainsworth was planning a massive expansion into Class III gaming and marketing the A600 Cabinet range, which the company claimed was a huge upgrade over the previous A560SL model. However,

Ainsworth failed to increase its sales in FY18 on the back of this product launch and the higher costs of producing the A600 meant that profits continued to fall.

As far as we can tell, the problem with Ainsworth is quite simple. The only way to grow is by installing new machines. Between 2010 and 2016, the number of new casinos built in the US per year rose from 438 to 524. However, this boom ended in 2017 when the number built dropped 10% to 460. The figure stayed in this region until 2019 and we all know what happened in 2020! North America is Ainsworth's biggest market and intense competition along with the decline in demand for new cabinets only caused further damage to the company's bottom line.

Ainsworth has also experienced numerous delays in gaining regulatory approval for its products. Due to the nature of the gaming business, most gaming machines must be audited extensively by the appropriate regulatory authority before they are allowed on a casino floor. After failing to gain approvals for new products in FY19, revenue generated in Australia and New Zealand fell by more than 43% in the corresponding period, with consolidated net profit falling by a whopping 66%.

Throughout this time, the company hoped that things would fall into place and A600 would take off. However, once the effects of COVID-19 became apparent and widespread lockdowns were enforced, operations effectively ground to a halt, driving Ainsworth to a loss of $43.4m in FY20.

Bouncing back

Ainsworth may be down, but it is not out by any means. After the failure of the A600, the company has introduced the A-Star cabinet with a sleek design and brand-new features. The company continues its foray into Class III gaming while also providing Class II systems to its current client base.

Ainsworth's focus is now on the North American market since it is significantly larger than the Australian and New Zealand ones. To that effect, the company restructured its debt in March 2021 through a $35m credit facility from the Western Alliance Bank, the first time the company has chosen a US-based bank for its financing needs.

In April 2021, the company signed a deal with Konami Gaming, the US gaming giant, to launch historical horse racing machines for Churchill Downs Incorporated, an American gaming company that owns numerous racetracks and casinos.

The company has also signed a deal worth US$30m with GAN Limited in May 2021, an internet-based gaming SaaS solutions provider. This should help bolster Ainsworth's revenue as the effects of the pandemic begin to wane and people begin to return to casinos in increasing numbers.

With expansions already planned in Michigan and Pennsylvania, Ainsworth is also aiming to diversify its operations by distributing its products in Eastern Europe through a partnership with Slotegrator.

A game of chance

It seems that, like many of the gamblers that use Ainsworth-made machines, the company has been having a string of bad luck over the last few years. However, we do believe that the company is finally on the right track and should be able to recover its position in the market to a reasonable extent.

The company is valued at an EV/EBITDA multiple of 9.6x for FY22 and 7x for FY23. With EBITDA expected to more than double in FY22 and increase by 37% in FY23, according to consensus estimates, we believe Ainsworth shares are pretty cheap.

That said, the company still has substantial amounts of debts to pay back. Although the company offered a dividend of $0.04 per share in FY18, it seems unlikely that dividend will be reinstated anytime soon.

We believe Ainsworth is a four-star investment with good upside potential, but with some downside risks as well, most notably its track record in new product development. While an investment in Ainsworth is not entirely a game of chance, it's clearly not a sure thing either.

SUNLAND GROUP

Get while the getting's good

Stocks Down Under rating: ★★★★

ASX: SDG
Market cap: A$352M
Dividend yield: 15.6% (100% Franked)

52-week range: A$1.16 / A$2.70
Share price: A$2.70

Based in Brisbane, Sunland Group is a fairly conventional real-estate company designing and constructing residential buildings in Australia. The company sees architecture as an art form and is constantly innovating in how it designs residential spaces that encourage community interaction. Creating integrated housing developments, apartment buildings and retail areas, Sunland has historically traded at a considerable discount to its book value. Management is on the case and has enacted a strategy that we believe will bring its market cap more in line with Sunland's book value.

Share price chart

Source: Tradingview

Stick to what you know

Sunland Group was founded in 1983 and listed on the ASX in 1995. The company's core business has always been real estate, with the focus changing from residential homes to apartment buildings to retail space, depending on the circumstances.

In collaboration with Versace, the Italian luxury fashion brand, Sunland developed the world's first fashion-branded hotel, the Palazzo Versace in Gold Coast, Australia in 2000. Sunland also developed Queensland Number One (Q1), the world's tallest residential building from 2005 to 2011.

Having become a fairly successful real estate company in the 2000s, Sunland began to expand into Dubai, with numerous projects during the decade. In FY09, the company experienced considerable losses through a joint venture with the EWM Group. The two companies were involved in building 'The Atrium', a mixed-use luxury development that was never constructed. Sunland was also involved in numerous legal proceedings regarding its operations in Dubai, all of which culminated in Sunland losing and having to pay all legal fees for

the opposing parties in December 2013.

For the most part, Sunland hoped to recreate some of its Australian successes in Dubai. A second Palazzo Versace was being developed, along with Dubai Number One (a clear homage to Q1). However, Sunland was unable to complete these projects due to the controversy surrounding their operations in Dubai and a shortage of funds. Both the Palazzo Versace and D1 were completed by the ENSHAA group, a UAE-based developer backed by the Emirates Investments Group.

After it failed in Dubai, Sunland decided to stick to what it knew best and refocused on development within Australia.

Back on track

The recourse for Sunland's project debt in Dubai was limited to their operations in UAE. As such, the Australian branch of Sunland operated pretty much independently and continued to go from strength to strength during this time.

Sunland has continued to purchase, develop and sell luxury real estate in Australia since its inception. While the Australian market has had its share of ups and downs, Sunland has managed to turn out a sizeable profit throughout most of its history by following a counter-cyclical approach, which in simple terms means to buy when prices are low and sell when prices are high. The company is currently developing three projects.

One of these projects is the Montaine residences in Mount Annan, Sydney. All 139 homes in the 5.5-hectare area have already been sold and the project is expected to finish in late 2022.

The Gold Coast has traditionally been the main area in which Sunland has developed its projects. Right now, the company has two projects there. The first is a luxury apartment building on Hedges Avenue. The second is the 42-hectare master-planned community, known as The Lakes. Located in Mermaid Waters, Sunland is currently constructing a retail village and four apartment towers. The overall expected value of The Lakes project is $1.3bn, ensuring that Sunland has ample business in the years to come.

Out with a bang

From a financial standpoint, Sunland is a sound company that is conservatively run. Not only has management shown that it adequately understands the Queensland real estate market, but it has also appropriately dispensed with excess cash, either through dividend payments or share buybacks. A lot of companies would try to diversify into something they do not understand, but Sunland has been down that road before to no avail.

In October 2020, the company released a strategic plan, outlining its vision. By the end of FY23, Sunland plans to offload inventory not under development and return the net asset value to its shareholders (once all the liabilities have been settled). Henceforth, the cash received by the company would not be reinvested into new developments. Instead, it will be paid out to shareholders, either through share buybacks or through dividend payments.

The main reason for the company to undertake such action is simple: According to company estimates and external advisors, the actual value of the assets held by the company is far greater than its market capitalisation. Therefore, the shareholders stand to benefit a lot more if the properties and projects are sold off individually with the cash value paid out.

As per the company's announcements, there will be no project pipeline after 2023, leading us to believe that the company will either close its doors or use revenue from its current projects to look for new opportunities. Despite its current price of $2.70, consensus estimates show a book value per share of $3.32 per the end of FY23, thereby making the Sunland Group a four-star investment with about 29% upside over a 2-year period.

MY FOOD BAG

When Private Equity is selling, be weary

Stocks Down Under rating: ★★★

ASX: MFB
Market cap: A$303M

52-week range: A$1.25 / A$1.67
Share price: A$1.25

Through its My Food Bag, Fresh Start and Bargain Box brands, Auckland-based My Food Bag offers consumers a plethora of online delivery meal-kit options. The online food delivery business exploded amid the COVID-19 pandemic as restrictions were imposed all over the world. As the delta strain changes the pandemic dynamic, we believe there is enough upside potential for this recently listed company, given its expanding addressable market and the multiple secular tailwinds.

Share price chart

Source: Tradingview

New Zealand's leading food delivery platform

My Food Bag was founded in 2013 and has since delivered over 84 million meal kits through its online service under the My Food Bag, Bargain Box and Fresh Start brands. As New Zealand's oldest meal kit provider, the company estimates that the country's retail food sector market is about NZ$37 billion in size. It delivers thousands of meal boxes with locally sourced ingredients with easy-to-follow recipes to consumers across New Zealand every day. The company is looking to expand its product offerings through innovation and a strong understanding of customer requirements. My Food Bag is part of the high-growth, online food delivery market. We believe the company's digital capabilities, growing brand awareness and nationwide coverage should help it gain traction in 2021 and beyond

Recent IPO

My Food Bag went public on 5 March 2021 at $1.85 per share and closed its first day of trading at a share price of $1.62. The stock has since dropped to its current price of $1.25. My Food Bag confirmed that existing shareholders retained an approximate 25% stake in the company post-IPO. The company aims to use some of

the IPO money to repay a part of its existing bank debt and the IPO allowed some of the existing shareholders to divest part of their investment. Prior to the IPO, My Food Bag's largest shareholder was private equity firm Waterman Fund, which held a 66% stake. Waterman now intends to retain at least a 15% stake in My Food Bag, while other shareholders intend to retain an aggregate of at least 8.7% in this stock.

Earnings trends

My Food Bag has managed to establish itself as a leading meal-kit provider in New Zealand driven by its e-commerce capabilities and nationwide distribution. Its platform has allowed the company to scale and it now serves over 300,000 customers. The company leverages insights from its customer base and their purchasing behaviour as well as its more than 10,000 recipes to drive day-to-day decision-making and improve customer engagement.

In the financial year that ended in March 2018, My Food Bag reported sales of NZ$149 million. This figure rose to NZ$153.3 million in FY20. Comparatively, its EBITDA rose much stronger, from NZ$12.4 million to NZ$16.3 million in the same period.

The COVID-19 pandemic acted as a massive tailwind for My Food Bag and the company generated NZ$190.7m in revenue during FY21, NZ$1.2m higher than the prospectus forecasts. Despite the earnings beat, management reaffirmed that FY22 sales are expected to drop slightly to NZ$186.4 million before resuming growth in FY23. Despite a slight expected decline in revenue for FY22 compared to FY21, EBITDA is estimated to rise by 20% to NZ$34 million in FY22.

Access to 86% of New Zealand's population

My Food Bag claims that it constantly reviews its meal kits to ensure they are priced competitively compared to supermarkets. It offers convenience to its customers and the meals are tailored to meet customers' dietary needs cost-effectively. During FY21, My Food Bag delivered 4.8m meals, an increase of 22.6% year-over-year.

My Food Bag's nationwide network allows it to deliver to around 86% of New Zealand's population. The company is confident it has enough capacity to support future growth given its leadership in the meal-kit delivery market. The company also indicated it will continue to expand its food-based offerings to align with changing consumer trends to increase customer retention. It is now looking to enter the online food and grocery market, which will be a key driver of revenue growth in the upcoming decade.

Its established platform helps My Food Bag to facilitate scalable and profitable growth, lowering the need to acquire customers by offering heavy discounts. And its asset-light model supports cash flow generation allowing the company to pay annual dividends as well.

If Private Equity is selling, why should I be buying?

Consensus growth forecasts imply that My Food Bag is trading at an EV/EBITDA multiple of 10x for FY22 and 9.5x for FY23. That's not too outrageous for a company growing its EBITDA by an estimated 17% in FY22. The year after, however, EBITDA is only expected to grow by 5.5%. By comparison, Marley Spoon, My Food Bag's closest peer on ASX, is valued at an EV/EBITDA multiple of 56.7x for FY22. However, Marley Spoon is expected to more than double its EBITDA in each of the next two years.

In a nutshell, this is why we believe Private Equity company Waterman Fund wanted to exit its position in My Food Bag…there's only limited growth left. And when Private Equity is listing a company, we're always very weary. Why should we be buying something a Private Equity firm wants to get rid off? As the share price drop post-IPO illustrated, you shouldn't. And going forward, we believe there are better investment opportunities out there. So right now, we're neutral on My Food Bag and it's three stars from us.

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.

You are receiving this email because you subscribed to our Stocks Down Under newsletter.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

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