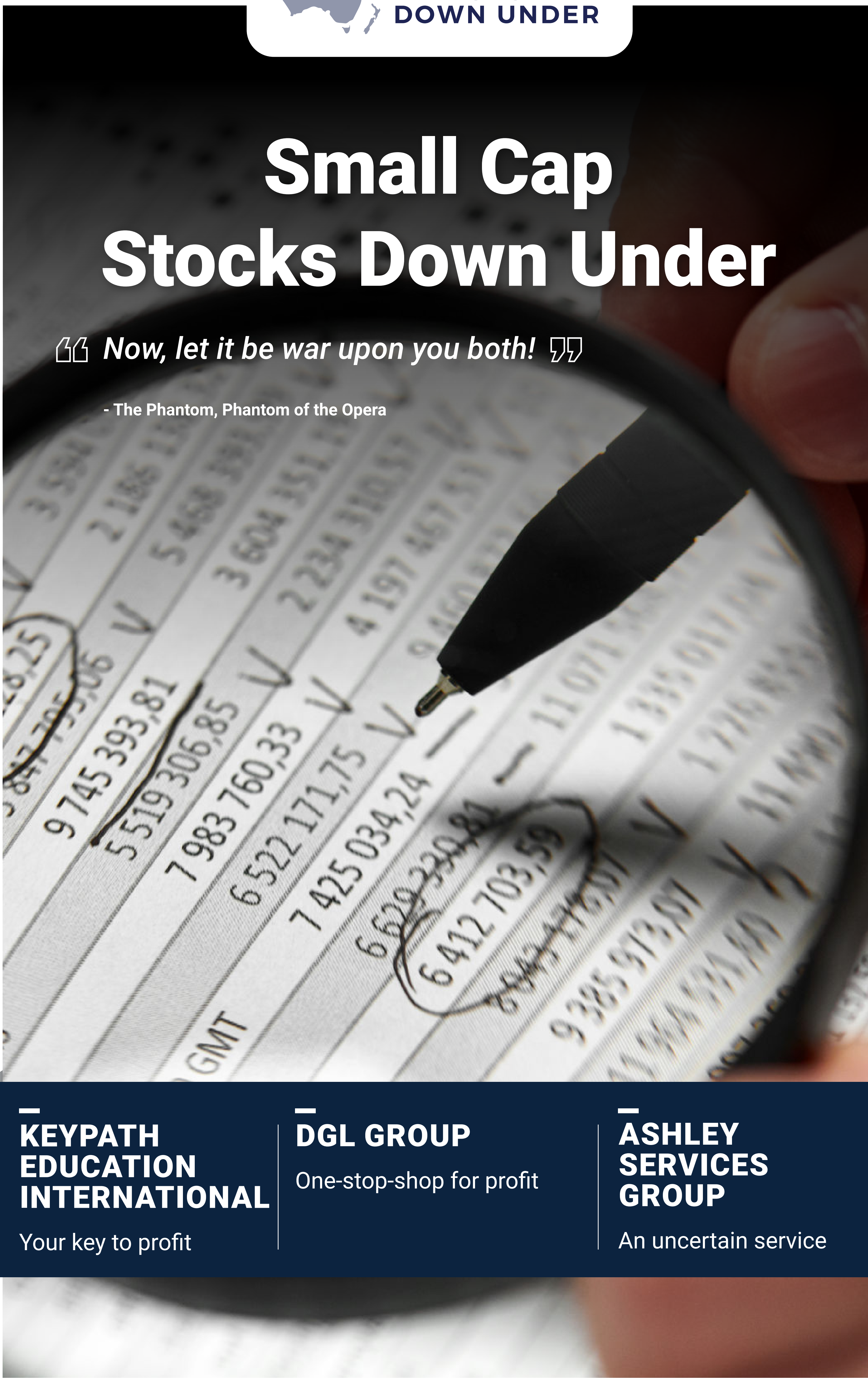
STOCKS DOWN UNDER

20 AUGUST 2021



Small Cap Stocks Down Under

“Now, let it be war upon you both!”

- The Phantom, Phantom of the Opera

KEYPATH EDUCATION INTERNATIONAL

Your key to profit

DGL GROUP

One-stop-shop for profit

ASHLEY SERVICES GROUP

An uncertain service

KEYPATH EDUCATION INTERNATIONAL

Your key to profit

Stocks Down Under rating: ★★★★

ASX: KED
Market cap: A$ 739M

52-week range: A$2.90 / A$4.02
Share price: A$ 3.53

If you wanted evidence of the strength of the ASX, look no further than the recent IPO of US-based Keypath Education International. This online education platform developer has expanded rapidly since its founding in 2014, mostly in the United States. In part due to this strong growth, the company currently still operates at a loss, but if FY21's results are any indication, Keypath is well on its way to teaching a masterclass in becoming profitable.

READ MORE

DGL GROUP

One-stop-shop for profit

Stocks Down Under rating: ★★★★

ASX: DGL
Market cap: A$ 501M

52-week range: A$0.93 / A$2.11
Share price: A$1.89

Headquartered in Melbourne, the DGL Group offers clients a one-stop-shop for all their chemical supply chain needs. The company is dual listed on the ASX and NZX (NZX: DGC), after raising $100m at $1.00 per share when it listed on 24 May 2021. Since that time, the company has made a number of rapid moves to expand through two acquisitions and the development of two new facilities. We believe the industry will see ongoing demand growth for the manufacturing, transport, storage and processing of chemicals and hazardous waste in Australia as the country continues its economic transition towards greater focus on research and development and specialised manufacturing. We believe this company is well placed to take full advantage of this demand.

READ MORE

ASHLEY SERVICES GROUP

An uncertain service

Stocks Down Under rating: ★★★

ASX: ASH
Market cap: A$ 70.5M
Dividend yield: 3.6% (100% Franked)

52-week range: A$0.31 / A$0.55
Share price: A$ 0.49

When it comes to the Ashley Services Group the first thing that should come to mind is white-collar. Not white-collar crime, but rather white-collar recruitment. This Sydney-based organisation specialises in finding permanent, temporary and contract white-collar candidates. The stock has been range-trading between $0.40 and $0.50 for most of 2021 and while this is towards the higher end of its 52-week range, we are extremely bullish on established, Australia-focused recruiting firms over the next few years. However, when we combine 1HY21's lacklustre recruitment division result with a lack of management forecasts, we believe this is one only for the watchlist at this time.

READ MORE

KEYPATH EDUCATION INTERNATIONAL

Your key to profit

Stocks Down Under rating: ★★★★

ASX: KED
Market cap: A$ 739M

52-week range: A$2.90 / A$4.02
Share price: A$ 3.53

If you wanted evidence of the strength of the ASX, look no further than the recent IPO of US-based Keypath Education International. This online education platform developer has expanded rapidly since its founding in 2014, mostly in the United States. In part due to this strong growth, the company currently still operates at a loss, but if FY21's results are any indication, Keypath is well on its way to teaching a masterclass in becoming profitable.

Share price chart

Source: Tradingview

Creating the key to higher education

Keypath Education International was technically founded in 2014 by current CEO Steve Fireng. Like most things in this world, the story is not so clear cut because Keypath's founding came about through the transformation of a different company, called Platform Advertising (founded 1989) where Steve was already CEO. He took a university enrolment company and converted it into the KeypathEDGE platform we know today.

Currently, Keypath's services revolve around the KeypathEDGE platform. This platform uses a proprietary and constantly updating database to provide universities with an edge when they are designing, updating and reviewing their curriculum. The KeypathEDGE platform achieves this goal through two main features. The first could be described as a version of Stocks Down Under for universities. The company has a database that constantly monitors employment, global industry and other social, economic and environmental trends. Its analysts use this to write reports and predictions on which skills and occupations are likely to see greater demand for graduates. The analyst reports are referred to as the Keypath's BLUEPRINT.

Utilising BLUEPRINT, Keypath collaborates with its university partners to develop its library of over 250 interactive online course designs. These templates allow universities to deploy a 'plug-and-play' approach, although they are easily customisable to the university's individual demands. Currently, Keypath delivers 130 online higher education programs used by over 30,000 students across Australia, the United States, Canada, the United Kingdom and Malaysia. However, Australian universities remain the main source of revenue.

Managing students before they even join

While KeypathEDGE's curriculum design features are clearly the crown jewel of Keypath's offerings, they don't stop there. The company has two other offerings that go hand-in-hand with curriculum design: marketing and student management. Part of Keypath's BLUEPRINT includes a growing database of over one million potential student leads, allowing for a better understanding of how to market uniquely designed courses. The database also allows for the targeted marketing of courses. This means universities that hire Keypath can expect a combination of individually-tailored marketing campaigns and more traditional, automated marketing such as SEO, content, affiliate, email, etc.

Once Keypath designs the course and finds the students, KeypathEDGE's platform allows for individual student monitoring and analysis. This includes facilitating student assistance and engagement online, keeping track of an individual's performance metrics and, using a proprietary prediction algorithm, attempting to head off issues at the pass by alerting the university to 'at-risk students' who require additional resources and attention before they start failing.

Still fumbling with the lock of profitability

Keypath is not yet profitable, with the market forecasting an EBITDA loss of US$6.7m in FY21 and US$13.1m during FY22, with the company finally becoming profitable during FY23. The good news is that we already know that Keypath generated US$98.1m in revenue during FY21 as it released its 4Q21 report on 29 July 2021. Unfortunately, we won't find out how high the loss was until it reports its full set of results on 30 August 2021.

We believe Keypath has developed a product that is both superior and needed in the higher education sector. Students require additional attention as classes become more complex, and universities and schools continue to charge higher prices. Keypath is in the early stages of its growth phase, but consensus estimates see revenue climbing from US$98.1m in the last financial year to US$127.6m in FY22 and US$166.1m in FY23, i.e. around 30% growth in both years. Given Keypath's EV/Revenue valuation of 4.5x and 3.5x for FY22 and FY23, respectively, we think there's value here. So, this one is four stars.

DGL GROUP

One-stop-shop for profit

Stocks Down Under rating: ★★★★

ASX: DGL
Market cap: A$ 501M

52-week range: A$0.93 / A$2.11
Share price: A$1.89

Headquartered in Melbourne, the DGL Group offers clients a one-stop-shop for all their chemical supply chain needs. The company is dual listed on the ASX and NZX (NZX: DGC), after raising $100m at $1.00 per share when it listed on 24 May 2021. Since that time, the company has made a number of rapid moves to expand through two acquisitions and the development of two new facilities. We believe the industry will see ongoing demand growth for the manufacturing, transport, storage and processing of chemicals and hazardous waste in Australia as the country continues its economic transition towards greater focus on research and development and specialised manufacturing. We believe this company is well placed to take full advantage of this demand.

Share price chart

Source: Tradingview

An IPO success story

The last year has been a mixed bag for the ASX's Initial Public Offerings, with a number of them collapsing, but the DGL Group is not one of them. The company issued 100m new shares at a price of $1 on 24 May 2021, raising $100m in new capital after listing for the first time on both the ASX and the NZX. Since then, shareholders have seen a rather solid gains, with the stock currently trading at $1.89 per share. What makes DGL so special? The company manufactures, transports, stores and processes chemicals and hazardous waste, a complex and highly skill-based industry with high entry barriers, but one that is experiencing significant demand.

Here's something you might not know. The chemical industry is one of Australia's largest manufacturing sectors, directly employing over 60,000 people and adding over $38bn to GDP in value add. The industry reaches into almost every other Australian sector, from the pesticides that keep our crops safe to the chemicals that purify our water. While not an overly exciting industry in terms of growth, it has been consistent at 2.2% annually between 2016 and 2021 and we don't expect a collapse in demand, especially now that mining is booming again. With over 60 registered product names and trademarks in Australia (mostly developed in-house), we believe these benefit both the transportation and processing divisions as well as DGL's manufacturing.

Manufacturing is the main game

DGL is split into three divisions: chemical manufacturing, warehousing and distribution, and environmental solutions. At 51% of FY20's $180m in revenue, chemical manufacturing is the clear breadwinner of the business. This division generates revenue through its eight manufacturing plants in Victoria (four), New South Wales (one) and New Zealand (three). While the company has proprietary chemical products that it manufactures and sells, DGL also generates revenue through contract manufacturing. In this form of manufacturing, an organisation with specific chemical intellectual property will hire DGL to produce and package the product, utilising both the expensive equipment and DGL's highly trained staff.

In a rare move for the Australian industry, DGL has decided not to specialise, but diversify its operations into related categories, like chemical warehousing and distribution. Due to the often volatile, toxic and valuable nature of chemicals and their components, storing and transporting them is far more difficult than it might appear at first brush. Doing so requires both specialised equipment and a specialised workforce. This is what is on offer to clients through DGL's chemical warehousing and distribution division.

While on the smaller side compared to its other two divisions, generating only 15% of FY20's total revenue, DGL is intent on expanding operations within it's warehousing and distribution division. Since the company IPOed it has announced plans to build new storage in New Zealand at its existing Mount Wellington facility in Auckland as well as build a brand-new warehousing, distribution and manufacturing facility in Irongate. Logistics has been a hot market for Real Estate Investment Trusts and we believe this division is ripe for expansion.

Environmental solutions generated 34% of FY20's total revenue and is really just a fancy name for waste disposal. Further utilising its chemical expertise, DGL provides collection, treatment and disposal services for hazardous waste products, like end-of-life lead-acid batteries as well as recycling lead and scrap and waste plastic. The company sells what it can salvage and uses its proprietary process to render the remaining waste safe for landfill.

Profit Ho!

According to management forecasts, the company is slated to generate $26m in EBITDA during FY21, followed by a significantly lower, but still respectable growth rate of 11.5% to $29m during FY22. However, the market is clearly more upbeat about DGL's prospects with consensus forecasts calling for EBITDA of $26.2m in FY21, $31.2m in FY22 and $39.7m in FY23. So, EBITDA is expected to grow by 19% and 27% respectively in FY22 and FY23. Not too shabby for a company in a low-growth industry.

With EV/EBITDA ratios of 16.3x and 12.8x for FY22 and FY23, we believe there is a disconnect between valuation and growth. In our book, DGL is pretty cheap given the growth the market is expecting, so its four stars from us.

ASHLEY SERVICES GROUP

An uncertain service

Stocks Down Under rating: ★★★

ASX: ASH
Market cap: A$ 70.5M
Dividend yield: 3.6% (100% Franked)

52-week range: A$0.31 / A$0.55
Share price: A$ 0.49

When it comes to the Ashley Services Group the first thing that should come to mind is white-collar. Not white-collar crime, but rather white-collar recruitment. This Sydney-based organisation specialises in finding permanent, temporary and contract white-collar candidates. The stock has been range-trading between $0.40 and $0.50 for most of 2021 and while this is towards the higher end of its 52-week range, we are extremely bullish on established, Australia-focused recruiting firms over the next few years. However, when we combine 1HY21's lacklustre recruitment division result with a lack of management forecasts, we believe this is one only for the watchlist at this time.

Share price chart

Source: Tradingview

Jobs, but no people

Australia has a massive shortage of workers. According to an AFR article on 6 April 2021, 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, who recorded job vacancies at 26.8% higher levels than pre-COVID-19.

According to Australian Hotels Association boss Stephen Ferguson what's unusual about the employment situation is that the rural hospitality industry can find staff. The lack of staff mainly seems to be an issue in Australia's capital cities where most migrants will often wind up. Accounting and law firms are already reporting sharp shortages of skilled labour, highlighting the fact that the worker shortage has moved well beyond blue collar labour. Warren Pearce, the head of the Association of Mining and Exploration Companies, stated that the mining industry has not seen issues hiring new staff, but is expecting shortages to arise soon.

Clearly, employers are having serious difficulty in finding staff. And based on the Coalition's recent budget commentary regarding international travel, or rather the lack thereof, it seems likely this situation will continue to worsen until at least the middle of 2022.

Burning at both ends of the candle

While this is bad for Australia, it is certainly positive for a company like the Ashley Services Group. Unlike other recruiting companies we have written about, like People Infrastructure (ASX: PPE | see 9 July 2021 report), Ashley Services is burning the white-collar labour shortage from both ends of the candle. Not only does the company offer recruitment services, but it also provides technical skill and up-skill training across a variety of specialties including, telecommunications, construction, children's services, management, aged care, writing, etc. It is important to note that the training in question is offered through five main institutes and one national assessment developer. Two of the institutes are in Queensland, two are in Western Australia and one is in Victoria. We believe these institutes will prove to see just as much benefit from the skills shortages as Ashley Services' recruitment service. We expect many companies will be forced to hire staff lacking in proper training, or by training and then promoting internally.

During 1HY21, Ashley Services generated $186m in revenue and $6.8m in EBITDA, an increase of 1.4% and 12.4%, respectively. The discrepancy between revenue growth and EBITDA growth was due to increased efficiencies. EBITDA margins increased by 36bps compared to 1HY20. Despite not being the largest division, the training division contributed the most to EBITDA growth (divisional EBITDA breakdown does not include corporate costs, 1HY21 had $2m in total corporate costs), generating $1.4m versus $800,000 during 1HY20 as many of this division's activities moved online.

The main income generator in 1HY21 remained labour-hiring. During the period, labour-hire generated $7.5m in EBITDA (divisional EBITDA breakdown does not include corporate costs), an increase of 4% year-over-year. We must admit this relatively low number wasn't very reassuring as 1HY21 was the time when hiring really took off again. Despite this lacklustre result, we remain cautiously optimistic as the recruitment industry is experiencing serious demand. Just take a look at Ashley Services' competitor People Infrastructure we mentioned earlier, who saw 49.3% growth in EBITDA after accounting for JobKeeper payments.

A need to recruit additional growth

It's fair to say we were disappointed with 1HY21's labour-hire division's result. Growth of only 4% year-over-year in the current environment is not a great achievement. The market didn't like the results either and the stock fell 20% in March. Since then, however, ASH has trended back up around $0.50 and is trading at a trailing 12-month EV/EBITDA ratio of 7.5x.

While this could be considered a discount to 1HY21's total EBITDA growth of 12.4%, we'll remain on the sidelines for now as we head towards Ashley Services' full year FY21 results release later this month. So, three stars for now.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and 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.

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