STOCKS DOWN UNDER

10 DECEMBER 2021

Small Cap Stocks Down Under

"Only the dead have seen the end of war."

- George Santayana (1863 - 1952), Spanish philosopher

CIVMEC

Epitome of stability

MYDEAL.COM.AU

A deal at its current price

AUSTIN ENGINEERING

Removing the dirt

CIVMEC

Epitome of stability

Stocks Down Under rating: ★★★★

ASX: CVL
Market cap: A$352M
Dividend yield: 0.01% (100% Franked)

52-week range: A$0.42 / A$0.80
Share price: A$0.70

Civmec is a Perth-based construction and engineering services company. It currently holds interests in companies engaged in everything from structural steelworks to shipbuilding services. Since 2009, the company has slowly been expanding its scope and now it serves oil and gas, infrastructure, defence and marine, and the metals and minerals sectors in Australia. While it does not have a lot of overseas contracts, the large portfolio of services allows Civmec to have a large pipeline of projects with a significant client base.

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MYDEAL.COM.AU

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Stocks Down Under rating: ★★★★

ASX: MYD
Market cap: A$228M

52-week range: A$0.52 / A$1.45
Share price: A$0.89

Melbourne-based Mydeal.com.au is an online retail marketplace featuring over 1,800 sellers, listing over 6m products across 2,000 categories, from furniture to homewares. The company is not yet profitable and we believe is unlikely to become so over the next couple of years But it managed to exhibit strong revenue growth over the last few years as it expanded its product offerings and the perks and services it provides to its customers. With a strong FY21 result, and the recent launch of its mobile app, we believe that for investors willing to take on some higher-than-average risk, we might just have a deal for you.

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ASX: ANG
Market cap: A$122M
Dividend yield: 1% (100% Franked)

52-week range: A$0.115 / A$0.245
Share price: A$0.195

At its core, the Perth-based company Austin Engineering is a manufacturing and repair company. It provides all sorts of manufacturing, delivery, repairing and on-site maintenance services for the industrial and resource sectors. The company has an extensive presence in Asia-Pacific and the Americas, and primarily works with equipment manufacturers and miners. Although the company has experienced a massive rise in its share price over the last six months, we believe it is justified by its financial performance. We think the company is finally at a turning point where it can be consistently profitable.

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Share price chart

Source: Tradingview

Straight out of the business school playbook

Civmec has been around since 2009. Initially, it provided bespoke engineering solutions to its clients. However, it began to vertically integrate its operations in the first half of the last decade. It can now serve a wide variety of its clients' engineering needs in four major sectors.

Construction is the company's primary business. Its two facilities in WA and NSW allow it to provide plate works, vessels, tanks, handling equipment, pipe spooling services, and steel and offshore structures.

Its vertical integration is what sets it apart from its competitors. For example, oil and gas represent a significant portion of the company's business. It can deliver projects on everything from fuel and power stations to refineries and subsea infrastructure. This allows Civmec to sign large-scale contracts with its clients and most of these end up contributing to its bottom line quite strongly.

In 2016, the company made a profound move to acquire Forgacs, the NSW-based shipbuilding company. In a deal worth $14.6m, Civmec acquired Forgacs not only to enter the shipbuilding business, but also for the 22.7-hectare facility with expansive river frontage. While the site was initially only used for shipbuilding, the company has over time been using it to perform tasks usually done at its other facility in NSW. Civmec is currently integrating its steel fabrication business with its shipbuilding facilities to better serve the marine and defence sectors.

Going public twice

Although Civmec almost exclusively serves the Australian market, it is incorporated in Singapore. It listed on the SGX in 2012 and dual-listed on the ASX in June 2018.

Prior to listing on the ASX, the company had been suffering from declining revenues and profits. Net profit fell from S$35m in FY14 to S$8.2m in FY17. However, the company's prospects changed for the better after the acquisition of Forgacs and the signing of multiple major contracts. Revenues more than doubled in FY18 (from S$346m to S$738m) and Civmec reported a net profit of S$25.5m for the year. Since then, while the company has been unable to generate revenues at the same scale, it has consistently had a large order book. Due to single contract values being very large, just a couple of contracts can significantly impact the bottom line. For example, the company's order book grew from $540m in 2Q19 to $820m in 3Q19.

FY21 was the next major year for Civmec. The company announced new contracts worth $175m in October. By December, its order book had grown to more than $1.1bn, with port infrastructure development contracts contributing largely to that figure. The company also secured further work on the Iron Bridge Magnetite Project, a project in WA that is expected to produce over 22 million tonnes of magnetite concentrate per year.

The foundation for a better future is in place

With its vertically integrated suite of solutions, the company is in a prime position to not only sign contracts for more projects, but also to offer additional services to its current client base (as demonstrated in the Iron Bridge project).

Civmec reported revenues of S$674m in FY21 and posted a net income of almost S$35m, close to its all-time high in FY14. The company has also begun serving the Australian navy on a large-scale basis, with work to construct the Fourth Royal Australian Navy Offshore Patrol Vessel in having begun in January 2021. Growth continued during 1Q22, as sales grew 31.8% and margins increased as administrative costs declined, allowing EBITDA to jump 46% year-over-year. Considering the company's past track record, we won't be surprised if more large-scale defence contracts followed.

Despite the 8% to 10% EBITDA growth expected for FY22 and FY23, Civmec is only trading at EV/EBITDA multiples of 5.5x and 5x for these years, which is cheap in the Stocks Down Under valuation handbook.

From FY13 to FY19, the company had been offering a consistent dividend of S$0.007. This increased to S$0.01 in FY20 and then S$0.02 in FY21. The current dividend yield, at 3.3%, is what we expect the company to continue to achieve for the foreseeable future.

We believe Civmec's operations are the epitome of stability. With a reasonable dividend yield and an attractive valuation, we think Civmec is currently a four-star investment, ideal for investors that want a stable company with a simple business model and a stable outlook.

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Share price chart

Source: Tradingview

Looking for a deal Australia?

MyDeal.com.au was founded in 2011 and has since grown to offer Australian's an extensive offering of home and lifestyle products across 1,800 registered sellers. The company's range of products extends from things as large as furniture to clothes and even tools and baby products. The company has experienced strong revenue growth over the last few years, averaging 278% per year between FY19 and FY21. Still, it remains unprofitable, posting an EBITDA loss of $5.2m during FY21. Despite this, we believe management is steering MyDeal.com.au in the right direction as shown by active customer growth averaging 218% during FY20 and achieving 83.1% during FY21.

In 2HY21, MyDeal.com.au launched a new offering that we believe was both long overdue and is likely to facilitate strong growth going forward. On 4 May 2021, the company launched a mobile application for iOS and Android mobile devices. It certainly is surprising that it took the company this long to do so, especially when the benefits are so clearly apparent.

Since June 2021, 200,000 instances of MyDeal.com.au's applications have been installed, while 13% of total sales were made via the company's mobile app. The new mobile app will offer push notifications, app-specific discount coupons, social media sharing options and has, what we believe to be, a seamless functionality. Based on the app's performance during the first 22 weeks since launch, we expect it to end FY22 well past its current 13% of total sales mark.

Private label is the future

A significant part of Kogan's (ASX: KGN | see 8 March c2021 report) success has been its private label products. The reason for this is simple, private label products are owned and controlled by the retailer, cutting out middlemen, marketing costs and licensing deals. So, not only are these products easier to keep in stock, but they also have significantly higher margins. Much like its mobile app, MyDeal.com.au was late to the private label game, starting with a soft launch as recently as FY20. Unsurprisingly, the 552 private label products sold during 1Q22 have quickly captured an increasingly sizable portion of gross sales at 6.9% of the total ($4.8m). What has helped the company keep costs down in such a volatile time for supply chains is the diversity of the company's network of factories in Vietnam, Taiwan and Indonesia.

During the first four months of FY22, MyDeal.com.au generated approximately 24% gross sales growth ($92.9m) while reaching $19.4m in revenue (50% year-on-year growth) and 940,726 active customers. One last important statistic for October 2021 is that 61% of transactions came from returning customers compared to 51% a year ago. We believe these results show that, just because lockdown has ended, MyDeal.com.au hasn't stopped growing and has managed to retain the customers it gained during COVID-19 as sales shifted online.

FY24 here we come

The market is currently expecting 35.8% revenue growth in FY22, to $52m, followed by 29.2% in FY23, to$67.2m. Despite this impressive revenue growth, it is not until FY24 that the market consensus estimates have MyDeal.com.au finally generating an EBITDA profit. However, we are strong believers in the power of private label's ability to drive profit and combining that the company's private label's growth so far with the new mobile app, leads us to believe these growth levels are likely on the conservative side.

Using the market's conservative estimates, MyDeal.com.au's valuation seems to be on the low side with FY22, FY23 and FY24 EV/Revenue multiples of 3.6x, 2.8x, and 2.2x, respectively. Therefore, when we take everything into account, a four-star rating seems to be the only proper conclusion for MyDeal.com.au.

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Share price chart

Source: Tradingview

A two-headed machine grows a third head

Austin Engineering does two different things. It designs and manufactures custom products, and it provides support services to its clients. The company's primary way to generate revenue is by providing customized mining equipment.

Many brands currently operate under Austin. The JEC and Westech brands are responsible for the manufacture and engineering of products worldwide. Austbore provides machining services and other support services for mining companies. Lastly, the Site Services brand is responsible for, well, site services.

As such, the company can offer a wide variety of products to service mining and related industries. Most of its products are related to surface operations, such as dump truck bodies, water tanks and ancillary equipment. The dump truck bodies can also be used underground.

Recently, the company has implemented a product diversification strategy. While the company still operates in the same segments, it is trying to utilize its engineering expertise to offer more products. In August 2021 alone, Austin Engineering won $30m worth of new contracts. Some of the contracts are for the company's core products and services, such as truck bodies. Others, however, are for brand new structures, such as underground mine chutes.

Essentially, Austin is now aiming to focus on its engineering solutions business with a particular focus on mining companies. It can leverage its current client base and provide additional services (that clients currently have to look for elsewhere).

A lot of world to explore

Austin Engineering has historically served clients in numerous countries. However, most of its operations have been concentrated in Australia and the Americas. Since the beginning of FY21, the company has been heavily focusing on expanding its client base in previously untapped markets.

In 1HY21, the company signed new contracts to provide truck bodies and buckets to Argentina, the Dominican Republic, Egypt and Europe. The company believes these contracts should allow it to expand further in these areas. To back this expansion, it has had to deal with its lingering debt problem. Due to the nature of the business and the enormous upfront costs of servicing contracts, the company has historically had large amounts of debt. While it has considerably reduced those debts (its net debt position went from $45.6m in FY17 to $18.6m in FY21), the company has also tried to reduce its debt payments.

In September 2020, Austin Engineering refinanced its debt with Export Finance Australia, allowing it to have access to a $15m revolving working capital facility. In August 2021, the company further refinanced its global debt with HSBC bank Australia, allowing the company to have a $35m facility in place. This two-year facility has a lower interest rate (1.1% line fee and a 2.05% margin over the bank bill swap bid rate). The new facility is expected to reduce debt servicing costs by around 25%.

An exciting direction

The mining sector did not experience a huge setback during COVID-19 due to the isolated locations of the mines and precautions taken by mining companies. However, Austin did withdraw its profit guidance for FY20. Still, the company achieved a net profit of over $5m, its first in many years. Apart from a contract termination in Colombia, the company did not experience any major setbacks during the pandemic.

The bane in Austin Engineering's existence has been its debt. Although the company has generated an operating profit every year since FY17, it has failed to convert that into net profit apart from FY20. However, it seems that management has been able to remove much of the dirt from its balance sheet in recent years. The new direction involving product and geographical diversification is exactly what the company needs in order to consistently generate profits in the future.

Austin Engineering expects its strong order flow to continue, aided by its expansion to new continents with strategic partners. The company is also shoring up its site services operations. In September 2021, it announced a partnership with the Mader Group, the Perth-based mobile and fixed plant equipment maintenance provider.

With only a minor loss of around $0.5m in FY21, we believe Austin Engineering is positioned to deliver profitability and dividends. In September 2020 the company offered a dividend for the first time since FY14 with a current dividend yield of 2.2%. However, we suspect that the company may increase its dividend if profits increase beyond FY20 levels going forward.

In its current state, we believe that Austin Engineering is a four-star investment. The stock is trading at a trailing 12-month EV/EBITDA multiple of 8.3x and therefore, we believe it is priced reasonably considering its multi-pronged approach and its financials have been on an upward stride since FY17, while the share price seems to be in a bottom-forming process currently. So, it seems Austin Engineering's future looks bright.

Pitt Street Research Pty Ltd

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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.

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