STOCKS DOWN UNDER

31 DECEMBER 2021

Small Cap Stocks Down Under

"Don't live the same year 75 times and call it a life."

- Robin Sharma (b. 1969), Canadian author

BOART LONGYEAR GROUP

Free at last

HEALTHCO HEALTHCARE AND WELLNESS REIT

Not too hot and not too cold

BEST & LESS GROUP

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BOART LONGYEAR GROUP

Free at last

Stocks Down Under rating: ★★★★

ASX: BLY
Market cap: A$772M

52-week range: A$2.50 / A$23.90
Share price: A$2.52

Headquartered in Salt Lake City, Utah (USA), but incorporated in Ontario, Canada, the Boart Longyear Group is one of the oldest mining products and services providers listed on the ASX. The company was founded in 1890 and over the last 132 years has expanded its operations into three main divisions: global drilling services, geological data services and global products. Things have not been going well for the company over the last few years and Boart was forced to swap $1.1bn of debt into equity. Now that Boart's debt is finally under control, is it time to drill into this stock?

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Stocks Down Under rating: ★★★

ASX: HCW
Market cap: A$735M
Dividend yield: 3.3% (0% Franked)

52-week range: A$2.07 / A$2.40
Share price: A$2.25

In a clear move to take advantage of the market's seemingly insatiable demand for anything healthcare related, on 6 September 2021, Home Consortium (ASX: HMC | see 17 August 2021 report) divested its healthcare investments at $2.00 per share. This divestment has formed the Sydney-based healthcare Real Estate Investment Trust (REIT), HealthCo Healthcare and Wellness REIT. The trust has a portfolio of hospitals, aged care and childcare facilities, government life sciences and research as well as primary care and wellness facilities. At the time of listing, HealthCo owned 27 properties valued at $555m with 96% occupancy and a Weighted Average Lease Expiry (WALE) of 9.4-years. Impressive statistics that the market seemed to think warranted a premium of 7.5% to its Net Tangible Asset value per share of $1.86. The trust is now trading $2.25 per share and while still trading at a premium, there have been subsequent acquisitions that we believe warrant its current price, but not more.

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ASX: BST
Market cap: A$508M

52-week range: A$2.16 / A$4.33
Share price: A$4.04

Sydney-based Best & Less Group (BST) IPO-ed on the ASX on 26 July 2021 at $2.16 per share and has so far made shareholders very happy, earning them an 87% profit. How has a clothing and footwear retailer provided shareholders with such an impressive return in only five months? Well, for one thing, it never hurts when you get to release a statement to the market saying you have "exceeded prospectus forecasts on all key metrics". But the question remains, is FY21's result repeatable, especially with the sharp difference between revenue and EBITDA growth?

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Share price chart

Source: Tradingview

132 years of history

The Boart Longyear Group's name aptly includes 'Longyear' as the company was founded in 1890. While we wish it were intentional, the company is actually named after its founder, Edmund J. Longyear when he formed the company to provide contract diamond drilling to the United States iron ore mining and steel industry. At the time, many companies in the US, like Carnage Steel, did both. It was not until the 1920s when Boart expanded outside of the United States when it gained its first international project, in Cuba of all places (copper mining). The company began to expand rapidly internationally after this contract, gaining contracts in China, Canada and many other countries over the next twenty years. Still, the company never ignored its US' operations and was even part of the construction of the Golden Gate Bridge by testing the nature of the rock formations that would have to support its weight.

Today, Boart operates in 15 different countries and designs, manufactures and sells drilling equipment and related products (including aftermarket parts) to customers in over 100 countries. As if that wasn't enough, over the last 132-years, Boart has acquired and developed more than 400 patents, with over 150 additional patent applications pending.

Boart generated US$683m in revenue (42% growth year-over-year) in the first nine months of 2021 and grew its EBITDA by 108% to US$93m. The company generated this revenue through its two divisions: global drilling services and global products.

The global drilling services division is the largest by both revenue and EBITDA, generating US$459m (37% growth) and US$74m (86% growth) in the first nine months of 2021, respectively. This division provides a wide range of drilling services to its global customer base, including diamond coring exploration, reverse circulation, large-diameter rotary, mine dewatering and pump services. Boart is experienced in mining most commodities, but especially copper, gold, nickel, zinc and uranium. The company also has experience in the energy sector.

Lastly, the global products division is responsible for developing Boart's intellectual property and the manufacturing and sale of drilling products and parts. In the first nine months of 2021, the division generated US$224m in revenue (52% growth) and US$51m in EBITDA (163% growth).

For those wondering why EBITDA growth was significantly higher than revenue for the period, Boart has recently undergone a massive restructuring and consolidation, which has led to massive cuts across the board. Therefore, we expect EBITDA growth to remain higher than revenue for the next few quarters.

Creditors on the side of Boart

In 2020 it became clear that Boart was in big trouble as it had a mountain of debt coming due and no clear way to pay it off. Fortunately, the company managed to convince its creditors not just to give the company more time, but to accept a swap of US$795m in debt for equity in a move that left Boart with less than US$200m in debt. Shareholders accepted this move in early 2021. After filling for United States Chapter 15 Bankruptcy to facilitate the debt for equity swap, the company relisted on the ASX at the beginning of October 2021.

Net debt as of 30 September 2021 was US$93m, which is quite serviceable for a company that generated US$14m in net cash in the first nine months of 2021. In other words, we believe it is safe to say the restructuring was a success and Boart is now out of the danger zone.

Time to drill into the new and improved Boart

Now that Boart's debt is finally under control, we believe the stock deserves investor attention again, especially since the company's creditors were so confident they took equity in exchange for their debt, a strong vote of confidence. The stock is currently trading at a 17.4x EV/EBITDA trailing 12-month multiple. We believe Boart is ready to take advantage of the start of a worldwide commodities supercycle that many are expecting, and combined with a likely continually expanded EBITDA margin makes this valuation undervaluing growth.

Investors have so far stayed away, with only a daily average volume of 10,000 shares traded in the last three months. We believe this has kept the share price down so far. With an eye towards FY22's year end results, we are giving Boart a four-star rating, but you will likely have to wait a bit before investors start paying attention again. So, be patient with this one.

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We all need healthcare

On 6 September 2021, Home Consortium divested its healthcare investments at $2.00 per share to form HealthCo Healthcare and Wellness REIT (Real Estate Investment Trust). At that time, the company had a Net Tangible Asset (NTA) value per share of $1.86 per share, based on 27 properties with a fair value of $555m. The portfolio was split between hospitals (generating 21% of annual income), aged care (7%) and childcare facilities (21%), government life sciences and research (15%), and primary care and wellness (27%) facilities (9% is classified as other). The portfolio is diversified across Queensland, Victoria, New South Wales and Western Australia. The portfolio's occupancy rate was 96%, with a Weighted Average Lease Expiry (WALE) of 9.4-years. In our view, these numbers place this REIT squarely in the high-quality category.

Acquisitions and dividend guidance

On 14 October 2021, HealthCo announced the acquisition of three additional assets for $200m in total. Once completed, HealthCo estimates that this will value the trust's portfolio value at $850m. The first of the three assets is not a single property, but rather the Metro Childcare portfolio with 13 new metropolitan childcare centres in New South Wales, Victoria and Western Australia. These centres have 100% occupancy and an unusually long WALE of 17.6 years. The acquisition is expected to settle in May 2022.

The second acquisition is a single property in Queensland, called Proxima, a health hub development situated in the existing Gold Coast Health and Knowledge precinct, commonly referred to as Lumina. The property is strategically located near the Gold Coast University Hospital, the Gold Coast Private Hospital and Griffith University campus. HealthCo already owned 50% of the property, but the $5m purchase increased ownership to 100%. The property is not yet fully developed and is forecasted to cost an additional $70m to complete, with a 5.65% expected annual yield. Despite not being complete, 61% is already pre-leased to Queensland Health, Griffith University and Sanctuary Early Learning, including a one year rental guarantee (post-completion) from the developer.

Lastly, HealthCo announced it was increasing its ownership in the George Private Hospital in New South Wales to 82%. The hospital's development started in September 2021 and is expected to be completed in the first half of 2023, costing an estimated $80m. The hospital is already 100% leased to Acurio Health Group on a 15-year triple net lease (the tenant or lessee agrees to pay all the expenses of the property, including taxes, maintenance, etc.).

HealthCo has announced its first distribution of $0.03 per share with an ex-dividend date of 30 December 2021 and a payment date of 25 February 2022. On 2 August 2021, management stated that HealthCo would be paying out a full year (FY22) distribution per unit of $0.074 and confirmed this guidance on 17 December 2021 when the 1HY22 distribution was announced.

Priced just right

Healthcare is undoubtedly in favour right now and we don't expect that to change anytime soon unless COVID-19 magically goes away. The sad truth is that most experts believe we have entered a period where worldwide pandemics will occur far more often than at any time in living memory. This is due to several factors that we won't go into right now. But the two main ones are climate change and increased regional instability. Therefore, we believe a premium is warranted when we value HealthCo, especially when considering the quality of the trust's property portfolio. The current (NTA) value per unit is approximately $2.06 after the recent $200m acquisition (portfolio fair value is $668m as of 14 October 2021), which places the trust squarely in fair value territory. Three stars.

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Best & Less Group has 245 stores in Australia and New Zealand (per 30 June 2021) that sell clothing and footwear for men, women and children. The New Zealand business operates under the Postie brand, rather than under the Best & Less brand due to Postie's 112-year-long history in the country. While the company sells products for men and women, it is focusing on expanding its share of the baby and kids apparel market. As Chairman Jason Murray said in the FY21 report, "our ambition is to be the number one choice for mums buying baby and kids' apparel at a value price point".

How FY21's results blew the prospectus forecasts out of the water

Best & Less IPO-ed on the ASX at 2.16 per share on 26 July 2021 and has since rallied hard to $4.04 per share on the back of FY21 smashing the company's prospectus forecasts. In FY21, Best & Less generated $663.2m in revenue and $71.6m in EBITDA, resulting in year-over-year growth rates of 6.1% and 165.2%, respectively. So, how exactly did the company "exceeded prospectus forecasts on all key metrics"?

We see it as a culmination of two main catalysts, the first being rather obvious. If the company generated 6.1% growth in revenue and 165.2% growth in EBITDA, the company's EBITDA margin must have shot up and it did, from 4.3% in FY20 to 10.8% in FY21. It is important to note that Best & Less managed to increase its EBITDA margin by only 0.3%-points in FY20. The reason the EBITDA margin jumped was due to the sustainable cuts to operating costs management has been making for a while now. We believe management will likely bring costs down further, but we don't expect the cuts to be anywhere near as significant as in FY21.

The second reason was management's successful transition towards online sales, growing them from 4.8% of total sales in FY19 to 7.3% in FY20, and an even more telling 9.2% in FY21. Management continues to be focused on the company's website and recently launched a mobile application. Despite the sizeable retail footprint, we believe online sales will continue to grow as a portion of total revenue. And since costs are generally lower with online sales due to less overhead, this will help our first point, the reduction in the cost of selling.

Lockdowns won't stop Best & Less

Best & Less' 165.2% EBITDA growth was incredible, but not a repeatable feat, in our view. The market agrees, and current consensus estimates have FY22 generate $88.3m (23.3% growth) in EBITDA on $647m in revenue. This results in an estimated 13.6% EBITDA margin. Despite the strong expected EBITDA growth in FY22, the market is only valuing the company at an FY22 EV/EBITDA multiple of 7.8x. Compared to other companies in Best & Less' space, growing the company's EBITDA margin from FY21's 10.8% is very doable. In fact, it is not unheard of for companies in this space to have EBITDA margins in excess of 20%. We certainly don't expect this to happen overnight, but at the current valuation, we believe there is plenty of upside in the shares. So, four stars from us.

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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