STOCKS DOWN UNDER

14 JANUARY 2022

Small Cap Stocks Down Under

"Do not be afraid; our fate cannot be taken from us; it is a gift."

- Dante Alighieri (1265 - 1321), Author of the Divine Comedy

NZME

Finally focusing on itself

DRA GLOBAL

Above average across the board

MMA OFFSHORE

Afloat and no longer taking on water

NZME

Finally focusing on itself

Stocks Down Under rating: ★★★

ASX: NZM
Market cap: A$243M
Dividend yield: 2.4% (85% Franked)

52-week range: A$0.65 / A$1.39
Share price: A$1.23

As the letters in its name will have suggested, NZME is based in Auckland, New Zealand. This company owns and operates numerous publications in its home country. The company uses print, radio and digital means to sell its content, although the digital operations are mostly the online form of legacy print media. NZME produces everything from news to entertainment and has a special focus on real estate, with 19 of its publications targeting that category. Print media is dying slowly, but can a company as diversified as NZME survive the onslaught?

READ MORE

DRA GLOBAL

Above average across the board

Stocks Down Under rating: ★★★★

ASX: DRA
Market cap: A$174M

52-week range: A$3.19 / A$4.69
Share price: A$3.21

DRA Global is a Perth-based engineering and operations management group. The company primarily operates as a solutions provider, engaging in concept development, engineering design, and project delivery. The most common projects relate to construction, with most of its clients hailing from the mining industry. DRA Global also provides maintenance, support, repair, and advisory services like most other diversified engineering companies. With a great track record of execution, its future is bright.

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MMA OFFSHORE

Afloat and no longer taking on water

Stocks Down Under rating: ★★★★

ASX: MRM
Market cap: A$144M

52-week range: A$0.285 / A$0.475
Share price: A$0.405

The Perth-based MMA Offshore provides a vast array of marine-related services. The main focus is on vessel services, subsea services and project logistics and the main customers are in the oil and gas industry. MMA has struggled to bring its operations into profit over the last few years. Management has a plan, but is it working?

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Share price chart

Source: Tradingview

Going local when the globe is going global

There is no reason for us to talk excessively about how print media and radio stations (along with television) are on their way out, as that is the conventionally accepted wisdom. When we analyse the legacy media business in modern times, we believe two conditions are necessary for survival. Either the company should be able large enough to still be profitable after losing a percentage of its business, or it should target a niche that the tech industry cannot (or will not) touch.

NZME is not a large company, despite having many brands under it. However, it does capitalise on the local news audience. The main brand under NZME's aegis is the New Zealand Herald, one of the country's largest newspapers by circulation and one of its most venerable. Numerous magazines are delivered at different frequencies underneath the New Zealand Herald, such as Be Well, Canvas and Viva.

There are numerous other publications too. Some, such as The Northern Advocate, deal with local news in specific regions of New Zealand. Others, like Essence, are focused on lifestyle, food, travel, and similar genres. As for real estate, NZME has numerous titles providing everything from listings to forecasts about the market.

NZME also has nine different radio stations. Seven of them provide music, with some covering various genres, whereas others focus on specifics such as classic rock or hip hop. Apart from the music stations, The Alternative Commentary Collective broadcasts ball-by-ball sports content, and Newstalk ZB focuses on news and talk radio.

When the government won't let you have what you want

After NZME listed on the ASX in 2016, the company's share price declined consistently from $0.89 per share in June 2017 to $0.16 per share in March 2020. However, the price has been on a sharp rise since then, and the stock is currently trading above $1.20. It is easy to ascertain why the price was falling - the terrible outlook for legacy media companies - but the recovery is a little harder to explain and involves the company protecting itself from digital threats by going digital itself. NZME has begun to offer much of its content in digital forms and also offers its radio stations through iHeartRadio, the online radio streaming service.

Another reason for the price decline pre-2020 was the company's continuous efforts to merge with Fairfax NZ, New Zealand's largest media company. The merger was declined in May 2017 by the New Zealand Commerce Commission (NZCC). The decision was appealed and rejected by the nation's High Court in December. Another appeal, this time to the Court of Appeal, was rejected in September 2018. After deciding not to appeal that decision, the company announced its plans to focus on debt reduction and fewer dividends. In November 2019, talks of a merger with Fairfax (now known as Stuff Media) were initiated once again, although they didn't lead anywhere. We suspect part of the 2020-21 rebound involves hopes NZME will ultimately be acquired by someone.

A three-year plan

In November 2020, NZME announced its three-year plan with a special focus on accelerating the switch to digital platforms and an expansion of audience. The company plans to expand the userbase of its radio stations, become the number one real estate platform through its OneRoof brand, and reduce its debt even further.

To achieve the goals outlined in its plan, the company has begun to offload certain brands. For example, GrabOne, an e-commerce platform, was sold to Global Marketplace New Zealand in August 2021 for NZ$17.5m.

While NZME has finally decided to focus on its core business rather than acquiring other ones, it is still trading at 13.7x its earnings. Consensus estimates forecast EBITDA increasing from NZ$53m in 2020 to NZ$65.9m in 2021, which means an EV/EBITDA multiple of 5.7x. Unfortunately, this growth is not forecasted to last, with 2022's EBITDA expected to decline slightly to NZ$65.2m (EV/EBITDA: 5.8x). More importantly, the company is expected to reduce its debt by the end of FY22 to a point where cash at hand can cover it.

Still, it is impossible not to note that NZME is in a declining industry and is doomed unless it manages to either go digital or achieve synergies through the right acquisitions or mergers. Total revenue is only forecasted to increase from NZ$311m in 2020 to only NZ$323.9m in 2022, showcasing how the fall of print media is inevitable.

NZME stopped offering a dividend at the end of FY18 but has restarted it this year. The total dividend in 2021 is expected to be NZ$0.06 per share, followed by an increase to NZ$0.07 per share in 2022. On 17 December 2021, management also announced a 12-month buyback program. The program would acquire up to 11% of shares outstanding on the ASX and NZX, costing up to NZ$30m. Considering the company's relatively healthy financial position but dire prospects, we think NZME is a three-star investment. It is valued fairly, but the yield is low and chances of significant growth are slim.

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Share price chart

Source: Tradingview

Diversified and experienced

DRA Global was initially founded in 1984 in South Africa, but the company moved its headquarters to Perth in 2018. For over three decades, DRA has provided various engineering solutions, slowly expanding its portfolio of services and the locations where it operates. The company now has a global presence, with a particular focus on mining and mining-related industries. However, it also serves the energy, water, and infrastructure industries.

DRA was a private company until July 2021, when it decided to list on both the ASX and the JSE in Johannesburg. By this time, the company had completed over 7,500 projects worldwide. In fact, the only region where the company's presence was minimal was Western Europe. The company had also been reporting strong financial results, with FY18 being the only year where the company showed a loss (owing primarily to increased operating costs during the year).

In total, the company only raised $11.7m in its IPO as it was primarily to provide investors with liquidity. Since DRA is profitable and the outlook from the management is positive ($600m worth of contracts were secured in 1H21), DRA plans to distribute between 30% and 60% of its Net Profit After Tax (NPAT) to shareholders.

Breaking down the divisions

DRA divides its portfolio of services into three broad categories, which it calls 'Originate', 'Deliver' and 'Optimise'. That doesn't sound like the sort of serious language engineers like to employ, but stick with us for a second.

DRA's 'Originate' team does engineering consultancy and concept design. However, the division also conducts feasibility studies, exploration, due diligence and regulatory research. Apart from this, the division has built up connections in numerous industries, and can leverage those connections to provide help with financing, deal structuring and grants.

The 'Deliver' team actually builds stuff, completing engineering designs and taking responsibility for contractual arrangements, procurement, logistics and project management. It's a truly international operation. So far, the company has designed and built mineral processing plants in 26 countries.

Lastly, there's the 'Optimise' team, whose talent is deployed once a plant is getting up and running and in need of quality assessment and control. This team does site maintenance (usually based on contractual employment), provides project execution models, and builds monitoring systems that help prevent malfunctions.

A solid foundation paves the way for progress

DRA's prospectus forecasted revenues in excess of $1.2bn in calendar 2021 (32% growth), with an EBITDA of $72.6m (11.9% growth). This is definitely feasible, as the company reported revenues of $570m in 1HY21 with an EBITDA of $38.6m.

Staying true to its promise to distribute most of its earnings, the company commenced a share buyback program in August, a mere month after its IPO. In total, the company planned to buyback 10% of its issued share capital. The plan was initially meant to conclude on 5 September, but the last purchase was at the end of December.

When it comes to valuing companies like DRA Global, competence, expertise, and experience are the main factors to be considered. DRA Global isn't short on all three, and its ability to win new business in 2021 is strong proof of concept.

Currently, the company is trading at a 2021 forecasted EV/EBITDA multiple of only a little over 1x. You read that right. Why so low? We guess because DRA is a new company that most investors don't know about yet. It is worth noting that liquidity is virtually non-existent at 5,300 daily shares traded on average over the last three months. We would consider the current valuation well below fair value before we even consider the significant dividend payments and other buyback programs. All-in-all, DRA is clearly an extremely strong four star stock.

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Share price chart

Source: Tradingview

Not exactly a mermaid

MMA Offshore was founded in 1989 as Mermaid Marine Australia. Over the last 33 years, the company has grown to encompass over 1,000 highly skilled employees, including everything from engineers to offshore construction specialists.

Since employees are not considered a financial asset, we have to consider MMA's most significant asset - its fleet of 25 vessels. These vessels are equipped to provide support for marine, renewable and subsea projects. If that was not impressive enough, the equipment on the vessels is inherently 'modular', meaning that the vessels can be altered slightly to provide a fit-for-purpose solution. While Australia and its surrounding oceans are a primary source of business for the company, operations stretch across the globe. As such, it anchors its vessels at geographically optimal locations to both cut costs and serve multiple markets. In cases where the company's fleet is inadequate or unavailable for a project, MMA charters third-party vessels.

As for the services provided by the vessels, MMA's fleet is capable of providing support for everything from drilling, construction, anchoring and towing, accommodation and repairs. If that was not enough for 25 vessels to be responsible for, MMA has a few more tasks for its fleet.

The vessels can also be hired for marine transportation, third-party onshore support, greenfield site support and 'critical subsea engineering services'. Critical subsea engineering services range from construction and maintenance to conducting geological surveys and ensuring project delivery.

Drowning in the currents of competition

In FY14, MMA Offshore reported a net profit of approximately $54m. However, depressed oil prices and lower demand for offshore services caused the company to experience a loss of $51m in FY15. That was the beginning of a long slide for MMA since the oil and gas industry was (and remains) by far the company's biggest source of clients. With the company providing tools that facilitate both exploration and production (mainly through construction support), global energy prices are always going to impact the company's business by a considerable amount.

The oil and gas markets continued to be challenging through FY16 and FY17, so there were significant losses in those years - $112m in FY16 and $354m in FY17, after impairment charges. While MMA's losses started due to a collapse in demand, the company was now also dealing with increasing competition. No wonder revenue fell from just under $800m in FY15 to just $221m in FY17.

With borrowings in excess of $300m at the end of FY17, the company was forced to dilute shareholders to recapitalise, placing $97m in new equity at $0.20 per share. Part of this $97m was used to optimise its fleet to focus on the higher-margin oil and gas operations. At the same time, management began to focus more on the subsea business to protect its operations from the oil and gas industry swings. As part of this reorganisation, in July 2019, the company acquired Neptune Marine Services for $18.5m. Neptune provides repair and maintenance services in Australia, Asia and the United Kingdom.

Attempting to swim ashore

While MMA has been citing the improving conditions of the offshore oil and gas industries in recent years, it has yet to see the big money return. After posting a loss of over $94m in FY20, MMA managed to produce a small Net Profit After Tax (NPAT) of $2.4m in FY21. Despite that return to profit, the company had to sell additional assets to stay afloat, including subleasing a significant portion of its Batam facility in Indonesia in May 2021.

MMA has continued working on reducing its debt levels. In September 2021, management achieved a $15m debt concession, similar to November 2020. This brings total debt down to approximately $158.6m with a debt/EBITDA multiple at 9.4x. The most consequential thing about the September debt concessions is that it is expected to reduce annual interest costs by $600,000. This brings FY21's manageable 3.5x EBITDA/interest expense multiple up to more like 3.7x. While MMA still has considerable debt, we believe FY21 was the first time in the last few years we could safely say it was 'manageable'.

The company is currently valued at 6x its FY21 EV/EBITDA. The market is forecasting EBITDA to decline 19.5% in FY22 to $29.7m due to COVID-19's resurgence. But this consensus estimate was made before the recent reduction in interest expense and before the company announced two new contract wins. We are therefore ready to believe FY22 has a potential upgrade in store. However, FY22 is already more than halfway over, and that means FY23 is more where the market will be looking. The current consensus estimates have EBITDA growing 34.7% year-over-year, to $40m. Based on these growth rates, MMA is valued at an FY22 and FY23 EV/EBITDA multiple of 7.5x and 5.6x, respectively. In our view, this places FY23's valuation at a steep discount, even if we ignore FY22 and compare FY21 to FY23.

MMA has come a long way since FY15 and still has a long way to go. While the waters are still a little choppy, we are, unlike the market, optimistic about this company's future. In our view the stock is heavily undervalued after FY21's strong performance, recent contract wins, and September's debt reduction. Four stars.

Pitt Street Research Pty Ltd

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