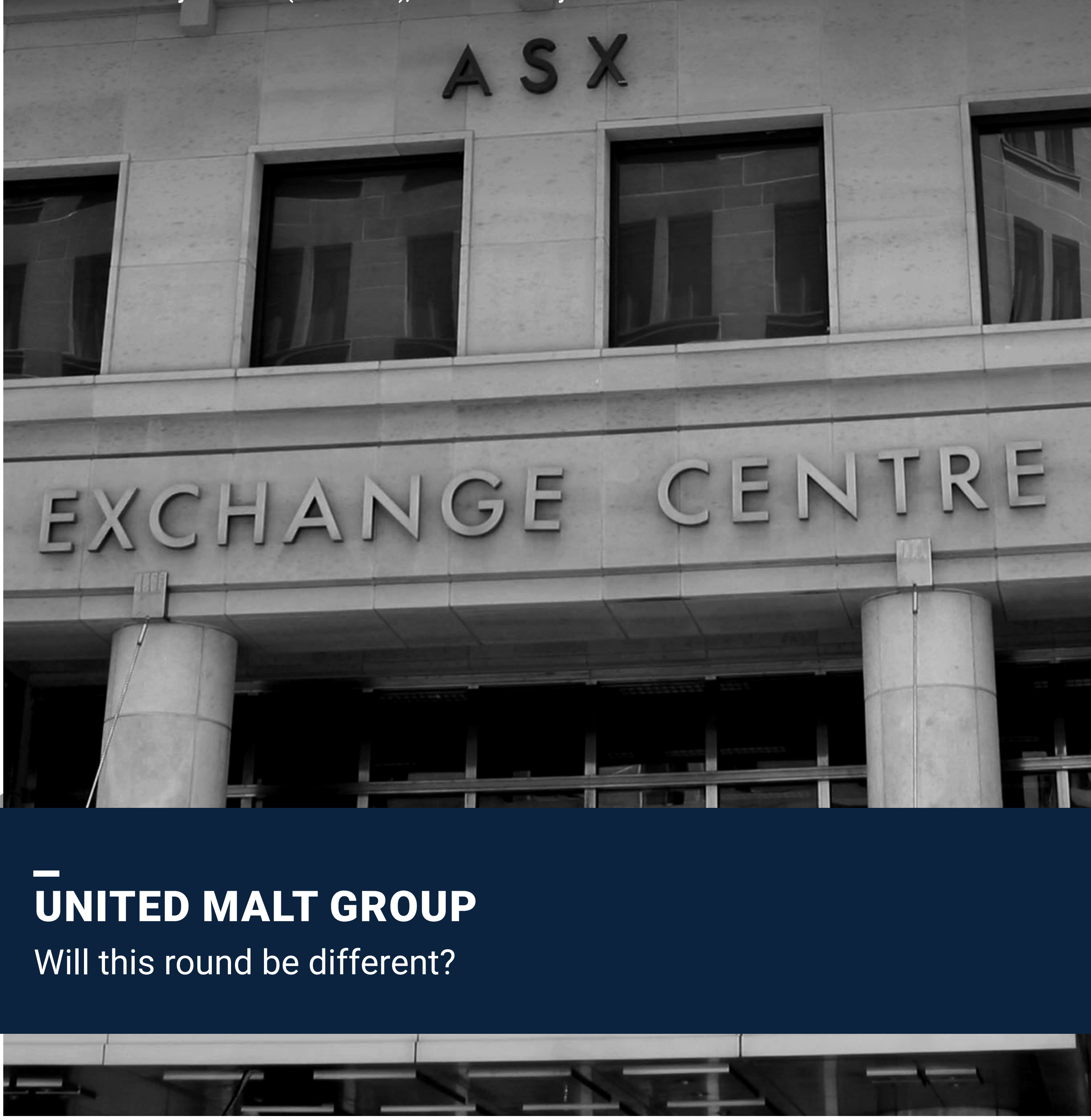
ASX Top 200 Stocks Down Under

"The successful investor must have patience to wait for the right moment, courage to buy or sell when the time arrives and liquid capital."

- Benjamin Roth (1894-1978), Author and lawyer



UNITED MALT GROUP

Will this round be different?

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Stocks Down Under rating: ★★★★

ASX: UMG
Market cap: A$1.2BN

52-week range: A$3.77 / A$4.76
Share price: A$3.87

It is now just over two years since March 2020, which saw the Corona Crash and spin out of United Malt Group (ASX: UMG) from GrainCorp (ASX: GNC). At first glance, grain may not seem like the most exciting industry, but that changes when you consider that this company provides ingredients to food and beverage companies – particularly beer brewers. UMG has suffered from the downturn in demand for craft beer. While we think the worst of the pandemic impacts are behind us and the company is well placed to perform when conditions normalise, we don't think conditions are 'back to normal' just yet.

Share price chart

Source: Tradingview

Malt makes beer brewing possible

Malt is a cereal grain where the grain is germinated and then dried. The malting process makes available certain sugars, principally maltose, that can then be fermented into beer. Beer is simply a mix of malt, hops, yeast and water. While beer is not the only use of malt – whisky, bagels and certain flavoured drinks are other examples - the world's third most popular drink accounts for over 90% of the world's malt and is indeed UMG's most important market.

UMG is the fourth biggest malt-maker after European giants Boortmalt, Malteries Soufflet and Malterop. It has 1.25Mtpa of capacity across 12 processing plants in Canada, the USA, Australia and the UK.

UMG has two segments: Processing, which processes locally crafted malt, and Warehouse/Distribution, which sells and distributes bagged malt and related products. The company has several competitive advantages, including having malting assets strategically located across barley growing regions and in close proximity to transport infrastructure, the ability to deliver ingredients to brewers on a 'just-in-time' basis and having a focus on craft beer, which is beer made by small independent brewers. The latter is important because craft beer uses malt more intensively than mainstream beer and because it is a rapidly growing market due to shifting consumer tastes. Craft beer is being embraced because of the perceived authenticity of individual brewers and the reputation of craft beers as a premium product.

COVID was tough, but it could have been worse

Thanks to COVID-19, UMG has not endured the easiest life on the ASX with restrictions on on-premises alcohol consumption – not just at pubs, but concerts and sports events too. Naturally, reduced demand for craft beer meant reduced demand for malt. Still, UMG's share price and financial performance could have been worse, especially compared to some of the ASX's pure-play craft beer brewers.

In FY20, UMG's revenue only fell 2% to $1.29bn and only by another 4% in FY21 to $1.24bn. Unfortunately, EBITDA fell 11% to $156.1m in FY20 and another 21% in FY21 to $123.3m. Its NPAT took a significant drop too – from $45.6m to $13.8m, including significant items.

You might've been forgiven for being disappointed about FY21, considering the rollout of the vaccine and how it had been viewed as the 'silver bullet' to end the pandemic and with it all disruptions. But the rollout didn't reach Australian shores in time to stop Delta lockdowns, while other factors were at play too. UMG blamed not just the lockdown-induced downturn, but costs of being a standalone entity, adverse forex effects and certain one-off items, such as the closure of Grantham and the project to replace the kiln at its Welshpool facility in Perth. Nonetheless, the company has continued to pay a dividend (5.5 cents a share in FY21) and cut its net debt by over $30m in the 6 months to 30 September 2021 – from $312.4m to $344.1m.

What does the future hold?

When releasing its FY21 results, UMG said sales volumes will approach FY19 levels, but it has also guided to a $8-$12m cost impact from supply chain issues. UMG's most recent update came at its AGM in February, in which the company noted supply chain disruptions and the Canadian drought were affecting it. One positive was unprecedented malt prices, although the company was unsure as to whether these prices would cancel out negative factors.

It has not given revenue or EBITDA guidance for FY22 (the 12 months to 30 September 2022), but UMG said the second half of FY22 and beyond looked positive so long as COVID-19 restrictions were not implemented again. Analyst consensus estimates for FY22 are $1.36bn in revenue and $154.8m in EBITDA respectively, which would be up 10% and 26% from FY21. Despite the projected growth, UMG is only trading at 9.6x EV/EBITDA and 20.4x P/E. Looking to FY23, UMG is forecast to generate $1.36bn in revenue – 6% higher than FY22 – and $190.2m in EBITDA – 22% higher than FY22. The multiples for FY23 are 7.8x EV/EBITDA and a 14.7x P/E. Then looking at our preferred EV/EBITDA-to-EBITDA-growth metric of 0.35 for FY23, we think UMD is quite attractively valued following the recent selloff.

We last covered UMG in mid-March last year. Shares have been through multiple cycles in that time but have recently retreated - currently trading at $3.87, down 9% in the last month. We think this company has a bright future when COVID-19 is behind us, and people can return to pubs, concerts and sports events without fear. Some of the capital expenditure that reduced earnings in FY21 will put it in good stead. Ultimately, it's four stars from us, but further potential COVID-induced turbulence should not come as a complete surprise.

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