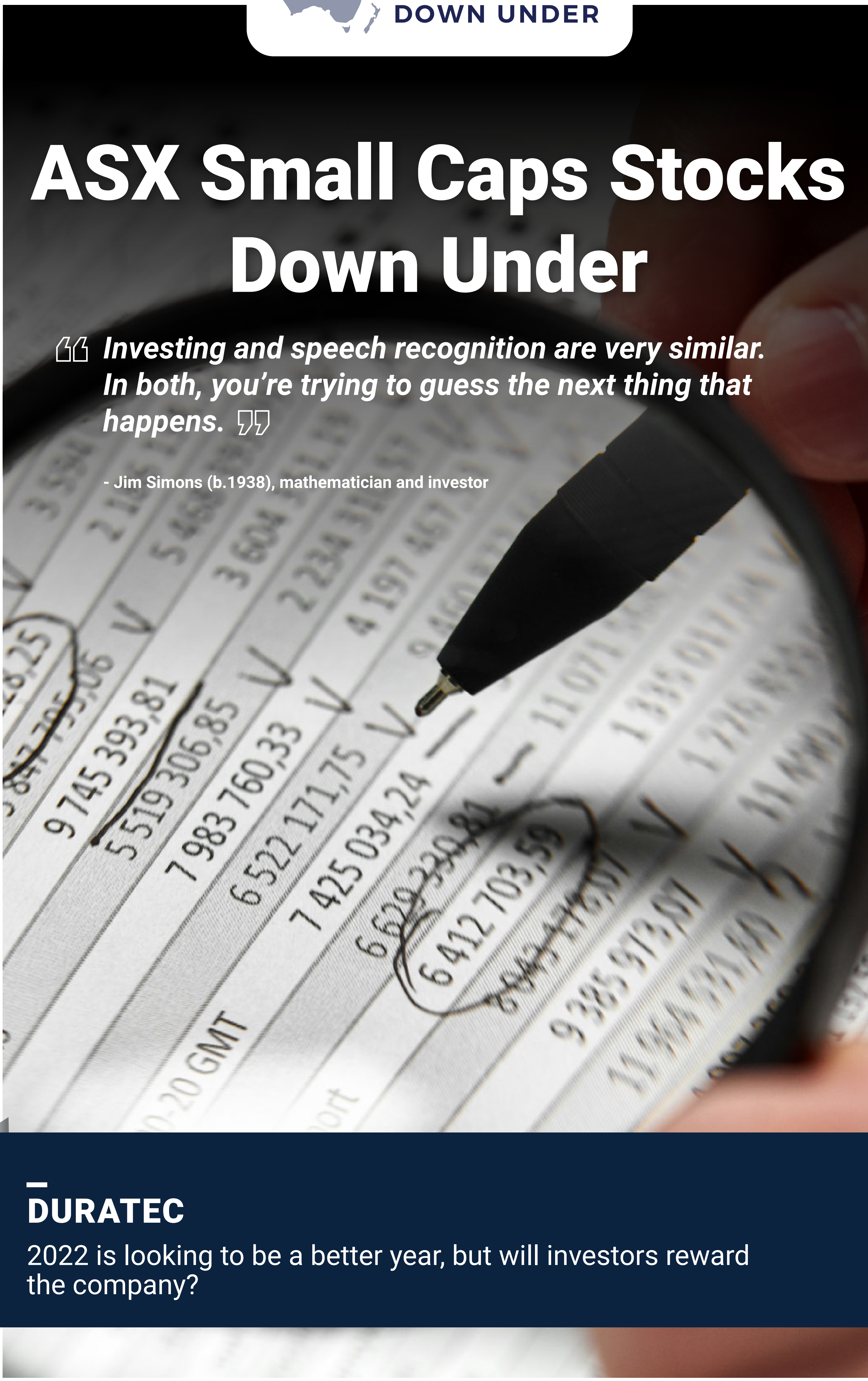
STOCKS DOWN UNDER

29 APRIL 2022



ASX Small Caps Stocks Down Under

> *Investing and speech recognition are very similar. In both, you're trying to guess the next thing that happens.*
>
> **- Jim Simons (b.1938), mathematician and investor**

DURATEC

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Stocks Down Under rating: ★★★★

ASX: DUR
Market cap: A$98.5M

52-week range: A$0.30 / A$0.53
Share price: A$0.42

The post-COVID infrastructure boom has been manifesting in Australia's GDP, but not so much in the ASX's construction and infrastructure stocks. Duratec is a company in this space, but instead of building new infrastructure, its work is aimed at protecting and extending the life of assets. Duratec has had some disappointing results, but its recent 1HY22 results showed it just might be turning a corner. With the share price at a premium, it appears investors are finally beginning to appreciate the strong earnings growth to come.

Share price chart

Source: Tradingview

Not just another infrastructure stock

Duratec is based in Western Australia and generates the majority of its business on that side of the Nullabor. It primarily repairs and maintains steel and concrete infrastructure, combatting issues such as corrosion and weathering. The failure of these kinds of infrastructures can cause significant problems, including costs of repair, inconvenience to users and in some cases even injuries and death to users. The Mascot Towers fiasco in 2019 is one such example.

Governments and companies have a fiduciary responsibility for their infrastructure to be safe as well as compliant with applicable building codes. Furthermore, it is also more efficient to repair or renovate infrastructure rather than demolish and rebuild, and this is Duratec's specialty.

The company services a number of industries in the private sector, including mining, energy, and utilities. But Duratec's biggest market by a wide margin is Australia's defence sector. An example of the work it does in defence is the HMAS Stirling Low-Level Bridge Repairs Project. This bridge was built in 1972 and required remediation of its reinforced concrete, structural steel and vehicle guard rails. Duratec undertook the works and now the asset is considered structurally sound until 2055. Duratec also has a joint venture business called DDR, which also provides infrastructure maintenance – it is majority Indigenous-owned and aims to provide employment opportunities for Indigenous Australians.

Many of Duratec's sectors are experiencing structural tailwinds beyond the general infrastructure boom and increased investments by governments and businesses. For example, the mining and energy sectors are benefiting from heightened commodity prices. And building codes continue to become stricter, leaving many of Duratec's clients scrambling to keep up. As of 5 January 2022, Duratec had an orderbook of $450.4m, tendered works of $550.9m and identified opportunities of $1.6bn. However, it has not had the easiest time as a listed company.

A tough start to listed life

Duratec listed in November 2020 at $0.50 per share and, as we noted the last time we covered Duratec, its results have been disappointing. In FY21, its revenue fell 4.7% to $235.7m and EBITDA fell 14.3% to $18.8m. Despite the infrastructure boom caused by COVID-19, the pandemic also caused delays and operating efficiencies, particularly in the Eastern Region. The investor shift from growth to value stocks also did not help this company's cause.

But Duratec has been trading better since its 1HY22 results, released on 1 March 2022. The company's revenue was $130.9m, up 5.5%, but its EBITDA (including DDR) fell 57% to $5.0m. Still, it is arguable the market was expecting a hit given COVID-19 construction slowdowns on the East Coast. More pleasingly, the company's work on hand position grew from $113m to $450.4m in a year and it won several major projects, including aviation fuel infrastructure at RAAF Base Tindal and Western Sydney Airport. The company promised its results would be skewed upwards by the second half and expects better results in FY23 without providing guidance.

Still, it paid an interim dividend of 0.5c a share and its 12-month trailing EV/EBITDA is only 7.1x, which is cheap. And since its results, there has been further positive news for Duratec. The company won a $13m contract to service defence infrastructure on six Sydney Harbour Federation Trust properties. Additionally, two of its directors have made on-market purchases of shares – Robert Harcourt bought over $32,000 and Christopher Oates bought ~$33,500 worth of Duratec shares.

FY22 results will be key

There's no question that Duratec is active in an industry with solid momentum right now. However, there are short-term logistical challenges, such as supply chain disruptions and wage pressures. The company says the worst is behind it, but only its FY22 results will tell.

We are encouraged by the company's continual investment in the face of adversity - growing its staff by 8% and increasing its geographical reach in 1HY22. Furthermore, it has remained cash flow positive and has been paying its shareholders dividends. Finally, from a technical perspective, Duratec is in an uptrend at the moment.

All things considered, we think Duratec is four stars. So long as the company delivers on its promises, the 2022 calendar year should turn out to be a better year for shareholders than 2021.

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