STOCKS DOWN UNDER

21 JUNE 2022

Emerging Stocks Down Under

"Fear incites human action far more urgently than does the weight of historical evidence."

- Jeremy Siegel (b. 1945), University of Pennsylvania finance professor

READYTECH

Still up from its IPO and a bright future ahead

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Stocks Down Under rating: ★★★★

ASX: RDY
Market cap: A$298.5

52-week range: A$2.10 / A$4.30
Share price: A$2.79

No investor wants anything to do with tech companies at the moment. Even the best of companies are being indiscriminately slammed in this market as investors fear rising interest rates and inflation. The ASX All Technology Index is down nearly 40% this year. But companies that are profitable are not faring as badly as the broader market and ReadyTech (ASX: RDY) is one of them.

Share price chart

Source: Tradingview

The Cloud transition is still early

We last covered ReadyTech in March 2021, giving it 4 stars when it was $1.70 and it is still well ahead of that, not to mention its IPO price of $1.50. The company is profitable, but more on that later. Its specialty is Cloud software, which is software delivered over the Internet as opposed to on-premise systems. You probably already know that companies are transitioning to the Cloud, unless you've spent the last few years on Planet Mars. This is because companies are looking to reduce costs, improve customer and employee experiences and enhance competitive advantages and differentiations.

But what you may not know is just how advanced the transition is. You'd be forgiven for thinking it is very advanced after the COVID lockdown-driven shift to remote working, but Goldman Sachs estimates it is only ~20% completed. It also estimates that revenues are US$235bn compared to enterprise IT revenues of US$1.4tn and that the Cloud could easily grab that and even more from non-digital spending.

Successful growth through the COVID years

It's a big opportunity, but where does ReadyTech fit in? It has a portfolio of Cloud software businesses, specialising in complex, underserved end markets. It has three segments – Education, Workforce and Government, and offers services including Customer Relationship Management (CRM), payroll, asset management and compliance. Each of these verticals face a lot of red tape and are adopting services, such as

ReadyTech, but it is still in an early stage of adoption. Councils spent roughly 1.5% of income on IT services, up from 1.0% in FY16, showing there is some way to go still. Even universities, which had their incomes dry up due to the lack of international students, are spending more than five years ago (2.0% versus 1.6%), but still have some room for growth. In making several acquisitions, ReadyTech has sought to become a 'one-stop shop', increasing the incentive for organisations to go with them rather than competing products.

Since listing in 2019, ReadyTech's share price has substantially risen, reaching an all-time high of $4.30. The company's financial statements have shown growth as well. In FY21, ReadyTech recorded $50m in revenue, $18.9m in EBITDA and $10.6m in NPAT, with all three figures more than 20% higher than FY20.

For FY22, ReadyTech is forecasting organic revenue growth in the mid-teens, so excluding the impact of acquisitions. Looking longer term, ReadyTech is targeting over $140m in revenue by FY26. Its 1HY22 results depicted it is on track for a solid full year result. It recorded a 63.7% jump in revenue to $35.7m, a 55.2% jump in EBITDA to $12.9m and an NPAT of $5.8m, up 336% from 1HY21.

Consensus estimates for FY23 predict $88.4m in revenue and $32.5m in EBITDA, both up 18% from consensus estimates for FY22. The stock is trading at very reasonable multiples for FY23, in our view, at just 9.2x EV/EBITDA and 19.5x P/E. Industry competitor and listed peer Technology One (ASX: TNE) is trading at 18.9x EV/EBITDA and 35.6x P/E despite having slower growth forecasted for FY23 – 12% growth in revenue and 15% in EBITDA. We also like that the company's CEO Marc Washbourne owns 4% of the company - a big stake in the company for a non-founding executive. All up, 45% of the company is owned by insiders.

Ready, Tech, Invest and Wait Long Term!

We'll cut to the chase straight away; we think this is a four-star stock even with the current challenges, which we will acknowledge. The current Tech Wreck is one of these difficulties, but arguably one of the least from an operational perspective. Other challenges include labour shortages, access to capital, competition from the tech giants and rising interest rates from an operational perspective. Obviously, higher interest rates decrease the value of future cash flows, but it will also increase the interest on debt finance. With equity market conditions as they are, it's a no brainer for companies to seek debt and for lenders to issue finance given higher interest rates, but it will be far more constraining to repay than in 2020-21.

We also think investors are pricing in a global recession in the next year and this will inevitably force a cutback in enterprise spending generally. Now, firms all need technology that works, so that will save existing customers - ReadyTech's churn rate is only ~3%. But you might argue that if ReadyTech's clients already use legacy software platforms (such as Oracle or SAP), inertia will get the better of them. In other words, they will not want to move to a new vendor simply because it is too hard. But we would rebut this argument with three points.

First, where there is value-add to be gained, firms will cough up the cash. Second, ReadyTech specifically targets underserved verticals that will continue to spend, particularly the government. And third, day to day share prices aside, profitable tech companies (in particular the global giants) have shown they can still grow their businesses (as distinct from share prices) in negative economic cycles and bearish equity markets. Technology One for instance still grew its revenue and profit in 2008 (by 41% and 17% respectively) when the GFC hit. In 2009, its profit dropped, but by less than 10% and it returned to growth in 2010. Its revenues continued to grow by over 10% in 2009 and 2010. Of course, this did not spare its share price falling by nearly a third between September 2008 and March 2009. But since then, its share price has gained over 1,000%, taking it to a $3.3bn ASX 200 stock. Its growth continued all the while, but it took the new bull market for investors to embrace the company.

Turning back to ReadyTech, we do think investors should hold off waiting for a clear support level to be established before getting into the company, e.g. around $2.50 or $2.30. Nevertheless, we think investors who want to hold the company for the long term will not be disappointed considering Cloud adoption in the segments it serves. And that is why we are still four stars on this one.

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