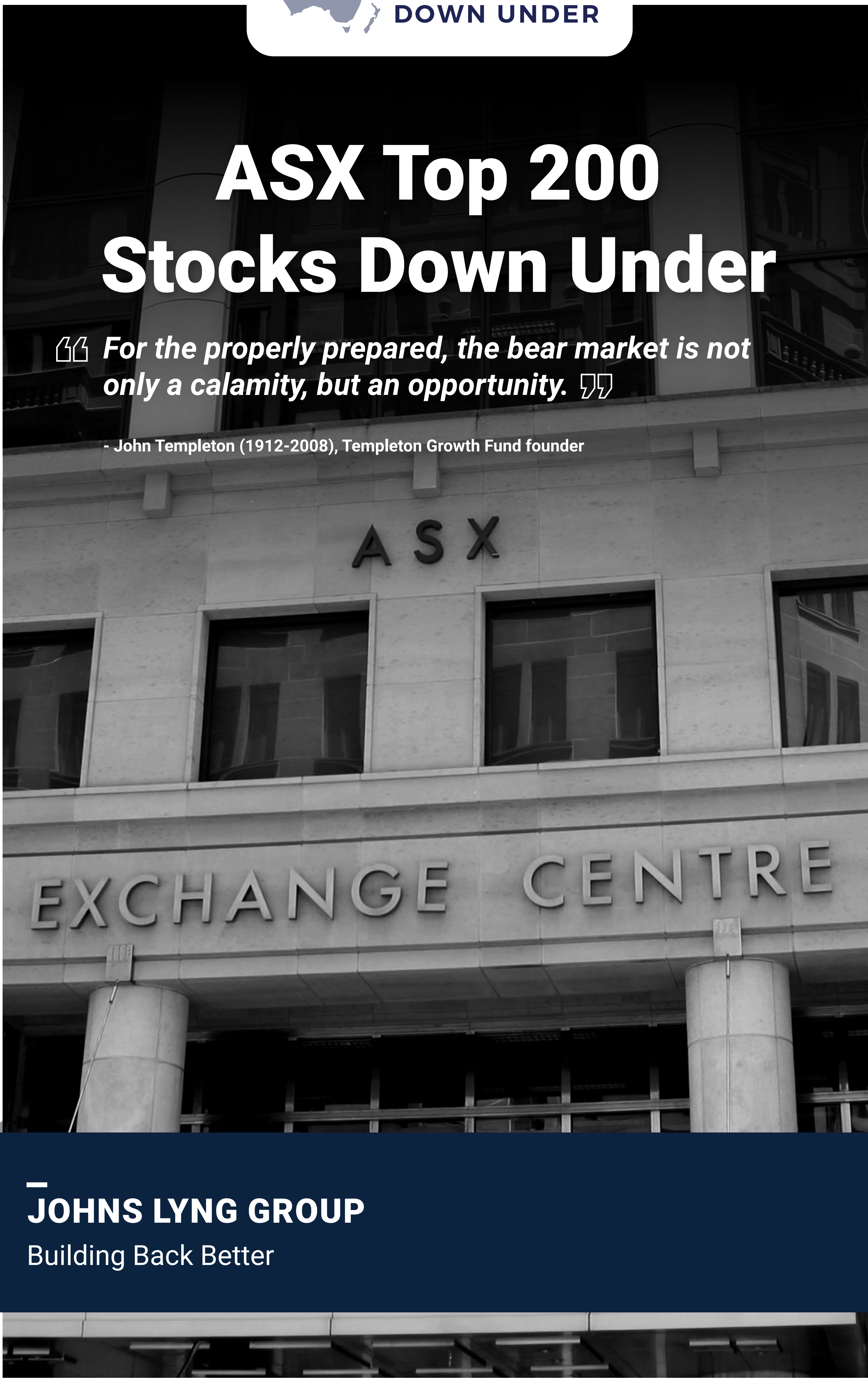
STOCKS DOWN UNDER

27 JUNE 2022

ASX Top 200 Stocks Down Under

"For the properly prepared, the bear market is not only a calamity, but an opportunity."

- John Templeton (1912-2008), Templeton Growth Fund founder



JOHNS LYNG GROUP

Building Back Better

JOHNS LYNG GROUP

Building Back Better

Stocks Down Under rating: ★★★★

ASX: JLG
Market cap: A$1.4BN

52-week range: A$4.51 / A$9.37
Share price: A$5.61

Johns Lyng Group is not just any ordinary ASX construction company. It is a restoration services company, repairing properties after damage by insured events, including weather and other impact incidents. We last covered it in September 2020 and even with the 2022 bear market it has still nearly doubled since then. It is also well up from its 2017 IPO price, which was only $1 per share. The catalyst has been increased repair works in the last 18 months that have helped its bottom line.

Share price chart

Source: Tradingview

A 21st century makeover

Johns Lyng Group was established in 1953 and for its first five decades was in the hands of the founding Lyng Family and was mostly a Victorian business. In 2003, current CEO Scott Didier bought it outright and has taken it to the next level. He has made it a national business and a public one, overhauled the culture and increased the business' turnover from $12m to more than $400m today. It has 17 companies across three operating divisions: Insurance Building & Restoration Services, Commercial Building Services and Commercial Construction. Beyond repair and restoration works, it provides hazardous waste removal, strata services, residential and commercial flooring, shop-fitting and emergency household repairs.

Johns Lyng has a long term track record of earnings growth, both as a private and public company. It has achieved a 25% revenue CAGR since 2004. In FY20, when the pandemic began, it generated revenue of $495.1m, EBITDA of $41m and an NPAT of $16.4m. In FY21, it made revenue of $568.4m, EBITDA of $52.8m and an NPAT of $20.7m - representing growth of 15%, 28% and 26% respectively.

Johns Lyng also has a history of under promising and overdelivering so far as its earnings are concerned and has done just that for its upcoming FY22 results. It had forecast $802.4m in revenue and $78.7m in EBITDA, up 41% and 49% from FY21, but earlier this month upgraded its guidance to $867m in revenue and $83m in EBITDA. The latter would represent 8% and 5.4% growth from previous guidance and, if replicated, 53% and 57% growth from its FY21 results.

A way to profit from climate change

The company has been able to increase its guidance because of an increase in catastrophe activity during FY22, including the NSW and Queensland floods in March, as well as increased demand for its business-as-usual services. If climate change continues, there's no doubt Johns Lyng will continue to see high demand for its catastrophe services in the future. However, ESG investors will hope that climate change policies will reduce these events.

Consensus estimates are expecting these events to continue, at least in the short term. For FY23, consensus estimates expect $1.04bn in revenue and $107.5m in EBITDA, up 20% and 30% respectively from the company's FY22 guidance. Johns Lyng has promised to provide guidance for FY23 upon release of its FY22 results. Reasonable growth is forecast for the years ahead: $1.14bn in revenue and $120.2m in EBITDA in FY24 (up 10% and 12% from the prior year), $1.3bn in revenue and $133m in EBITDA in FY25 (up 14% and 11%) and $1.39bn in revenue and $151.6m in EBITDA in FY26 (up 7% and 14%).

Johns Lyng's valuation multiples for FY23 are 12.8x EV/EBITDA and 27.3x P/E, respectively. While this valuation is higher than the ASX 200 average, we believe it is very attractive given the expected EBITDA growth rate in FY23 of 30%. You see, it implies a ratio of just 0.41 on our beloved EV/EBITDA-to-EBITDA-growth valuation-to-growth metric.

Possible headwinds, but they're only short term

What about inflation and supply chain issues? As of early June, the company has told shareholders it has not been materially impacted by either. But investors have every right to be wary considering the extent to which other companies have been hit and punished by shareholders. Of course, you have to distinguish between short term issues such as these and long term issues that threaten its market position. Pexa's (ASX: PXA) forthcoming loss of its monopoly is one such example of the latter – see our June 20 article for more insight – but if Johns Lyng got hit, this would be an example of the former.

Another negative thing investors should be aware of is that Scott Didier and COO Lindsay Barber recently sold 1 million shares each. The reason they gave was 'to manage their personal asset portfolios'. No financial advisor would advise against asset diversification, but selling shares is an implicit sign that directors don't think the company can go further (they would not be selling if they did). Of course, it's a different story when directors are forced to sell shares, such as to pay a tax bill or a divorce. The share sales occurred in mid-May and Didier and Barber sold at $6.25 and $6.65 a share respectively. They netted ~$13m all up, but had they waited until mid-June they would've received only ~$10m with the share price decline since then. Still, the pair retain healthy stakes of 20.6% and 5.0%, which is significant for non-founding executives.

Ultimately, we are giving Johns Lyng four stars and we would probably give it four stars even if it was being affected by supply chain issues. Given how long the business has been around, and its track record of delivery in all markets, what the business could achieve in spite of any such issues cannot be underestimated.

Still, we note the business has been in a downtrend given the current market conditions and has not yet found a clear support level. Consequently, investors may want to wait for one before buying in.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!