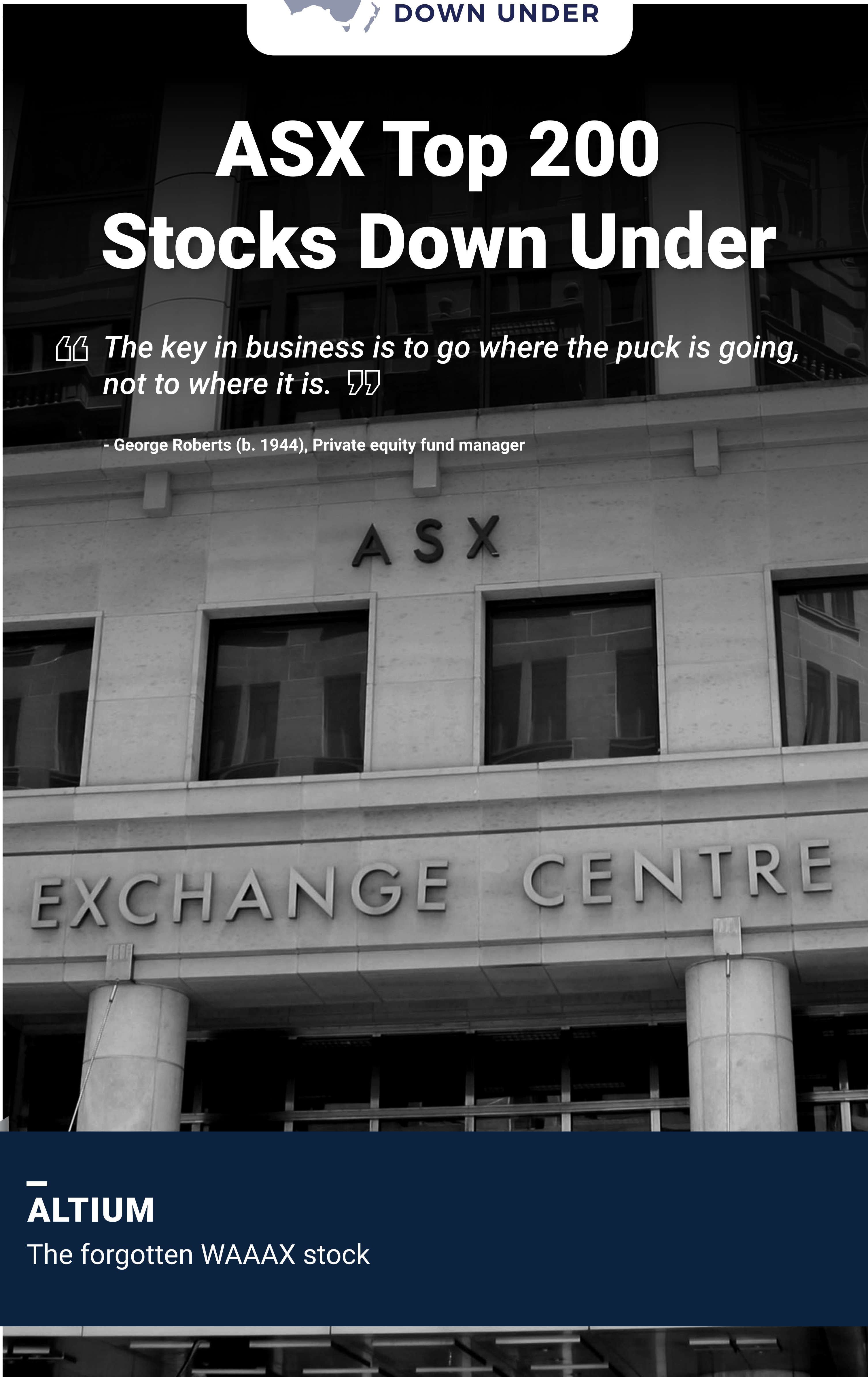
STOCKS DOWN UNDER

12 SEP 2022

ASX Top 200 Stocks Down Under

The key in business is to go where the puck is going, not to where it is.

- George Roberts (b. 1944), Private equity fund manager



ALTIUM

The forgotten WAAAX stock

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Stocks Down Under rating: ★★★★

ASX: ALU
Market cap: A$5.0BN

52-week range: A$24.32 / A$45.30
Share price: A$37.80

Remember the acronym WAAAX used by ASX investors for a few years before the Tech Crunch of 2022? Most would be familiar with four of the five companies making up the acronym - WiseTech, AfterPay (now Block), Appen and Xero - but we think fewer would be familiar with the fifth member, Altium. You see, Altium may have a longer history than the other four, having listed way back in 1999 - back then it could raise $30m at $2 per share. But in that history there have been some bad times that took the stock as low as 9c in 2011. Since 2011, however, it has been onwards and upwards, and Altium's latest results certainly made investors take notice.

Share price chart

Source: Tradingview

Building an ecosystem

Altium has three major assets. First, a software package called Altium Designer that helps engineers design printed circuit boards, a key component of electronic devices. Second, a design and a search engine for electrical components called Octopart that today is critical design component of the electrical supply chain but, if Altium has its way, will become the go-to ecosystem for global engineering. And third, a cloud platform called Altium 365 that connects all aspects of (and people involved in) the engineering process. With Altium 365 customers can quickly determine if designs can be manufactured and start the ball rolling faster than the status quo. Altium reckons 365 is where the Big Money is going to come from in the decade ahead.

Investors have been excited about Altium because of the rise in demand for electronics and the expectation of even better things ahead – self-driving cars, 5G communication, data science and IoT connectivity. During the pandemic, sales took a beating as projects dried up or deferred. But now the computer parts shortage, and the decoupling of the Chinese and American economies, is definitely playing into the company's favour.

Investors are taking notice

Altium shares are up over 20,000% since the lows of 2011 but are also up over 40% since the middle of May 2022. A significant proportion of this year's share price increase has come after the FY22 numbers, which arguably couldn't have been better. All of Altium's metrics were up including revenue by 23% (to US$220.8m), EBITDA by 33% (to US$79.8m), EBITDA margin by 2.9% (to 36.2%) and NPAT by 57% (to US55.5m). The company declared a 47cps dividend, up 18%, and recorded operating cash flow of US$72.5m, up 30%.

Altium credited Octopart, which saw 85% revenue growth, and Altium 365 adoption (monthly active users grew from 19,700 to 24,700 in a year) for its FY22 success. It has also helped that the company sales are more reliant on recurring subscription revenue rather than paying upfront.

For FY23, Altium issued guidance of US$255m-US$265m (15-20% growth) and an EBITDA margin of 35%-37%. This would be US$89.3m in a worst-case scenario (if the lower end of revenue and EBITDA margin guidance was achieved) or US$98.1m in a best-case scenario. The mid-point, US$93.7m in EBITDA, would represent 17.4% growth from FY22. Not bad, eh?

Consensus estimates for Altium forecast US$256.6m in revenue and US$92.8m in EBITDA, which is skewed towards the lower end of guidance. In FY24, consensus estimates forecast US$298.9m in revenue and $112.6m in EBITDA which would be 16% and 21% higher than FY23. Okay, Altium's multiples do suggest it is over-valued – at 32.9x EV/EBITDA, 50.9x P/E and 3.1x PE/G (typically a PE/G multiple over 1x suggests that a company is overvalued relative to the growth forecast). But we would note two things here. First, these are lower multiples than WiseTech (ASX: WTC) and Xero (ASX: XRO) - WiseTech is nearly at 80x P/E and Xero is still EPS negative. Admittedly, Altium's multiples are higher than Block and Appen which have both come down substantially in the last 12 months. Second, you could well argue that you get what you pay for – and we will here.

What we like about Altium

Altium's solid performance in FY22, and the tailwinds prevailing in FY23, are enough to earn the stock a four-star rating. There are three further things of note that are icing on the sentiment cake. First, as more and more users adopt the platform, there will be a network effect – more users will bring in more users and so on and so on. Second, CEO Aram Mirkazemi has 7.25% of the company, a significant proportion for an ASX 200 stock. We like companies with significant management skin in the game because there is increased incentive to perform in the long-term compared to discretionary bonuses. Third, the company has been a takeover target in the past: Autodesk made a bid at $38.50 a year ago but was rejected by Altium. And we wouldn't be surprised if Autodesk gave it a second look after its recent results. Or maybe even another suitor keen to grab a piece of the emerging electronics ecosystem.

There are some risks with Altium, the biggest of which is that it may miss its short-term guidance, or long-term targets, for whatever reason. This company has been brave enough to publicly target US$500m in revenue and 100,000 new subscribers by FY26, plus an EBITDA margin of 38-40%. No doubt, these goals are achievable, but the stock could be punished if it doesn't. After all, one of the key reasons why the FY22 result was embraced was because it exceeded the company's prior guidance and analyst expectations. But as long as economic conditions do not deteriorate (causing engineering projects to be delayed as they were in 2020), we have every reason to believe that the good times will roll on for Altium. Four stars.

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