STOCKS DOWN UNDER

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ASX Top 200 Stocks Down Under

If you set out to be liked, you will be prepared to compromise on anything, and would achieve nothing.

- Margaret Thatcher (1925-2012), Prime Minister of the UK (1979-1990)

APM HUMAN SERVICES

A growing cake with an ESG cherry on top

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Stocks Down Under rating: ★★★★

ASX: APM
Market cap: A$3.1B

52-week range: A$2.41 / A$3.55
Share price: A$3.38

Who said you couldn't make money doing good? APM Human Services provides human services, including matching of job seekers and employers, vocational education and workplace injury prevention. It is a business that generated more than $1.3bn in revenue and nearly $300m in earnings during the last financial year and is forecast by management and consensus analysts' estimates to grow in the mid-teens during FY23. So why aren't more investors taking notice?

Share price chart

Source: Tradingview

Serving the masses

APM's history goes back to 1994 when it was founded by Megan Wynne, who still chairs the company today, owning a stake of over 20% and becoming a billionaire in the IPO process. Under her leadership the company has grown to serve over 1.1 million people in 11 countries. During FY22, APM supported 639,466 job seekers, 111,493 people with mental health needs, 185,802 people with a disability to optimise independence, 40,000 ex-offenders with community integration and 25,807 defense personnel and veterans with their health and transition back to civilian life.

The company employs over 10,000 people, roughly 4,000 of which were able to become shareholders in the company through its listing. The IPO came late last year, raising $1bn at $3.55 per share.

Exceeding prospectus forecasts

For FY22 APM's prospectus tipped $1.30bn in revenue, $295m in EBITDA and a $155m net profit, all of which were more than 20% higher than FY21. But the company exceeded all these targets with $1.33bn in revenue, $308m EBITDA and a $166.3m NPAT. Its cash flow from operations was positive too by $281.9m, up 25% from the year before and 11% higher than its prospectus forecasts, and it closed out the year with a $171.4m cash balance.

The company is guiding to earnings growth in the 'mid-teens' in the medium term. Consensus estimates are more cautious, however, forecasting $349m in EBITDA in FY23 (up 13%), $383.33m in FY24 (up 10%) and $406m in FY25 (up 6%).

Revenue consensus estimates are on a similar trajectory, i.e. $1.6bn in FY23 (up 19%), $1.77bn in FY24 (up 11%) and $1.8bn in FY25 (up 4%). It's EV/EBITDA and P/E for FY23 look reasonable at 10x and 16.6x respectively, although its PEG multiple of 1.1x (assuming 15% long term growth) suggests it is slightly overvalued.

So why are investors skeptical?

Why has the market not been keen on this company? Well, most obviously, the market conditions have been less than ideal since listing. You could argue the fact that APM was spun out of private equity hasn't helped. Investors haven't been keen to touch private equity-led IPOs after several horror stories in recent years. Sure, APM could have performed better since listing, but it could have gone a lot worse too – just ask Adore Beauty (ASX: ABY).

Perhaps investors aren't keen on APM's industry given the scrutiny on the aged and disability care sectors. Or perhaps they think the company is too reliant on government contracts and fear if these are torn up, there goes the company. We accept there has been scrutiny on these sectors in recent years, but we consider it unlikely that the company will lose contracts. APM has long-term relationships with its customers and higher satisfaction relative to its peers – with a DES Star rating over 30% above the market average. For the record, DES stars are awarded by the government in recognition of performance. A significant number of contracts were up for review during FY22 and the bulk of them were renewed.

Maybe investors are just wary of companies that have relied significantly on M&A to grow. In relation to the latter, we observe that it has slowed down the pace of M&A since listing. There were media reports (in the AFR's Street Talk column) last month that it was going to buy competitor Angus Knight (for 'at least a few hundred million dollars'), but the company denied it. We note that 43% of APM's FY22 revenue growth came from acquisitions, while the remainder was organic. So, yes, the company is reliant on acquisitions, but it is clearly growing organically in its own right as well.

We're backing this one because the future looks bright

What will the catalysts be for the APM going forward? In its core operations, we think increased focus on people with disabilities and the aged will be the main drivers, especially since the Royal Commission. Additionally, health and wellbeing (both physically and mentally) will be important moving forward. While that is true of all companies in APM's industry, we think APM will derive most of the benefits as it maintains its industry-leading position. Remember that there are significant barriers to entry in the industry and APM boasts significant customer satisfaction. And we aren't worried about inflation too much given APM's contracts have period price reviews.

We also like the ESG element to this company from its core operations alone. Just re-read the second paragraph to see how many people it helps. APM says it is aligned with five of the UN 17 sustainable development goals. It is also one of the few companies to have a majority female senior leadership team, has assisted more than 1,600 Ukrainian refugees who have relocated to Australia since Russia's invasion and has a Reconciliation Action Plan that has been given the blessing of Reconciliation Australia.

We do concede that this may not be one to hold for 3 to 5 years if consensus estimates are right, as these suggest slow growth. But in the short term, there are few other companies set to grow earnings in the teens and having a positive societal impact in the process. Four stars from us.

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