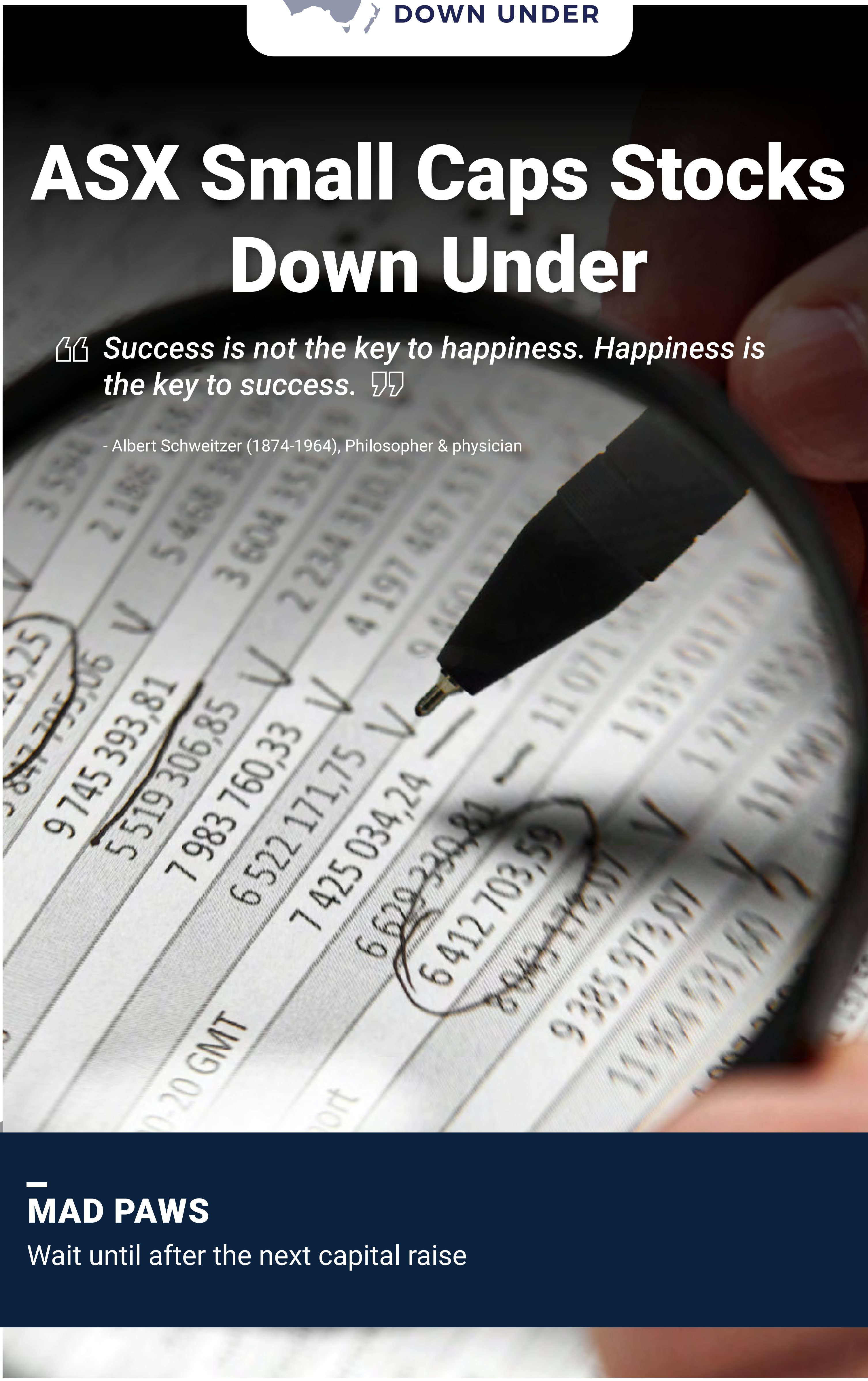
STOCKS DOWN UNDER

28 OCT 2022



ASX Small Caps Stocks Down Under

Success is not the key to happiness. Happiness is the key to success.

- Albert Schweitzer (1874-1964), Philosopher & physician

MAD PAWS

Wait until after the next capital raise

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Stocks Down Under rating: ★★

ASX: MPA
Market cap: A$36.8M

52-week range: A$0.12 / A$0.26
Share price: A$0.13

Just how can ASX investors gain exposure to the pet market? Mad Paws (ASX:MPA) claims to be one such company, offering various pet care services and products. The few pet care companies that have listed on the ASX have endured success, such as National Veterinary Clinics and Greencross, which were both acquired. Mad Paws hasn't had the same share price success though. Not yet, anyway.

Share price chart

Source: Tradingview

Covid meant MPA had to diversify

Mad Paws was founded in 2014 by Justus Hammer, Alexis Soulopoulos and Jan Pacas, all of whom remain with the company today. After previously raising money privately - headlined by a $5m investment from Qantas - it went public in March 2021. Shares were priced at 20c a share and the company was valued at ~$40m.

The business has historically specialised in pet sitting and dog walking, generating revenue from services and booking fees. But it has branched out its offerings over time. The pandemic meant that it had no choice, with everyone stuck at home not allowed to have visitors. Mad Paws now also offers pet insurance and a pet food subscription service, among other offerings. These all span across a pet's entire lifecycle, thereby increasing repeat customer rates and lowering customer acquisition costs.

Recession proof?

However, the COVID-19 pandemic has also increased the market for pet services generally due to the uptake in pet adoption. 62% of Australians now own at least one pet, 48% of which are dog owners and 37% are cat owners.

The company has estimated that the implied Total Addressable Market (TAM) is $30.3bn as more people adopt pets and spend more on them. And its vision is 'being the most trusted and convenient brand to rely on for all pet-related needs'. As of mid-October 2022, Mad Paws boasts 264,000 cumulative customers and there have been 558,000 cumulative bookings, a figure so far unaffected by the tougher economic times.

Financials don't look so good, when you take a deeper look

Consensus estimates for the current financial year, FY23, suggest $30.8m in revenue and-/-$4.2m in EBITDA, which would be a 201% revenue gain and a 49% improvement in EBITDA considering it generated $10m in revenue and -/-$8.21m in EBITDA in FY22. For FY24, consensus estimates call for $49.3m in revenues and +$4.5m in EBITDA. However, these were before the company's latest quarterly results, which came out 8 days ago.

The company boasted operating revenue of $5.4m, up 301% from the prior corresponding period and customer receipts of $10.2m. But it burned cash to the tune of $1.5m from operating activities and it now has just 2.3 quarters in cash left ($3.5m). It generated $10.4m in receipts from customers, but this was cancelled out by product manufacturing and operating costs ($8.3m) and staff costs ($2.1m).

On the positive side, the company expects to be EBITDA profitable by the middle of next calendar year, but there was no word as to NPAT profitability. We also observe that in FY22, it shed $6.5m in operating activities ($928k for Q4) and closed with ~6 quarters in cash left. In just three months, the quarterly cash outflow has grown by 64% (from $928k to $1.5m) in anticipation of the seasonal peak in activities, but the number of quarters of cash left has fallen to just 2.

It is highly likely that Mad Paws will need to raise capital before becoming EBITDA positive, which will further dilute shareholders. And given the current trading circumstances, brokers are having to offer larger discounts to the current market price in order to get their clients to buy into capital raisings.

We joined the company's conference call and management told us they thought revenue growth alone would mean it would reach profitability, arguing there was a steady cost base. There is indeed a consistent cost base, but it is not going in the direction implied. Product manufacturing and operating costs grew ~20% while receipts from customers grew by just 14%.

Too many red flags

Unfortunately, this company raises further red flags for us beyond its cash flow situation. One of these is 'hot trends' and how it plays out is best illustrated by Zoono (ASX: ZNO). Essentially shares surge due to FOMO (Fear of Missing Out) before eventually retreating as investor money jumps to the next short-term thing. Many trends, hand sanitisers for Zoono and pet ownership for Mad Paws, are indeed happening, but that doesn't mean that an ASX microcap will capture the bulk of the benefits (at least in the longer term).

The second red flag for us is when companies allude to large target markets. As we mentioned Mad Paws says its TAM is $30.3bn. It'd be one thing if it was alluding to specific pet care verticals, but to talk about all pet care spending is questionable. We're not questioning that there is a large TAM, after all there are 30.4m pets in Australia. Rather, it's questionable that it can capture a significant share of the total market, as opposed to a large share in certain segments of the market.

There are some ASX companies that have been sold off unfairly in 2022, but others were fairly sold off and we think Mad Paws falls into the latter category. Two stars, at least until the next capital raise is done and the company is closer to EBITDA profitability.

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