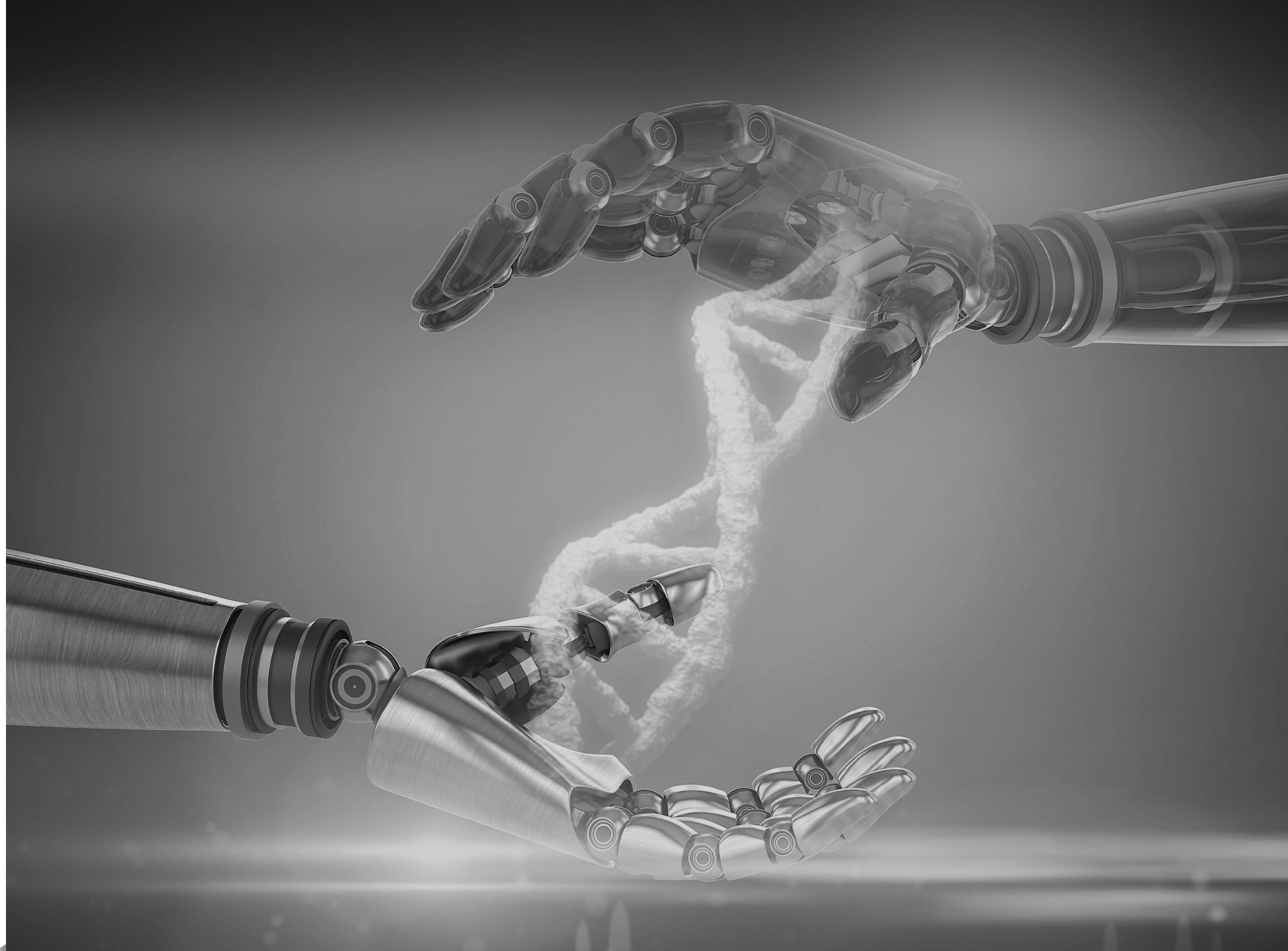
1 NOV 2022

Emerging Stocks Down Under

Every right implies a responsibility; every opportunity an obligation; and every possession, a duty.

- John D. Rockefeller (1839-1937), Business magnate & philanthropist



CIRRUS NETWORKS

The next IT services play to shine?

CIRRUS NETWORKS

The next IT services play to shine?

Stocks Down Under rating: ★★★★

ASX: CNW
Market cap: A$33.7M

52-week range: A$0.024 / A$0.037
Share price: A$0.034

The IT services space has been a good space to be in for ASX companies, primarily because companies are spending more and more on IT services - $37bn was spent in 2021 and this is expected to grow at a CAGR of 4.1% over 2021-25 to $43.5bn. Many ASX companies in this space and their shareholders have reaped the rewards. Atturra (ASX: ATA) has nearly doubled since its IPO last year, while Empired and DWS were taken over at hefty premiums. One company that has not had a good run is Cirrus Networks. Is its time coming, or are there legitimate reasons why it has lagged its peers?

Share price chart

Source: Tradingview

An IT services play with West Australian roots

Cirrus Networks began in 2012 in Western Australia and listed on the ASX in 2014 through a reverse takeover of flailing explorer Liberty Resources. It had plans for organic growth in WA and wanted to enter the East Coast through M&A activity.

Cirrus is a Managed Service Provider (MSP). MSPs such as Cirrus deliver IT services, like network, application, infrastructure and security, via ongoing and regular support and active administration on customers' premises in their own data centres or in third party data centres. Cirrus also provides advisory services and Cloud infrastructure. It partners with several companies to provide their IT infrastructure, including Amazon Web Services for Cloud Services as well as Cisco and Microsoft. Cirrus boasts an impressive list of clients in the public and private sectors, including the Commonwealth Bank, Crown, Newcrest Mining, Linfox and Fortescue Metals.

Like its peer Atturra, Cirrus is a Microsoft Gold Partner, a title granted by Microsoft that certifies that the partner has a close relationship with Microsoft and is committed to high levels of customer care. Cirrus is also one of only three companies in the ANZ region to be a Star partner of NetApp, which is a similar certification for Microsoft Gold but for NetApp.

Dragged down by COVID and post-COVID challenges

By any measure, Cirrus is in a better position than it was a decade ago, recording over $100m in revenue for two consecutive years now. But it has not been all smooth sailing. The company has been hit by supply chain delays and labour shortages. And last year, it undertook a company restructure, which led to the departure of long-term CEO Matt Sullivan.

Arguably the biggest challenge for the company was being a takeover target of Webcentral that made a 3.2c per share bid, worth $26m and made the argument that it could run Cirrus more profitably. Cirrus management was never in favour of the deal, arguing the deal was opportunistic and the bid undervalued the company. Still, it had to hold a vote on the issue (which shareholders rejected) but also had to resist attempts by Webcentral to overthrow the board. Even when Webcentral had conceded defeat, Cirrus had to endure Webcentral selling its accumulated stake in the company (which had reached 18.5% when everything was said and done). So, where does that leave Cirrus Networks now?

Growth is forecast for FY23, but how will this occur?

For FY23, the company has not given specific guidance, but has told shareholders the year began strongly and that there will be strong earnings growth, underpinned by the Icon Water Contract. This three-year deal with the ACT Government-owned water services provider was secured in April and is worth $15.5m.

Turning to consensus estimates for FY23, these call for $114m in revenue and $5.5m in EBITDA, up 10% and 166% from FY22. For FY24, consensus estimates predict $118.8m in revenue and $6.8m in EBITDA, which would be up 4% and 23% from FY23. The company's multiples look cheap, with EV/EBITDA at 4.4x and P/E at 8.5x. Shareholders might be skeptical that a company with flat earnings growth can suddenly jump to 166% growth. But you might be able to account for this growth with the Icon Water deal.

We've seen this situation before

It has only been a couple of weeks since we covered Infomedia (ASX: IFM), which was caught up in takeover talks that ultimately came to nothing. The difference with Infomedia was that it walked away before even putting the deal to a shareholder vote, opting to get on with business after weeks of being caught up in discussions. The similarity is that we wouldn't be surprised to see future bids and they will need to be at a hefty premium for management to entertain the offer. And it is not as if there's no precedent for M&A deals in the IT space.

On the other hand, we think that the business has turned a corner after a difficult period and has significant growth potential ahead of it, especially relative to the low multiples it is trading at. There is always a risk in trusting consensus estimates, especially when the earnings growth is 166%. But if it can continue to win new contracts, and spending on IT services continues to grow, we think it is not unrealistic at all. Four stars.

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!

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content is financial advice but is not (and cannot be construed or relied upon as) personal financial advice. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Please make sure that investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of unpredictable market and economic factors.

Stocks Down Under/Pitt Street Research directors and staff may own shares in the companies mentioned in our articles, videos, reports and analyses.