Research as a Service

Stealth Global Holdings Ltd

1H FY20 Results Commentary

Primed for operating leverage

Distribution – Wholesale

20th March 2020

Stealth Global Holdings Limited (ASX:SGI) has reported ~15% sales growth in its core Australian operations over 1H20, well above incumbents as it continues to focus on service and participate in national contracts for the first time. Other sales trends were as expected with the BSA (Bisley) JV in the UK building momentum and African sales declining as SGI exits this low margin business. On the earnings front, our key takeaway is that SGI is primed for operating leverage from core sales growth. Our understanding post 1H is that the group's in-stock position and the relatively unaffected mine/infrastructure sites around the country have had minimal impact on trading to-date. Similarly in a statement released 19 March, Wesfarmers highlighted that its Industrial & Safety division was "experiencing strong demand for critical projects including essential protective clothing, cleaning and hygiene products and medical gases, offset by some weakness due to disruption to customers' normal operations". At the current share price SGI is trading at a forecast 10% EV/sales in FY20, a 50%-90% discount to our designated distribution peer group. SGI is in the early stages of consolidation, gaining market share in its core business and expanding into new markets with a relatively low-risk business model. Taking current equity risk premiums into account, our DCF is now $0.27/share, implying significant upside from current share price levels.

Business model

Stealth Global Holdings is a business to business distributor of a wide range of industrial, safety and workplace consumable products. In addition to traditional wholesale supply and wide range distribution, Stealth seeks to establish preferred and/or exclusive sales arrangements with suppliers and/or customers, establishing a key point of differentiation with peers. Such arrangements target new markets (such as the Bisley Workwear JV in the UK) or own label (such as the Protect a Load acquisition). Resulting volumes offer a virtuous circle of scale, operational efficiency and margin growth.

Key take outs from the 1H20 result & future implications

Australian sales on a pro-forma basis increased 15% in 1H20 to $30.9m, well above market leader Wesfarmers (-2%) as the group continues to win market share on service and participation in new markets outside WA. African sales declined as the group prepares to exit this low margin business, while BSA sales contributed for the first time. Gross margins were as forecast at 25.4%, with Australia well above this (estimated at 29%) and Africa well below (estimated between 9% and 10%). It is no wonder this business is being exited and will result in higher reported margins for the group going forward. SGI's focus on being "in-stock" in a market fearful of supply disruptions and the relatively unaffected nature of mining/infrastructure projects to-date places the group in a good position to trade through current market turmoil.

Base case valuation A$0.27/share fully diluted

Our base case DCF valuation for SGI has been lowered to $0.27/share (previously $0.34/share) predominately on the back of a higher equity risk premium, with earnings estimates outside of Africa relatively unchanged medium-term. As a sense check this implies an FY21 PER of 11x, at the top-end of peers but by no means excessive should operational leverage be demonstrated.

Historical earnings and RaaS Advisory estimates

Year end	Revenue(A$m)	EBITDA* (A$m)	NPAT reported (A$m)	EPS Adj (c)	PER adj (x)	EV/REV (x)
Jun-19a	62.8	2.1	0.5	0.01	nm	0.08
Jun-20e	75.4	1.2	(0.2)	0.01	8.8	0.10
Jun-21e	85.5	4.0	2.3	0.02	2.5	0.06
Jun-22e	96.1	7.0	4.0	0.04	1.4	0.03

Source: Company Data, RaaS Advisory Estimates *RaaS includes transactional costs in EBITDA calc.

Share details

ASX Code	SGI
Share price	$0.06
Market Capitalisation	$5.7M
Shares on issue	94.9M
Enterprise value	$7.8M
Net Debt 31 Dec	$2.1M
Free float	~60%

Share performance (12 months)

Upside Case

- Service based model takes market share from incumbent players
- With size comes improved gross margins from buying and mix opportunities.
- The opportunity to participate in national supply contracts for the first time

Downside Case

- Acquisitions fail to deliver expected revenues and/or synergies/efficiencies
- Larger competitors react with sharper price offerings
- Largest customer and/or suppliers go direct

Board of Directors

Christopher Wharton	Non-Executive Chair
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1H FY20 result in detail

SGI's results remain messy to analyse with Heatley's only owned for 3-months in the PCP, additional senior management (costs) added over the period, AASB16 implementation and a number of unusual items called out for the half.

From a sales perspective the story is simple:

- The group continues to take share from incumbents in Australia, with sales growing ~15% on a pro-forma basis over the half. Wesfarmers Industrial sales declined 2% while key customers such as DOW (1H20 sales +2.9%) and MND (1H20 sales -2.6%) have experienced subdued conditions despite strong order books.
- African sales declined ~12% as the group readies to exit this low & declining margin business.
- BSA sales are in their infancy and contributed ~$800k over the half following initial pipe filling during 2H19. The BSA offering is now said to be in 64 stores across the UK.

Exhibit 1: 1H20 sales analysis - statutory & pro-forma

Region	1H19	1H20	Comment
Revenue - Statutory	24.50	39.67	
Australia	15.50	30.94	Heatley's for only 3-months in 1H19
Africa	9.00	7.93	-12% as company exits low margin work
BSA	0.00	0.79	Into 64 stores
Revenue - Pro-forma	36.00	39.67	
Australia	27.00	30.94	+15%, mostly organic growth
Africa	9.00	7.93	
BSA	0.00	0.79	

Sources: Company financials & RaaS estimates

EBITDA analysis

Excluding the impact of AASB16, we calculate underlying EBITDA of $728k in 1H20 (RaaS estimate $0.9m), or ~$1.2m if initial losses from the BSA JV are excluded. This number excludes transaction costs of $208k and BSA investment costs of $365k but includes investment into new staff ($370k) which we see as ongoing albeit in advance of new business. Note that we include the transaction costs of $208k in our estimate of underlying EBITDA for H1 FY20 of $0.52m in our forecast for FY20 EBITDA of $1.2m.

While not disclosed, we estimate an improvement in the Australian business after all costs (management has cited operating margins before corporate costs increasing from 4.6% to 6.9%), a decline in African earnings (lower gross margin and loss of sales leverage) and BSA JV losses of A$440k (100% consolidated).

We are not stressing about the minutia of EBITDA this half in the knowledge that Australian operational leverage and BSA profitability are forecast just around the corner, while Africa is set to become an insignificant impact on the business into FY21 given the current low level of margin in that business.

A reconciliation of EBITDA depending on what is included and excluded is presented on the following page for completeness.

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Exhibit 2: 1H20 EBITDA reconciliation

Line item	$mil	Comment
Reported EBITDA	1.75	Non-IFRS
LESS		
Actual Rent paid	0.58	Now a charge in Depreciation as per AASB16
Investment in Staff	0.37	Not seen as one-off but required for growth
Adjusted EBITDA	**0.80**	
LESS		
Transaction costs	0.21	Acquisition that did not eventuate during the half
BSA JV investment	0.37	One-off in nature
Other	0.08	
REPORTED EBITDA	0.15	On an Ex-AASB16 basis
ADD Rent Paid	0.58	
Statutory EBITDA	**0.73**	**Under AASB16 and as reported**

Sources: Company financials & RaaS estimates

Outlook

We believe it is only a matter of time before we see operating leverage in this business as the core Australian business continues to grow and BSA moves to profitability. Key drivers behind our existing assumptions are listed below:

- **Australia**. Sales growth will continue to be driven by market share gains as national accounts are accessed for the first time following the addition of the ISG group overlaid with the groups continued service focus.

  Part of the service offering of the group is being in stock at all times where possible which should help the business in current markets as customers are wary of supply shortages. Much like supermarket shelves, customers are also looking for bigger orders less often to mine sites.

  To-date mine sites and infrastructure projects appear relatively unaffected by tightening social distancing regulations, which should cushion downside near-term.

  Complementary private labels (including First Aid and the Protect a load acquisition) will not only boost differentiation but also margin medium-term. We have double digit sales growth into FY21, slowing to high single digit medium-term.

  Stealth represents only ~4.5% of Wesfarmers Industrial & Safety division sales in FY20, offering significant opportunities medium-term.

  We expect higher earnings driven by sales leverage to operating costs, which are expected to stabilise with key human resources already in place to deliver this growth.

- **Africa**. Sales are expected to decline sharply over the next 12-months as the contract with Capital Drilling in Africa moves to a transactional basis. It is difficult to gauge what level of transactional business will take place, but any sales are expected at a much higher margin than the current 9%-10% GP. Operating costs are expected to be adjusted accordingly, resulting in minimal (but negative) impact to EBITDA.
- **BSA.** From 64 stores at present we estimate representation in 120 stores by FY21 and 200 longer-term. A full-year's impact of such exposure is expected to see sales of A$10m by FY21.
- **Other.** No material adjustments are expected in 2H20 or FY21, and no additional acquisitions are forecast.
- **NPAT** will be subdued in FY20 but we expect operational leverage to appear in FY21 on the back of Australian growth and reduced BSA losses/early profit.

Peer comparison

We consider listed peers for SGI to be:

- Distribution businesses with a mix of brands and private label;
- Small/micro-cap in size;
- Gross margins in the 20%-40% range;
- Dealing with much larger companies as a rule in a competitive environment.

Our selected ASX listed peers are:

Paragon Care Limited (ASX:PGC), is a supplier of a wide range of healthcare equipment and consumables to hospitals and aged care facilities. The group has grown by acquisition and is currently consolidating this position.

Cellnet (ASX:CLT), is a distributor of a range of branded accessories for mobile phones across Australia and New Zealand.

Coventry Group (ASX:CYG), supplies a range of fastening systems, cabinet hardware systems, fluid hydraulics, lubrications, refuelling systems and other products across a range of channels. The group has three distinct businesses, Cooper Fluid Systems, Nubco and Trade Distribution.

Supply Networks (ASX:SNL) operates under the Multispares brand, and supplies truck and bus parts across Australia (~90% of revenue) and New Zealand, with a focus on "quality" components and service.

Most of the peers selected have encountered significant trading issues in recent years and combined with the recent share market correction we do not see comparisons outside of SNL as being onerous or unrealistic.

SGI continues to trade at a 50%-90% discount to peers on an EV/sales basis (10% vs 21% for Cellnet, 28% for Coventry and 51% for Paragon). In general SGI's working capital/sales is superior to the peer group, GP% near the mid-point and Debt/EBITDA below average.

Exhibit 3: Peer financial comparison

Company Name	Ticker	Share price (cps)	Mkt Cap ($m)	FY20 sales ($m)	FY20 NPAT ($m)	Net debt ($m)	FY19 PER (x)	1H20 GP%	1H20 WC/sales	EV/sales
Supply Networks	SNL	3.50	143	135	9.5	10	15.2	41.7%	30%	113%
Paragon Healthcare	PGC	0.14	45	245	15.1	80	3.0	38.0%	22%	51%
Coventry Group	CYG	0.72	64	253	9.7	6	6.6	38.5%	23%	28%
Cellnet	CLT	0.14	9	108	0.4	14	21.6	19.9%	25%	21%
Stealth Global	SGI	0.06	6	75	0.8	2	6.7	26.5%	9%	10%

Sources: Company financials, Thomson Reuters

DCF Valuation

Our base case DCF valuation is now $0.27/share, down from $0.34/share due to a higher equity risk premium (to 7% from 6.5%) and lower sales & margin assumptions for the African business. Key assumptions regarding BSA and Australian profitability remain relatively unchanged.

$0.27/share implies a PER on our FY21 EPS (the first forecast year of a positive BSA contribution) of 11x, which feels about right relative to current peer comparison, forecast risk and market cap.

Exhibit 4: Base case DCF valuation

Parameters	
Discount Rate / WACC	11.5%
Terminal growth rate assumption (inflation adjusted)	2.0%
In A$m	
Present value of cashflows	11.0
Present value of terminal value	14.7
PV of enterprise	25.7
Net value ($m)	25.5
Net value per share	$0.27

Source: RaaS estimates

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Exhibit 5: Financial Summary

Stealth Global (SGI.AX)					
Profit and Loss (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20F**	**FY21F**	**FY22F**
Revenue	23.1	62.8	75.4	85.5	96.1
Gross profit	4.3	15.3	20.0	24.3	27.8
GP margin %	18.8%	24.4%	26.5%	28.4%	29.0%
Underlying EBITDA	(0.4)	2.1	1.2	4.0	7.0
Depn	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)
Amort	0.0	0.0	0.0	0.0	0.0
EBIT	(0.5)	1.9	1.0	3.7	6.7
Interest	(0.0)	(0.1)	(0.3)	(0.2)	(0.1)
Tax	0.0	(0.2)	(0.2)	(1.0)	(1.7)
Minorities	0.0	0.1	0.2	(0.3)	(0.9)
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0
NPAT pre significant items	(0.5)	1.7	0.6	2.3	4.0
Significant items	0.0	(1.2)	(0.9)	0.0	0.0
NPAT (reported)	**(0.5)**	**0.5**	**(0.2)**	**2.3**	**4.0**
Cash flow (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20F**	**FY21F**	**FY22F**
EBITDA (inc minority adj)	(0.4)	1.0	1.4	3.7	6.1
Interest	(0.0)	(0.1)	(0.3)	(0.2)	(0.1)
Tax	(0.2)	(0.6)	(0.3)	(0.6)	(1.3)
Working capital changes	1.6	(0.6)	(1.1)	(0.4)	(0.9)
Operating cash flow	1.0	(0.3)	(0.3)	2.5	3.8
Mtce capex	(0.1)	(0.3)	(0.4)	(0.4)	(0.5)
Free cash flow	0.9	(0.6)	(0.7)	2.0	3.3
Growth capex	0.0	0.0	0.0	0.0	0.0
Acquisitions/Disposals	(0.3)	(7.8)	(0.8)	(0.3)	0.0
Other	0.0	0.1	(0.4)	0.0	0.0
Cash flow pre financing	0.6	(8.4)	(1.8)	1.8	3.3
Equity	(0.1)	11.4	0.0	0.0	0.0
Debt	(0.4)	(1.3)	0.0	0.0	0.0
Net Dividends paid	0.0	0.0	0.0	0.0	(1.1)
Net cash flow for year	0.1	1.7	(1.8)	1.8	2.1
Balance sheet (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20F**	**FY21F**	**FY22F**
Cash	0.3	2.0	0.2	2.0	4.1
Accounts receivable	3.8	15.9	16.1	18.2	20.5
Inventory	0.3	6.3	7.3	7.8	8.8
Other current assets	0.1	0.6	0.6	0.6	0.6
Total current assets	*4.5*	*24.7*	*24.1*	*28.6*	*33.9*
PPE	0.2	0.6	0.8	0.9	1.1
Goodwill	0.5	6.9	7.1	7.1	7.1
Investments	0.0	0.0	0.4	0.4	0.4
Deferred tax asset	0.3	1.1	1.1	1.1	1.1
Other non current assets	0.3	0.0	0.3	0.3	0.0
Total non current assets	*1.2*	*8.6*	*9.7*	*9.9*	*9.8*
Total Assets	5.7	33.3	33.9	38.5	43.7
Accounts payable	5.6	16.3	16.5	18.7	21.0
Short term debt	0.6	1.8	1.8	1.6	1.6
Tax payable	0.0	0.0	0.0	0.0	0.0
Other	0.1	1.0	1.0	1.0	1.0
Total current liabilities	*6.2*	*19.2*	*19.3*	*21.3*	*23.6*
Long term debt	0.0	0.3	0.0	0.0	0.0
Other non current liabs	0.0	0.9	2.0	2.0	1.2
Total long term liabilities	*0.0*	*1.2*	*2.0*	*2.0*	*1.2*
Total Liabilities	6.2	20.4	21.3	23.4	24.8
Net Assets	**(0.6)**	**12.9**	**12.5**	**15.2**	**18.9**
Share capital	0.1	13.0	13.0	13.0	13.0
Accumulated profits/losses	(0.7)	(0.2)	(0.4)	1.8	4.7
Reserves	0.1	0.3	0.3	0.3	0.3
Minorities	0.0	(0.1)	(0.3)	0.0	0.9
Total Shareholder funds	**(0.6)**	**12.9**	**12.5**	**15.2**	**18.9**

Share price (18 March 2020)					A$	0.060
Interim (A$m)	**H118**	**H218**	**H119**	**H219**	**H120**	**H220F**
Revenue	na	na	24.3	38.5	39.7	35.7
EBITDA	na	na	0.9	1.2	0.5	0.7
EBIT	na	na	0.8	1.1	0.4	0.6
NPAT (normalised)	na	na	0.6	1.1	(0.1)	0.3
Minorities	na	na	(0.1)	0.2	0.2	0.0
NPAT (reported)	na	na	0.4	0.1	(0.9)	0.3
EPS (normalised)	na	na	na	0.002	(0.010)	0.003
EPS (reported)	na	na	na	0.002	(0.010)	0.003
Dividend (cps)	na	na	0.000	0.000	0.000	0.000
Imputation				30.0	30.0	30.0
Operating cash flow	na	na	na	na	na	na
Free Cash flow	na	na	na	na	na	na
Divisionals	**H118**	**H218**	**H119**	**H219**	**H120**	**H220F**
Australian Revenue	na	na	15.3	26.5	30.9	29.4
African Revenue	na	na	9.0	10.7	7.9	4.3
BSA			0.0	1.4	0.8	2.0
Total Revenue	**na**	**na**	**24.3**	**38.5**	**39.7**	**35.7**
Gross profit	na	na	7.7	7.6	10.1	9.9
Gross Profit Margin %	na	na	31.7%	19.8%	25.4%	27.8%
Employment	na	na	3.0	6.4	6.4	6.2
Admin	na	na	1.4	2.1	2.3	2.3
Occupancy/Other	na	na	0.7	0.8	0.9	0.8
Total costs	**na**	**na**	**5.1**	**9.3**	**9.6**	**9.3**
EBITDA	**na**	**na**	**2.6**	**(1.7)**	**0.5**	**0.7**
EBITDA margin %	na	na	10.7%	(4.4%)	1.3%	1.9%
Margins, Leverage, Returns		**FY18A**	**FY19**	**FY20F**	**FY21F**	**FY22F**
EBITDA margin %		(1.7%)	3.3%	1.6%	4.7%	7.3%
EBIT margin %		(2.1%)	3.0%	1.3%	4.4%	7.0%
NPAT margin (pre significant items)		(2.2%)	2.7%	0.9%	2.7%	4.2%
Net Debt (Cash)		0.29	0.14	1.67	(0.38)	(2.51)
Net debt/EBITDA (x)	(x)	nm	nm	nm	nm	nm
ND/ND+Equity (%)	(%)	32.8%	(1.1%)	(15.4%)	2.4%	11.7%
EBIT interest cover (x)	(x)	n/a	0.1x	0.3x	0.0x	0.0x
ROA		nm	9.7%	3.0%	10.4%	16.3%
ROE		nm	7.7%	(1.7%)	16.4%	23.4%
ROIC		nm	30.0%	19.6%	55.2%	47.8%
NTA (per share)		0.07	0.06	0.06	0.08	0.12
Working capital		-1.5	5.8	6.9	7.3	8.2
WC/Sales (%)		**(6.3%)**	**9.3%**	**9.1%**	**8.6%**	**8.6%**
Revenue growth		nm	172.2%	20.0%	13.4%	12.4%
EBIT growth pa		nm	nm	(47.5%)	277.2%	79.0%
Pricing		**FY18A**	**FY19**	**FY20F**	**FY21F**	**FY22F**
No of shares (y/e)	(m)	nm	77	95	95	95
Weighted Av Dil Shares	(m)	nm	77	95	95	95
EPS Reported	cps	nm	0.006	0.007	0.024	0.042
EPS Normalised/Diluted	cps	nm	0.006	0.007	0.024	0.042
EPS growth (norm/dil)		nm	nm	10%	252%	75%
DPS	cps	0.000	0.000	0.000	0.007	0.010
DPS Growth		n/a	n/a	n/a	n/a	43%
Dividend yield		0.0%	0.0%	0.0%	11.7%	16.7%
Dividend imputation		30	30	30	30	30
PE (x)			nm	8.8	2.5	1.4
PE market		18	18	18	18	18
Premium/(discount)			nm	(51.0%)	(86.1%)	(92.1%)
EV/EBITDA		nm	nm	5.1	1.5	0.5
FCF/Share	cps	nm	nm	(0.019)	0.019	0.034
Price/FCF share		nm	nm	(3.1)	3.2	1.7
Free Cash flow Yield		nm	nm	(32.1%)	31.6%	57.5%

Source: RaaS Advisory

FINANCIAL SERVICES GUIDE

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Effective Date: 26th November 2018

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