Research as a Service

Millennium Services Group Ltd

1HFY21 result commentary

The gross margin is back

Millennium Services Group Ltd (ASX:MIL) has delivered an underlying 1H21 interim result ahead of forecast, with EBITDA of $7.0m against $5.2m forecast and $2.4m in the previous corresponding period (PCP). The beat was at the gross profit ($0.7m) and operating cost ($1.1m) lines with benefits from elevated higher margin ad-hoc work and lower operating costs. The reported gross margin year-on-year increased 220bps on the back of significant investment in systems to better manage employees, together with the continued exit of unprofitable contracts, and is now at a level comparable to peers, and, in our view sustainable. Debt reduction was also greater than expected, with net debt at December 31, 2020 $7.1m against $15m forecast, placing the group in a strong position to win new business and/or explore acquisitions. The core sales base is recovering slowly from COVID- related disruptions, and the group still cites a qualified sales pipeline of $532m over the next 18-months. Such business spans across a range of sectors and promises a more diverse revenue stream medium-term, which is one of management's strategic priorities. Our current estimates imply a fraction of this pipeline is won. Looking forward we are expecting lower underlying 2H21 NPAT relative to 1H21, but a significant improvement on the PCP, driven by the same drivers as 1H21 (lower costs and higher gross margins) together with lower interest expense. Despite the near-term beat, our medium-term numbers remain relatively unchanged, as to does our DCF at $1.60/share. We are cognisant of rising 10-year bond yields but are comfortable our medium-term numbers are conservative. Our DCF implies FY21 EV/EBITDA of 7.2x.

Business model

MIL is essentially a human services business, bidding for predominantly fixed rate contracts with opportunities for volume gains and ad hoc services, across the essential services of cleaning & security for durations of 3-5 years with large corporates. Satisfying contractual obligations utilising a vast workforce and procuring consumables for the jobs within the contacted price is the key to profitability. Historically focusing on cleaning and security services within major shopping centres, MIL is looking to de-risk the retail exposure by moving into new sectors including Aviation, Aged care, Education and Government. An increased focus on compliance (Fair Work, Modern Slavery Act and Labour Hire regulations) and utilising the ASX listed nature of the business will be key prongs in this push.

Turnaround evident in the composition of 1H21 numbers

With sales slowly recovering from COVID disruptions, the highlight of the 1H21 result has been the payback from systems implementation and contract negotiations evidenced in the gross margin, which was 220bps higher than the PCP (~$3m EBIT). A focus on the cost base has also contributed ~$1.1m in EBIT improvements, and this cost base can support solid sales growth over the medium-term, offering further operating leverage.

Valuation remains $1.60/share despite near-term beat

Our medium-term numbers are relatively unchanged despite the 1H21 beat, with just the speed of gross margin recovery a surprise near-term. We had already forecast improved gross margins, lower costs and modest sales gains over the forecast period. A tweak to 10-year bond assumptions offsets the near-term earnings beat.

Historical earnings and RaaS Advisory estimates

Year end	Adj Revenue (A$m)	Und. EBITDA (A$m)	NPAT adjusted (A$m)	EPS (adj) (c)	P/E (x)	EV/Sales (x)
06/19a	294.7	0.1	(18.7)	nm	0.0	0.20
06/20a	257.3	4.0	(3.3)	(0.07)	nm	0.25
06/21e	265.0	11.2	3.4	0.07	9.1	0.15
06/22e	278.3	11.8	4.1	0.09	7.6	0.13
06/23e	292.2	12.5	5.9	0.13	5.2	0.11

Source: Company data, RaaS Advisory Estimates for FY21e, FY22e and FY23e

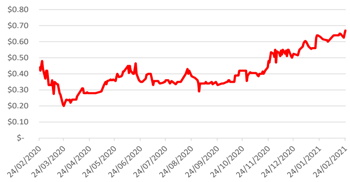
Human Services

25th February 2021

Share details

ASX Code	MIL
Share price (24th Feb)	$0.67
Market Capitalisation	$31.0M
Shares on issue	45.9M
Net Debt at 31 Dec 20	$7.1M
Free float	~31.5%

Share performance



Upside Case

- Converting a portion of the $532m qualified pipeline over the next 18-months
- Successfully diversify industry exposure to including Government, Education, Aged Care and Commercial
- EPS accretive acquisitions

Downside Case

- Competitive margin pressure re-emerges.
- Technology disruption, mainly in security.
- Fail to get workforce to embrace new rostering systems

Board of Directors

Roger Smeed	Chairman
Darren Boyd	CEO
Rohan Garnett	Non-Executive Director
Stuart Grimshaw	Non-Executive Director

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1H21 financial results

All the signals we wanted to see from this "classic turnaround story" were evident in the 1H21 result, namely:

- Improved gross margins, +220bps on a reported basis and +480bps on an underlying basis relative to the PCP and back to somewhere near historical levels after years of investment in systems and contract reviews.
- Lower operating costs as the business is "right sized".
- All achieved on flat sales growth as the quality of business remains the focus. The awarding of new business has been impacted by COVID related decision making but still very much on the horizon.

JobKeeper payments to support the ~5,000 MIL staff resulted in a net gain for the business of ~$17.3m over the half, even after related staff top-up payments, boosting reported NPAT to $17.1m but more importantly reducing debt to $7.1m as at December 31, well below the $34.6m reported in June 2020.

Excluding JobKeeper the underlying earnings of MIL improved significantly over the period, from a loss of $0.8m at the NPAT line to a profit of ~$2.6m.

Exhibit 1: MIL 1H21 result summary

Line item	1H20	1H21	%CHG	Comment
Sales	135.1	135.0	0%	**In-line with PCP and $2m below RaaS**
Cleaning	111.4	107.9	-3%	
Security	23.7	27.2	15%	Major beneficiary of ad-hoc
Gross Profit	17.0	19.9	17%	**+220bps above PCP**
GP%	12.6%	14.8%	17%	+90bps and above RaaS forecasts
Operating Costs	14.7	12.9	-12%	**Cost focus evident**
EBITDA	2.4	7.0	196%	Strong result and $1.8m above RaaS
Depreciation/rent	2.4	2.3	-7%	
EBIT	0.0	4.7	nm	
Abnormals	0.0	14.5		JobKeeper
Adjustments	0.9	0.1		COVID related gross profit incentives
Adjusted NPAT	-0.8	2.6	nm	The key metric
Reported NPAT	-0.8	17.1	nm	

Sources: Company financials & RaaS estimates

Gross margin update

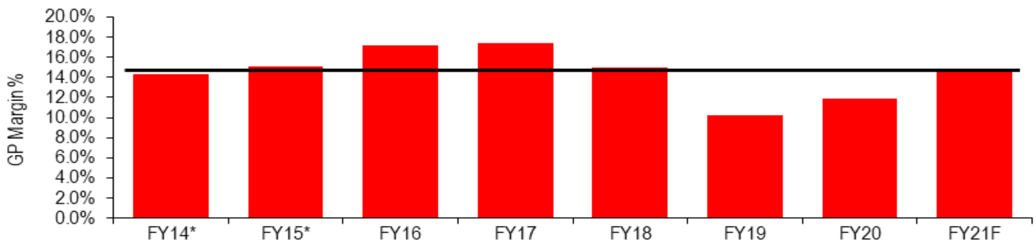
The most important metric from the 1H21 result and the key driver of the result was the improvement in gross margin from 12.6% to 14.8% on a reported basis, and 410bps underlying, an increase of 220bps or ~$3.0m in EBIT.

The gross margin for MIL represents the fixed price/rate of the contract less the human resources and consumables allocated to satisfy such contracts. The cost of "head office" and area managers sit below the line in operating costs.

In human terms this represents all cleaning and security staff and their supervisors, while consumables include all cleaning products and accessories required for the job.

Margins have returned to FY16 levels and at this level are believed to be sustainable.

Exhibit 2: MIL historical gross profit %



Source: Company financials

Investment case re-visited

MIL is a classic turnaround story which is clearly past the earnings inflection point, continued delivery of which is likely to see the group "re-rated" for its underlying recurring and defensive earnings:

- The group operates in markets worth an estimated $11.7bn (Cleaning) and $9.8bn (Investigation & Security Services) according to IBIS. In the cleaning business (~70% of MIL revenue) MIL has less than 2% market share in a market where the top-4 largest players have less than 10% of the market, offering significant market share opportunities.
- A recent IBISWorld report on the Australian cleaning sector suggests following CAGR growth of -0.5% between FY17 and FY21F, the cleaning sector will grow by a CAGR 3.6% between FY22 and FY26 on the back of a COVID recovery and a trend to more regular and comprehensive cleans.
- The group has highlighted a "qualified" pipeline of opportunities in the cleaning market of $281m and in the security market of $251m over the next 18-months, and only needs to win a fraction of this to hit our sales estimates.
- Net debt was just $7.1m in December 2020, completely reshaping the balance sheet from year ago levels and providing a solid base from which to grow and/or acquire.
- Gross margins are back to "targeted" levels and based on extensive historical and peer analysis we feel these margins are sustainable.
- The underlying cost base has been reduced by ~$3m and have "right sized" the business for a revenue base of at least ~$300m, offering further operating leverage.

Exhibit 3: MIL divisional earnings forecasts

	2020A	2021F	2022F	2023F	2024F
Sales	257.3	265.0	278.3	292.2	306.8
Cleaning	213.3	216.0	226.7	238.1	250.0
Security	44.0	49.0	51.5	54.1	56.8
Gross Profit	30.8	38.3	40.5	41.8	43.9
GP%	12.0%	14.5%	14.6%	14.3%	14.3%
Operating Costs	26.8	27.1	28.7	29.3	30.0
EBITDA	4.0	11.2	11.8	12.5	13.9
Depreciation	5.9	4.6	4.8	3.0	2.5
EBIT	-1.9	6.6	7.0	9.5	11.4
Interest expense	3.2	1.8	1.2	1.0	0.8
Tax expense	0.0	1.5	1.7	2.5	3.2
Adjustments	1.7	0.1	0.0	0.0	0.0
Adjusted NPAT	-3.3	3.4	4.1	5.9	7.4
Abnormals	19.8	14.5	0.0	0.0	0.0
Reported NPAT	16.5	17.9	4.1	5.9	7.4

Source: Company financials & RaaS estimates

RaaS
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Peer Comparison

Our assessed peer group for MIL rely on a mix of human resources and consumables to deliver services, typically under contract, mostly on a fixed rate basis. These companies are people heavy and rely on the efficient management & utilisation of these people to deliver contracted outcomes and derive an acceptable return.

Since our initiation report the MIL share price is up 20% against an average decline of 1% for the peer group.

Exhibit 4: Peer Group financial comparison – FY20

Company Name	Ticker	Share price (cps)	Mkt Cap (A$m)	FY20 Net Debt (A$m)	FY20(f) EBITDA (A$m)	FY20(f) Sales (A$m)	GP%	Working Capital/Sales	EV/ sales (x)	EV/ EBITDA
Service Stream	SSM	1.70	696	-19.0	105.5	928	22.7%	-6.2%	0.73	6.4
Johns Lyng	JLG	3.30	739	-24.2	38.6	495	20.3%	-5.4%	1.44	18.5
People Infrastructure	PPE	3.25	300	-31.4	22.9	371	11.2%	2.8%	0.72	11.7
GR Engineering	GNG	1.33	206	-30.2	11.3	222	10.5%	-2.6%	0.79	15.6
Licopodium	LYL	5.78	229	-54.4	26.4	207	15.7%	2.3%	0.85	6.6
BSA Limted	BSA	0.30	130	-34.9	21.0	486	11.6%	-2.9%	0.20	4.5
Southern Cross Electrical	SXE	0.55	136	-55.2	20.6	415	10.7%	9.5%	0.20	3.9
Primero Group	PGX	0.54	92	-15.2	9.5	206	8.8%	1.9%	0.37	8.1
Decmil	DCG	0.54	69	-17.8	-45.5	451	-0.2%	-3.8%	0.11	-1.1
AVERAGE				**-31.4**			**13.9%**	**-0.1%**	**0.66**	**5.9**
Millennium	MIL	0.67	31	7.1	4.0	257	12.0%	3.0%	0.15	9.4

Sources: Company financials, RaaS estimates * (Only SSM, LYL, BSA, SXE, PGX) # Ex DCG ^ Dec-2020

Looking at MIL against our selected peer group using FY20 metrics we would highlight:

- MIL's gross margin is now just above the group average in FY20;
- On key valuation metrics MIL:
  - Is trading at an EV/sales multiple of 0.15x, well below the group average of 0.65x and all peers with the exception of DCG (0.11x), which has a number of potential liabilities overhanging;
  - Now trading at a forecast EV/EBITDA of 3.5x FY21 against the peer groups 5.9X FY20;
- Working capital requirements for the peer group are low, averaging -0.1% to sales. In FY20 MIL was 3.0% but historically has average closer to 1%;

DCF valuation

We derive a DCF valuation for MIL of $1.60/share or A$88m enterprise value, with the following key assumptions:

- WACC of 10.5% incorporating a beta of 1.3x and a risk free rate of 1.4%. In theory the recurring and essential services nature of the MIL business should attached a lower beta than 1.3x, and we believe this will be the case as improved numbers continued to be delivered;
- Medium-term growth rate beyond our forecast period of 3.0%;
- Terminal growth rate of 2.2%;
- Sustainable gross margins of 14.3%;
- A base FY21 revenue base (ex COVID disruptions) of $265m;
- Longer-term working capital to sales of 2.0%
- Capex to sales accelerating to 0.9% from 0.8% in FY20.

Exhibit 5: MIL Base Case DCF valuation

Parameters	Outcome
Discount Rate / WACC	10.5%
Beta	1.3x
Terminal growth rate assumption	2.2%
Sum of PV	38.6
PV of terminal Value	44.8
PV of Enterprise	83.4
Debt (Cash)	9.8
Net Value - Shareholder	73.6
No of shares on issue	45.9
NPV	$1.60

Source: RaaS estimates

Exhibit 6: Financial Year Financial Summary

Millennium Services (MIL.AX)						Share price (24 February 2021)					A$	0.670
Profit and Loss (A$m)						**Interim (A$m)**	**H119**	**H219**	**H120**	**H220**	**H121**	**H221**
Y/E 30 June	**FY19A**	**FY20A**	**FY21F**	**FY22F**	**FY23F**	Revenue	153.7	141.0	135.1	146.8	159.7	130.0
Revenue	294.7	257.3	265.0	278.3	292.2	EBITDA	(2.4)	2.5	2.4	1.7	7.0	4.2
Gross profit	30.1	30.8	38.3	40.5	41.8	EBIT	(6.7)	(2.0)	(0.0)	(1.8)	4.7	1.8
GP margin %	10.2%	12.0%	14.5%	14.6%	14.3%	NPAT (normalised)	(5.2)	(9.2)	(1.7)	(3.3)	2.5	0.8
Underlying EBITDA	0.1	4.0	11.2	11.8	12.5	Minorities	0.0	1.0	2.0	3.0	4.0	5.0
Depn	(8.8)	(5.9)	(4.6)	(4.8)	(3.0)	NPAT (reported)	(8.7)	(10.1)	(0.8)	(2.5)	2.6	0.8
Amort	0.0	0.0	0.0	0.0	0.0	EPS (normalised)	nm	nm	nm	(0.055)	0.056	0.017
EBIT	(8.7)	(1.9)	6.6	7.0	9.5	EPS (reported)	nm	nm	nm	(0.055)	0.056	0.017
Interest	(2.5)	(3.2)	(1.8)	(1.2)	(1.0)	Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.000
Tax	(3.2)	0.0	(1.5)	(1.7)	(2.5)	Imputation						
NPAT	(14.3)	(5.0)	3.3	4.1	5.9	Operating cash flow	na	na	na	na	na	na
Adjustments	(4.4)	1.7	0.1	0.0	0.0	Free Cash flow	na	na	na	na	na	na
Adjusted NPAT	**(18.7)**	**(3.3)**	**3.4**	**4.1**	**5.9**	**Divisionals**	**H119**	**H219**	**H120**	**H220**	**H121**	**H221**
Abnormals (net)	(26.8)	19.8	14.5	0.0	0.0	Cleaning	125.4	115.9	111.4	102.0	107.9	108.1
NPAT (reported)	**(45.5)**	**16.5**	**17.9**	**4.1**	**5.9**	Security	28.4	25.1	23.7	20.2	27.2	21.9
Cash flow (A$m)						(Other)	-	-	-	24.6	24.7	-
Y/E 30 June	**FY19A**	**FY20A**	**FY21F**	**FY22F**	**FY23F**	Total Revenue	**153.7**	**141.0**	**135.1**	**146.8**	**159.7**	**130.0**
EBITDA (inc cash rent)	0.1	3.3	10.2	10.8	11.5							
Interest	(2.5)	(3.2)	(1.8)	(1.2)	(1.0)	Gross profit	13.0	17.1	17.0	13.8	19.9	18.4
Tax	(0.9)	0.5	0.0	(1.7)	(2.5)	Underlying GP Margin %	8.5%	12.2%	12.6%	11.3%	14.8%	14.2%
Working capital changes	2.2	(16.6)	8.9	(0.2)	(0.3)	Operating Costs						
Operating cash flow	**(1.1)**	**(16.0)**	**17.4**	**7.7**	**7.6**	Employment	10.1	8.6	8.3	16.4	16.2	9.0
Mtce capex	(1.3)	(2.2)	(2.3)	(2.5)	(2.6)	Other	8.8	7.0	5.5	4.9	6.2	5.2
Free cash flow	**(2.4)**	**(18.2)**	**15.1**	**5.2**	**5.0**	Exceptional	- 3.5	- 0.9	0.9	- 9.2	- 9.5	-
Growth capex	0.0	0.0	0.0	0.0	0.0	Total costs	**15.4**	**14.6**	**14.7**	**12.1**	**12.9**	**14.2**
Acquisitions/Disposals	0.0	0.0	0.0	0.0	0.0							
Other	(2.7)	(2.5)	(2.5)	(2.5)	(2.5)	**EBITDA**	**(2.4)**	**2.5**	**2.4**	**1.7**	**7.0**	**4.2**
Cash flow pre financing	(5.1)	(20.7)	12.6	2.7	2.5	EBITDA margin %	(1.6%)	1.8%	1.7%	1.1%	4.4%	3.2%
Equity	0.0	0.0	0.0	0.0	0.0	Margins, Leverage, Returns		**FY19A**	**FY20A**	**FY21F**	**FY22F**	**FY23F**
Debt	(3.6)	1.6	(20.0)	(2.0)	(3.0)	EBITDA margin %		0.0%	1.6%	4.2%	4.2%	4.3%
Net Dividends paid	0.0	0.0	0.0	0.0	0.0	EBIT margin %		(2.9%)	(0.7%)	2.5%	2.5%	3.2%
Net cash flow for year	(8.7)	(19.1)	(7.4)	0.7	(0.5)	NPAT margin (pre significant items)		(6.4%)	(1.3%)	1.3%	1.5%	2.0%
Balance sheet (A$m)						Net Debt (Cash)		27.1	34.6	10.1	5.5	1.0
Y/E 30 June	**FY19A**	**FY20A**	**FY21F**	**FY22F**	**FY23F**	Net debt/EBITDA (x)	(x)	314.9 x	8.6 x	0.9 x	0.5 x	0.1 x
Cash	2.7	1.8	6.3	8.9	10.4	ND/ND+Equity (%)	(%)	42.7%	63.5%	83.3%	160.0%	(14.0%)
Accounts receivable	19.5	29.8	21.1	22.1	23.2	EBIT interest cover (x)	(x)	n/a	n/a	0.3x	0.2x	0.1x
Inventory	0.8	1.2	1.3	1.2	1.3	ROA		nm	(3.5%)	10.8%	11.4%	14.6%
Other current assets	1.2	2.5	6.1	6.7	8.2	ROE		nm	nm	nm	nm	nm
Total current assets	*24.2*	*35.3*	*34.7*	*39.0*	*43.1*	ROIC		nm	nm	nm	nm	nm
PPE	11.4	8.6	7.2	5.9	5.6	**NTA (per share)**		-0.95	-0.60	-0.21	-0.12	0.01
Goodwill	7.5	7.5	7.5	7.5	7.5	**Working capital**		-1.8	14.8	5.9	6.0	6.3
Right of use asset	0.0	2.9	2.9	2.9	2.9	**WC/Sales (%)**		**(0.6%)**	**5.7%**	**2.2%**	**2.2%**	**2.2%**
Deferred tax asset	0.2	7.4	7.4	7.4	7.4	**Revenue growth**		nm	(12.7%)	3.0%	5.0%	5.0%
Other	0.1	0.1	0.1	0.1	0.1	**EBIT growth pa**		nm	nm	(453.8%)	6.8%	34.7%
Total non current assets	*19.1*	*26.5*	*25.2*	*23.9*	*23.5*	**Pricing**		**FY19A**	**FY20A**	**FY21F**	**FY22F**	**FY23F**
Total Assets	43.4	61.9	59.9	62.8	66.6	No of shares (y/e)	(m)	45.9	45.9	45.9	45.9	45.9
Accounts payable	22.2	16.3	16.5	17.3	18.2	Weighted Av Dil Shares	(m)	45.9	45.9	45.9	45.9	45.9
Short term debt	29.8	36.4	0.0	0.0	0.0							
Provisions	26.1	22.4	22.4	22.4	22.4	EPS Reported	cps	nm	0.359	0.389	0.089	0.129
Lease liabilities/other	0.0	0.8	0.8	0.8	0.8	EPS Normalised/Diluted	cps	nm	(0.073)	0.073	0.089	0.129
Total current liabilities	*78.0*	*76.0*	*39.7*	*40.6*	*41.4*	EPS growth (norm/dil)		nm	nm	-201%	21%	45%
Long term debt	0.0	0.0	16.4	14.4	11.4	DPS	cps	0.000	0.000	0.000	0.000	0.000
Other non current liabs	1.8	5.8	5.8	5.8	5.8	DPS Growth		n/a	n/a	n/a	n/a	n/a
Total long term liabilities	*1.8*	*5.8*	*22.2*	*20.2*	*17.2*	Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%
Total Liabilities	79.8	81.8	62.0	60.8	58.6	Dividend imputation		30	30	30	30	30
Net Assets	**(36.4)**	**(19.9)**	**(2.1)**	**2.1**	**8.0**	PE (x)			nm	9.1	7.6	5.2
						PE market		18	18	18	18	18
Share capital	19.0	19.0	19.0	19.0	19.0	Premium/(discount)			nm	(49.3%)	(58.1%)	(71.1%)
Reserves	(8.4)	(8.5)	(8.5)	(8.5)	(8.5)	EV/EBITDA		672.7	16.2	3.6	3.1	2.5
Retained Earnings	(46.9)	(30.3)	(12.5)	(8.4)	(2.5)	FCF/Share	cps	(4.535)	(4.535)	58.763	15.578	15.219
Minorities	0.0	0.0	0.0	0.0	0.0	Price/FCF share		(14.773)	(14.773)	1.140	4.301	4.402
Total Shareholder funds	**(36.4)**	**(19.9)**	**(2.0)**	**2.1**	**8.0**	Free Cash flow Yield		(6.8%)	(6.8%)	87.7%	23.3%	22.7%

Source: RaaS Advisory

FINANCIAL SERVICES GUIDE

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- who we are
- our services
- how we transact with you
- how we are paid, and
- complaint processes

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What Financial Services are we authorised to provide? RaaS is authorised to

- provide general advice to retail and wholesale clients in relation to
    - Securities
- deal on behalf of retail and wholesale clients in relation to
    - Securities

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In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

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