Research as a Service

Stealth Global Holdings Ltd

FY20 Results Commentary

Well positioned for long-term growth

Distribution – Wholesale

22nd September 2020

Stealth Global Limited (ASX:SGI) has reported adjusted EBIT (which excludes transaction costs and initial BSA investment costs) of ~$0.9m, down from the reported ~$1.9m in FY19. Most of this decline related to higher BSA start-up operating losses (+$0.7m on FY19 and predominantly COVID related), a lower African contribution (~$0.7m on FY19) as this low margin business is exited and significant investment in Australian senior management, ecommerce, and network (~$0.9m) for future growth. By definition this implies a solid underlying result for the core Australian business, which delivered 35% sales growth over the year and the key driver for the 8% group sales growth to $68m. Looking forward, the early momentum of BSA looks to be resuming with solid orders early in FY21 while the impact of the African withdrawal should washout of the numbers, leaving SGI with a much improved gross margin profile. Australia now dominates the group's sales mix and ultimately the Australian cost base has been set-up for a much bigger business, with future sales growth expected to see significant operating leverage.

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, margin growth and profit growth.

Key take outs from the FY20 result & future implications

There are a number of moving parts when assessing SGI sales & EBIT including a deliberate exit from Africa (at one time 30% of group revenue), expected start-up losses from the BSA JV in the UK (100% consolidated so higher than SGI's true 50% share), investment in senior people and an ecommerce platform for expected growth in Australia, transaction costs in reviewing potential acquisitions, Jobkeeper payments in Australia over Q4FY20 and initial BSA investment costs. With that in mind the delivered FY20 adjusted EBITDA of $1.2m (statutory $0.3m) is less relevant than the group's long-term potential to leverage sales growth off a cost base built for growth, aided by an improved gross margin mix.

Base case valuation A$0.23/share fully diluted

Our base case DCF valuation for SGI has been lowered from $0.27/share to $0.23/share on the back of more modest near-term BSA estimates and the complete withdrawal from Africa. Our Australian assumptions remain intact with a forecast 8% CAGR sales growth over the next 4-years. SGI is well priced relative to peers on a revenue to sales basis (14% against 24%-27% to the nearest peers based in reported FY20 sales), with demonstrated operating leverage likely to close this gap.

Historical earnings and RaaS Advisory estimates

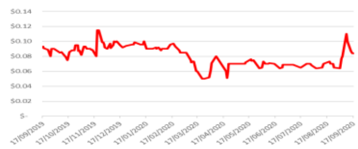
Year end	Revenue(A$m)	EBITDA (A$m)	NPAT reported (A$m)	EPS Adj (c)	PER adj (x)	EV/REV (x)
Jun-19a	62.8	2.1	0.5	0.01	nm	0.12
Jun-20a	68.1	0.3	0.0	0.00	34.7	0.18
Jun-21e	69.9	1.5	0.7	0.01	14.0	0.16
Jun-22e	77.8	3.7	2.1	0.02	4.6	0.13

Source: Company Data, RaaS Advisory Estimates

Share details

ASX Code	SGI
Share price	$0.084
Market Capitalisation	$8.0M
Shares on issue	94.9M
Enterprise value	$9.4M
Net Debt 30 Jun	$1.4M
Free float	~60%

Share performance (12 months)



Upside Case

- Service based model takes market share from incumbent players
- With size comes improved gross margins and NPAT 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
Michael Arnold	Managing Director
John Groppoli	Non-Executive Director
Alan Cransberg	Non-Executive Director

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FY20 result in detail

1H20

Sales and EBITDA numbers contain a number of moving parts but from a sales perspective key points to note regarding 1HFY20 included:

- **Australia**. SGI took market share from incumbents in Australia, with sales growing ~15% on a pro-forma basis and 100% on a statutory basis with the benefit of the Heatleys acquisition for 6-months against 3-months in the PCP. Wesfarmers Industrial sales declined 2% over the same period.
- **African** sales declined ~12% as the group prepared to exit this low & declining margin business.
- **BSA** sales contributed ~$0.8m over the half following initial pipe filling during 2H19 with 64 stores stocking the product.

2H20

The moving parts continued into 2H20 with COVID-19 adding further challenges. Key observations include:

- **Australia** sales declined ~3% over 2H20 which included a 20% decline in Q4, impacted by the COVID related regional shutdowns across WA delaying or deferring projects, SGI's key market. Key client Monodelphous suggested 10% of their 2H20 sales were diverted to future years due to shutdown impacts, so the SGI sales result was well within industry trading conditions. By definition Q3FY20 sales growth was solid and benefitted from management's in-stock inventory focus.

  The Q4 sales decline qualified SGI for Jobkeeper ($1.4m in Q4FY20) which offset the estimated lost sales over the quarter (~$0.8m at the GP level if 1H sales momentum had continued into Q4). A significant investment in the senior management cost base ($0.83m for the year) and into the group's ecommerce platform was also highlighted, which should benefit future year sales leverage.

- **African** sales in 2H20 were $2.4m against ~$10.7m in the PCP as the company deliberately exited this low margin (GP% of ~8%-10%) region.

  We estimate a $0.7m EBIT decline over FY20 but the group will ultimately benefit from higher gross margins medium-term (24.4% to 26.6% over FY20) and the removal of the fixed cost base (with Africa representing most of managements highlighted $1.4m fixed cost reduction over the year).

- **BSA** sales were severely impacted by UK COVID-19 shutdowns, with sales of ~$0.3m against 1H20 of ~$0.8m.
  We estimate a consolidated $1m EBIT loss over FY20 (100% consolidated so higher than SGI's true 50% share), against an estimated consolidated loss of $0.3m in FY19.

Exhibit 1: SGI sales by half year by region

Variable	1H19	1H20	% Chg	2H19	2H20	% Chg
Revenue - Statutory	24.5	39.7	62%	37.2	28.1	-24%
Australia	15.5	30.9	100%	26.5	25.7	-3%
Africa	9.0	7.9	-12%	10.7	2.5	-77%
BSA	0.0	0.8	nm	1.4	0.3	-77%
GP%	21.2%	25.4%		20.5%	28.3%	

Source: Company financials and RaaS Analysis

Adjusted EBIT/EBITDA

The introduction of AASB16 (rent at the deprecation line as opposed to the occupancy cost line in FY19), initial investment costs in BSA, acquisition due diligence & transaction costs, additional senior management heads and job keeper allowance in Q4FY20 offer a number of moving parts when analysing EBIT and EBITDA.

We exclude new senior management heads from any adjustment as they are ongoing for the business, include Jobkeeper as there was arguably an offsetting GP impact from lost sales, add-back actual rent paid to the occupancy line so a comparison can be made to FY19 and add-back the transaction costs and initial BSA investment costs to derive our adjusted EBITDA figure.

Exhibit 2 below summarises the moving parts of all adjustments by half-year.

Exhibit 2: FY20 EBITDA reconciliation by half-year

Line item	1H20	2H20	FY20	Comment
Reported EBITDA	1.75	1.44	3.19	Non-IFRS, includes $1.4m job keeper in 2H20
LESS				
Actual Rent paid	0.58	0.58	1.16	Now a charge in Depreciation as per AASB16
Investment in Staff	0.37	0.46	0.83	Not seen as one-off but required for growth
Adjusted EBITDA	**0.80**	**0.40**	**1.20**	**(EBIT $0.9m)**
LESS				
Transaction costs	0.21	0.25	0.46	Acquisition that did not eventuate during the half
BSA JV investment	0.37	0.12	0.49	One-off in nature
Other	0.08	-0.07	0.01	
REPORTED EBITDA	**0.15**	**0.10**	**0.25**	**On an Ex-AASB16 basis**
ADD Rent Paid	0.58	0.58	1.16	
Statutory EBITDA	0.73	0.68	1.41	**Under AASB16 and as reported**

Sources: Company financials & RaaS estimates

Outlook

We hold the view that it is only a matter of time before we see operating leverage in this business as the core Australian business continues to grow off a cost base built for growth, and BSA gains traction in the UK after the COVID induced setback in 2HFY20. Key drivers behind our existing assumptions are listed below:

- **Australia**. Sales growth should continue to be driven by market share gains as national accounts are accessed for the first time and new platforms such as ecommerce are introduced. Our FY21 numbers call for 8% sales growth, skewed to 2H21 as the group cycles the weak trading conditions. Our medium-term numbers also imply 8% CAGR growth with little change in the cost base. Job keeper is expected to continue into Q1FY21 at similar rates to Q4FY20. Market share gains and increased private label sourcing should slowly improve gross margins over time.

  Stealth represents only ~3.9% of Wesfarmers Industrial & Safety division sales in FY20, offering significant market gain opportunities medium-term.

- **Africa**. We have now assumed a complete withdrawal from Africa in our numbers going forward. The impact is modest given the low margin nature of this business, the low 2H20 base and the reduction in the fixed cost base of this business as a result.
- **BSA.** Orders have already been received for A$1.5m of stock this half, well above that recorded in 2H20 (~$0.3m). That said we have lowered our near-term growth expectations for this JV as COVID disruptions linger
- **Group.** We estimate Australia will represent ~90% of group consolidated sales in FY21 and as a result will be the key sales/earnings driver near-term. Group gross margins as a result will continue to increase due to mix and aided by increasing private label/own products. Operating costs should not increase over the next 2-years offering significant operating leverage to sales growth.

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 as a result we do not see comparisons outside of SNL as being onerous or unrealistic.

SGI is currently trading at half the FY20 EV/sales of the nearest peer (CLT 24% and CYG 27%) despite being marginally profitable in FY20 under difficult Q420 trading conditions.

Exhibit 3: Peer financial comparison

Company Name	Ticker	Share price (cps)	Mkt Cap ($m)	FY20 sales ($m)	FY20 NPAT adj ($m)	Net debt ($m)	FY20 PER (x)	FY20 GP%	FY20 WC/sales	EV/sales
Supply Networks	SNL	4.85	198	137	9.5	8	21.1	41.8%	31%	150%
Paragon Healthcare	PGC	0.17	53	231	5.6	74	3.5	37.6%	22%	55%
Coventry Group	CYG	0.72	64	247	0.8	3	6.6	37.6%	19%	27%
Cellnet	CLT	0.04	9	96	-1.9	14	-4.8	18.8%	19%	24%
Stealth Global	SGI	0.08	8	68	0.3	1	29.1	26.6%	11%	14%

Sources: Company financials, Thomson Reuters

DCF Valuation

Our base case DCF valuation is now $0.23/share, down from $0.27/share due lower near-term BSA estimates and the complete withdrawal from Africa. Key assumptions around Australian profitability remain relatively unchanged.

$0.23/share implies a PER on our FY22 EPS (the first forecast year of a positive BSA contribution) of 11.0x and EV/Sales of 35%, which feels about right relative to current peer comparison, forecast risk and market cap.

Exhibit 4: Base case DCF valuation

Parameters	
Discount Rate / WACC	10.0%
Terminal growth rate assumption (inflation adjusted)	2.0%
In A$m	
Present value of cashflows	10.0
Present value of terminal value	14.8
PV of enterprise	24.8
Net value ($m)	21.7
Net value per share	$0.23

Source: RaaS estimates

Exhibit 5: Financial Summary

Stealth Global (SGI.AX)					
Profit and Loss (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20**	**FY21F**	**FY22F**
Revenue	23.1	62.8	68.1	69.9	77.8
Gross profit	4.3	15.3	18.1	21.0	23.7
GP margin %	18.8%	24.4%	26.6%	30.0%	30.5%
Underlying EBITDA	(0.4)	2.1	0.3	1.5	3.7
Depn	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)
Amort	0.0	0.0	0.0	0.0	0.0
EBIT	(0.5)	1.9	0.1	1.2	3.3
Interest	(0.0)	(0.1)	(0.4)	(0.4)	(0.3)
Tax	0.0	(0.2)	0.2	(0.3)	(0.9)
Minorities	0.0	0.1	0.4	0.2	(0.1)
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0
NPAT pre significant items	(0.5)	1.7	0.3	0.7	2.1
Significant items	0.0	(1.2)	(0.3)	0.0	0.0
NPAT (reported)	**(0.5)**	**0.5**	**0.0**	**0.7**	**2.1**
Cash flow (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20**	**FY21F**	**FY22F**
EBITDA (inc minority adj)	(0.4)	1.0	0.7	1.6	3.6
Interest	(0.0)	(0.1)	(0.4)	(0.4)	(0.3)
Tax	(0.2)	(0.6)	0.2	(0.0)	(0.6)
Working capital changes	1.6	(0.6)	(1.8)	0.3	(0.8)
Operating cash flow	1.0	(0.3)	(1.3)	1.5	1.8
Mtce capex	(0.1)	(0.3)	(0.3)	(0.3)	(0.4)
Free cash flow	0.9	(0.6)	(1.6)	1.2	1.4
Growth capex	0.0	0.0	0.0	0.0	0.0
Acquisitions/Disposals	(0.3)	(7.8)	(0.5)	(0.3)	0.0
Other	0.0	0.1	(0.0)	0.0	0.0
Cash flow pre financing	0.6	(8.4)	(2.2)	0.9	1.4
Equity	(0.1)	11.4	0.0	0.0	0.0
Debt	(0.4)	(1.3)	(0.4)	0.0	0.0
Net Dividends paid	0.0	0.0	0.0	0.0	0.0
Net cash flow for year	0.1	1.7	(2.5)	0.9	1.4
Balance sheet (A$m)					
Y/E 30 June	**FY18A**	**FY19**	**FY20**	**FY21F**	**FY22F**
Cash	0.3	2.0	1.1	2.0	3.4
Accounts receivable	3.8	15.9	7.9	8.1	9.1
Inventory	0.3	6.3	7.9	7.6	8.5
Other current assets	0.1	0.6	0.7	1.1	0.0
Total current assets	*4.5*	*24.7*	*17.6*	*18.9*	*21.0*
PPE	0.2	0.6	0.7	0.8	0.9
Goodwill	0.5	6.9	7.1	7.1	7.1
Investments	0.0	0.0	0.0	0.0	0.0
Deferred tax asset	0.5	1.1	1.5	1.5	1.5
Right of use asset	0.0	0.0	3.5	3.5	3.5
Total non current assets	*1.2*	*8.6*	*12.8*	*12.9*	*13.0*
Total Assets	5.7	33.3	30.4	31.8	33.9
Accounts payable	5.6	16.3	8.2	8.4	9.4
Short term debt	0.6	1.8	2.7	2.4	2.4
Lease liabilities	0.0	0.0	3.5	3.5	3.5
Other	0.1	1.0	(1.0)	(1.0)	(1.1)
Total current liabilities	*6.2*	*19.2*	*13.4*	*13.3*	*14.2*
Long term debt	0.0	0.3	1.5	1.5	1.5
Other non current liabs	0.0	0.9	2.8	3.7	2.9
Total long term liabilities	*0.0*	*1.2*	*4.3*	*5.2*	*4.3*
Total Liabilities	6.2	20.4	17.7	18.5	18.5
Net Assets	**(0.6)**	**12.9**	**12.7**	**13.2**	**15.4**
Share capital	0.1	13.0	13.0	13.0	13.0
Accumulated profits/losses	(0.7)	(0.2)	(0.1)	0.6	2.7
Reserves	0.1	0.3	0.3	0.3	0.3
Minorities	0.0	(0.1)	(0.6)	(0.7)	(0.6)
Total Shareholder funds	**(0.6)**	**12.9**	**12.7**	**13.2**	**15.4**

Share price (21 September 2020)					A$	0.084
Interim (A$m)	**H118**	**H218**	**H119**	**H219**	**H120**	**H220**
Revenue	na	na	24.3	38.5	39.7	28.4
EBITDA	na	na	0.9	1.2	0.5	(0.2)
EBIT	na	na	0.8	1.1	0.4	(0.4)
NPAT (normalised)	na	na	0.6	1.1	(0.1)	(0.5)
Minorities	na	na	(0.1)	0.2	0.2	0.3
NPAT (reported)	na	na	0.4	0.1	(0.3)	(0.5)
EPS (normalised)	na	na	na	0.002	(0.003)	(0.006)
EPS (reported)	na	na	na	0.002	(0.003)	(0.006)
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**	**H220**
Australian Revenue	na	na	15.3	26.5	30.9	25.7
African Revenue	na	na	9.0	10.7	7.9	2.5
BSA			0.0	1.4	0.8	0.3
Total Revenue	**na**	**na**	**24.3**	**38.5**	**39.7**	**28.4**
Gross profit	na	na	7.7	7.6	10.1	8.1
Gross Profit Margin %	na	na	31.7%	19.8%	25.4%	28.3%
Employment	na	na	3.0	6.4	6.4	5.7
Admin	na	na	1.4	2.1	2.3	1.8
Occupancy/Other	na	na	0.7	0.8	0.9	0.7
Total costs	**na**	**na**	**5.1**	**9.3**	**9.6**	**8.3**
EBITDA	**na**	**na**	**2.6**	**(1.7)**	**0.5**	**(0.2)**
EBITDA margin %	na	na	10.7%	(4.4%)	1.3%	(0.7%)
Margins, Leverage, Returns		**FY18A**	**FY19**	**FY20**	**FY21F**	**FY22F**
EBITDA margin %		(1.7%)	3.3%	0.4%	2.1%	4.7%
EBIT margin %		(2.1%)	3.0%	0.1%	1.7%	4.3%
NPAT margin (pre significant items)		(2.2%)	2.7%	0.4%	1.0%	2.6%
Net Debt (Cash)		0.29	0.14	3.06	1.90	0.45
Net debt/EBITDA (x)	(x)	nm	nm	nm	nm	nm
ND/ND+Equity (%)	(%)	32.8%	(1.1%)	(31.6%)	(16.7%)	(3.0%)
EBIT interest cover (x)	(x)	n/a	0.1x	6.8x	0.3x	0.1x
ROA		nm	9.7%	0.2%	3.8%	10.2%
ROE		nm	7.7%	0.1%	5.2%	14.3%
ROIC		nm	30.0%	10.5%	48.7%	46.0%
NTA (per share)		0.07	0.06	0.06	0.06	0.09
Working capital		-1.5	5.8	7.6	7.3	8.1
WC/Sales (%)		**(6.3%)**	**9.3%**	**11.2%**	**10.5%**	**10.5%**
Revenue growth		nm	172.2%	8.4%	2.6%	11.3%
EBIT growth pa		nm	nm	(96.6%)	1738.9%	180.1%
Pricing		**FY18A**	**FY19**	**FY20**	**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	0.003	0.007	0.022
EPS Normalised/Diluted	cps	nm	0.006	0.003	0.007	0.022
EPS growth (norm/dil)		nm	nm	-53%	147%	204%
DPS	cps	0.000	0.000	0.000	0.000	0.005
DPS Growth		n/a	n/a	n/a	n/a	n/a
Dividend yield		0.0%	0.0%	0.0%	0.0%	6.0%
Dividend imputation		30	30	30	30	30
PE (x)			nm	29.1	11.8	3.9
PE market		18	18	18	18	18
Premium/(discount)			nm	61.8%	(34.5%)	(78.5%)
EV/EBITDA		nm	nm	13.3	5.9	2.4
FCF/Share	cps	nm	nm	(0.006)	0.010	0.015
Price/FCF share		nm	nm	(14.4)	8.8	5.5
Free Cash flow Yield		nm	nm	(7.0%)	11.4%	18.2%

Source: RaaS Advisory

FINANCIAL SERVICES GUIDE

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If you have a complaint about our service you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below. BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.

Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)
In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

Professional Indemnity Insurance

BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.

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