RESEARCH REPORT

CORPORATE CONNECT

Stealth Global Holdings (SGI)

FY22 result delivers material step forward

Price Target	$0.36
Share Price	$0.12
Implied Return	200%

Investment Summary

- SGI recently reported its FY22 results, delivering a record profit and building on the steady improvement of recent years. The strong result was driven by organic growth, several recent acquisitions, and associated scale benefits.
- Highlights from the result include Group revenue from continuing operations of $99.6m (+49.3% on pcp), underlying Group EBITDA of $4.9m (+75% on pcp) and underlying NPAT of $1.2m (+200%). The result was slightly ahead of our forecasts, with revenue +3.6%, EBITDA +5.9% and NPAT +12.5%.
- The acquisitions of United Tools (Mar 2022), Skipper Transport Parts (Aug 2021) and C&L Tool Centre (Dec 2020) contributed to the strong result. They significantly extend and diversify SGI's products, target markets, customer/ supplier base, and store/branch network, helping to build competitive advantage. We expect significant synergy benefits to be realised over time.
- SGI continues to see favourable industry demand conditions in the underlying end markets of key customers in the mining, construction, transport, energy and infrastructure sectors. The company thus retains a positive outlook for FY23, further supported by the acquisitions. There is no guidance for FY23, but SGI is targeting EBITDA margins of c.8% by FY2025.
- We have made only minor changes to our forecasts following the FY22 result. We derive an updated DCF equity value for SGI of $0.36 per share, with potential upside if full synergies can be extracted. We note SGI continues to trade on very undemanding forward multiples.

Earnings Estimates (A$)

		FY21	FY22	FY23e	FY24e	FY25e
Sales	$m	69.7	99.6	126.3	145.0	154.9
growth	%		42.8%	26.8%	14.8%	6.8%
EBITDA	$m	3.1	4.9	6.4	7.8	9.0
EBIT	$m	1.4	2.3	3.7	5.0	6.0
margin	%		2.3%	2.9%	3.5%	3.9%
PBT	$m	1.0	1.6	2.4	3.6	4.4
Adj NPAT	$m	0.6	1.2	1.7	2.5	3.1
growth	%		89.9%	42.0%	47.5%	23.6%
Rep NPAT	$m	0.6	0.6	1.7	2.5	3.1
Adj EPS	cps	0.6	1.2	1.7	2.5	3.1
EPS grwth	%		89.9%	42.0%	47.5%	23.6%
PE	x	19.0	10.0	7.0	4.8	3.9
DPS	cps	0.0	0.0	0.0	0.9	1.4
Payout	%	0.0%	0.0%	0.0%	35.8%	45.0%
Div yield	%	0.0%	0.0%	0.0%	7.5%	11.7%

Source: Company data and CCR estimates

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Company Data

ASX code	SGI
ASX price	$0.12
Shares on issue	99.7m
Market capitalisation	$12.0m
Cash on hand	~$4.7[1]
12-month price range	$0.097 – $0.175
ASX turnover (3m avg. daily vol.)	0.2m

[1] Cash = 4D balance

Key Personnel

Michael Arnold	Managing Director
John Boland	Chief Financial Officer
Luke Cruskall	Chief Operating Officer
Christopher Wharton	Non-Executive Chairman

Major Shareholders

Michael Alan Arnold	10.9%
Ms Narelle Edmunds	10.7%
EGP Capital Pty Ltd	8.1%
Challenger Limited	7.0%
Rosefield Asset Pty Ltd <S.R. Bushell A/C>	5.1%

Price Chart (ASX: SGI)

Source: Factset

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Investment Thesis

Stealth Global Holdings (SGI) is a leading distributor of industrial MRO, safety, and workplace consumable products, with a strong market position in Australia. The key elements of the investment thesis for SGI are as follows:

- Industrial consumables exposure – SGI provides direct exposure to the growing industrial consumables market, driven by favourable conditions across key industries, expanding industrialisation and improving workplace safety regulations. In terms of market opportunity, independent research estimates the size of the Australian Industrial MRO market at approximately $40bn. Around 95% of SGI's revenue is attributable to non-discretionary items.
- Diverse operating platform – The company has a geographically diverse operating platform with extensive operational capability across Australia.
- Full service offering – SGI tenders a complete service offering with traditional and digital sales channels ensuring all customers are appropriately serviced based on their purchasing preferences.
- Acquisitions accelerating growth – Over the near term, SGI will benefit from increasing contributions from several recent acquisitions, including C&L Tool Centre (Dec 2020), Skipper Transport Parts (Aug 2021), and United Tools (Mar 2022), which in aggregate add $40m+ annual revenue.
- Acquisition synergies upside – The company also expects to progressively extract significant synergies from these acquisitions, including $34m+ incremental revenue and at least $0.5m in costs. We expect the resulting material increase in the scale of the business will enable it to deliver significant additional benefits in time through greater purchasing power and other economies of scale.
- New contract wins – At the AGM last November, SGI announced the award of several new customer contracts. The combined annual value of these contracts is >$18m once ramped up, estimated in 6-12 months.
- Medium-term target – SGI has guided to EBITDA margins of c.8% by FY2025. This target appear reasonable, noting that US peers in the Maintenance, Repairs and Operations (MRO) industry typically generate EBITDA margins closer to the mid-teens.
- Large diversified customer base – SGI has approximately 5,500 active business customers across resources, engineering, construction and transportation industries, as well as trade/retail customers. Currently the largest customer accounts for <5% of group revenue.
- Strong relationships – SGI has long standing relationships with key suppliers, brand and channel partners across the supply chain and product segments, sourcing from >2,500 suppliers across 17 countries. The company holds various distribution rights for a number of high quality, recognised brands that are highly desirable to customers (e.g. Bisley Workwear). Overall SGI supplies >1.0m consumable products.
- Experienced management team – The company has a management team with extensive industry experience and track record of delivering profitable business growth. Management also hold significant shareholdings, ensuring alignment with investors.
- Pipeline for growth – SGI has a strong pipeline of potential opportunities, with a number of brand partnership, channel partnership and/or complementary business acquisition opportunities available to pursue.

Milestones

Key events and data points to track the company's progress over coming periods include the following;

- Upcoming AGM in November.
- 1H23 result due in February 2023.
- Demonstrated progress with integration of previous acquisitions C&L Tool Centre (Dec 2020), Skipper Transport Parts (Aug 2021), and United Tools (Mar 2022).
- Progressive delivery of expected acquisition synergies, including $34m+ annual revenue synergies and at least $0.5m in costs.
- Successful ramp up of new contracts, boosting revenue by >$18m.
- Progressive margin improvement driven by scale benefits and reaching medium term 8% EBITDA margin target in FY25.
- Declaration of maiden dividend.

Review of FY22 result

SGI delivers material step forward

Stealth Global Holdings (SGI) reported its FY22 results on 30 August, delivering another record profit for the company, building further on the steady improvement over recent years. The strong result was driven by organic growth, several recent acquisitions, and associated benefits of scale. Notably, the result was achieved despite SGI's strategic exit from the UK operations via the divestment of its 50% interest in BSA Brands (UK) to its JV partner Bisley Workwear in March 2022. This followed the earlier acquisition of Bisley in December 2021 by global PPE supplier Protective Industrial Product (PIP) based in NY.

Key result highlights

The main highlights from the result are as follows:

- Group revenue from continuing operations of $99.6m (+49.3% on pcp). Excluding the positive impact of the acquisitions, we estimate underlying revenue was around $64m, representing organic growth of ~9%.
- Gross profit from continuing operations of $30.1m (+56.0% on pcp). This represents a gross margin of 30.2%, up from 28.9% in the pcp. Gross margin has now expanded by >60% over recent years from 18.5% in FY18, driven by greater scale and better buying terms.
- Reported Group EBITDA from continuing operations of $4.0m (+37.9% on pcp). This included $0.9m of transaction costs related to the acquisitions ($0.6m after tax), which we treat as a non-recurring item. The FY21 result also included transaction costs ($1.4m), together with Government incentive income (mainly Jobkeeper) of $1.5m.
- Underlying Group EBITDA from continuing operations of $4.9m (+75% on pcp), adjusting for the above non-recurring items.
- Underlying NPAT from continuing operations of $1.2m (+200%).

The FY22 result was slightly ahead of our forecasts, with revenue +3.6% and EBITDA +5.9%. EBIT was also higher than expected, albeit hampered by higher D&A. NPAT was 12.5% ahead of our forecast on the back of lower net interest and tax charges.

Fig. 1 – Stealth FY22 result v. CCR forecast

A$m	FY22 actual (Cont. op.)	CCR Forecast	Variance
Revenue	99.60	96.11	3.6%
EBITDA	4.90	4.63	5.9%
D&A	-2.57	-2.37	8.1%
EBIT	2.33	2.25	3.5%
Net Interest	-0.72	-0.73	-1.0%
Tax	-0.41	-0.46	-10.3%
NPAT	1.20	1.06	12.5%

Source: CCR

Acquisitions

The recent strategic acquisitions which have contributed to the result include the following:

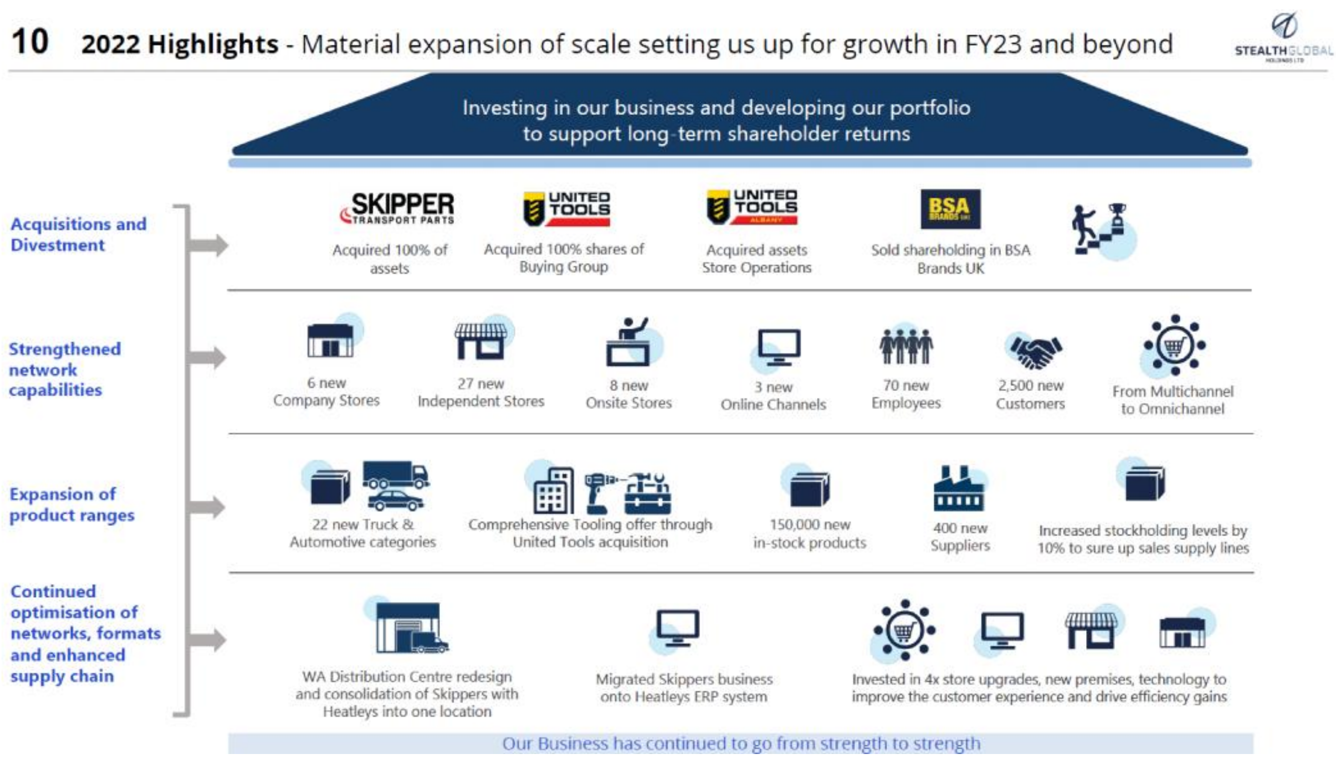
- United Tools Albany (UTA) branch acquired May 2022 (2 months contribution)
- United Tools Limited (UTL) acquired effective Mar 2022 (4 months contribution)
- Skipper Transport Parts (STP) acquired in Aug 2021 (10.5 months contribution)
- C&L Tool Centre acquired Dec 2020 (full 12 months contribution cf. 7 months in pcp)

These strategic acquisitions significantly extend and diversify SGI's products, target markets, customer base, supplier base, and store/branch network, as well as helping to build SGI's competitive advantage. The store network (company owned and independents) doubled in number from 33 to 66, with a further 6 online marketplaces.

The acquisitions contribute significantly to growth in FY22 and FY23 as they work up to full period contributions. We also expect there is scope for significant synergy benefits to be realised over time. This will likely comprise both revenue and cost synergies through cross-selling, duplication removal and scale benefits. Furthermore, the Industrial MRO supply and related distribution industries remain fragmented, offering further acquisition opportunities for SGI going forward.

The above acquisitions and others completed over recent years support and progress SGI's strategy of building a larger, more relevant and diversified Industrial distribution business. SGI is now aiming to improve customer experience through a renewed operating model focused on 3 key business areas, being Business, Consumer, and Member, supported by a single vertically integrated platform.

Fig. 2 – SGI expanded portfolio of businesses



Source: SGI

Cash flow and Balance sheet

Operating cash flow for FY22 was $0.9m. While this was down on FY21 ($2.0m), the pcp included the benefit of $1.8m in Government incentive receipts.

The sale of the UK operations netted cash proceeds of $1.7m for SGI, which was redeployed into part funding for the United Tools acquisition and re-investment in the business generally.

At period end, SGI had cash on hand of $4.7m (pcp $3.1m). Overall, the company had $7.5m of working capital facilities in place at the end of June (pcp $7.5m) to support future organic growth and potential acquisitions.

Net debt stood at $10.2m (pcp $4.2m), after the acquisitions completed in FY22, deferred consideration and investment in inventory, facilities, and capex. Adding lease liabilities and the remaining deferred acquisition obligations lifts net debt to $20.2m. Based on this measure, gearing (Nd / Nd+E) pushed up to 57% (pcp 45%). EBIT interest cover was respectable at 3.2x.

Outlook

SGI notes that the current global economic outlook is quite uncertain, given inflation pressures and rising interest rates. COVID-19 continues to impact its operations and industry at large through elevated levels of absenteeism, supply chain disruption and increased costs. COVID disruption was especially evident in July, but abated in August.

Despite the uncertainty, SGI continues to see favourable industry demand conditions in the underlying end markets and geographies of its key customers. This includes the mining, construction, transport, infrastructure and energy sectors. Consequently the company retains a positive outlook for FY23, with growth expected across all businesses, customers and markets. The outlook is further supported by full year contributions and synergy benefits from the recent acquisitions, which underpin improved profitability over the next 2 years. The company also maintains an active focus on cost control and capital management.

While SGI expects revenue and earnings to grow in FY23, it has not provided any earnings guidance at this early stage in the year. It will however, continue to provide quarterly market updates.

CCR forecast changes

We have made minor changes to our forecasts for SGI following the FY22 result. Revenue and EBITDA for FY23 have been upgraded by around 4% and 5% respectively given the better than expected result. However at the EBIT level, the upgrade is smaller given allowance for higher than expected D&A. With investment in working capital and other assets also higher than expected, SGI ended FY22 with ~$5m more debt than previously modelled. Consequently, net interest costs will be higher and an incremental drag at the PBT level. Overall, we therefore reduce forecast NPAT for FY23 from $1.82m to $1.70m (and to a lesser extent for outer years).

We have also rolled our model for the FY22 result. This results in a new updated DCF valuation for SGI of $0.36 per share (previously $0.33 per share).

It is important to note that our forecasts and valuation are based on a number of assumptions, which could vary significantly in nature, timing and magnitude from the estimates we have adopted. Given the significant recent transformation of the company, there is naturally a high level of uncertainty surrounding any forecast assumptions, and accordingly our forecasts and valuation should be treated with due caution.

Fig. 3 – DCF Valuation

Year	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
EBIT	3.7	5.0	6.0	7.1	8.1	9.2
Depreciation & Amort	2.7	2.8	3.0	3.1	3.3	3.4
Tax	-0.7	-1.1	-1.3	-1.6	-1.9	-2.2
Adj for Net Int tax shield	-0.4	-0.4	-0.5	-0.5	-0.5	-0.6
Inv in Net working capital	-3.0	-1.7	-0.8	-1.1	-1.1	-1.1
Operating CF before financing	**2.2**	**4.7**	**6.4**	**7.0**	**7.8**	**8.8**
Capex	-0.7	-0.7	-0.7	-0.8	-0.8	-0.9
Inv in Intangibles	-2.5	-2.6	-2.7	-2.9	-3.0	-3.2
Inv in net other assets	-0.8	-1.0	-2.0	-0.8	-0.8	-1.0
Free CF before financing	**-1.7**	**0.4**	**1.0**	**2.6**	**3.3**	**3.8**
Terminal Value [FCF*(1+g)/(WACC-g)]	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**90.6**

Risk free rate (Rf)	3.75%	NPV of explicit free cash flow	$5.7
Market risk premium (Rm-Rf)	6.5%	NPV of terminal value	$54.4
Beta (β)	1.40	**Total Company Value ($m)**	**$60.1**
Cost of equity capital (Ke)	12.9%		
		Less Net Debt	-$21.5
Cost of debt (Kd)	7.0%	Less Minority Interests	$0.0
Corporate tax rate (Tc)	30.0%	**Value of Equity ($m)**	**$38.6**
Target gearing [d/(d+e)]	50.0%		
WACC	8.9%	Shares on Issue (EFPO) (m)	110.3
		Adj for notional conversion ($m)	1.2
Terminal growth rate (g)	4.5%	**Value per share ($)**	**$0.36**

Source: CCR and company data

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Stealth Global (SGI: A$0.120)

Valuation data

Year ending Jun	2021	2022	2023f	2024f	2025f
EPS (c)	**0.6**	**1.2**	**1.7**	**2.5**	**3.1**
P/E ratio (x)	**19.0**	**10.0**	**7.0**	**4.8**	**3.9**
P/E relative					
EPS growth (%)		**89.9%**	**42.0%**	**47.5%**	**24%**
EV / EBIT (x)	**0.0**	**15.8**	**10.1**	**7.4**	**6.1**
EV / EBITDA (x)	0.0	7.5	5.8	4.7	4.1
CFPS (c)	2.0	0.9	5.2	5.9	6.4
Price / CF (x)	0.0	13.6	2.3	2.0	1.9
DPS (c)	0.0	0.0	0.0	0.9	1.4
Yield (%)	**0.0%**	**0.0%**	**0.0%**	**7.5%**	**11.7%**
Franking (%)	0%	0%	0%	100%	100%
NTA per share	$0.29	$0.41	$0.51	$0.58	$0.63
Pr / NTA	0.4	0.3	0.2	0.2	0.2

Profit and loss ($m)

Year ending Jun	2021	2022	2023f	2024f	2025f
Sales revenue	69.7	99.6	126.3	145.0	154.9
growth over pcp	*2.5%*	*43%*	*27%*	*15%*	*6.8%*
EBITDA	3.1	4.9	6.4	7.8	9.0
Dep'n and amort'n	(1.7)	(2.6)	(2.7)	(2.8)	(3.0)
EBITAg	**1.4**	**2.3**	**3.7**	**5.0**	**6.0**
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**1.4**	**2.3**	**3.7**	**5.0**	**6.0**
growth over pcp	*-18%*	*61.2%*	*57%*	*37%*	*21%*
Net interest expense	(0.5)	(0.7)	(1.2)	(1.4)	(1.6)
Pre-tax profit	1.0	1.6	2.4	3.6	4.4
Tax	(0.4)	(0.4)	(0.7)	(1.1)	(1.3)
Effective tax rate	*36.5%*	*25.5%*	*30.0%*	*30.0%*	*30.0%*
Preference dividends	0.0	0.0	0.0	0.0	0.0
Minorities	(0.0)	0.0	0.0	0.0	0.0
Share of assoc	0.0	0.0	0.0	0.0	0.0
CCR adjustments	0.0	0.0	0.0	0.0	0.0
CCR adj profit	**0.6**	**1.2**	**1.7**	**2.5**	**3.1**
Reported profit (pre abn)	0.6	1.2	1.7	2.5	3.1
Abn / extra's (after tax)	(0.1)	(0.6)	0.0	0.0	0.0
Reported net profit	0.6	0.6	1.7	2.5	3.1

Profitability ratios

Year ending Jun	2021	2022	2023f	2024f	2025f
EBITDA / sales (%)	4%	4.9%	5.0%	5.4%	5.8%
EBITAg / sales (%)	**2%**	**2.3%**	**2.9%**	**3.5%**	**3.9%**
EBIT / sales (%)	**2%**	**2.3%**	**2.9%**	**3.5%**	**3.9%**
Return on assets (%)	2.1%	2.8%	3.7%	4.6%	5.2%
Return on equity (%)	4%	8%	10.1%	14%	15.4%
Dividend cover (x)	0.0	0.0	0.0	2.8	2.2

Liquidity and leverage ratios

Year ending Jun	2021	2022	2023f	2024f	2025f
Net debt / (cash) ($m)	11.7	20.2	21.5	22.2	23.2
Debt / equity (%)	1.0%	1.7%	1.6%	1.6%	1.5%
Net debt / equity (%)	**0.8%**	**1.3%**	**1.3%**	**1.2%**	**1.2%**
Interest cover (x)	3.2	3.2	3.0	3.5	3.7

Segments ($m)

	2021	2022	2023f	2024f	2025f
Aust	66.4	99.4	126.1	144.8	154.7
UK	2.9	0.0	0.0	0.0	0.0
ROW	0.0	0.0	0.0	0.0	0.0
Corporate	0.4	0.2	0.2	0.2	0.2
Sales revenue	**69.7**	**99.6**	**126.3**	**145.0**	**154.9**
Aust	4.4	8.8	11.3	13.0	14.4
UK	0.2	0.0	0.0	0.0	0.0
ROW	(0.0)	(0.0)	0.0	0.0	0.0
Corporate	(1.5)	(3.9)	(4.9)	(5.2)	(5.4)
EBITDA	**3.1**	**4.9**	**6.4**	**7.8**	**9.0**

Cashflow ($m)

Year ending Jun	2021	2022	2023f	2024f	2025f
EBIT	1.4	2.3	3.7	5.0	6.0
Net interest paid	(0.5)	(0.7)	(1.2)	(1.4)	(1.6)
Dep'n and amort'n	1.7	2.6	2.7	2.8	3.0
Tax paid	(0.4)	(0.4)	(0.7)	(1.1)	(1.3)
Dividends from assoc	0.0	0.0	0.0	0.0	0.0
Gross cash from op'n	**2.3**	**3.8**	**4.4**	**5.3**	**6.1**
(Inc) / dec in wk'g cap	(1.7)	(4.2)	(3.0)	(1.7)	(0.8)
Other	1.4	1.4	0.8	0.5	0.3
Operating cashflow	**2.0**	**0.9**	**2.1**	**4.2**	**5.6**
Investing cashflows					
Capital expenditure	(2.6)	(4.0)	(0.7)	(0.7)	(0.7)
Asset sales	0.0	0.0	0.0	0.0	0.0
Investments / Divestments	0.0	0.0	0.0	0.0	0.0
Other	2.8	3.4	(2.8)	(3.3)	(4.6)
Financing cashflows					
Equity raised	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	(0.9)	(1.4)
Chg in loans	**3.5**	**5.7**	**2.6**	**1.5**	**1.5**
Other non-op flows	(2.8)	(3.4)	(0.0)	0.0	(0.0)
Net chg in cash	**3.0**	**2.6**	**1.3**	**0.9**	**0.5**

Balance sheet ($m)

Year ending Jun	2021	2022	2023f	2024f	2025f
Cash	3.1	4.7	6.0	6.9	7.4
Receivables	11.4	18.1	22.4	25.2	26.5
Inventories	10.7	14.1	17.8	20.1	21.5
Other	0.0	0.0	0.0	0.0	0.0
Current assets	**25.3**	**36.9**	**46.3**	**52.3**	**55.4**
Net PPE	1.2	2.2	2.3	2.5	2.6
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	0.0	0.0	0.0	0.0	0.0
Other intangibles	14.7	20.3	20.7	21.0	21.4
Other	2.6	2.0	2.4	3.0	4.9
Non-current assets	**18.5**	**24.6**	**25.4**	**26.5**	**28.8**
Total assets	**43.8**	**61.5**	**71.6**	**78.8**	**84.2**
Debt	14.8	24.9	27.6	29.1	30.6
Payables	12.8	18.6	23.6	27.1	28.9
Other	2.3	2.9	3.7	4.2	4.5
Total liabilities	**29.9**	**46.5**	**54.9**	**60.4**	**64.1**
Equity / reserves	35.2	35.3	35.3	34.4	33.0
Retained profits	(20.8)	(20.2)	(18.5)	(16.0)	(12.9)
Total s/h funds	**14.4**	**15.1**	**16.8**	**18.4**	**20.1**
Minorities	(0.6)	0.0	0.0	0.0	0.0
Total funds emp.	**43.8**	**61.5**	**71.6**	**78.8**	**84.2**

Model summary as at 14/9/22

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