Lin Capital Management Inc.

Equity Research

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Industrials (Homebuilding & Construction Supplies)

ADENTRA Inc.

(ADEN-T) C$30.04

Q3/F22 Results: Solid Quarter, Resilient Demand

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Event

Q3/F22 results was released on November 8, 2022. Q4/2022 results will be released on March 13, 2023.

Impact: POSITIVE

Third quarter sales grew 39.9% to $659.7 million (C$856.7 million)**,** a year-over-year increase of $188.0 million**.** It was a solid quarter with broad-based growth, which includes a 10.4% organic sales growth and a 29.9% acquisition-based growth.

Gross profit climbed 19.6%, or $22.8 million, to $139.0 million, with gross profit margin percentage of 21.1%, as compared to 24.6% in the same period last year.

Depreciation and amortization increased by $24.5 million to $48.5 million for the nine months ended September 30, 2022. This increase mainly relates to the acquisition and operations of the Novo and Mid-Am (two most recent acquisitions) and is primarily comprised of $12.3 million of amortization on acquired intangible assets, and $12.1 million from depreciation related to operations.

Profit per share was $1.28; adjusted profit per share was $1.32 per share.

Adjusted EBITDA climbed 3.4% to $66.0 million (C$85.7 million), from $63.8 million during the same period in 2021.

Quarterly dividend was $0.13 per share, which represents an 8% YoY increase.

Operating cash flow before changes in working capital, per share was $1.84.

Return of capital to shareholders of approximately $12 million in the quarter, comprised of share repurchases and quarterly dividends.

In the near term, management anticipates that rising inflation and recent interest rate hikes will have a negative impact on economic activity, and it may result in a moderation of demand for ADENTRA's products. Over the long term, management continues to see a multi-year runway for growth in the repair and remodel (~40% of sales), residential (~40% of sales) and commercial end-market (~15% of sales).

Investment Recommendation

We issue a **BUY** recommendation based on a target price of C$39.95. We expect the stock to continue to re-rate higher as the company continues to demonstrate the growth potential once Q4 results release on Monday.

Recommendation:	**BUY**
Risk:	**MEDIUM**
12-Month Target Price:	**C$39.95**
12-Month Dividend (Est.):	**C$0.42**
12-Month Total Return:	**33.0%**

Market Data (C$)

Current Price	30.71
52-week range	22.66 - 43.11
Market Cap(f.d)(mm)	714.00
Current Dividend ($)	0.39
Dividend Yield	1.60%
Avg. Daily Trading Vol.	62,448

Financial Data ($)

Fiscal Y-E	December
Shares O/S (f.d)(mm)	23.31
Diluted Shares O/S (f.d)(mm)	23.50
Net Debt ($mm)	$407.4
P/E (TTM)	3.58x
EV/EBITDA	4.8x

Estimates ($)

Year	2021A	2022E	2023E	2024E
Sales ($mm)	1,616.2	2585.9	3,361.7	4.037.0
EBITDA ($mm)	148.3	226.6	168.1	201.7
EBIT ($mm)	111.8			
Net Income ($mm)	142.0			
EPS ($)	4.81			
Return on Assets (%)	12.3			

EPS (f.d.) Quarterly Estimates ($)

Year	2021A	2022E	2023E	2024E
Q1	0.08	0.10	-	-
Q2	0.08	0.09	-	-
Q3	0.08	0.12	-	-
Q4	0.09	-	-	-

Valuations

Year	2021A	2022E	2023E	2024E
EV/Sales	0.75x	0.72x	0.53x	-
EV/EBITDA	8.8x	6.2x	4.7x	-
P/E (f.d.)	11.0x	5.4x	7.4x	-

All figures in US $, unless otherwise specified

Company Profile

Founded in 1967, ADENTRA Inc. is a Canada-based distributor of architectural products.
The company is engaged in the business of distributing its products to fabricators, home centers, and professional dealers servicing the new residential, repair and remodel, and commercial construction end markets.

Please see the following pages for more information.

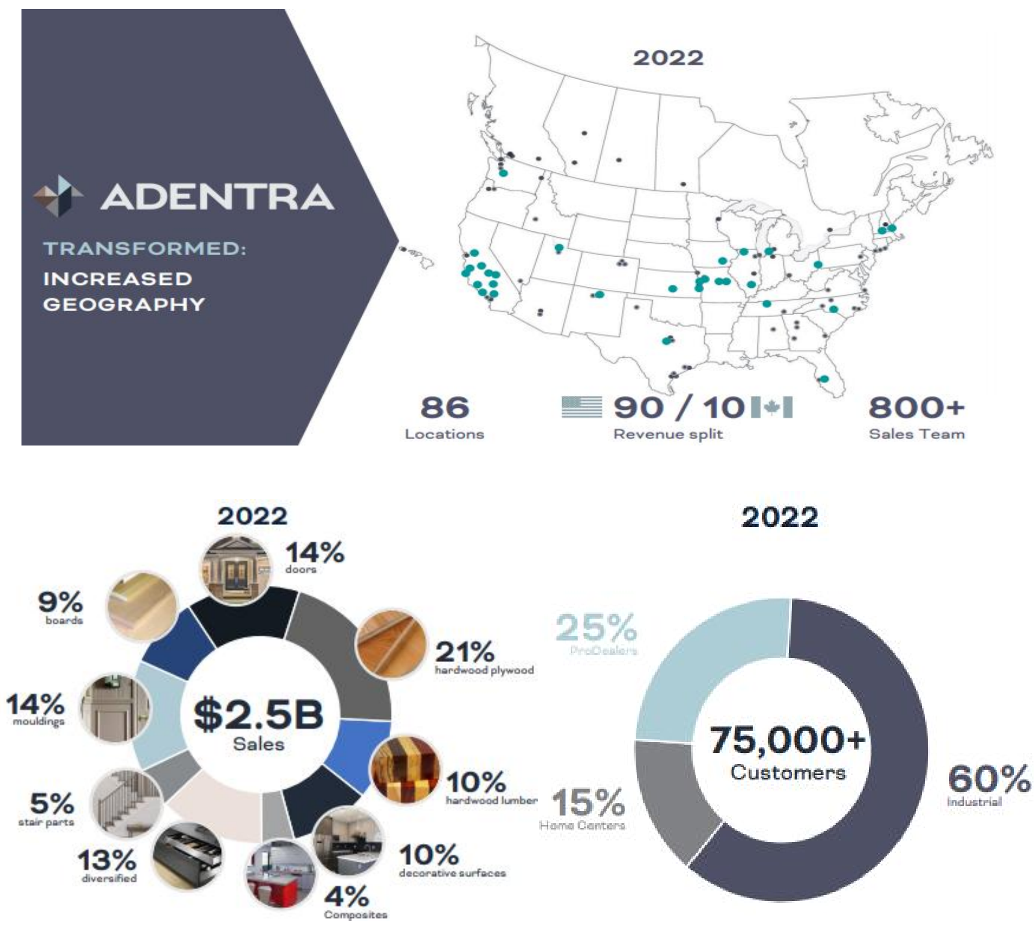
Details

Company Overview

ADENTRA Inc. Is one of North America's largest suppliers of specialty building products to fabricators, home centers, and professional dealers servicing the repair and remodel, residential, and commercial construction end-markets. The company currently operates a network of 86 facilities in the United States and Canada. And it provides supply solutions to approximately 75,000 customers and clients and uses over four channels to market, which include industrial, home center, ProDealer, and architects and designers. The company's portfolio includes architectural panels, trim and millwork, stair parts and railings, interior and exterior doors, windows, kitchen cabinets, decorative surfaces, decorative and functional hardware, plywood, hardwood lumber and boards, veneers, fasteners and adhesives, roofing, decking, and siding.

The company was formerly known as Hardwoods Distribution Inc., and changed its name to ADENTRA Inc. in December 2022. It was incorporated in 2012 and is headquartered in Langley, BC. The company is listed on TSX under the ticker ADEN, and it reports its financial results in US dollars.

Exhibit 1: Revenue Breakdown



Source: Annual reports, MD&A

Industry Outlook

A downward shift in economic momentum from interest rate hikes and continued inflationary pressure has been reflected in the recent slowdown in new housing activity. Since 1950, residential spending typically rebounds quickly after recessionary periods. Long-term averages support residential spending representing 4-7% of the total US GDP.

The repair and remodel market should remain well supported by a record level of home equity in the U.S. and a median home age of over 40 years. Disaster repairs and mitigation projects following Hurricane Ian are also expected to support the home remodeling market in the coming year.

Multi-family housing alternatives are an important segment of the industry, providing increasing supply and addressing gaps in single-family supply/affordability. Total housing starts are expected to decline in 2023, with a mixed recovery between single-family and multi-family by 2024. Over the longer term, leading indicators for the residential construction market remain highly favorable.

Non-residential spending reached a peak before COVID, and its growth was positive in 2022 (increasing 6% from 2021). Mix shift away from manufacturing will be favorable for ADENTRA through 2025.

Home improvement and remodeling will continue to be healthy in the near term given the housing stock scale and high levels of home equity to support the financing of renovations

Overall construction spending will soften in the near term, however, opportunities exist in remodeling (digital transformation continues), and nonresidential construction (in the Southern US).

Exhibit 2: Key Assumptions

Assumptions	Projection periods				
	2023	**2024**	**2025**	**2026**	**2027**
Income Statement Assumptions					
Sales (% growth)	30.0%	20.0%	10.0%	5.0%	2.0%
Cost of Goods Sold (% sales)	80.0%	80.0%	80.0%	80.0%	80.0%
SG&A (% sales)	15.0%	15.0%	15.0%	15.0%	15.0%
Depreciation & Amortization (% sales)	2.6%	2.6%	2.6%	2.6%	2.6%
Cash Flow Statement Assumptions					
Capital Expenditures (% of sales)	0.3%	0.3%	0.3%	0.3%	0.3%
Current Assets					
Days Sales Outstanding (DSO)	37.3	37.3	37.3	37.3	37.3
Days Inventory Held (DIH)	85.0	85.0	85.0	85.0	85.0
Prepaid and Other Current Assets (% of sales)	1.3%	1.3%	1.3%	1.3%	1.3%
Current Liabilities					
Days Payable Outstanding (DPO)	16.0	16.0	16.0	16.0	16.0
Accrued Liabilities (% of sales)	3.0%	3.0%	3.0%	3.0%	3.0%
Other Current Liabilities (% of sales)	2.5%	2.5%	2.5%	2.5%	2.5%

Source: Analyst estimates

Exhibit 3: WACC Calculation

WACC Calculation		Note
Target Capital Structure		
Debt-to-Total Capitalization	50.0%	Leverage increases due to acquisitions. Use historical average.
Equity-to-Total Capitalization	50.0%	
Cost of Debt		
Cost-of-Debt	6.05%	From Capital IQ for BB rating
Tax Rate	25.1%	Most recent year tax rate
After-tax Cost of Debt	**4.53%**	
Cost of Equity		
Risk-free Rate	4.0%	Interpolated yield on 10-year U.S. Treasury
Market Risk Premium	7.0%	Historical equity risk premium was about 7% (for small cap stocks)
Levered Beta	1.30	Regress ADEN against SPTSX to obtain raw beta. Then adjusted.
Cost of Equity	13.1%	
WACC	**8.82%**	

Source: Capital IQ, analyst estimates

Valuation (Absolute and Relative)

We used Free Cash to Firm (FCFF) method due to changes in the capital structure for the past few years (e.g. acquisitions), and we believe the firm will continue to do so in the foreseeable future. The target price under the FCFF method was C$38.61.

We used comparable companies from Capital IQ. Due to the nature of the business (capital intensive), we prefer EBITDA over EBIT. The average target price under relative valuation was C$45.30. Note that there were not many truly comparable companies in this case, therefore, we would rely more on our absolute valuation.

Exhibit 4: Discounted Cash Flow Analysis

	Historical Period		Projection Period				
	2021	2022	2023	2024	2025	2026	2027
Sales	**$1,616,199.0**	**$2,585,918.4**	**$3,361,693.9**	**$4,034,032.7**	**$4,437,436.0**	**$4,659,307.8**	**$4,752,493.9**
% growth	*74.1%*	*60.0%*	*30.0%*	*20.0%*	*10.0%*	*5.0%*	*2.0%*
Cost of Goods Sold	(1,243,289.0)	(2,000,000.0)	(2,689,355.1)	(3,227,226.2)	(3,549,948.8)	(3,727,446.2)	(3,801,995.1)
Gross Profit	**$372,910.0**	**$585,918.4**	**$672,338.8**	**$806,806.5**	**$887,487.2**	**$931,861.6**	**$950,498.8**
% margin	*23.1%*	*22.7%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Selling, General & Administrative	(224,579.0)	(359,326.4)	(504,254.1)	(605,104.9)	(665,615.4)	(698,896.2)	(712,874.1)
EBITDA	**$148,331.0**	**$226,592.0**	**$168,084.7**	**$201,701.6**	**$221,871.8**	**$232,965.4**	**$237,624.7**
% margin	*9.2%*	*8.8%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Depreciation & Amortization	36,579.0	64,697.3	87,404.0	104,884.9	115,373.3	121,142.0	123,564.8
EBIT	**$111,752.0**	**$161,894.7**	**$80,680.7**	**$96,816.8**	**$106,498.5**	**$111,823.4**	**$114,059.9**
% margin	*6.9%*	*6.3%*	*2.4%*	*2.4%*	*2.4%*	*2.4%*	*2.4%*
Taxes	28,013.7	40,583.3	20,224.8	24,269.8	26,696.8	28,031.6	28,592.2
EBIAT	**$83,738.3**	**$121,311.3**	**$60,455.8**	**$72,547.0**	**$79,801.7**	**$83,791.8**	**$85,467.6**
Plus: Depreciation & Amortization	36,579.0	64,697.3	87,404.0	104,884.9	115,373.3	121,142.0	123,564.8
Less: Capital Expenditures	(4,463.0)	(7,140.8)	(8,740.4)	(10,488.5)	(11,537.3)	(12,114.2)	(12,356.5)
Less: Inc./(Dec.) in Net Working Capital			98,439.4	(141,789.7)	(85,073.8)	(46,790.6)	(19,652.1)
Unlevered Free Cash Flow			**$237,558.9**	**$25,153.7**	**$98,563.9**	**$146,029.0**	**$177,023.9**
WACC	8.82%						
Discount Period			1.0	2.0	3.0	4.0	5.0
Discount Factor			0.92	0.84	0.78	0.71	0.66
Present Value of Free Cash Flow			**$218,299.0**	**$21,240.4**	**$76,482.0**	**$104,126.4**	**$115,993.6**

Source: Company Documents, Capital IQ, analyst estimates

Enterprise Value		Implied Equity Value and Share Price	
Cumulative Present Value of FCF	**$536,141.3**	Enterprise Value	$1,314,650.2
		Less: Total Debt	(415,191.0)
Terminal Value		Less: Preferred Stock	-
Terminal Year EBITDA (2027E)	$237,624.7	Less: Noncontrolling Interest	-
Exit Multiple	5.0	Plus: Cash and Cash Equivalents	7,762.0
Terminal Value	**$1,188,123.5**		
Discount Factor	0.66	**Implied Equity Value**	**$907,221.2**
Present Value of Terminal Value	**$778,508.9**		
% of Enterprise Value	*59.2%*	Fully Diluted Shares Outstanding	23,496.7
Enterprise Value	**$1,314,650.2**	**Implied Share Price**	**$38.61**

Source: Company Documents, Capital IQ, analyst estimates

Exhibit 5: Relative Valuation

Relative Valuation			
Company Name	**EV/ LTM Revenues**	**EV/LTM EBITDA**	**P/LTM Diluted EPS**
Doman Building Materials Group Ltd. (TSX:DBM)	0.4	7.2	7.2
Interfor Corporation (TSX:IFP)	0.4	1.8	2.3
Richelieu Hardware Ltd. (TSX:RCH)	1.3	8.4	13
Toromont Industries Ltd. (TSX:TIH)	2.1	11.5	20.6
Russel Metals Inc. (TSX:RUS)	0.5	4	6.2
West Fraser Timber Co. Ltd. (TSX:WFG)	0.6	1.8	-
Louisiana-Pacific Corporation (NYSE:LPX)	1.1	3	5.1
Taiga Building Products Ltd. (TSX:TBL)	0.1	2.3	3.5
Finning International Inc. (TSX:FTT)	0.8	7	10.9
Grafton Group plc (LSE:GFTU)	0.9	5.6	10.1
Mean	0.8	5.3	8.8
Median	0.7	4.8	7.2
ADENTRA Inc. (TSX:ADEN)	0.5	4.7	3.6
LTM stats	2520.2	257.2	6.34
Implied price per share	56.4	23.8	55.7
Average	**45.3**		

Source: Company Documents, Capital IQ, analyst estimates

Justification of Target Price

Based on the above, the weights we assigned to absolute and relative valuation were 80% and 20%. This gives the weighted average target price of **C$39.95.**

Half of the revenue growth was organic (the other half was through acquisition), so we expect sales will be 30% for FY 2023 (given 60% for FY 2022). Other variables are in line with historical average.

The exit EV/EBITDA multiple we used was 5.0x, and it is in line with the historical average. We view as appropriate due to near-term macro uncertainty and acquisitions, and we believe that the resiliency and growth potential of the business have meaningfully sustainably improved over the past two years.

This target price represents a **33.0%** return in the next twelve months. Therefore, we issued a **BUY** recommendation.

Key Risks to Target Price

Key risks to our target price include: economic growth, debt is not well covered by operating cash flow; acquisitions that do not create shareholder value; interest rate uncertainty; foreign exchange exposure (CAD/USD).