Research as a Service

Millennium Services Group Ltd

Q1 FY24 cashflow

Strongest quarterly revenue growth since H2 FY18

Human Services

23 October 2023

Millennium Services Group Ltd (ASX:MIL) has released its Q1 FY24 cash flow incorporating updated revenue commentary. Contracted revenue rose 14.3%, an acceleration on Q4 FY23 on the back of new contract wins and wage inflation. Total growth was 12.6%, the strongest growth since H2 FY18. Operating cash flow was negative $3.6m, a 23% improvement on the pcp (implying improved gross margins) with both impacted by the timing of collections and an additional fortnightly wage payment. For these reasons, MIL quarterly cash flow can be volatile but not an area of concern. Net debt excluding trade financing (related to the funding of wage payment timing) ended the quarter at $3.1m. MIL's share price has performed exceptionally well since July 2023, up 118% against a decline in the selected peer average of 8%. This performance has narrowed MIL's discount to peers to 6% using FY23 actuals and 40% using FY24 estimates. A multiple equal to the peer group using MIL's FY24 estimates would imply a share price of $1.08/share.

Business model

MIL is a human services business with a focus on the essential services of cleaning and security, bidding for predominantly long-term contracts that have annual contract adjustments to protect MIL from movements in labour resource costs. Additional volumes over and above those contracted can be gained from ad-hoc services, which represent ~10% of group revenue at a higher average margin. Satisfying contractual obligations utilising a vast workforce and procuring consumables for the jobs within the contracted price is 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 to demonstrate transparency in these important areas (which most large private companies can't achieve), will be key in this push.

Contract revenue growth with improved margins

The 14.3% increase in contracted revenue for Q1 FY24 is an improvement over the 12.2% growth in Q4 FY23 on the back of new contract wins, material contract extensions and the impacts of wage inflation. While gross margins were not disclosed, using cash receipts and product costs in the 4C as a guide Q1 FY24 saw a modest improvement over Q1 FY23, which was impacted by the timing of contracted wage inflation pass through. Leverage from this revenue growth and improved gross margins off a relatively fixed cost base is key to delivering EBITDA guidance of $12.2m-$13.2m for FY24, at least 55% ahead of FY23. We have made no change to estimates as a result the Q1 FY24 cash flow release.

Relative EV/EBITDA implies a $1.08/share valuation

Our assessed peer group average FY23 EV/EBITDA multiple is now 4.2x, down from 4.8x in August 2023. Applying this multiple to MIL's FY24 RaaS estimates (given they are well above FY23) implies a valuation of $1.08/share. We see no reason why this business does not deserve multiples closer to the peer average given average contract length (three-five years), relatively low working capital, low capex intensity and market consolidation opportunities. To sense check, our DCF valuation is $1.15/share.

Historical earnings and RaaS' estimates (in A$m unless otherwise stated)

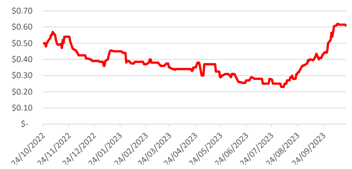
Year end	Revenue	Adj. EBITDA	NPAT adj.	P/E adj (x)	EV/adj EBITDA (x)	Yield (%)
06/22a	260.6	11.1	3.9	7.2	2.9	0
06/23a	265.8	7.9	1.4	20.0	4.0	0
06/24f	301.0	12.6	4.3	6.5	2.4	4.9
06/25f	313.0	13.7	5.4	5.2	1.9	6.6

Source: Company data, RaaS estimates for FY24f and FY25f

Share Details

ASX code	MIL
Share price (20 Oct)	$0.61
Market capitalisation	$28.0M
Shares on issue	45.9M
Net debt at 30-Sep-23 (excl. debtor finance)	$3.1M
Free float	~31.5%

Share Performance



Upside Case

- New contract wins
- Successfully diversify industry exposure to include government, education and aged care
- EPS accretive/complementary acquisitions

Downside Case

- Competitive margin pressures re-emerge
- Sizable contract loss
- Timing of wages growth vs contracts clauses

Board of Directors

Darren Perry	Chairman
Royce Galea	CEO
Rohan Garnett	Non-Executive Director

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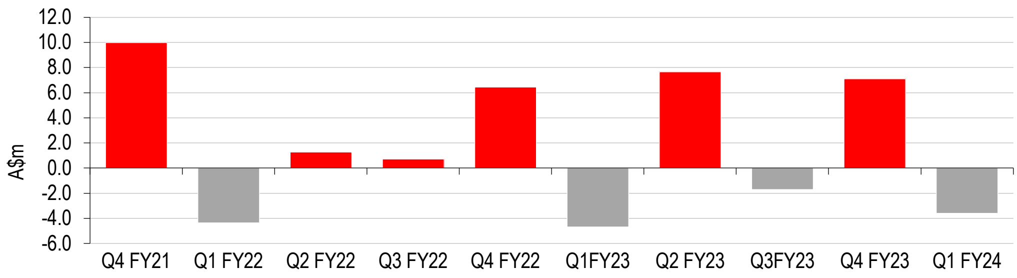
Q1 FY23 Revenue/Cash Flow Update

Key takeaways from the Q1 FY24 4C cash flow release include:

- **Negative cash flow of $3.6m,** which was an improvement of 23% on the $4.7m out flow reported Q1 FY22, with both quarters impacted by the timing of prior quarter collections and the payment of an extra fortnight's wages. For these reasons MIL's quarterly cash flow numbers are volatile quarter to quarter as the chart below demonstrates.

Exhibit 1: MIL quarterly cash flow history



Source: Company announcements

- **Implied gross margin improvement**. Q1 FY23 delivered a 12.8% gross margin, well below the ~15% target due to the timing in recouping contracted wage cost increases. Using Q1 FY23 cash receipts and product operating costs as a guide to gross margins there is a modest improvement in Q1 FY24 over Q1 FY23, implying an improved gross margin.
- **Net debt (excluding debtor financing) of $3.1m**, or $11m including the $7.9m debtor financing facility used to fund the extra fortnight payment in the quarter (~$6.5m).
- **Improved contract revenue growth of 14.3%** against the 12.2% delivered in Q4 FY23 on the back of new contract wins and wage cost inflation.
- **Lower ad-hoc revenues, down 6%** to be 7% of revenue, down from 8% of revenue in Q1 FY23.
- **Total revenue growth of 12.6%, the highest since H2 FY18.**

Exhibit 2: MIL quarterly sales history (in A$m unless otherwise stated)

	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24
Sales	**63.3**	**66.2**	**68.2**	**68.0**	**71.3**
Contract	58.2	60.2	62.4	62.7	66.5
Ad hoc	5.1	6.0	5.8	5.3	4.8
% growth	(3.5)	0.1	3.5	8.1	12.6
Sales mix (%)					
Contract	92	91	91	92	93
Ad hoc	8	9	9	8	7

Source: Company announcements and RaaS estimates

FY24 Outlook

Management has provided some detailed guidance with a relatively narrow range for FY24 across several line items which we discuss below.

- **Revenue** guidance is for $300m-$305m, implying 12.8%-14.8% growth on FY23.

New contract wins (including Amazon, Baby Bunting, new Security contracts and first time business in Darwin), material contract extensions ($310m) and wage inflation/cost put-throughs are all key reasons for this growth. Importantly 95% of the forecast revenue is contracted for FY24.

- **Gross margins.** While no explicit guidance was provided, given the 5.75% award wage increase effective July 2023 we expect some pressure in passing this increase through to contracted clients in full, and as a result have assumed gross margins just 30bps above FY23 at 14.6%.
- **Operating costs**. In-line with FY23 we have assumed a 4.0% increase on operating costs, with management focused on delivering operational leverage.
- **EBITDA guidance as a result is $12.2m-$13.2m**, again a relatively narrow range and implying underlying growth of 54%-67%.
- **Interest expense** remains elevated despite low debt levels due to the invoice financing facility.
- **Codee (Minorities).** We have assumed Codee Cleaning Services contributes at a similar level to FY23, which was well above FY22.
- **Dividends set to resume in FY24** at 30%-40% of sustainable NPAT. Using RaaS estimates for NPAT of $4.4m, a 30% payout implies a dividend of 3cps implying a yield of 5% at the current share price.

Relative Peer Group Valuation

We compare MIL to other listed small-cap players that rely heavily on human resources and to a lesser extent equipment to deliver their services to typically larger clients.

The table below summarises actual FY23 metrics across a wide range of variables. We also provide MIL FY24 estimates given the magnitude of forecast EBITDA uplift relative to peers.

MIL currently trades at a material (6%) discount to the FY23 EV/EBITDA peer average of 4.2x despite generally longer contract terms, similar gross margins, and lower working capital/capex requirements.

This discount increases to 40% if we use forecast MIL FY24 metrics against peer FY23 metrics.

Exhibit 3: Peer group financial comparison – FY23a (in A$m unless otherwise stated)

Company name	Ticker	Share price (cps)	Mkt. cap.	Net debt (cash) (Jun-23)	Adj. EBITDA	revenue	GP%	Working capital/sales %	EV/ Sales (x)	EV/ EBITDA
GR Engineering	GNG	2.20	341	-78.9	42.1	551	11	0	0.48	6.2
PeopleIn	PPE	1.61	162	73.3	61.1	1,186	8	8	0.20	3.8
Licopodium	LYL	8.79	349	-81.7	73.0	328	26	10	0.82	3.7
Southern Cross Electrical	SXE	0.80	208	-77.6	35.4	465	16	3	0.28	3.7
Ashley Services	ASH	0.59	85	5.7	18.9	549	16	3	0.16	4.8
BSA Limited	BSA	0.60	43	2.1	14.0	240	26	(3)	0.19	3.2
AVERAGE							**17**	**4**	**35%**	**4.2**
Millennium (FY23a)	MIL	0.61	28	3.3	7.9	266	14	1	0.12	4.0
Millennium (FY24f)	MIL	0.61	28	3.3	12.6	301	14	1	0.10	2.5

Sources: Company financials, Refinitiv, RaaS estimates

Outlook And Investment Case

- The group operates in markets worth an estimated $11.7b (cleaning) and $9.8b (investigation and security services), according to IBISWorld. In the cleaning business (~83% of MIL revenue) MIL has less than 2% market share in a market where the top-four largest players have less than 10% of the market, offering significant market-share opportunities.
- The group's growth strategy will look to use the current balance sheet, ASX listing and trading history to increase "value-add" services, participate in industry rationalisation, and use technology such as rostering and traffic-flow systems and robotics to improve operating efficiencies.
- The acquisition of 49% of Codee Cleaning Services in December 2021 overlays industry consolidation with an increasing focus on ESG, with Codee performing exceptionally well in FY23.
- Net debt was just $3.1m as at September 2023 (excluding trade finance), providing a solid base from which to grow and/or acquire while looking at capital management options. MIL has undrawn banking facilities of $12m.
- Gross margin has been under pressure from timing issues associated with significant award wage increases in recent years (4.8% in FY22 and 5.75% in FY23) but recent guidance suggests this is being worked through with key clients under contracted cost pass-through clauses.
- A change in debt covenants, strong balance sheet and improved earnings paves the way for the resumption of dividends in FY24. A 30%-40% pay-out ratio at current prices would imply a dividend yield of between 5% using RaaS estimates.
- Recent M&A transactions of similar businesses add valuation support to MIL, namely the 75% purchase of Linc Personnel by Ashley Services for 3.4x EBITDA, and the 100% acquisition of BIC by Bidvest for ~8.8x EBITDA.

Exhibit 4: Financial Summary (in A$m unless otherwise stated)

Millennium Services (ASX.MIL)					
Profit and Loss (A$m)					
Y/E 30 June	**FY21A**	**FY22A**	**FY23A**	**FY24F**	**FY25F**
Revenue	273.7	260.6	265.8	301.0	313.0
Gross profit	40.8	39.8	37.7	43.6	45.6
GP margin %	14.9%	15.3%	14.2%	14.5%	14.6%
Underlying EBITDA	11.6	11.1	7.9	12.6	13.7
Depn	(4.9)	(4.6)	(4.3)	(4.5)	(4.3)
Minorities (AT)	0.0	0.1	0.2	0.2	0.2
EBIT	6.8	6.7	3.8	8.3	9.6
Interest	(1.8)	(1.2)	(1.9)	(2.2)	(2.0)
Tax	(1.6)	(1.6)	(0.5)	(1.8)	(2.2)
NPAT (adj)	**3.4**	**3.9**	**1.4**	**4.3**	**5.4**
Adjustments	(1.2)	(1.6)	(0.8)	0.0	0.0
NPAT	**2.2**	**2.3**	**0.6**	**4.3**	**5.4**
Abnormals (net)	15.2	0.0	0.0	0.0	0.0
NPAT (reported)	**17.4**	**2.3**	**0.6**	**4.3**	**5.4**
Cash flow (A$m)					
Y/E 30 June	**FY21A**	**FY22A**	**FY23A**	**FY24F**	**FY25F**
EBITDA (inc cash rent/JK)	29.3	10.0	6.8	11.5	12.5
Interest	(1.8)	(1.2)	(1.9)	(2.2)	(2.0)
Tax	(0.1)	(2.4)	(2.9)	(1.8)	(2.2)
Working capital changes	12.9	(1.6)	3.8	0.0	0.0
Operating cash flow	**40.3**	**4.8**	**5.9**	**7.6**	**8.3**
Mtce capex	(2.2)	(1.8)	(2.6)	(2.4)	(2.3)
Free cash flow	**38.1**	**3.0**	**3.3**	**5.2**	**6.0**
Growth capex	0.0	0.0	0.0	0.0	0.0
Acquisitions/Disposals	0.0	0.0	0.0	0.0	0.0
Other	(2.1)	(2.2)	(1.5)	(1.0)	(1.0)
Cash flow pre financing	36.0	0.8	1.8	4.2	5.0
Equity	0.0	0.0	0.0	0.0	0.0
Debt drawdown/(repay)	(21.4)	(2.0)	(1.2)	(3.0)	(1.0)
Net Dividends paid	0.0	0.0	0.0	(0.7)	(1.6)
Net cash flow for year	**14.6**	**(1.2)**	**0.5**	**0.5**	**2.4**
Balance sheet (A$m)					
Y/E 30 June	**FY21A**	**FY22A**	**FY23A**	**FY24F**	**FY25F**
Cash	7.3	1.9	3.3	3.6	6.1
Accounts receivable	18.0	17.3	16.0	18.0	18.8
Inventory	1.1	1.2	1.6	1.8	1.9
Other current assets	2.3	1.9	2.3	5.3	7.0
Total current assets	*28.8*	*22.3*	*23.2*	*28.8*	*33.7*
PPE	7.0	6.8	7.7	6.7	5.8
Goodwill	7.5	7.5	7.5	7.5	7.5
Right of use asset	3.0	1.7	2.7	2.7	2.7
Deferred tax asset	8.5	7.8	8.0	8.0	8.0
Equity accounted Investee	0.0	1.3	1.5	1.5	1.5
Total non current assets	*26.0*	*25.0*	*27.4*	*26.4*	*25.5*
Total Assets	54.9	47.4	50.6	55.2	59.2
Accounts payable	17.3	15.0	17.9	20.2	21.0
Short term debt	5.5	4.7	4.4	1.4	0.4
Provisions	22.6	20.0	19.8	22.5	23.4
Lease liabilities/other	5.5	3.4	1.2	1.2	1.2
Total current liabilities	*50.9*	*43.1*	*43.4*	*45.3*	*46.0*
Long term debt	2.1	1.2	2.2	2.2	2.2
Other non current liabs	4.1	2.7	3.7	3.7	3.7
Total long term liabilities	*6.2*	*3.9*	*5.9*	*5.9*	*5.9*
Total Liabilities	57.1	47.0	49.2	51.1	51.9
Net Assets	**(2.3)**	**0.4**	**1.4**	**4.0**	**7.4**
Share capital	19.1	19.1	19.2	19.2	19.2
Reserves	(8.3)	(7.9)	(7.6)	(7.6)	(7.6)
Retained Earnings	(13.1)	(10.8)	(10.2)	(7.4)	(4.2)
Minorities	0.0	0.0	0.0	0.0	0.0
Total Shareholder funds	**(2.4)**	**0.4**	**1.4**	**4.1**	**7.4**

Share price (20 October 2023)					A$	0.610
Interim (A$m)	**H122A**	**H222A**	**H123A**	**H223A**	**H124F**	**H224F**
Revenue	131.7	128.9	129.6	136.1	148.0	153.0
EBITDA	6.7	4.4	2.8	5.1	5.5	7.1
EBIT	4.4	2.2	0.6	2.9	3.3	4.8
NPAT (adjusted)	**2.7**	**1.0**	**(0.1)**	**1.3**	**1.5**	**2.6**
Minorities (AT)	0.0	0.1	0.1	0.1	0.1	0.1
NPAT (reported)	**1.9**	**0.2**	**(0.7)**	**1.1**	**1.5**	**2.6**
EPS (normalised)	0.041	0.005	(0.016)	0.024	0.033	0.056
EPS (reported)	0.041	0.005	(0.016)	0.024	0.033	0.056
Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.015
Imputation						
Operating cash flow	na	na	na	na	na	na
Free Cash flow	na	na	na	na	na	na
Divisionals	**H122A**	**H222A**	**H123A**	**H223A**	**H124F**	**H224F**
Cleaning	99.6	103.5	107.7	113.1	122.4	126.5
Security	32.1	25.3	21.9	23.1	25.6	26.5
(Other)	-	-	-	-	-	-
Total Revenue	**131.7**	**128.9**	**129.6**	**136.1**	**148.0**	**153.0**
Gross profit	21.0	18.8	18.1	19.6	21.4	22.2
Underlying GP Margin %	15.9%	14.6%	14.0%	14.4%	14.5%	14.5%
Operating Costs						
Employment	8.8	8.9	9.7	9.0	10.1	9.4
Other	5.5	5.5	5.6	5.5	5.8	5.7
Exceptional	-	-	-	-	-	-
Total costs	**14.3**	**14.4**	**15.3**	**14.5**	**15.9**	**15.1**
Underlying EBITDA	**6.7**	**4.4**	**2.8**	**5.1**	**5.5**	**7.1**
EBITDA margin %	5.1%	3.4%	2.2%	3.8%	3.7%	4.6%
Margins, Leverage, Returns		**FY21A**	**FY22A**	**FY23A**	**FY24F**	**FY25F**
EBITDA margin %		4.3%	4.3%	3.0%	4.2%	4.4%
EBIT margin %		2.5%	2.6%	1.4%	2.8%	3.1%
NPAT margin (pre significant items)		0.8%	0.9%	0.2%	1.4%	1.7%
Net Debt (Cash)		0.3	4.0	3.3	0.0	-3.5
Net debt/EBITDA (x)	(x)	0.0 x	0.4 x	0.4 x	0.0 x	-0.3 x
ND/ND+Equity (%)	(%)	11.5%	111.7%	169.6%	1.2%	32.1%
EBIT interest cover (x)	(x)	0.3x	0.2x	0.5x	0.3x	0.2x
ROA		11.6%	13.1%	7.8%	15.7%	16.7%
ROE		nm	nm	nm	nm	nm
ROIC		nm	nm	nm	nm	nm
NTA (per share)		-0.21	-0.15	-0.13	-0.07	0.00
Working capital		1.9	3.5	-0.3	-0.4	-0.4
WC/Sales (%)		**0.7%**	**1.3%**	**(0.1%)**	**(0.1%)**	**(0.1%)**
Revenue growth		(2.9%)	(4.8%)	2.0%	13.3%	4.0%
EBIT growth pa		nm	(1.1%)	(42.9%)	117.3%	15.2%
Pricing		**FY21A**	**FY22A**	**FY23A**	**FY24F**	**FY25F**
No of shares (y/e)	(m)	45.9	45.9	45.9	45.9	45.9
Weighted Av Dil Shares	(m)	45.9	45.9	45.9	45.9	45.9
EPS Reported	cps	0.379	0.049	0.013	0.094	0.117
EPS Adjusted	cps	0.074	0.085	0.031	0.094	0.117
EPS growth (norm/dil)		nm	14%	-64%	208%	24%
DPS	cps	0.000	0.000	0.000	0.030	0.040
DPS Growth		n/a	n/a	n/a	n/a	33%
Dividend yield		0.0%	0.0%	0.0%	4.9%	6.6%
Dividend imputation		30	30	30	30	30
PER Adjusted (x)		8.2	7.2	20.0	6.5	5.2
PE market		15	15	15	15	15
Premium/(discount)		(45.4%)	(52.2%)	33.1%	(56.9%)	(65.1%)
EV/EBITDA		2.4	2.9	4.0	2.2	1.8
FCF/Share	cps	83.0	4.9	14.2	11.2	13.2
Price/FCF share		0.7	12.5	4.3	5.4	4.6
Free Cash flow Yield		136.1%	8.0%	23.9%	18.4%	21.6%

Source: RaaS estimates

FINANCIAL SERVICES GUIDE

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