

Millennium Services Group Ltd

Q1 FY23 Cash Flow/Update

Solid underlying contract growth

Millennium Services Group Ltd (ASX:MIL) has released its Q1 FY23 cash flow incorporating updated revenue commentary. Contracts revenue rose 4% despite cycling the last of the QIC contract expiry (underlying growth estimated at ~11%). Ad-hoc revenues were lower as guided and forecast as COVID-related activity declined. Operating cash flow was negative \$4.7m, similar to the pcg due to both the timing of collections and the number of fortnightly wage payments in a quarter. 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 \$1.4m. The renegotiation of finance facilities remains well advanced and is key for the resumption in dividend payments. MIL's share price has performed well since July 2022, up 78% against the selected peer average of 11%. Despite this performance the group continues to trade at a 55% FY22a EV/EBITDA discount to the peer group. A multiple closer to the peer group would imply a share price of \$1.20/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 ~15% 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 keys in this push.

Debt renegotiation remains a key catalyst

MIL quarterly cash flow numbers can be volatile depending on the timing of collections and the payment of wages. Revenue trends (higher contract/lower ad-hoc) and gross margins (a touch higher than FY22) have been well flagged, so there are few surprises in the September quarter 4C. With net debt at \$1.4m (ex-trade finance) the renegotiation of debt facilities and removal of dividend covenants is a key catalyst in coming months. On our estimates a 50% pay-out ratio on FY23 EPS estimates would imply a yield of 12% fully franked.

Relative EV/EBITDA implies a \$1.20 valuation

Our assessed peer group average FY22 EV/EBITDA multiple implies a \$1.20/share valuation for MIL (5.3x EV/EBITDA), and we see no reason why this business does not deserve multiples closer to the peer average given average contract length (three-five years), relative working capital intensity and market opportunities. Recent M&A activity would imply a valuation of \$0.84/share based on the (ASX:ASH) purchase of Linc Personnel, and \$2.14/share based on the (JSE:BVT) acquisition of BIC. To sense check, our DCF valuation is \$1.15/share.

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

Year end	Adj. revenue	Und. EBITDA	NPAT rep.	EPS adj. (c)	P/E (x)	EV/Adj. EBITDA
06/21a	273.7	11.6	2.2	0.07	6.4	1.9
06/22a	260.6	11.1	2.3	0.09	5.6	2.3
06/23f	266.0	11.8	5.2	0.11	4.3	1.9
06/24f	276.6	12.5	5.9	0.13	3.7	1.4

Source: Company data, RaaS estimates for FY23f and FY24f

Human Services

31st October 2022

Share Details

ASX code	MIL
Share price (28-Oct)	\$0.48
Market capitalisation	\$22.0M
Shares on issue	45.9M
Net debt at 30-Sep-22	\$1.4M
Free float	~31.5%

Share Performance



Upside Case

- Converting a portion of the tender pipeline over the next 18 months
- 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

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

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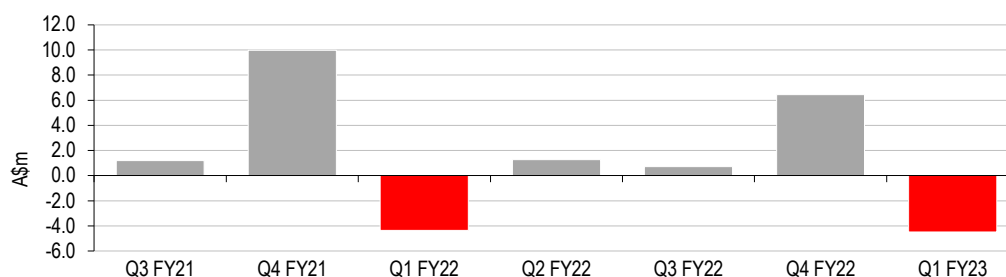
*The author owns shares

Q1 FY23 Revenue/Cash Flow Update

Key takeaways from the Q1 FY23 4C cash flow release include:

- **Negative cash flow of \$4.7m**, which was similar to Q1 FY22 due to 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

- **Net debt (excluding trade financing) of \$1.4m.** The currently finance facilities expiry at the end of December and the company is "well under way in the process of seeking to renegotiate its finance facilities". This is key for the resumption of dividends currently restricted by existing covenants.
- **Improved contract revenue with growth of 4.0%** despite cycling the last of the QIC contract expiry during the quarter. Adjusted for QIC (~\$3.8m in the PCP) we estimate underlying growth closer to 11%.
- **Lower ad-hoc revenues at 8% of revenue**, down from 15% in Q1 FY22, and while guided (due to a reduction in Victorian Government COVID activity) is at the low end of management guidance.

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

	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23
Sales	65.6	66.1	65.9	62.9	63.3
Contract	55.9	54.8	55.4	55.9	58.2
Ad hoc	9.7	11.4	10.5	7.0	5.1
% growth	2.0	(6.5)	(5.0)	(9.1)	(3.5)
Sales mix (%)					
Contract	85	83	84	89	92
Ad hoc	15	17	16	11	8

Source: Company announcements and RaaS estimates

Contracted sales through the year are very similar quarter-to-quarter and highlight the predictability of the business. Ad-hoc sales are declining as a % of sales as COVID-related work comes to an end.

Outlook

Revenue

Management is targeting 8%-10% organic contract revenue growth in FY23, which is in-line with our current expectations, reconciled in the table below. This growth will be required to offset lower ad-hoc revenue (forecast at 10% of revenue against 15% in FY22) and the last quarter of QIC contract expiry.

Management has revealed 97% of FY22 revenue is contracted in FY23, 81% in FY24 and 53% in FY25, highlighting the longer-term nature of contracts relative to our selected peers.

Exhibit 3: FY23 MIL sales reconciliation

Variable	A\$
Starting revenue base (FY22)	260.6
Less ad-hoc normalisation (from 15% to 11% of sales)	(9.6)
Less remaining QIC contract expiry (Sept qtr)	(7.0)
Add implied contract organic growth	21.0
FY23 RaaS forecast revenue	266.0
(Implied contract revenue growth)	9%

Source: RaaS estimates

Gross margin

The gross profit margin has been guided to 15.5%, up from 15.3% in FY22 despite the reduction in the ad-hoc mix (higher margin) on the back of procurement initiatives.

Operating costs

Despite wage costs being passed through there has been an increased focus on business development investment which is factored into our cost assumptions. Other costs remain relatively flat and exclude any assumptions of “one-off” costs.

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 FY22 metrics across a wide range of variables. MIL currently trades at a material (55%) discount to the FY22 EV/EBITDA peer average of 5.3x despite generally better contract terms, similar gross margins, and generally lower working capital requirements. Since 1 July 2022, the peer group has risen an average of 11% against a 78% increase in the MIL share price.

Exhibit 4: Peer group financial comparison – FY22 (in A\$m unless otherwise stated)

Company name	Ticker	Share price (cps)	Mkt. cap.	FY22 net debt	Adj. FY22 (f) EBITDA	FY22 (f) revenues	GP%	Working capital/sales %	EV/ Sales (x)	EV/ EBITDA
GR Engineering	GNG	2.26	351	(97.8)	56.4	652	12	(1)	0.39	4.5
PeopleIn	PPE	3.16	318	45.7	47.1	682	15	8	0.53	7.7
Licopodium	LYL	6.99	278	(99.4)	32.4	229	27	10	0.78	5.5
Southern Cross Electrical	SXE	0.67	174	(53.1)	35.3	553	13	11	0.22	3.4
Ashley Services	ASH	0.67	96	3.6	18.7	450	16	6	0.22	5.3
AVERAGE							17	7	0.43	5.3
Millennium	MIL	0.48	22	4.0	11.1	261	15	1	0.10	2.3

Sources: Company financials, RaaS estimates; *Pro-forma (Prices at 28 October 2022)

DCF Valuation

Our DCF valuation sits at \$1.15/share with key assumptions including:

- WACC 11.3% including a RFR of 3.5%, beta of 1.2x and equity risk premium of 6.5%;
- Medium-term growth rate of 3.0%, perpetuity growth of 2.2%; and
- Sustainable gross margin of 15.3% and EBITDA margin of 4.6%.

Exhibit 5: MIL base-case DCF valuation

Parameters	Outcome
Discount rate / WACC	11.3%
Beta	1.2x
Terminal growth rate assumption	2.2%
Sum of PV (\$m)	28.9
PV of terminal value (\$m)	27.9
PV of enterprise (\$m)	56.8
Debt (cash) (\$m)	4.0
Net value – shareholder (\$m)	52.8
No. of shares on issue (m)	45.9
NPV (\$/share)	\$1.15

Source: 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 (~70% 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.
- 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 of 3.6% between FY22 and FY26 on the back of a COVID recovery and a trend to more regular and comprehensive cleans.
- The group's three-year 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.
- Net debt was just \$1.4m as at September 2022 (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 \$14.9m.
- Gross margins are back to "targeted" levels and based on historical and peer analysis we feel these margins are sustainable at ~15% and EBITDA margins 4.5%-5.0%.
- A change in debt covenants would pave the way for the resumption of dividends. Based on FY22 RaaS adjusted EPS forecasts, a 50% pay-out ratio at current prices would imply a dividend yield of 12%.
- 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 6: Financial Summary (in A\$m unless otherwise stated)

Millennium Services (ASX:MIL)						Share price (27 October 2022)						A\$	0.480				
Profit and Loss (A\$m)						Interim (A\$m)						H121	H221	H122A	H222A	H123F	H223F
Y/E 30 June	FY20A	FY21A	FY22A	FY23F	FY24F	Revenue	159.7	138.7	131.7	128.9	131.9	134.1					
Revenue	257.3	273.7	260.6	266.0	276.6	EBIT DA	7.0	4.7	6.7	4.4	6.5	5.3					
Gross profit	30.8	40.8	39.8	41.1	42.6	EBIT	4.7	2.0	4.4	2.2	4.4	3.3					
GP margin %	12.0%	14.9%	15.3%	15.5%	15.4%	NPAT (normalised)	2.5	0.9	2.7	1.0	2.9	2.1					
Underlying EBIT DA	4.0	11.6	11.1	11.8	12.5	Minorities (AT)	0.0	0.0	0.0	0.1	0.1	0.1					
Depn	(5.9)	(4.9)	(4.6)	(4.0)	(3.8)	NPAT (reported)	1.9	0.3	1.9	0.2	2.9	2.1					
Minorities (AT)	0.0	0.0	0.1	0.1	0.1	EPS (normalised)	0.041	0.007	0.041	0.005	0.062	0.045					
EBIT	(1.9)	6.8	6.7	7.9	8.9	EPS (reported)	0.041	0.007	0.041	0.005	0.062	0.045					
Interest	(3.2)	(1.8)	(1.2)	(0.6)	(0.5)	Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.000					
Tax	5.3	(1.6)	(1.6)	(2.2)	(2.5)	Imputation											
NPAT (adj)	0.3	3.4	3.9	5.2	5.9	Operating cash flow	na	na	na	na	na	na					
Adjustments	1.7	(1.2)	(1.6)	0.0	0.0	Free Cash flow	na	na	na	na	na	na					
NPAT	2.0	2.2	2.3	5.2	5.9	Divisionals	H121	H221	H122A	H222A	H123F	H223F					
Abnormals (net)	14.5	15.2	0.0	0.0	0.0	Cleaning	107.9	109.0	99.6	103.5	100.4	107.8					
NPAT (reported)	16.5	17.4	2.3	5.2	5.9	Security	27.2	29.7	32.1	25.3	31.5	26.3					
Cash flow (A\$m)						(Other)	24.7	-	-	-	-	-					
Y/E 30 June	FY20A	FY21A	FY22A	FY23F	FY24F	Total Revenue	159.7	138.7	131.7	128.9	131.9	134.1					
EBIT DA (inc cash rent/JK)	19.4	29.3	10.0	10.7	11.4												
Interest	(3.2)	(1.8)	(1.2)	(0.6)	(0.5)	Gross profit	21.7	19.1	21.0	18.8	21.1	20.1					
Tax	0.5	(0.1)	(2.4)	(2.2)	(2.5)	Underlying GP Margin %	16.1%	13.8%	15.9%	14.6%	16.0%	15.0%					
Working capital changes	(16.6)	12.9	(1.6)	(0.1)	(0.1)	Operating Costs											
Operating cash flow	0.1	40.3	4.8	7.8	8.3	Employment	15.9	9.4	8.8	8.9	9.0	9.1					
Mtce capex	(2.2)	(2.2)	(1.8)	(1.9)	(1.9)	Other	6.2	5.0	5.5	5.5	5.6	5.7					
Free cash flow	(2.1)	38.1	3.0	6.0	6.4	Exceptional	- 7.3	-	-	-	-	-					
Growth capex	0.0	0.0	0.0	0.0	0.0	Total costs	14.8	14.4	14.3	14.4	14.6	14.8					
Acquisitions/Disposals	0.0	0.0	0.0	0.0	0.0												
Other	(1.7)	(2.1)	(2.2)	(2.0)	(2.0)	EBITDA	7.0	4.7	6.7	4.4	6.5	5.3					
Cash flow pre financing	(3.8)	36.0	0.8	4.0	4.4	EBIT DA margin %	4.4%	3.4%	5.1%	3.4%	4.9%	3.9%					
Equity	0.0	0.0	0.0	0.0	0.0	Margins, Leverage, Returns		FY20A	FY21A	FY22A	FY23F	FY24F					
Debt drawdown/(repay)	1.6	(21.4)	(2.0)	(3.0)	(1.6)	EBIT DA margin %		1.6%	4.3%	4.3%	4.4%	4.5%					
Net Dividends paid	0.0	0.0	0.0	0.0	0.0	EBIT margin %		(0.7%)	2.5%	2.6%	3.0%	3.2%					
Net cash flow for year	(2.2)	14.6	(1.2)	1.0	2.8	NPAT margin (pre significant items)		0.8%	0.8%	0.9%	1.9%	2.1%					
Balance sheet (A\$m)						Net Debt (Cash)		34.6	0.3	4.0	0.1	-4.2					
Y/E 30 June	FY20A	FY21A	FY22A	FY23F	FY24F	Net debt/EBIT DA (x)	(x)	8.6 x	0.0 x	0.4 x	0.0 x	-0.3 x					
Cash	1.8	7.3	1.9	2.8	5.5	ND/ND+Equity (%)	(%)	63.5%	11.5%	111.7%	(1.8%)	32.4%					
Accounts receivable	29.8	18.0	17.3	17.7	18.4	EBIT interest cover (x)	(x)	n/a	0.3x	0.2x	0.1x	0.1x					
Inventory	1.2	1.1	1.2	1.3	1.3	ROA		(6.0%)	11.6%	13.1%	16.2%	17.1%					
Other current assets	2.6	2.3	1.9	4.6	4.9	ROE		nm	nm	nm	nm	nm					
Total current assets	35.5	28.8	22.3	26.3	30.1	ROIC		nm	nm	nm	nm	nm					
PPE	8.6	7.0	6.8	5.8	5.0	NTA (per share)		-0.60	-0.21	-0.15	-0.04	0.03					
Goodwill	7.5	7.5	7.5	7.5	7.5	Working capital		14.8	1.9	3.5	3.6	3.7					
Right of use asset	2.9	3.0	1.7	1.7	1.7	WC/Sales (%)		5.7%	0.7%	1.3%	1.3%	1.3%					
Deferred tax asset	7.4	8.5	7.8	7.8	7.8	Revenue growth		(12.7%)	6.4%	(4.8%)	2.1%	4.0%					
Equity accounted Investee	0.0	0.0	1.3	1.3	1.3	EBIT growth pa		nm	(463.7%)	(1.1%)	18.3%	12.2%					
Total non current assets	26.4	26.0	25.0	24.0	23.2	Pricing		FY20A	FY21A	FY22A	FY23F	FY24F					
Total Assets	61.9	54.9	47.4	50.3	53.3	No of shares (y/e)	(m)	45.9	45.9	45.9	45.9	45.9					
Accounts payable	16.3	17.3	15.0	15.4	16.0	Weighted Av Dil Shares	(m)	45.9	45.9	45.9	45.9	45.9					
Short term debt	36.4	5.5	4.7	1.7	0.1												
Provisions	22.4	22.6	20.0	20.4	21.2	EPS Reported	cps	0.359	0.379	0.049	0.112	0.129					
Lease liabilities/other	0.8	5.5	3.4	3.4	3.4	EPS Adjusted	cps	0.006	0.074	0.085	0.112	0.129					
Total current liabilities	76.0	50.9	43.1	40.9	40.7	EPS growth (norm/dil)		nm	nm	14%	32%	15%					
Long term debt	0.0	2.1	1.2	1.2	1.2	DPS	cps	0.000	0.000	0.000	0.000	0.010					
Other non current liabs	5.8	4.1	2.7	2.7	2.7	DPS Growth		n/a	n/a	n/a	n/a	n/a					
Total long term liabilities	5.8	6.2	3.9	3.9	3.9	Dividend yield		0.0%	0.0%	0.0%	0.0%	2.1%					
Total Liabilities	81.8	57.1	47.0	44.7	44.6	Dividend imputation		30	30	30	30	31					
Net Assets	(19.9)	(2.3)	0.4	5.6	8.8	PER Adjusted (x)		nm	6.4	5.6	4.3	3.7					
						PE market		15	15	15	15	15					
Share capital	19.0	19.1	19.1	19.1	19.1	Premium/(discount)		nm	(57.0%)	(62.4%)	(71.5%)	(75.1%)					
Reserves	(8.5)	(8.3)	(7.9)	(7.9)	(7.9)	EV/EBIT DA		14.0	1.9	2.3	1.9	1.4					
Retained Earnings	(30.3)	(13.1)	(10.8)	(5.6)	(2.5)	FCF/Share	cps	(4.535)	83.023	4.895	13.012	13.902					
Minorities	0.0	0.0	0.0	0.0	0.0	Price/FCF share		(10.584)	0.578	9.807	3.689	3.453					
Total Shareholder funds	(19.9)	(2.4)	0.4	5.6	8.7	Free Cash flow Yield		(9.4%)	173.0%	10.2%	27.1%	29.0%					

Source: RaaS

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

ABN 92 168 734 530

AFSL 456663

Effective Date: 6th May 2021

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- how we transact with you
- how we are paid, and
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