

# Stealth Global Holdings Ltd

Update note

## African reset in the pursuit of higher margins

Stealth Global Holdings Limited (ASX:SGL) has announced the restructure of its African business in the pursuit of higher gross margins and improved capital employed. The African business through the supply of consumables and drilling equipment to Capital Drilling (also a major shareholder) represented ~26% (or \$19.7m) of proforma sales in FY19. We had estimated a GP% of 11% for this business in FY19 and 10% >FY20, but the company has indicated “it only produced single digit gross profit percentage returns”. With Australian margins sitting >29% and UK margins at ~35% there are clearly better margin opportunities for the company. From January 2020 Stealth will now only supply higher margin consumables to Capital on a “transactional” basis and has established a business development team to secure similar business in medium to larger clients. Our earnings assumptions had already pre-empted this directionally based on management commentary. By our estimates the current African revenue base could halve and gross profit maintained if gross profit margins can be lifted to 18% - still well below peers.

### Business model

Stealth Global Holdings is an Australian multinational distribution group providing a wide range of industrial, safety and workplace consumable products and supply solutions to business customers. As a supplier and distributor, Stealth offer a comprehensive assortment of products to support customers with purchasing options and solutions that are essential in the operation of their business. Resulting volumes offer a virtuous circle of scale, operational efficiency and margin growth.

### African operations in focus

The Capital Drilling contract was a key plank in the establishment of Stealth, but since the acquisition of Heatley's and the establishment of the BSA JV in the UK, the Capital Drilling revenue stream has been diluted to ~26% of proforma sales.

Of greater importance is the GP% which is now said to be “single digit”, so assuming a 9% GP% on FY19 sales implies \$1.7m or ~10% of group GP\$. This analyst cannot think of a wholesaler with a GP% this low, and it is no wonder an improved outcome is being sought. Stealth can basically halve revenue, achieve a GP% of 18% (still low by wholesale peers) and deliver the same GP\$ outcome (assuming no change in operating costs).

Our numbers had already pre-empted this move to some extent with African revenues forecast to decline 20% in FY20 and a GP% of only 10% assumed for FY20. Given this and the fact that the restructure does not come into effect until January 2020 we see no need to change earnings assumptions at present.

### Base case valuation A\$0.34/share unchanged

Our base case DCF valuation for SGL is unchanged at \$0.34/share. As a sense check this implies an FY21 PER of 10.7x incorporating most of the African restructure in our opinion. This would imply an EV/sales of 43%, equal to listed peer Coventry Group (ASX:CYG) based on FY19 sales.

#### Historical earnings and RaaS Advisory estimates

Year end	Revenue(A\$m)	EBITDA (A\$m)	NPAT (A\$m)	EPS (c)	PER (x)	EV/REV (x)
Jun-18a #	65.9	nm	nm	nm	nm	nm
Jun-19a #	74.5	2.1	0.5	0.006	13.3	0.12
Jun-20e	78.1	2.9	1.5	0.02	4.8	0.10
Jun-21e	89.5	5.1	3.0	0.03	2.8	0.07

Source: Company Data, RaaS Advisory Estimates #Pro-forma

## Distribution – Wholesale

8<sup>th</sup> October 2019

### Share details

ASX Code	SGL
Share price	\$0.09
Market Capitalisation	\$9M
Shares on issue	94.9M
Enterprise value	\$9.1M
Net Debt 30 Jun	\$0.14M
Free float	~60%

### Share performance (12 months)



### Upside Case

- Service based model takes market share from incumbent players
- With size comes improved gross margins 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 supplier go direct

### Board of Directors

Christopher Wharton	Non-Executive Chair
Michael Arnold	Managing Director
Giovanni Groppoli	Non-Executive Director
Peter Unsworth	Non-Executive Director

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## Current RaaS African forecasts

Based on published numbers and management commentary we had already assumed lower gross margins for the African business (~10%-11%). Furthermore, given the increased focus on East Coast Australia and BSA in the UK we had already built-in lower sales from Africa as the group focuses on higher gross margin and higher growth opportunities (African sales forecast to decline 22% in FY20).

The revelation of “single digit” gross profit margins from African operations highlights why management are looking for better opportunities elsewhere. Our “distribution” peer comparison in our initiation report [Going National & International](#) revealed the lowest gross margins over FY19 in our universe to be Funtastic (ASX:FUN) at 16.7% and Cellnet (ASX:CLT) at 20.7%, well above Stealth in Africa.

Given our current assumptions and the fact that the new agreement begins January 2020 we feel there is no need for a change in earnings estimates. Exhibit 1 below highlights our current assumptions for the African operations of SGI.

<b>Exhibit 1: Current RaaS forecasts for the African operations of SGI</b>					
	FY18	FY19	FY20	FY21	FY22
Sales	19.4	19.7	15.3	15.3	14.9
Gross Profit	3.1	2.2	1.5	1.5	1.5
GP%	16%	11%	10%	10%	10%

Source: Company Financials & RaaS estimates

## African sales & GP% analysis

A 9% GP% margin on reported FY19 African sales of \$19.0m implies a gross profit contribution of \$1.7m for the African operations in FY19. The simple analysis below highlights the various revenue & GP% required to generate the same gross profit dollars.

Under the new contract arrangements SGI would only need to generate \$9.5m in revenue at an 18% GP% for example to achieve the same gross profit dollar contribution currently. This analysis assumes that the operating costs required to achieve such outcomes are unchanged, which we believe they would be.

<b>Exhibit 2: SGI African GP\$ at various revenue and GP% assumptions</b>					
African Revenue (\$m)	9%	12%	15%	18%	21%
8.2	0.7	1.0	1.2	1.5	1.7
9.5	0.9	1.1	1.4	1.7	2.0
11.4	1.0	1.4	1.7	2.1	2.4
14.3	1.3	1.7	2.1	2.6	3.0
19.0	1.7	2.3	2.9	3.4	4.0

Source: Company Financials & RaaS estimates

## DCF valuation of \$0.34/share unchanged

We derive our DCF valuation using a WACC of 10.1%, Beta 1.4, terminal growth rate of 2.0%. Our terminal value makes up \$0.19/share of our valuation. As we have previously highlighted in our reports, the exhibit below highlights what we see as the key variables/assumptions in our DCF analysis. The discount rate (WACC) and domestic gross margin assumption (driven by private label and scale) are the key sensitivities to our valuation, not the Capital drilling contract.

<b>Exhibit 3: SGI DCF sensitivities</b>					
Variable	Current	+/-	Change (cps)	Change (%)	Comments
Domestic GP% by FY24	30.6%	1.0%	0.06	16%	Key sensitivity
WACC	10.1%	1.0%	0.04	11%	Key assumption
MT Domestic growth rate	10.0%	1.0%	0.02	5%	Australian operations
% Troy stores by FY24	40.0%	5.0%	0.01	2%	Not the only BSA assumpt
Capital Drilling GP%	10.0%	1.0%	0.00	1%	Low margin limits impact

Source: RaaS estimates

#### Exhibit 4: Financial Summary

Stealth Global (SGI.AX)						Share price (7 October 2019)		A\$						0.09
Profit and Loss (A\$m)						Interim (A\$m)		H118A	H218A	H119	H219	H120F	H220F	
Y/E 30 June	FY18A	FY19	FY20F	FY21F	FY22F	Revenue	na	na	24.3	38.5	38.7	39.4		
Revenue	23.1	62.8	78.1	89.5	97.7	EBITDA	na	na	0.9	1.2	0.9	1.9		
Gross profit	4.3	15.3	20.3	24.1	27.1	EBIT	na	na	0.8	1.1	0.8	1.8		
GP margin %	18.8%	24.4%	25.9%	26.9%	27.7%	NPAT (normalised)	na	na	0.6	1.1	0.5	1.0		
Underlying EBITDA	(0.4)	2.1	2.9	5.1	6.9	Minorities	na	na	(0.1)	0.2	(0.1)	0.2		
Depn	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)	NPAT (reported)	na	na	0.4	0.1	0.2	1.0		
Amort	0.0	0.0	0.0	0.0	0.0	EPS (normalised)	na	na	na	0.002	0.003	0.011		
EBIT	(0.5)	1.9	2.6	4.8	6.6	EPS (reported)	na	na	na	0.002	0.003	0.011		
Interest	(0.0)	(0.1)	(0.2)	(0.2)	(0.1)	Dividend (cps)	na	na	0.000	0.000	0.000	0.008		
Tax	0.0	(0.2)	(0.8)	(1.3)	(1.7)	Imputation			30.0	30.0	30.0	30.0		
Minorities	0.0	0.1	0.1	(0.3)	(0.7)	Operating cash flow	na	na	na	na	na	na		
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0	Free Cash flow	na	na	na	na	na	na		
NPAT pre significant items	(0.5)	1.7	1.8	3.0	4.0	Divisionals	H118A	H218A	H119A	H219A	H120F	H220F		
Significant items	0.0	(1.2)	(0.3)	0.0	0.0	Australian Revenue	na	na	15.3	26.5	29.4	29.9		
NPAT (reported)	(0.5)	0.5	1.5	3.0	4.0	African Revenue	na	na	9.0	10.7	7.7	7.6		
Cash flow (A\$m)						BSA			0.0	1.4	1.6	1.9		
Y/E 30 June	FY18A	FY19	FY20F	FY21F	FY22F	Total Revenue	na	na	24.3	38.5	38.7	39.4		
EBITDA (inc minority adj)	(0.4)	1.0	3.0	4.8	6.2									
Interest	(0.0)	(0.1)	(0.2)	(0.2)	(0.1)	Gross profit	na	na	7.7	7.6	11.2	9.0		
Tax	(0.2)	(0.6)	(0.6)	(1.0)	(1.5)	Gross Profit Margin %	na	na	31.7%	19.8%	29.0%	22.9%		
Working capital changes	1.6	(0.6)	(0.3)	(0.9)	(0.6)									
Operating cash flow	1.0	(0.3)	1.9	2.7	3.9	Employment	na	na	na	na	na	na		
Mtce capex	(0.1)	(0.3)	(0.4)	(0.4)	(0.5)	Occupancy	na	na	na	na	na	na		
Free cash flow	0.9	(0.6)	1.5	2.3	3.4	Other costs	na	na	na	na	na	na		
Growth capex	0.0	0.0	0.0	0.0	0.0	Total costs	na	na	6.8	6.4	10.3	7.1		
Acquisitions/Disposals	(0.3)	(7.8)	(0.3)	(0.3)	0.0									
Other	0.0	0.1	(0.4)	0.0	0.0	EBITDA	na	na	0.9	1.2	0.9	1.9		
Cash flow pre financing	0.6	(8.4)	0.9	2.0	3.4	EBITDA margin %	na	na	3.7%	3.2%	2.4%	4.9%		
Equity	(0.1)	11.4	0.0	0.0	0.0	Margins, Leverage, Returns		FY18A	FY19	FY20F	FY21F	FY22F		
Debt	(0.4)	(1.3)	0.0	0.0	0.0	EBITDA margin %		(1.7%)	3.3%	3.7%	5.7%	7.1%		
Net Dividends paid	0.0	0.0	0.0	(1.4)	(1.7)	EBIT margin %		(2.1%)	3.0%	3.4%	5.4%	6.8%		
Net cash flow for year	0.1	1.7	0.9	0.6	1.7	NPAT margin (pre significant items)		(2.2%)	2.7%	2.3%	3.4%	4.1%		
Balance sheet (A\$m)						Net Debt (Cash)		0.29	0.14	(1.02)	(1.86)	(3.60)		
Y/E 30 June	FY18A	FY19	FY20F	FY21F	FY22F	Net debt/EBITDA (x)	(x)	nm	nm	nm	nm	nm		
Cash	0.3	2.0	2.9	3.5	5.2	ND/ND+Equity (%)	(%)	32.8%	(1.1%)	6.7%	10.3%	15.7%		
Accounts receivable	3.8	15.9	16.6	19.1	20.8	EBIT interest cover (x)	(x)	n/a	0.1x	0.1x	0.0x	0.0x		
Inventory	0.3	6.3	6.6	7.5	8.2	ROA		nm	9.7%	7.6%	12.8%	15.7%		
Other current assets	0.1	0.6	0.0	0.0	0.5	ROE		nm	7.7%	10.9%	19.9%	22.6%		
Total current assets	4.5	24.7	26.1	30.0	34.7	ROIC		nm	30.0%	32.8%	44.4%	44.9%		
PPE	0.2	0.6	0.8	0.9	1.1	NTA (per share)		0.07	0.06	0.08	0.10	0.13		
Goodwill	0.5	6.9	6.9	6.9	6.9	Working capital		-1.5	5.8	6.1	7.0	7.6		
Investments	0.0	0.0	0.4	0.4	0.4	WC/Sales (%)		(6.3%)	9.3%	7.8%	7.8%	7.8%		
Deferred tax asset	0.3	1.1	1.1	1.1	1.1	Revenue growth		nm	172.2%	24.4%	14.6%	9.2%		
Other non current assets	0.3	0.0	0.3	0.3	0.0	EBIT growth pa		nm	nm	38.8%	83.4%	37.0%		
Total non current assets	1.2	8.6	9.5	9.7	9.5	Pricing		FY18A	FY19	FY20F	FY21F	FY22F		
Total Assets	5.7	33.3	35.5	39.7	44.2	No of shares (y/e)	(m)	nm	77	95	95	95		
Accounts payable	5.6	16.3	17.1	19.6	21.4	Weighted Av Dil Shares	(m)	nm	77	95	95	95		
Short term debt	0.6	1.8	1.8	1.6	1.6									
Tax payable	0.0	0.0	0.0	0.0	0.0	EPS Reported	cps	nm	0.006	0.019	0.032	0.042		
Other	0.1	1.0	1.0	1.0	1.0	EPS Normalised/Diluted	cps	nm	0.006	0.019	0.032	0.042		
Total current liabilities	6.2	19.2	19.9	22.2	24.0	EPS growth (norm/dil)		nm	nm	204%	70%	32%		
Long term debt	0.0	0.3	0.0	0.0	0.0	DPS	cps	0.000	0.000	0.008	0.015	0.020		
Other non current liabs	0.0	0.9	1.3	1.3	0.9	DPS Growth		n/a	n/a	n/a	100%	33%		
Total long term liabilities	0.0	1.2	1.3	1.3	0.9	Dividend yield		0.0%	0.0%	8.3%	16.7%	22.2%		
Total Liabilities	6.2	20.4	21.2	23.5	24.9	Dividend imputation		30	30	30	30	30		
Net Assets	(0.6)	12.9	14.3	16.2	19.3	PE (x)			nm	4.8	2.8	2.1		
						PE market		15.2	15.2	15.2	15.2	15.2		
Share capital	0.1	13.0	13.0	13.0	13.0	Premium/(discount)			nm	(68.5%)	(81.5%)	(86.0%)		
Accumulated profits/losses	(0.7)	(0.2)	1.3	2.9	5.2	EV/EBITDA		nm	nm	2.5	1.4	0.8		
Reserves	0.1	0.3	0.3	0.3	0.3	FCF/Share	cps	nm	nm	0.009	0.021	0.036		
Minorities	0.0	(0.1)	(0.3)	0.1	0.8	Price/FCF share		nm	nm	9.9	4.3	2.5		
Total Shareholder funds	(0.6)	12.9	14.3	16.2	19.3	Free Cash flow Yield		nm	nm	10.1%	23.5%	39.9%		

Source: RaaS Advisory Note that we have incorporated the unaudited revenue and pre tax operating loss for FY19

# FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

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In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

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