Millennium Services Group Ltd

H1 FY22 Result

A stock for the times

Millennium Services Group Ltd (ASX:MIL) has reported H1 FY22 adjusted EBITDA of $6.6m (-4.3% on the PCP) and NPAT of $2.7m (+8% on the PCP and driven by lower interest expense) on a sales decline of 2% due to the loss of the QIC contract. MIL continues to see elevated levels of higher margin "ad-hoc" revenues (now 16% of total) which is driving management's estimate of underlying revenues growth of 3.7% for the period. Reported numbers include a range of corporate and COVID-19-related one-off's which we have treated as such. Tender activity has been subdued during COVID-19 but there appears to be signs of life with management highlighting $70m in contracts currently at tender. Some wins on this front are key for MIL near-term, as is a resumption in dividend payments currently constrained by banking covenants. MIL continues to trade at a material discount to peers at a forecast 2.5x FY22 EV/EBITDA against a peer average of 4.6x despite 80% of forecast revenues expected to come from existing three–five year contracts. The average peer multiple would imply a share price of $1.15/share.

Business model

MIL is a human services business, bidding for predominantly fixed-rate contracts with opportunities for volume gains and ad-hoc services, across the essential services of cleaning and security for durations of three-five years with large corporates. 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 will be keys in this push.

Adjusted numbers are key to value recognition

Reported numbers over the past two years have been positively (mainly government grants) and negatively (corporate costs, redundancies, customer support, staff top-ups) impacted by a number of "one-off's". Our numbers adjust for these, and the result reveals solid underlying earnings which are holding despite a significant contract loss. Our estimated underlying EBITDA of $11.0m for FY22 implies just 2.5x EV/EBITDA.

Valuation between $1.15 (relative multiple) and $1.52 (DCF)

The peer group average FY22 EV/EBITDA multiple implies a $1.15/share valuation for MIL (4.6x EV/EBITDA), and we see no reason why this business does not deserve peer-average multiples given average contract length, relative working capital intensity and market opportunities. As a sense check, our DCF valuation sits around $1.52/share, down from $1.60/share due to lower medium-term growth assumptions, with no acquisitions assumed.

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

Year end	Adj. Revenue	Und. EBITDA	NPAT (adj.)	EPS (adj.) (c)	P/E (x)	EV/Sales (x)
06/20a	257.3	4.0	2.0	0.04	nm	0.22
06/21a	273.7	11.6	2.2	0.05	10.2	0.08
06/22e	263.2	11.0	3.1	0.07	7.2	0.10
06/23e	273.7	12.6	5.5	0.12	4.1	0.08

Source: Company data; RaaS estimates for FY22e and FY23e

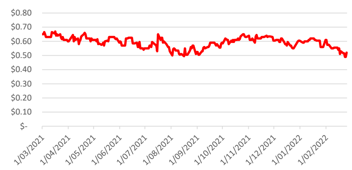
Human Services

28th February 2022

Share Details

ASX code	MIL
Share price (25-Feb)	$0.52
Market capitalisation	$23.9M
Shares on issue	45.9M
Net debt at 31-Dec-21	$8.5M
Free float	~31.5%

Share Performance



Upside Case

- Converting a portion of the $70m tender pipeline over the next 12 months
- Successfully diversify industry exposure to include government, education and aged care
- EPS accretive/complimentary acquisitions

Downside Case

- Competitive margin pressure re-emerges
- Sizable contract loss
- Wages growth above contract clauses

Board of Directors

Stuart Grimshaw	Chairman
Scott Alomes	CEO
Rohan Garnett	Non-Executive Director
Darren Perry	Non-Executive Director

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H1 FY22 Result Summary

Key takeaways from the H1 FY22 result include:

- **Operating revenues** declined 2% on the back of the loss of the QIC contract beginning September 2021. Management estimate underlying growth of 3.7%. Ad-hoc revenues continue to be strong, and we estimate 8% growth over the period against a decline in contract revenues of 4%, which is supportive of gross margins.
  We estimate a H1 FY22 sales mix of 84%/16% contract to ad-hoc.
- **Gross margins** remained strong at or above targeted margins at 15.9%, aided by the ad-hoc revenues.
- **Operating costs** adjusted for "one-off's" declined as support costs for the QIC contract were removed.
- **Adjustments** for the period included NZ wage support ($0.6m) and corporate ($1.2m) including advisory, due diligence and redundancy costs.
- **Interest expense** was 60% (or $0.7m) below the PCP due to lower debt levels.

Exhibit 1: MIL H1 FY22 underlying earnings summary

Variable (A$000')	H1 FY21	H1 FY22	% CHG	Comments
Sales	**135.0**	**131.7**	**(2%)**	**Loss of QIC contract**
Cleaning	107.9	99.6	(8%)	
Security	27.2	32.1	18%	Hiring ad hoc benefits
Gross profit	21.7	21.0	(3%)	
GP%	16.1%	15.9%	(1%)	Holding at solid levels
Operating costs	14.8	14.3	(3%)	
EBITDA	**7.0**	**6.7**	**(4%)**	Solid considering contract loss
Depreciation	2.3	2.3		
EBIT	**4.7**	**4.4**		
Abnormals	15.2	0.0		JobKeeper in H1 FY21
Adjustments	(-0.7)	(-0.8)		Incorporates all "one-off's"
Adjusted NPAT	**2.5**	**2.7**	**8%**	
Reported NPAT	17.1	1.9		
Net debt	3.1	8.8		Payment cycles can dramatically impact

Source: Company announcements

Outlook And Investment Case

FY21 ex-JobKeeper now provides a sustainable base from which to forecast following a number of years of restructuring. Key assumptions with regards to outlook are detailed below:

- 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 revenues) 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 3.6% between FY22 and FY26 on the back of a COVID-19-related 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, an increased focus on ESG 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 the increasing focus on ESG, and similar acquisitions should be expected.

- MIL lost the $28m QIC cleaning contract from October 2021 but gained ~$6m from a new contract with Westfield Southland. Our numbers factor a "right sizing" of the cost base to limit the damage of this contract loss.
- Tender activity has been subdued through COVID-19 but appears to be improving, with $70m in contracts currently under tender. An average 12% success rate implies $8.5m in new business or 3% of current revenues.
- The current cost base can support additional revenues, offering operating leverage should new business be secured.
- Gross margins are back to "targeted" levels and based on extensive historical and peer analysis we feel these margins are sustainable at management's targeted 15% range.
- Net debt was just $8.5m as at December 2021, completely reshaping the balance sheet from year-ago levels and providing a solid base from which to grow and/or acquire while looking at capital management options. MIL has undrawn banking facilities of ~$14m.

Earnings Update

We have fine-tuned our earnings expectations following the H1 FY22 result release and outlook comments. In summary, near-term numbers are slightly higher while we have made modest (1%-2%) reductions to medium-term revenues growth expectations given modest tender activity.

Exhibit 2: MIL earnings revisions

FY to June	2022	2023	2024	2025	Comments
Revenue ($m)					
Old	261.8	274.9	288.6	303.0	
New	263.2	273.7	284.7	296.1	
% CHG	0.5%	(0.4%)	(1.4%)	(2.3%)	Modest MT reductions
EBITDA ($m)					
Old	10.4	12.1	13.5	15.0	
New	11.0	12.6	13.7	14.7	
% CHG	5.5%	4.1%	1.0%	(1.8%)	Better GP% FY22/FY23
NPAT ($m)					
Old	3.5	5.4	6.4	7.4	
New	4.0	5.5	6.3	7.2	
% CHG	13.2%	1.7%	(1.4%)	(3.9%)	

Source: RaaS estimates

Valuation Update

We have reduced our DCF valuation from $1.60/share to $1.52/share on the back of modest medium-term reductions in underlying revenues. Key assumptions include:

- WACC 10.8% including a RFR of 2.0%, beta of 1.2x and equity risk premium of 7.0%;
- Medium-term growth rate of 3.0%, perpetuity growth of 2.2%; and
- Sustainable gross margin of 15% and EBITDA margin of 5%.

From a multiple perspective we estimate the peer average EV/EBITDA multiple (including the likes of SMM, BSA, SXE, ASH and GNG) in FY22 is 4.6x against the current 2.5x for MIL. A similar multiple would imply a share price for MIL closer to $1.15/share.

RaaS
Research as a Service

Exhibit 3: Financial Summary (In A$m unless otherwise stated)

Millennium Services (ASX.MIL)					
Profit and Loss (A$m)					
Y/E 30 June	**FY19A**	**FY20A**	**FY21A**	**FY22F**	**FY23F**
Revenue	294.7	257.3	273.7	263.2	273.7
Gross profit	30.1	30.8	40.8	39.4	41.1
GP margin %	10.2%	12.0%	14.9%	15.0%	15.0%
Underlying EBITDA	0.1	4.0	11.6	11.0	12.6
Depn	(8.8)	(5.9)	(4.9)	(4.5)	(4.4)
Minorities (AT)	0.0	0.0	0.0	0.1	0.1
EBIT	(8.7)	(1.9)	6.8	6.5	8.3
Interest	(2.5)	(3.2)	(1.8)	(0.8)	(0.5)
Tax	(3.2)	5.3	(1.6)	(1.7)	(2.3)
NPAT	(14.3)	0.3	3.4	4.0	5.5
Adjustments	(4.4)	1.7	(1.2)	(0.8)	0.0
Adjusted NPAT	**(18.7)**	**2.0**	**2.2**	**3.1**	**5.5**
Abnormals (net)	(26.8)	14.5	15.2	0.0	0.0
NPAT (reported)	**(45.5)**	**16.5**	**17.4**	**3.1**	**5.5**
Cash flow (A$m)					
Y/E 30 June	**FY19A**	**FY20A**	**FY21A**	**FY22F**	**FY23F**
EBITDA (inc cash rent/JK)	0.1	19.4	29.3	10.1	11.7
Interest	(2.5)	(3.2)	(1.8)	(0.8)	(0.5)
Tax	(0.9)	0.5	(0.1)	(1.7)	(2.3)
Working capital changes	2.2	(16.6)	12.9	(9.8)	(0.5)
Operating cash flow	**(1.1)**	**0.1**	**40.3**	**(2.3)**	**8.4**
Mtce capex	(1.3)	(2.2)	(2.2)	(1.8)	(1.9)
Free cash flow	**(2.4)**	**(2.1)**	**38.1**	**(4.1)**	**6.5**
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	(2.7)	(2.5)	(2.1)	(2.0)	(2.0)
Cash flow pre financing	(5.1)	(4.6)	36.0	(6.1)	4.5
Equity	0.0	0.0	0.0	0.0	0.0
Debt drawdown/(repay)	(3.6)	1.6	(21.4)	(1.0)	(3.0)
Net Dividends paid	0.0	0.0	0.0	0.0	0.0
Net cash flow for year	**(8.7)**	**(3.0)**	**14.6**	**(7.1)**	**1.5**
Balance sheet (A$m)					
Y/E 30 June	**FY19A**	**FY20A**	**FY21A**	**FY22F**	**FY23F**
Cash	2.7	1.8	7.3	(3.2)	(1.8)
Accounts receivable	19.5	29.8	18.0	24.7	25.7
Inventory	0.8	1.2	1.1	1.0	1.0
Other current assets	1.2	2.5	2.2	0.0	0.0
Total current assets	*24.2*	*35.3*	*28.7*	*22.5*	*24.9*
PPE	11.4	8.6	7.0	5.2	3.7
Goodwill	7.5	7.5	7.5	8.5	8.5
Right of use asset	0.0	2.9	3.0	3.0	3.0
Deferred tax asset	0.2	7.4	8.5	8.5	8.5
Other	0.1	0.1	0.1	0.1	0.1
Total non current assets	*19.1*	*26.5*	*26.2*	*25.4*	*23.8*
Total Assets	43.4	61.9	54.9	47.9	48.7
Accounts payable	22.2	16.3	17.3	14.0	14.6
Short term debt	29.8	36.4	5.5	0.0	0.0
Provisions	26.1	22.4	22.6	19.9	20.7
Lease liabilities/other	0.0	0.8	5.5	7.9	4.9
Total current liabilities	*78.0*	*76.0*	*50.9*	*41.8*	*40.2*
Long term debt	0.0	0.0	2.1	1.1	(1.9)
Other non current liabs	1.8	5.8	4.1	4.1	4.1
Total long term liabilities	*1.8*	*5.8*	*6.2*	*5.2*	*2.2*
Total Liabilities	79.8	81.8	57.1	47.0	42.3
Net Assets	**(36.4)**	**(19.9)**	**(2.3)**	**0.9**	**6.4**
Share capital	19.0	19.0	19.1	19.1	19.1
Reserves	(8.4)	(8.5)	(8.3)	(8.3)	(8.3)
Retained Earnings	(46.9)	(30.3)	(13.1)	(9.8)	(4.3)
Minorities	0.0	0.0	0.0	0.0	0.0
Total Shareholder funds	**(36.4)**	**(19.9)**	**(2.4)**	**0.9**	**6.4**

Share price (24 February 2022)					A$	0.490
Interim (A$m)	**H120**	**H220**	**H121**	**H221**	**H122F**	**H222F**
Revenue	135.1	146.8	159.7	138.7	131.7	131.5
EBITDA	2.4	1.7	7.0	4.7	6.7	4.3
EBIT	(0.0)	(1.8)	4.7	2.0	4.4	2.1
NPAT (normalised)	(1.7)	2.0	2.5	0.9	2.7	1.2
Minorities (AT)	0.0	0.0	0.0	0.0	0.0	0.1
NPAT (reported)	(0.8)	2.8	1.9	0.3	1.9	1.2
EPS (normalised)	nm	0.061	0.041	0.007	0.041	0.026
EPS (reported)	nm	0.061	0.041	0.007	0.041	0.026
Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.000
Imputation						
Operating cash flow	na	na	na	na	na	na
Free Cash flow	na	na	na	na	na	na
Divisionals	**H120**	**H220**	**H121**	**H221**	**H122F**	**H222F**
Cleaning	111.4	102.0	107.9	109.0	99.6	100.9
Security	23.7	20.2	27.2	29.7	32.1	30.5
(Other)	-	24.6	24.7	-	-	-
Total Revenue	**135.1**	**146.8**	**159.7**	**138.7**	**131.7**	**131.5**
Gross profit	17.0	13.8	21.7	19.1	21.0	18.4
Underlying GP Margin %	12.6%	11.3%	16.1%	13.8%	15.9%	14.0%
Operating Costs						
Employment	8.3	16.4	15.9	9.4	8.8	8.6
Other	5.5	4.9	6.2	5.0	5.5	5.5
Exceptional	0.9	- 9.2	- 7.3	-	-	-
Total costs	**14.7**	**12.1**	**14.8**	**14.4**	**14.3**	**14.1**
EBITDA	**2.4**	**1.7**	**7.0**	**4.7**	**6.7**	**4.3**
EBITDA margin %	1.7%	1.1%	4.4%	3.4%	5.1%	3.3%
Margins, Leverage, Returns		**FY19A**	**FY20A**	**FY21A**	**FY22F**	**FY23F**
EBITDA margin %		0.0%	1.6%	4.3%	4.2%	4.6%
EBIT margin %		(2.9%)	(0.7%)	2.5%	2.5%	3.0%
NPAT margin (pre significant items)		(6.4%)	0.8%	0.8%	1.2%	2.0%
Net Debt (Cash)		27.1	34.6	0.3	4.3	-0.1
Net debt/EBITDA (x)	(x)	314.9 x	8.6 x	0.0 x	0.4 x	0.0 x
ND/ND+Equity (%)	(%)	42.7%	63.5%	11.5%	125.8%	1.8%
EBIT interest cover (x)	(x)	n/a	n/a	0.3x	0.1x	0.1x
ROA		nm	(3.5%)	11.6%	12.7%	17.2%
ROE		nm	nm	nm	nm	nm
ROIC		nm	nm	nm	nm	nm
NTA (per share)		-0.95	-0.60	-0.21	-0.17	-0.05
Working capital		-1.8	14.8	1.9	11.7	12.2
WC/Sales (%)		**(0.6%)**	**5.7%**	**0.7%**	**4.4%**	**4.4%**
Revenue growth		nm	(12.7%)	6.4%	(3.8%)	4.0%
EBIT growth pa		nm	nm	(463.7%)	(3.6%)	27.5%
Pricing		**FY19A**	**FY20A**	**FY21A**	**FY22F**	**FY23F**
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	nm	0.359	0.379	0.068	0.120
EPS Normalised/Diluted	cps	nm	0.043	0.048	0.068	0.120
EPS growth (norm/dil)		nm	nm	11%	43%	75%
DPS	cps	0.000	0.000	0.000	0.000	0.000
DPS Growth		n/a	n/a	n/a	n/a	n/a
Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%
Dividend imputation		30	30	30	30	30
PE (x)			nm	10.2	7.2	4.1
PE market		18	18	18	18	18
Premium/(discount)			nm	(43.1%)	(60.2%)	(77.3%)
EV/EBITDA		576.6	14.1	2.0	2.4	1.8
FCF/Share	cps	(4.535)	(4.535)	83.023	(13.950)	14.169
Price/FCF share		(10.804)	(10.804)	0.590	(3.513)	3.458
Free Cash flow Yield		(9.3%)	(9.3%)	169.4%	(28.5%)	28.9%

Source: RaaS estimates

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

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