

HiTech Group Australia

Commercial & Professional

HIT-ASX A\$ 1.18

TARGET PRICE A\$1.23

HIT-ASX A\$ 1.18

Hitech Group Australia Ltd. engages in supplying information technology and telecommunications recruitment services for contract staff. The company was founded by Raymond Hazouri on October 14, 1993 and is headquartered in Sydney, Australia.

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FY18 earnings review

The ICT recruitment industry continues to show strength, and on the 13th August, HiTech Group Australia (HiTech) delivered a solid FY18 result with EBITDA in line with our \$3.7m forecast.

A lot to like with this result, with operating revenue \$26.4m, up +13% on (pcp), Gross Profit +12% on (pcp), and leverage dropping through to an NPAT of \$2.68m, an increase of +16% on FY17.

Investor return

Why a BUY? Even after a 12m period of +37% TSR appreciation versus the Small Ordinaries, we see dividend yield support, along with continued organic and potential non-organic growth underpinning the share-price, toward the target price – capital appreciation +3.9% and gross yield of +10.9% drives a TSR of 14.8%.

FY19F gross yield of ~10%

We have maintained our forecast payout ratio of 100% driving a fully franked 9 cents dividend.

Pristine balance sheet

Cash balance at \$5.8m, an increase of 13% over pcp has no debt and cash available of ~\$5m. Based on our forecasts and dividend payout ratio, cash levels will be maintained unless an acquisition can be sourced and/or capital is utilised for organic growth opportunities.

Industry position

While barriers to entry in the recruitment space are low we are comfortable that the quality of the Board and management will ensure HiTech keeps pace with market and technological developments while acquiring and consolidating new business lines to grow and diversify the earnings base. Technology disruption continues to play-out in a number of industry verticals (Banking/Fintech) and Wall Street has seen graduates shunning a career in Investment Banking for Silicon valley. HiTech earns most of its revenue through contracting to the ICT market. As firms continue to downsize their full-time work forces, the use of outsourcing and contracted workforces will continue to grow. This combined with forecast strong growth in the ICT staffing levels ensures HiTech is well placed to capitalise on these longer-term trends.

Valuation

Our 12-month forward price target is set at \$1.23, based on a blend of DCF (w_{ACC} , 10%, $\beta=1.0$), P/E Multiple, and EV/EBITDA. We increase our P/E multiple of 15x, a 25% discount to Small Ords as appropriate; balancing the liquidity challenge (~65% held by founders/Hazouri family) against high growth and attractive yield.

Website

<http://hitechaust.com/>

Company Data

Shares outstanding (m)	38.1
Price (\$)	1.18
Market Capitalisation (\$m)	44.9
Free Float (%)	37%
Free Float Market Capitalisation (\$m)	16.7
12 month low (\$)	0.63
12 month high (\$)	1.20
Average daily volume (3 month) ('000)	0.5
Forecast Stock Capital Return	4%
Forecast Total Stock Gross Return	15%

Data Source: FactSet

Earnings Summary (A\$m)

Year end June	FY17	FY18F	FY19F	FY20F
Sales revenue	23.3	26.4	29.1	31.5
EBITDA	3.4	3.7	4.6	5.0
PBT	3.5	3.7	4.6	5.0
Underlying NPAT	2.4	2.6	3.2	3.5
Reported NPAT	2.3	2.6	3.2	3.5
Reported EPS (c)	6.6	7.4	9.1	9.9
Underlying EPS diluted (c)	6.1	5.9	7.3	8.0
Underlying P/E (x)	10.5	19.9	16.1	14.8
DPS (c)	6.0	8.0	9.0	10.0
Payout ratio (%)	87%	108%	100%	100%
Franking (%)	100%	100%	100%	100%
Dividend yield (%)	5.1%	6.8%	7.6%	8.5%
Gross Yield (%)	13.4%	9.7%	10.9%	12.1%

Data Source: Company, APP Securities

Share Price Performance



Source: FactSet

APP Securities contributes all company estimates to Bloomberg, Thomson Reuters, FactSet and Capital IQ.

HiTech Australia						HIT-ASX						
Summary						Profit and Loss A\$m						
Recommendation	BUY	Sales revenue	18.3	23.3	26.4	29.1	31.5					
Price (\$)	1.18	COGS	(14.4)	(18.6)	(21.1)	(23.2)	(25.1)					
Target Price (\$)	1.23	Gross Profit	3.9	4.7	5.3	5.9	6.3					
Upside (Downside) (%)	3.9%	<i>Gross Profit Margin</i>	21.3%	20.2%	20.1%	20.2%	20.2%					
Gross Yield FY19 (%)	10.9%	Other operating costs	(1.4)	(1.3)	(1.6)	(1.3)	(1.4)					
Total Stock Return (%)	14.8%	EBITDA	2.5	3.4	3.7	4.6	5.0					
Shares (m)	38.1	D&A	0.0	0.0	0.0	0.0	0.0					
Diluted shares(m)	43.7	EBIT	2.5	3.4	3.7	4.6	5.0					
Market Capitalisation (\$m)	44.9	<i>Margin</i>	13.7%	14.7%	14.1%	15.8%	15.8%					
Free Float Market Capitalisation (\$m)	16.7	Net interest	0.0	0.0	0.0	0.0	0.0					
Valuation						PBT	2.5	3.5	3.7	4.6	5.0	
Discounted Cash Flow						Tax	(0.7)	(1.0)	(1.1)	(1.4)	(1.5)	
Diluted Value per share (\$)	\$1.19	Underlying NPAT	1.8	2.4	2.6	3.2	3.5					
Cash adjusted P/E (x)						Non-recurring items	0.4	(0.1)	0.0	0.0	0.0	
Forecast P/E Multiple (x)	15.0	Reported NPAT	2.2	2.3	2.6	3.2	3.5					
Diluted Value per share (\$)	\$1.38	Cashflow A\$m						FY16	FY17	FY18	FY19F	FY20F
EV/EBITDA						Operating EBITDA	2.5	3.4	3.7	4.6	5.0	
Forecast EV/EBITDA (x)	8.0	Change in working capital	0.1	0.2	0.6	(0.0)	(0.1)					
12 month forward EBITDA (\$m)	4.7	Net interest	0.0	0.0	0.0	0.0	0.0					
Enterprise Value (\$m)	37.7	Tax paid	(0.6)	(1.5)	(1.1)	(1.4)	(1.5)					
Net Cash (Debt) (\$m)	6.7	Other	(0.1)	(0.2)	0.0	0.0	0.0					
Cash from option exercise	4.0	Operating cashflow	1.9	1.9	3.2	3.2	3.4					
Value (\$m)	48.4	Capital expenditure	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)					
Diluted Value per share (\$)	\$1.11	Net Divestment/(Acquisitions)	0.7	0.7	0.0	0.0	0.0					
Financial Metrics						Other	0.0	0.0	0.0	0.0	0.0	
	FY16	FY17	FY18	FY19F	FY20F	Investing cashflow	0.6	0.5	(0.1)	(0.1)	(0.1)	
Reported EPS (c)	7.0	6.6	7.4	9.1	9.9	Change in Debt	0.0	0.0	0.0	0.0	0.0	
Underlying EPS (c)	5.8	6.9	7.4	9.1	9.9	Change in Equity	0.0	0.1	0.6	0.0	0.0	
Underlying EPS diluted (c)	4.9	6.1	5.9	7.3	8.0	Dividends paid	0.0	(1.7)	(2.5)	(3.0)	(3.3)	
Underlying P/E (x)	6.5	9.3	16.0	12.9	11.9	Other	0.0	0.0	0.0	0.0	0.0	
P/E (diluted & cash adj.) (x)	3.3	8.0	16.1	12.8	11.8	Financing cashflow	0.0	(1.6)	(1.8)	(3.0)	(3.3)	
DPS (c)	2.0	6.0	8.0	9.0	10.0	Net cashflow	2.6	0.8	1.3	0.1	(0.0)	
Payout ratio (%)	34.4%	87.4%	108.5%	100.0%	100.0%	Balance Sheet A\$m						
Franking (%)	100%	100%	100%	100%	100%	Cash and Deposits	4.4	5.2	5.9	6.6	6.6	
Dividend yield (%)	1.7%	5.1%	6.8%	7.6%	8.5%	Receivables	3.1	2.6	2.6	2.9	3.1	
Gross Yield (%)	7.6%	13.4%	9.7%	10.9%	12.1%	Financial assets	0.6	0.0	0.0	0.0	0.0	
Book value (c)	16.3	16.8	17.0	19.0	19.4	Other Current Assets	0.0	0.2	0.0	0.0	0.0	
Net Tangible Assets (c)	16.2	16.7	15.5	17.5	17.8	Total Current Assets	8.1	8.0	8.5	9.5	9.7	
Price to Book value (x)	2.3	3.8	6.9	6.2	6.1	PPE	0.1	0.2	0.2	0.3	0.5	
Price to NTA (x)	2.3	3.8	7.6	6.8	6.6	Deferred tax assets	0.1	0.1	0.1	0.1	0.1	
Cash Conversion	100%	99%	116%	100%	99%	Intangibles (incl. goodwill)	0.0	0.0	0.0	0.0	0.0	
Op. cashflow per share (c)	5.1	4.3	7.1	7.1	7.6	Other	0.0	0.0	0.7	0.7	0.7	
Price to OCFs (x)	7.0	13.5	16.1	16.0	15.0	Total Non Current Assets	0.1	0.3	1.0	1.1	1.2	
Interest cover (EBIT/Net int) (x)	n/m	n/m	n/m	n/m	n/m	Total Assets	8.2	8.3	9.5	10.6	11.0	
Underlying ROE (%)	37.1%	38.3%	36.8%	40.7%	41.5%	Payables	1.4	1.2	1.3	1.4	1.6	
Underlying ROA (%)	9.1%	10.4%	10.4%	11.4%	11.5%	Interest Bearing Debt	0.0	0.0	0.0	0.0	0.0	
Multiples						Other	0.8	0.4	0.7	0.8	0.8	
	FY16	FY17	FY18	FY19F	FY20F	Total Current Liabilities	2.2	1.6	2.0	2.2	2.4	
Net debt	(4.4)	(5.2)	(5.9)	(6.6)	(6.6)	Interest Bearing Debt	0.0	0.0	0.0	0.0	0.0	
Market Equity (Y/E)	13.7	25.4	51.5	51.5	51.5	Long Term Provisions	0.0	0.1	0.1	0.1	0.1	
EV	9.3	20.2	45.6	44.9	44.9	Deferred Tax	0.0	0.0	0.0	0.0	0.0	
EV/EBITDA (x)	3.7	5.6	11.2	8.9	8.2	Total Non Current Liabilities	0.0	0.1	0.1	0.1	0.1	
EV/EBIT (x)	3.7	5.6	11.2	8.9	8.2	Total Liabilities	2.3	1.7	2.1	2.3	2.5	
Growth Rates						Shareholders Equity	2.9	3.1	3.7	3.7	3.7	
	FY16	FY17	FY18	FY19F	FY20F	Retained Earnings/(Losses)	2.7	3.4	3.2	3.2	3.2	
Revenue growth (%)	22%	28%	13%	10%	8%	Reserves/Other	0.3	0.2	0.5	1.4	1.6	
Gross Profit growth (%)	22%	21%	13%	11%	8%	Minority Interests	0.0	0.0	0.0	0.0	0.0	
EBITDA growth (%)	85%	37%	8%	23%	9%	Total Equity	6.0	6.7	7.4	8.3	8.5	
Underlying EPS (dil) growth (%)	62%	23%	-2%	24%	9%							

Full Year Preliminary Release

- HIT has reported broadly in line with our estimates, albeit revenue was a shade lower \$26.4m vs \$27.5m estimated, a GP of \$5.3m led to a consistent 20.2% margin in line with FY17, better improvement in costs saw EBITDA coming in at \$3.8m in-line with or estimated \$3.7m EBITDA.
- Final dividend of 4 cents, brings a DPS of 8 cents for the full-year, with the company maintaining a healthy cash-balance of \$5.8m, and this despite a payout ratio of 108% (fully-diluted basis). We remain comfortable with the forecast payout ratio considering the B/S has no debt, and operationally the business delivers strong cash-conversion – we would revisit this depending on corporate activity.
- Operating cash-flow, \$3.2m was impressive and up 70% on the FY17 result of \$1.9m.
- We make minimal changes to our forecasts, and see a fully-diluted FY19 P/E of 15.6x, and forecast 12% three-year EPS CAGR profile as attractive, particularly when compared with the ASX Small Industrials on 20.2x P/E multiple and similar growth outlook.

Figure 1. HiTech Group Australia Profit and Loss

Y/E June	\$m	FY16	FY17	FY18	FY19F	FY20F	FY21F
Contracting and permanent placement revenue		18.3	23.3	26.4	29.1	31.5	33.2
Other Revenue		0.0	0.0	0.03	0.0	0.0	0.0
Total Sales		18.3	23.3	26.4	29.1	31.5	33.2
Cost of Services		(14.4)	(18.6)	(21.1)	(23.2)	(25.1)	(26.5)
Gross Profit		3.9	4.7	5.3	5.9	6.3	6.7
Administration		(1.1)	(1.2)	(1.2)	(1.3)	(1.4)	(1.4)
Other		(0.3)	(0.0)	(0.4)	0.0	0.0	0.0
Total other operating expenditure		(1.4)	(1.3)	(1.6)	(1.3)	(1.4)	(1.4)
EBITDA		2.5	3.4	3.7	4.6	5.0	5.3
Depreciation							
EBITA		2.5	3.4	3.7	4.6	5.0	5.3
Amortisation of intangibles		0.0	0.0	0.0	0.0	0.0	0.0
Underlying EBIT		2.5	3.4	3.7	4.6	5.0	5.3
Interest income		0.0	0.0	0.0	0.0	0.0	0.0
Interest expense		0.0	0.0	0.0	0.0	0.0	0.0
Net Interest income/(expense)		0.0	0.0	0.0	0.0	0.0	0.0
Underlying PBT		2.5	3.5	3.7	4.6	5.0	5.3
Taxation		(0.7)	(1.0)	(1.1)	(1.4)	(1.5)	(1.6)
Underlying NPAT		1.8	2.4	2.6	3.2	3.5	3.7

Source: Company data, APP Securities

Supporting Our View

- We are forecasting continued growth in revenue (+7.9%, 3 year CAGR), but at lower levels than that have been achieved over the last three years (CAGR of +20%), and keep our gross margins steady at 20.2% consistent with FY17, FY18.
- With the recruitment market highly fragmented we see plenty of opportunity for HIT to bolt-on acquisitions, or move into adjacent markets.
- Labour market statistics continue to remain favourable for job-seekers - And we note the May-2018 budget, and the Turnbull Government's decision to invest approximately \$2.4 billion in growing Australia's research, science and technology capabilities. This includes: additional funding for national research infrastructure; the Australian Technology and Science Growth Plan that will deliver cutting edge digital infrastructure; more opportunities to skill our workforce; a new space agency; and measures to boost our export potential. These investments support the creation of new ideas, encourage commercial opportunities, and underpin successful businesses and new jobs.

Valuation

The average of our three valuation techniques gives us a 12 month forward blended valuation of \$1.23 (up from \$1.11), primarily reflecting roll forward and marginally higher earnings.

Figure 2. HiTech Australia Group Valuation

12 month forward price (P/E)	Jun-18	Aug-19	Jun-19	Aug-20	Jun-20	Aug-21	Jun-21
HIT underlying EPS (\$) (diluted)	0.059	0.075	0.073	0.081	0.080	0.085	0.084
Forecast P/E (x)	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Unadjusted Value	\$0.89	\$1.13	\$1.10	\$1.21	\$1.20	\$1.28	\$1.26
Net Cash (Debt)	5.9	6.7	6.6	6.6	6.6	6.7	6.6
Cash from exercised options	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Total Cash post option exercise	9.9	10.7	10.6	10.6	10.6	10.7	10.6
Cash value per share	\$0.23	\$0.25	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24
Value	\$1.12	\$1.38	\$1.34	\$1.46	\$1.44	\$1.52	\$1.51
12 month forward price DCF	Jun-18	Aug-19	Jun-19	Aug-20	Jun-20	Aug-21	Jun-21
HiTech Australia DCF	\$1.15	\$1.19	\$1.19	\$1.22	\$1.22		
12 month forward price (EV/EBITDA)	Jun-18	Aug-19	Jun-19	Aug-20	Jun-20	Aug-21	Jun-21
HIT underlying EBITDA (\$)	3.7	4.7	4.6	5.0	5.0	5.3	5.3
Forecast EV/EBITDA (x)	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Forecast Enterprise Value	29.7	37.7	36.7	40.4	39.8	42.5	42.0
Net Cash (Debt)	5.9	6.7	6.6	6.6	6.6	6.7	6.6
Option exercise	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Forecast Equity	39.6	48.4	47.3	51.0	50.4	53.1	52.7
Diluted shares	43.7	43.7	43.7	43.7	43.7	43.7	43.7
Per share (diluted)	\$0.91	\$1.11	\$1.08	\$1.17	\$1.16	\$1.22	\$1.21
Blended valuation	Jun-18	Aug-19	Jun-19	Aug-20	Jun-20	Aug-21	Jun-21
12 month forward (Cash adjusted P/E)	\$1.12	\$1.38	\$1.34	\$1.46	\$1.44		
12 month forward price DCF	\$1.15	\$1.19	\$1.19	\$1.22	\$1.22		
12 month forward EV/EBITDA	\$0.91	\$1.11	\$1.08	\$1.17	\$1.16		
Blended target	\$1.06	\$1.23	\$1.21	\$1.28	\$1.27		

Source: Company data, APP Securities

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Terminal Value methodology - APP Securities' Discounted Cash Flow (DCF) valuation applies a terminal growth rate to the last forecast year's cash flow and discounts the amount using Weighted Average Cost of Capital (WACC). The Terminal Value is tested using ASX-listed company multiples. For resource company's there is no terminal value because cash flows are forecast to the end of mine life.

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