

HiTech Group Australia**Commercial & Professional Services****HIT-ASX A\$ 0.86 TARGET PRICE A\$1.10 BUY**

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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david.fraser@appsecurities.com.au**1H18 Confirms FY18F Outlook - 100% payout ratio sustainable - PT up from \$1.00 to \$1.10****HiTech Group Australia (HiTech) continues to look attractive on every financial metric in our view**

It is trading on a cash adjusted P/E of ~10.0 times. NB: At the end of FY18, we forecast HiTech will have cash on balance sheet equal to \$0.15 per share.

Investor return

Based on our price target and forecast dividend yield, HiTech offers investors a total stock return of over 40%.

FY18F gross yield of ~13%

We have raised our forecast payout ratio to 100% lifting our FY18F dividend to \$0.08, fully franked.

Pristine balance sheet

HIT 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.

Basic investment proposition.

We believe HiTech is in a very solid position and will be able to grow its business through organic growth and EPS accretive acquisitions. HiTech has made no secret that it wants to grow. HiTech stated at its FY17 result that it is "ready to take advantage of market opportunities and EPS accretive acquisitions to increase stakeholder returns" and that "acquisition targets are currently under consideration subject to" its strict criteria.

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. 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 trends.

Valuation

The average of our three valuation techniques gives us a 12 month forward blended valuation of \$1.11. Thus; our 12-month forward price target is set at \$1.10.

Website<http://hitechaust.com/>**Company Data**

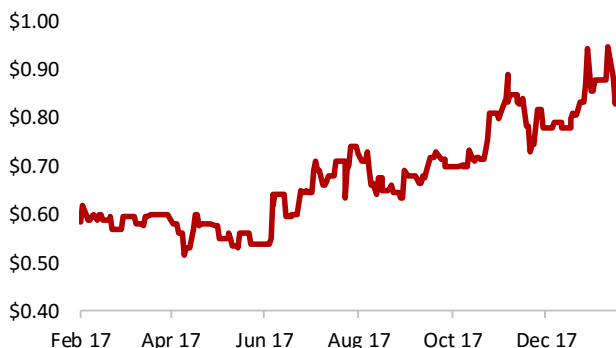
Shares outstanding (m)	35.2
Price (\$)	0.86
Market Capitalisation (\$m)	30.2
Free Float (%)	32%
Free Float Market Capitalisation (\$m)	9.7
12 month low (\$)	0.51
12 month high (\$)	0.95
Average daily volume (3 month) ('000)	12.9
Forecast Stock Capital Return	28%
Forecast Total Stock Gross Return	41%

Data Source: FactSet

Earnings Summary (A\$m)

Year end June	FY17	FY18F	FY19F	FY20F
Sales revenue	23.3	27.2	30.2	33.2
EBITDA	3.4	4.0	4.6	5.1
PBT	3.5	4.1	4.6	5.1
Underlying NPAT	2.4	2.8	3.2	3.6
Reported NPAT	2.3	2.8	3.2	3.6
Reported EPS (c)	6.6	8.0	9.1	10.2
Underlying EPS diluted (c)	6.1	6.4	7.4	8.2
Underlying P/E (x)	10.5	13.4	11.7	10.5
DPS (c)	6.0	8.0	9.0	10.0
Payout ratio (%)	87%	100%	100%	100%
Franking (%)	100%	100%	100%	100%
Dividend yield (%)	7.0%	9.3%	10.5%	11.6%
Gross Yield (%)	13.4%	13.3%	15.0%	16.6%

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	27.2	30.2	33.2				
Price (\$)	0.86	COGS	(14.4)	(18.6)	(21.8)	(24.1)	(26.5)				
Target Price (\$)	1.10	Gross Profit	3.9	4.7	5.4	6.1	6.7				
Upside (Downside) (%)	27.9%	<i>Gross Profit Margin</i>	21.3%	20.2%	19.9%	20.2%	20.2%				
Gross Yield (%)	13.3%	Other operating costs	(1.4)	(1.3)	(1.4)	(1.5)	(1.6)				
Total Stock Return (%)	41.2%	EBITDA	2.5	3.4	4.0	4.6	5.1				
Shares (m)	35.2	D&A	0.0	0.0	0.0	0.0	0.0				
Diluted shares(m)	43.7	EBIT	2.5	3.4	4.0	4.6	5.1				
Market Capitalisation (\$m)	30.2	<i>Margin</i>	13.7%	14.7%	14.8%	15.3%	15.4%				
Free Float Market Capitalisation (\$m)	9.7	Net interest	0.0	0.0	0.0	0.0	0.0				
Valuation						PBT	2.5	3.5	4.1	4.6	5.1
Discounted Cash Flow						Tax	(0.7)	(1.0)	(1.2)	(1.4)	(1.6)
Diluted Value per share (\$)	\$1.25	Underlying NPAT	1.8	2.4	2.8	3.2	3.6				
Cash adjusted P/E (x)						Profit	1.8	2.4	2.8	3.2	3.6
Forecast P/E Multiple (x)	12.0	Minority interests	0.0	0.0	0.0	0.0	0.0				
Diluted Value per share (\$)	\$1.06	Reported NPAT	2.2	2.3	2.8	3.2	3.6				
EV/EBITDA						Cashflow A\$m					
Forecast EV/EBITDA (x)	8.0	Operating EBITDA	2.5	3.4	4.0	4.6	5.1				
12 month forward EBITDA (\$m)	4.4	Change in working capital	0.1	0.2	(0.2)	(0.1)	(0.2)				
Enterprise Value (\$m)	35.1	Net interest	0.0	0.0	0.0	0.0	0.0				
Net Cash (Debt) (\$m)	5.3	Tax paid	(0.6)	(1.5)	(1.2)	(1.4)	(1.5)				
Cash from option exercise	4.0	Other	(0.1)	(0.2)	0.0	0.0	0.0				
Value (\$m)	44.4	Operating cashflow	1.9	1.9	2.6	3.1	3.4				
Diluted Value per share (\$)	\$1.02	Capital expenditure	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)				
Financial Metrics						Net Divestment/(Acquisitions)	0.7	0.7	0.0	0.0	0.0
	FY16	FY17	FY18F	FY19F	FY20F	Other	0.0	0.0	0.0	0.0	0.0
Reported EPS (c)	7.0	6.6	8.0	9.1	10.2	Investing cashflow	0.6	0.5	(0.1)	(0.1)	(0.1)
Underlying EPS (c)	5.8	6.9	8.0	9.1	10.2	Change in Debt	0.0	0.0	0.0	0.0	0.0
Underlying EPS diluted (c)	4.9	6.1	6.4	7.4	8.2	Change in Equity	0.0	0.1	0.0	0.0	0.0
Underlying P/E (x)	6.5	9.3	10.8	9.4	8.5	Dividends paid	0.0	(1.7)	(2.5)	(3.0)	(3.3)
P/E (diluted & cash adj.) (x)	3.3	8.0	10.1	8.8	7.9	Other	0.0	0.0	0.0	0.0	0.0
DPS (c)	2.0	6.0	8.0	9.0	10.0	Financing cashflow	0.0	(1.6)	(2.5)	(3.0)	(3.3)
Payout ratio (%)	34.4%	87.4%	100.0%	100.0%	100.0%	Net cashflow	2.6	0.8	0.1	0.0	0.0
Franking (%)	100%	100%	100%	100%	100%	Balance Sheet A\$m					
Dividend yield (%)	2.3%	7.0%	9.3%	10.5%	11.6%	Cash and Deposits	4.4	5.2	5.3	5.3	5.3
Gross Yield (%)	7.6%	13.4%	13.3%	15.0%	16.6%	Receivables	3.1	2.6	3.0	3.4	3.7
Book value (c)	16.3	16.8	16.1	16.7	17.3	Financial assets	0.6	0.0	0.0	0.0	0.0
Net Tangible Assets (c)	16.2	16.7	16.1	16.7	17.3	Other Current Assets	0.0	0.2	0.2	0.2	0.2
Price to Book value (x)	2.3	3.8	5.3	5.1	5.0	Total Current Assets	8.1	8.0	8.6	8.9	9.2
Price to NTA (x)	2.3	3.8	5.4	5.2	5.0	PPE	0.1	0.2	0.3	0.4	0.5
Cash Conversion	100%	99%	95%	97%	97%	Deferred tax assets	0.1	0.1	0.1	0.1	0.1
Op. cashflow per share (c)	5.1	4.3	5.8	6.9	7.7	Intangibles (incl. goodwill)	0.0	0.0	0.0	0.0	0.0
Price to OCFs (x)	7.0	13.5	14.2	12.1	10.9	Other	0.0	0.0	0.0	0.0	0.0
Interest cover (EBIT/Net int) (x)	n/m	n/m	n/m	n/m	n/m	Total Non Current Assets	0.1	0.3	0.4	0.5	0.6
Underlying ROE (%)	37.1%	38.3%	41.0%	44.8%	48.1%	Total Assets	8.2	8.3	9.0	9.4	9.8
Underlying ROA (%)	9.1%	10.4%	11.6%	12.5%	13.3%	Payables	1.4	1.2	1.3	1.5	1.6
Multiples						Interest Bearing Debt	0.0	0.0	0.0	0.0	0.0
	FY16	FY17	FY18F	FY19F	FY20F	Other	0.8	0.4	0.5	0.5	0.5
Net debt	(4.4)	(5.2)	(5.3)	(5.3)	(5.3)	Total Current Liabilities	2.2	1.6	1.8	2.0	2.2
Market Equity (Y/E)	13.7	25.4	37.5	37.5	37.5	Interest Bearing Debt	0.0	0.0	0.0	0.0	0.0
EV	9.3	20.2	32.3	32.2	32.2	Long Term Provisions	0.0	0.1	0.1	0.1	0.1
EV/EBITDA (x)	3.7	5.6	7.0	6.1	5.5	Deferred Tax	0.0	0.0	0.0	0.0	0.0
EV/EBIT (x)	3.7	5.6	7.0	6.1	5.5	Total Non Current Liabilities	0.0	0.1	0.1	0.1	0.1
Growth Rates						Total Liabilities	2.3	1.7	1.9	2.1	2.3
	FY16	FY17	FY18F	FY19F	FY20F	Shareholders Equity	2.9	3.1	3.1	3.1	3.1
Revenue growth (%)	22%	28%	17%	11%	10%	Retained Earnings/(Losses)	2.7	3.4	3.4	3.4	3.4
Gross Profit growth (%)	22%	21%	15%	13%	10%	Reserves/Other	0.3	0.2	0.6	0.8	1.1
EBITDA growth (%)	85%	37%	17%	14%	11%	Minority Interests	0.0	0.0	0.0	0.0	0.0
Underlying EPS (dil) growth (%)	62%	23%	6%	14%	11%	Total Equity	6.0	6.7	7.0	7.3	7.6

Interim

HIT has reported a solid 1H18 result.

Financials all in line with our current forecasts for FY18F.

Interim dividend of 4 cents, fully franked, up on our forecast 3c for the interim and our FY18F forecast of 6c!

We have lifted our revenue growth assumption from 12.5% to 15.0% for FY18F given the solid performance in 1H18 (i.e. 27% on pc). NB: We assume the sundry income in 1H18 does not repeat in the 2H.

We have raised our forecast payout ratio to 100% lifting our FY18F dividend to \$0.08, fully franked that implies a FY18F gross yield of 13%.

Gross margin in 1H 19.1% versus 17.3% in pc.

Cash on B/S \$5.9m up from \$5.2m at FY17.

Operating cash flow \$1.9m versus \$0.7m.

Figure 1. HiTech Group Australia Profit and Loss

A\$m	FY15	FY16	1H17	2H17	FY17	1H18	2H18F	FY18F	FY19F	FY20F
Contracting and permanent placement revenue	15.0	18.3	11.0	12.3	23.3	12.9	13.9	26.8	30.2	33.2
Other Revenue	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.4	0.0	0.0
Total Sales	15.0	18.3	11.0	12.3	23.3	13.3	13.9	27.2	30.2	33.2
<i>Growth</i>		21.5%	34.9%	21.7%	27.6%	20.7%	12.9%	16.6%	11.0%	10.0%
Cost of Services	(11.9)	(14.4)	(9.1)	(9.5)	(18.6)	(10.8)	(11.0)	(21.8)	(24.1)	(26.5)
Gross Profit	3.2	3.9	1.9	2.8	4.7	2.5	3.0	5.4	6.1	6.7
<i>Margin</i>	21.1%	21.3%	17.3%	22.7%	20.2%	18.5%	21.2%	19.9%	20.2%	20.2%
Administration	(0.8)	(1.1)	(0.6)	(0.6)	(1.2)	(0.8)	(0.6)	(1.4)	(1.4)	(1.5)
Other	(1.0)	(0.3)	(0.1)	0.1	(0.0)	(0.2)	0.2	(0.0)	(0.0)	(0.0)
Total other operating expenditure	(1.8)	(1.4)	(0.7)	(0.6)	(1.3)	(0.9)	(0.4)	(1.4)	(1.5)	(1.6)
EBITDA	1.3	2.5	1.2	2.2	3.4	1.5	2.5	4.0	4.6	5.1
Depreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITA	1.3	2.5	1.2	2.2	3.4	1.5	2.5	4.0	4.6	5.1
Amortisation of intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Underlying EBIT	1.3	2.5	1.2	2.2	3.4	1.5	2.5	4.0	4.6	5.1
Interest income	0.0	0.0	0.0	0.0	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	0.0	0.0	0.0	0.0
Net Interest income/(expense)	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Underlying PBT	1.3	2.5	1.2	2.3	3.5	1.5	2.5	4.1	4.6	5.1
Taxation	(0.4)	(0.7)	(0.4)	(0.7)	(1.0)	(0.5)	(0.8)	(1.2)	(1.4)	(1.5)
Underlying profit after tax	0.9	1.8	0.8	1.6	2.4	1.1	1.8	2.8	3.2	3.6
<i>Growth</i>		91.2%	22.7%	47.9%	34.1%	27.3%	11.9%	17.5%	14.2%	11.2%
Statutory NPBT	1.3	3.1	1.3	2.0	3.3	1.5	2.5	4.1	4.6	5.1
Tax	(0.5)	(0.9)	(0.4)	(0.6)	(1.0)	(0.5)	(0.8)	(1.2)	(1.4)	(1.6)
Reported NPAT	0.8	2.2	0.9	1.4	2.3	1.1	1.7	2.8	3.2	3.6
Average Shares	31.0	31.0	31.0	35.2	35.2	35.2	35.2	35.2	35.2	35.2
EPS	2.6	7.0	3.0	3.9	6.6	3.0	5.0	8.0	9.1	10.2
Underlying EPS	3.0	5.8	2.7	4.5	6.9	3.0	5.0	8.1	9.2	10.3
DPS	0.0	2.0	3.0	3.0	6.0	4.0	4.0	8.0	9.0	10.0

Source: Company data, APP Securities

We are forecasting continued growth in revenue but at lower levels than that have been achieved over the last five years (CAGR of 19.5%). Our base case forecasts assume revenue growth in FY18F of 15% then growth rates to lower by 2.5% p.a.

We are forecasting gross margins to be maintained at FY17 levels, but given our declining revenue growth assumptions we are comfortable with our forecasts.

Investment Case

In our view HiTech Group Australia (HiTech) continues to look an attractive investment opportunity. The stock is trading on a FY18F EV/EBITDA multiple of sub 7.0 times, a three-year PEG ratio of 1.0 and a cash adjusted P/E of 10 times. NB: At the end of FY18F, HiTech has forecast cash on balance sheet equal to \$0.15 per share.

We are forecasting HIT will pay a fully franked dividend of \$0.08 per share in FY18F (gross yield over 13%), lifting to \$0.09 in FY19F.

While barriers to entry in the recruitment space are low we are comfortable that the quality of the Board and management will ensure HIT keeps pace with market and technological developments while continuing to offer existing clients a broader suite of recruitment and information and communications technology (ICT) consulting solutions in addition to base contracting agreements.

HiTech has no debt and cash available of ~\$5m, so is in a very solid position to grow its business through organic growth and EPS accretive acquisitions in a highly-fragmented market. We expect the Board and management to target acquisitions that fit the existing company culture and industry of HIT's existing client base, and are EPS accretive. HiTech stated at its FY17 results that it is "ready to take advantage of market opportunities and EPS accretive acquisitions to increase stakeholder returns" and that "acquisition targets are currently under consideration subject to" its strict criteria.

HiTech intends to pursue organic growth through on-boarding new clients, enhancing the service offering provided to existing clients by providing a broader suite of recruitment and ICT consulting solutions in addition to base contracting agreements, and expanding the company's ICT offering into high margin consulting and services space i.e. Cloud, Security and Software as a service (SaaS).

The company generates the majority of its revenue from supplying ICT contracting and consulting, meaning revenue is almost entirely recurring. Revenue is underpinned by a long term, blue chip customer base with a number of significant client supplier agreements recently extended for three to seven years including the Department of Human Services and the Department of Infrastructure.

We expect companies and government agencies to continue to reduce full time equivalent work force numbers while continuing to outsource, thus increasing contracting job hours. HiTech is perfectly placed to benefit from this ongoing trend. FY17 delivered the company's third consecutive year of double digit revenue and profit growth.

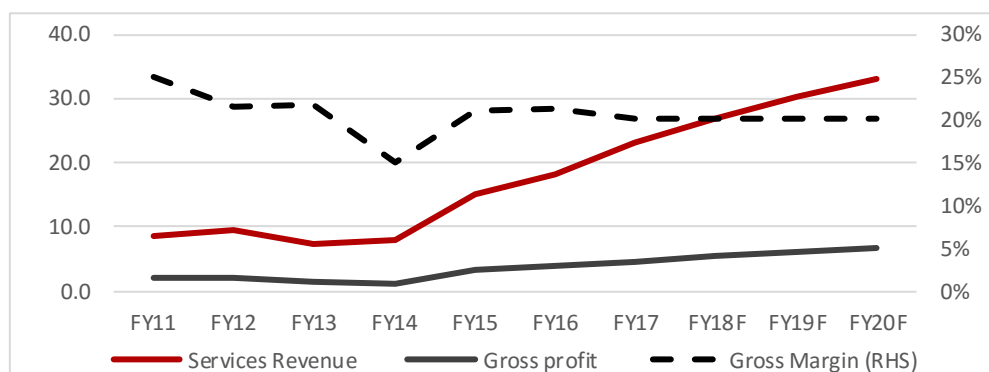
Figure 2. HiTech Group Australia Service Revenue growth and Gross Margin (A\$m)

A\$m	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18F	FY19F	FY20F
Services Revenue	8.7	9.6	7.3	8.0	15.0	18.3	23.3	26.8	30.2	33.2
Growth		9.5%	-23.7%	9.1%	88.6%	21.5%	27.6%	15.0%	12.5%	10.0%
Gross profit	2.2	2.1	1.6	1.2	3.2	3.9	4.7	5.4	6.1	6.7
Gross Margin (RHS)	25.1%	21.5%	21.7%	15.2%	21.1%	21.3%	20.2%	20.2%	20.2%	20.2%

Source: Company data, APP Securities

Revenue has grown at a compound average growth rate (CAGR) of ~18% since FY11 despite a drop off in FY13 reflecting a move away from low margin business.

Figure 2. HiTech Group Australia Service Revenue and Gross Margin Growth (A\$m)



Source: Company data, APP Securities

Valuation

The average of our three valuation techniques gives us a 12 month forward blended valuation of \$1.11 (up from \$0.98, primarily reflecting roll forward and marginally higher earnings).

Our 12-month forward price target is set at \$1.10 (up from our previous \$1.00)

Figure 3. HiTech Australia Group Valuation

12 month forward price (P/E)	Jun-18	Feb-19	Jun-19	Feb-20	Jun-20
HIT underlying EPS (\$) (diluted)	0.064	0.070	0.074	0.079	0.082
Forecast P/E (x)	12.0	12.0	12.0	12.0	12.0
Unadjusted Value	\$0.77	\$0.84	\$0.88	\$0.95	\$0.98
Net Cash (Debt)	5.3	5.3	5.3	5.3	5.3
Cash from exercised options	4.0	4.0	4.0	4.0	4.0
Total Cash post option exercise	9.3	9.3	9.3	9.3	9.3
Cash value per share	\$0.21	\$0.21	\$0.21	\$0.21	\$0.21
Value	\$0.98	\$1.06	\$1.10	\$1.16	\$1.20
12 month forward price DCF	Jun-18	Feb-19	Jun-19	Feb-20	Jun-20
HiTech Australia DCF	\$1.22	\$1.25	\$1.26	\$1.29	\$1.30
12 month forward price (EV/EBITDA)	Jun-18	Feb-19	Jun-19	Feb-20	Jun-20
HIT underlying EBITDA (\$)	4.0	4.4	4.6	4.9	5.1
Forecast EV/EBITDA (x)	8.0	8.0	8.0	8.0	8.0
Forecast Enterprise Value	32.2	35.1	36.8	39.6	41.0
Net Cash (Debt)	5.3	5.3	5.3	5.3	5.3
Option exercise	4.0	4.0	4.0	4.0	4.0
Forecast Equity	41.5	44.4	46.1	48.9	50.3
Diluted shares	43.7	43.7	43.7	43.7	43.7
Per share (diluted)	\$0.95	\$1.02	\$1.06	\$1.12	\$1.15
Blended valuation	Jun-18	Feb-19	Jun-19	Feb-20	Jun-20
12 month forward (Cash adjusted P/E)	\$0.98	\$1.06	\$1.10	\$1.16	\$1.20
12 month forward price DCF	\$1.22	\$1.25	\$1.26	\$1.29	\$1.30
12 month forward EV/EBITDA	\$0.95	\$1.02	\$1.06	\$1.12	\$1.15
Blended target	\$1.05	\$1.11	\$1.14	\$1.19	\$1.21

Source: Company data, APP Securities

Discounted cash flow valuation

We have used a cost of equity of 11.0% based off an equity beta of 1.0 (NB: FactSet observed equity beta for HiTech is 0.81), a risk-free rate of 5.0% and a market risk premium of 6.0%. Given our assumed debt levels are zero going forward we have a weighted average cost of capital (WACC) of 11.0%. We have discounted 10 years of free cash flows and applied a nominal terminal growth rate of 3.0% (2.5% inflation and 0.5% real growth).

Figure 4. HiTech Australia Discounted Cash Flow Valuation

DCF Operating Cash Flows	FY18F	FY19F	FV20F	FY21F	FY22F	FV23F	FY24F	FY25F	FV26F	FY27F	Terminal
EBITA incl other income (expens)	4.0	4.6	5.1	5.5	5.8	6.0	5.9	5.8	5.8	5.8	
Ungearing taxation	(1.2)	(1.4)	(1.5)	(1.7)	(1.7)	(1.8)	(1.8)	(1.8)	(1.7)	(1.7)	
Depreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Increase in Working Capital	(0.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Capital Expenditure	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	
Acquisitions/Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Disposals/Capital Raised	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Standard Free Cashflow	2.5	3.1	3.5	3.8	4.0	4.1	4.0	4.0	3.9	3.9	55.8
FCF Timing Factor	0.4	1.4	2.4	3.4	4.4	5.4	6.4	7.4	8.4	9.4	10.4
Discount Factor	1.0	1.1	1.3	1.4	1.5	1.7	1.8	2.0	2.2	2.4	2.7
Discounted FCF	2.4	2.7	2.8	2.7	2.6	2.4	2.2	2.0	1.8	1.6	20.8
Valuation	\$m										
Explicit Cashflows (10 Years)	23										
Terminal Value	21										
Total Firm Value	44										
Plus Cash (Net debt)	5										
Option exercise cash	4										
Total Equity Claims	53										
Diluted Shares	44										
Per Share Value	\$1.22										

Source: Company data, APP Securities

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