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DGL Group (DGL)

One small step

Recommendation

Buy (Buy)

Price

\$2.40

Target (12 months)

\$3.00 (previously \$3.05)

GICS Sector

Materials

Expected Return

Capital growth	25.0%
Dividend yield	0.0%
Total expected return	25.0%

Company Data & Ratios

Enterprise value	\$699.8m
Market cap	\$660.0m
Issued capital	275.0m
Free float	38.2%
Avg. daily val. (52wk)	\$605,000
12 month price range	\$0.94 - \$3.28

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.00	2.14	
Absolute (%)	-20.00	12.15	
Rel market (%)	-18.58	15.54	

Absolute Price



SOURCE: IRESS

Navigating strongly versus disruptive backdrop

We largely anticipated a vanilla AGM for DGL as the company begins working through the initial stages of integrating a combined seven new businesses (\$69.5m), or 25 new sites, into its Trans-Tasman chemicals logistics network. As such, the highlight of the AGM was DGL effectively disclosing guidance on these acquisitions in the order of \$15.0m pro-forma EBITDA in FY22e. This amount implies minimal earnings slippage, if anything, on LTM earnings from these businesses prior to acquisition (\$15.2m), and against a challenging backdrop of disruption in supply lines and significant raw material price inflation, we view this as a positive outcome. Other relevant commentary included DGL continuing to perform “in-line with expectations”.

Tapering DGL’s pricing and leverage to LME lead in 2H22e

In Australian dollar terms LME lead has averaged A\$3,170/t during 1H22e, up >18% on the average of 2H21. Market tightness has persisted due to (1) China announcing that metals processing and lead battery manufacturing will be targeted with stricter pollution limits; (2) force majeure at major primary lead smelters in Europe (Stolberg) and in Henan, China; and (3) discrepancies in stock registered with LME (record lows) and Shanghai Futures (record highs) – exacerbated by supply chain issues. We think China possibly relaxing bans on Australian coal, along with recent signals that lead stocks are beginning to leave China poses downside risk to prices in 2H22e, particularly if improvements to bulk shipping result in possibly sudden LME deliveries. We elect to bring forward our long term pricing assumptions to 2H22e (\$A2,800/t, prev. A\$3,000/t) and take a more conservative view on DGL’s earnings leverage to lead (+/- 5% price now ~\$0.8m EBITDA, prev. ~\$1.0m) over FY22e – in part given that there is no guidance to DGL’s core business (Feb ’22). Underlying FY22e EBITDA is reduced to \$33.4m (prev. \$34.4m) however there are no other material changes to forecasts.

We believe DGL is in position to annualise \$42.9m EBITDA equating to 51.1% YoY growth in FY22e (\$48.4m pro forma). In our view, guidance on acquisitions is a small step towards DGL validating its growth strategy, focused on industry consolidation, as one that is scalable and sustainable. We reiterate our Buy rating and \$3.00ps PT.

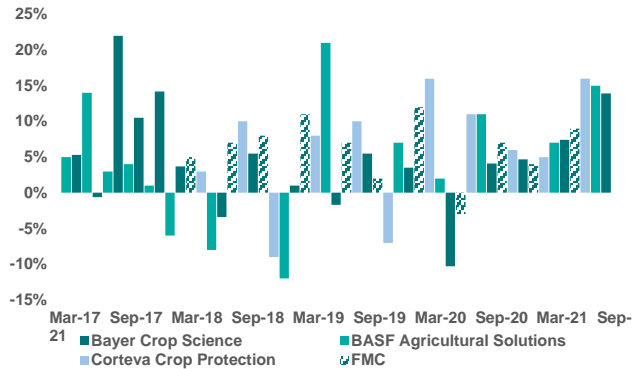
Earnings Forecast

Year end 30 June	FY21	FY22e	FY23e	FY24e
Sales revenue (\$m)	196.5	237.4	258.0	293.1
Revenue incl. acquisitions (\$m)	196.5	298.0	353.0	395.4
EBITDA Total (\$m)	28.4	42.9	55.5	66.0
NPAT (underlying) (\$m)	11.6	18.9	26.0	33.4
NPAT (reported) (\$m)	11.3	18.9	26.0	33.4
EPS (adjusted) (cps)	4.5	7.0	9.4	12.2
EPS growth (%)	140.0%	54.6%	35.4%	28.6%
PE (x)	53.2	34.4	25.4	19.7
EV/EBITDA (x)	24.9	16.5	12.6	10.1
FCF Yield (%)	0.0%	-2.4%	1.4%	4.4%
EV/EBITDA (x)	24.9	16.5	12.6	10.1
Dividend (eps)	3.4	0.0	0.0	0.0
ROE (%)	5.9%	7.7%	9.6%	11.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

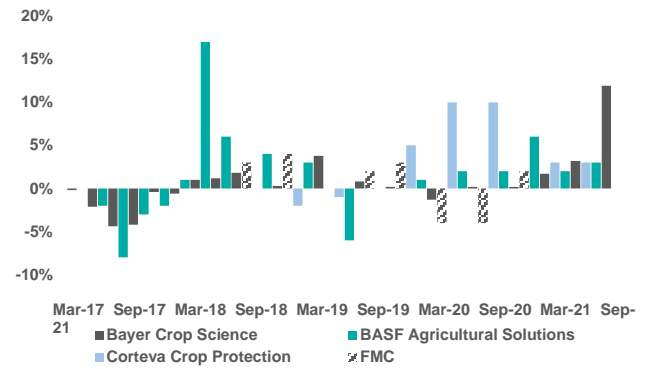
Key Charts

Figure 1 - Industry quarterly volume growth (% YoY)



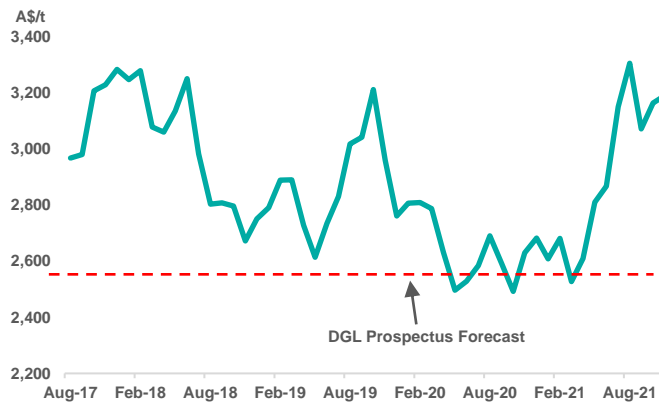
SOURCE: COMPANY DATA, BELL POTTER SECURITIES

Figure 2 - Industry quarterly pricing growth (% YoY)



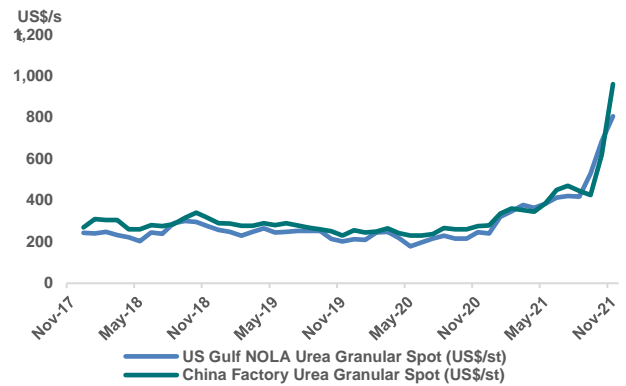
SOURCE: COMPANY DATA, BELL POTTER SECURITIES

Figure 3 - LME lead price - monthly average (A\$/t)



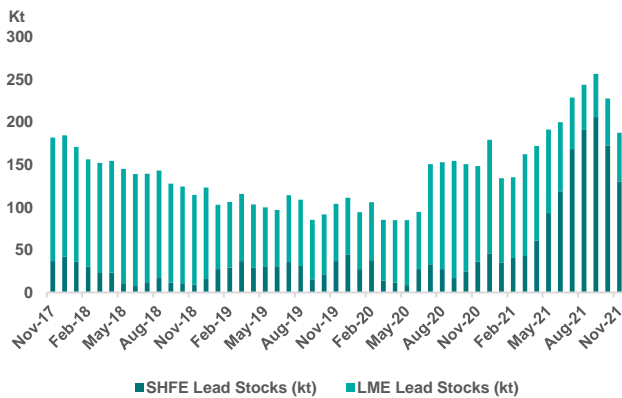
SOURCE: BLOOMBERG, DGL PRICES CONTRACTS AGAINST MONTHLY AVERAGE LME PRICE (AUD)

Figure 4 - Urea granular spot - US Gulf, China Factory (US\$/t)



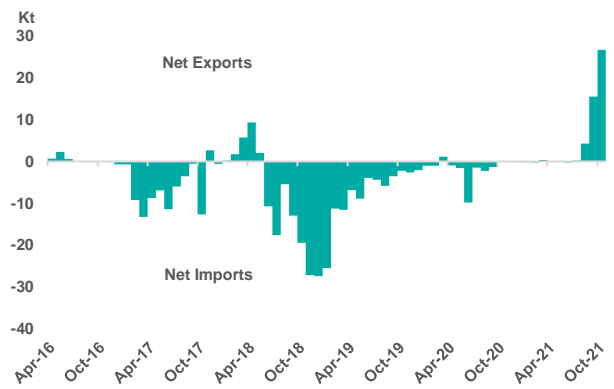
SOURCE: BLOOMBERG, BELL POTTER SECURITIES

Figure 5 - Lead stocks registered with LME and SHFE (kt)



SOURCE: LME, SHFE, BELL POTTER SECURITIES

Figure 6 - Chinese lead monthly net exports (kt)



SOURCE: CUSTOMS, FAST MARKETS, BELL POTTER SECURITIES

Earnings Revisions

The main changes we make to our forecasts are in FY22e and include updating our estimates on earnings for acquisitions (\$15.2m down to \$15.0m) for the guidance disclosed at DGL's AGM. We also elect to bring forward our long term pricing assumptions to 2H22e (\$A2,800/t, prev. A\$3,000/t) and take a more conservative view on DGL's earnings leverage to lead (+/- 5% price now \$0.8m in EBITDA, prev. \$1.0m) over FY22e – in part given that there is no guidance to DGL's core business (Feb '22).

Underlying FY22e EBITDA is reduced to \$33.4m (prev. \$34.4m). Changes in future periods are to some extent carried forward however our view on the organic growth opportunities within the business is largely unchanged. Specifically, these include 11.5% earnings growth in FY22e, increasing as DGL's lead in capex begins to generate a return on capital in FY23e and FY24e.

Figure 7 - DGL earnings revisions

Year end 30 June	FY22e A\$m			FY23e (A\$m)			FY24e (A\$m)		
	Old	New	Change	Old	New	Change	Old	New	Change
Group revenue excl. acquisitions (A\$m)	231.5	237.4	2.5%	254.9	258.0	1.2%	297.4	293.1	-1.5%
Revenue from acquisitions (A\$m)	60.6	60.6	0.0%	99.3	95.0	-4.3%	105.4	102.2	-3.0%
Total Revenue (A\$m)	292.1	298.0	2.0%	354.2	353.0	-0.3%	402.8	395.4	-1.9%
Total EBITDA (A\$m)	44.1	42.9	-2.7%	56.8	55.5	-2.2%	67.4	66.0	-2.1%
... Margin %	15.1%	14.4%	-70bps	16.0%	15.7%	-30bps	16.7%	16.7%	nm

SOURCE: BELL POTTER SECURITIES ESTIMATES

The abovementioned revisions result in a moderate reduction to our Price Target, from \$3.05ps to \$3.00ps. On a 12-month view, our Buy rating is unchanged.

DGL Group (DGL)

Company Description

DGL Group (DGL) is a vertically integrated specialty chemicals and logistics company providing integrated manufacturing, third party logistics (3PL) and environmental services for Trans-Tasman agriculture, construction, mining and automotive industries. DGL serves in excess of 2,000 customers across its 51 owned and/or operated sites.

Investment View

We remain constructive on DGL's acquisition strategy and unique vertical across the dangerous chemicals life cycle, believing that DGL's industries are ideally poised for consolidation, and favour operators with both scale (route density) and multiple services. DGL trades on a pro-forma EV/EBITDA of 14.5x, which we see as an opportunity to Buy for long-term growth. We currently have a 12 month price target of \$3.00ps on DGL.

DGL's expansive period of corporate activity in FY22e has seen a total of \$69.5m spent across six new businesses and 25 new sites. Whilst the scale of this future integration is an emerging risk to execution, we think this is outweighed by the potential upside to successful integration. We are backing management's track record of (albeit smaller) business combinations, with a view that if latent capacity and/or earnings can be absorbed from acquisitions earlier than anticipated then DGL's industry consolidation strategy is highly scalable and repeatable.

Investment Thesis

Differentiated end-to-end supply chain service: The breadth of DGL's operations spanning the entire back end chemical lifecycle is unrivalled by any Trans-Tasman competitor. Under new Chain of Responsibility (CoR), DGL can reduce costs and regulatory obligations of customers over pure-play competitors by spreading compliance liabilities across a customer's full business

Aligned with decarbonisation trend: DGL is focused on providing 'closed loop' services to customers. As further solutions develop through continuous improvement, we think DGL will be able to absorb latent capacity in other verticals within the business to drive group margin improvement.

Annuity earnings from ULABs: DGL owns and operates two of Australia's five approved used lead acid battery (ULAB) recycling plants and generates relatively defensible earnings against these assets (c.25% revenue).

Key Risks

Competition: DGL faces competition from more capitalised operators. Its market position could reduce if competitors secure new contracts, acquire additional assets or assume irrational pricing strategies. Our forecasts imply DGL winning additional services of existing customers, including from competitors, however adoption rates may be slower than anticipated due to pre-existing contracts, pricing susceptibility or reliance on another party.

Occupational Health and Safety: DGL faces a number of OHS associated risks including hazardous materials exposure for staff, injuries associated with manual handling and transport, the operation of machinery, and mobile plant and dust exposure accidents.

Acquisition and integration risk: DGL's growth strategy involves acquisitions that have inherent due diligence, capital allocation and business integration risk.

Table 1 - Financial summary

DGL Group (DGL)				
Share Price:	\$2.40	Target Price:	\$3.05	
No. of issued shares:	\$275.0m	Market cap:	\$660.0m	

Income Statement (A\$m)	FY20	FY21	FY22e	FY23e	FY24e
Year Ending June 30					
Revenue excl. acquisitions	180.1	196.5	237.4	258.0	293.1
Revenue from acquisitions	-	-	60.6	95.0	102.2
Total Revenue	180.1	196.5	298.0	353.0	395.4
Total EBITDA	19.2	28.4	42.9	55.5	66.0
Depreciation & amortisation	(11.6)	(11.3)	(14.1)	(16.5)	(16.9)
EBIT	7.5	17.1	28.8	39.0	49.1
Net interest	(1.6)	(2.3)	(2.0)	(2.1)	(1.7)
Pre tax profit	5.9	14.8	26.8	36.9	47.5
Tax expense	(1.1)	(3.2)	(7.9)	(10.9)	(14.1)
Normalised NPAT	4.8	11.6	18.9	26.0	33.4
Reported NPAT	4.8	11.3	18.9	26.0	33.4

Cashflow (A\$m)	FY20	FY21	FY22e	FY23e	FY24e
Gross cashflow	18.6	29.7	29.6	52.1	66.4
Operating cash flow	17.6	28.0	25.2	40.7	51.1
Finance Lease Payments	(7.9)	(6.9)	(9.4)	(10.2)	(10.2)
CAPEX	(25.6)	(21.0)	(31.0)	(21.5)	(12.0)
Free cash flow	(15.9)	0.1	(15.2)	9.0	28.9
Cash payments for acquisitions	-	-	(38.4)	-	-
Proceeds from issuance	-	94.6	-	-	-
Movement in borrowings	17.7	(19.6)	18.9	-	-
Dividends	-	(8.7)	-	-	-
Other	0.1	(26.5)	-	-	-
Change in cash held	1.9	39.9	(34.7)	9.0	28.9
Cash at beginning of period	2.1	3.9	43.8	9.1	18.1
Cash at year end	3.9	43.8	9.1	18.1	47.0

Balance Sheet (A\$m)	FY21	FY22e	FY23e	FY24e
Cash	43.8	9.1	18.1	47.0
Receivables	22.5	33.1	35.2	36.1
Inventory	14.4	30.8	32.5	33.1
Property, Plant & Equipment	133.2	173.4	188.6	193.9
Right of use assets	22.7	22.7	22.7	22.7
Intangibles (incl. goodwill)	28.0	83.6	83.6	83.6
Other non current assets	12.8	12.8	12.8	12.8
Total assets	205.4	365.5	393.6	429.3
Trade payables	17.1	30.8	31.1	33.1
Debt	38.0	56.9	56.9	56.9
Lease liabilities	7.0	7.0	7.0	7.0
Other	20.1	25.6	27.3	27.7
Total Liabilities	146.9	120.3	122.3	124.7
Net Assets	58.5	245.2	271.2	304.6
Share capital	192.3	223.4	223.4	223.4
Reserves	(31.7)	(31.7)	(31.7)	(31.7)
Retained earnings	34.8	53.6	79.6	113.0
Shareholders Equity	58.5	245.2	271.2	304.6

Segmental Revenues - Underlying (FY20	FY21	FY22e	FY23e	FY24e
Environmental Solutions	61.9	63.2	78.9	86.9	105.4
Revenue growth		2.1%	24.8%	10.1%	21.4%
Chemical Manufacturing	94.2	97.3	115.3	121.6	130.8
Revenue growth		3.3%	18.5%	5.5%	7.5%
Warehousing & Distribution	27.6	40.9	48.2	55.0	62.9
Revenue growth		48.0%	17.9%	14.0%	14.5%
Inter-Company Eliminations	(3.7)	(4.9)	(5.0)	(5.5)	(6.0)

Valuation Ratios	FY20	FY21	FY22e	FY23e	FY24e
Basic EPS (cps)	1.9	4.5	7.0	9.4	12.2
Diluted EPS (cps)	1.9	4.5	7.0	9.4	12.2
EPS growth (%)		140.0%	54.6%	35.4%	28.6%
Adjusted PE (x)	127.6	53.2	34.4	25.4	19.7
EV/Sales (x)		3.3	3.0	2.7	2.3
EV/EBITDA (x)		24.9	16.5	12.6	10.1
EV/EBIT (x)		41.4	24.6	17.9	13.6
PE (x)	127.6	53.2	34.4	25.4	19.7
FCF per share (cps)	-6.2	0.0	-5.7	3.3	10.5
FCF yield %	-2.6%	0.0%	-2.4%	1.4%	4.4%
NTA per share (\$ps)		0.65	0.59	0.68	0.80
P/NTA (x)		3.7	4.1	3.5	3.0
Book value (\$ps)		0.8	0.9	1.0	1.1
Price/Book (x)		3.2	2.7	2.4	2.2
DPS (cps)	0.0	3.4	0.0	0.0	0.0
Payout ratio %	0.0%	75.0%	0.0%	0.0%	0.0%
Dividend Yield %	0.0%	1.4%	0.0%	0.0%	0.0%

Performance Ratios	FY20	FY21	FY22e	FY23e	FY24e
EBITDA margin excl. acquisitions (%)	10.6%	14.5%	14.0%	15.3%	16.5%
EBITDA margin incl. acquisitions (%)	10.6%	14.5%	14.4%	15.7%	16.7%
EBIT Margin (%)	4.2%	8.7%	9.7%	11.1%	12.4%
Net debt/(cash)		(5.9)	47.8	38.7	9.9
ROE (%)		5.9%	7.7%	9.6%	11.0%
ROIC (%)		6.2%	9.2%	11.3%	12.0%
FCF Realisation (%)	-148.1%	0.6%	-64.3%	28.0%	72.0%
OCF Realisation (%)	97.4%	131.9%	66.8%	94.7%	102.0%
Asset turn excl. leases (years)		6.5	7.0	6.3	7.3
Capex/Depn excl. leases (x)		0.0	6.5	3.4	1.8
EBIT Net Interest Cover (x)	4.6	7.4	14.7	18.5	29.7

Interim Results (A\$m)	1H21	2H21	1H22e	2H22e	1H23e
Sales revenue	92.5	104.0	119.1	118.3	122.7
Total revenue (incl. acquisitions)	92.5	104.0	132.2	165.8	170.2
Total EBITDA	12.9	15.5	17.7	25.2	25.7
EBIT	(20.6)	(22.3)	(26.0)	(23.8)	(26.1)

Assumptions	FY20	FY21	FY22e	FY23e	FY24e
LME Lead Price (USD)	1,971	1,978	2,190	2,035	2,000
Currency: AUD/NZD	1.07	1.05	1.09	1.09	1.09
Currency: AUD/USD	0.72	0.67	0.74	0.73	0.73

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Disclosure: Bell Potter Securities acted as joint lead manager to DGL's May '20 IPO and received fees for that service.

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