Two strong reports – Vita Group and Altium

by Roger Montgomery

And the gold medal goes to…

We reckon Vita Group (ASX:VTG) and Altium's (ASX:ALU) full year 2016 profit results are arguably two of the reporting season's best.

Altium's software is used to design PCB (printed circuit boards), which are at the heart of intelligent systems, electronics and the move to link almost everything to the internet (the Internet of Things trend). With 25 years of continuous R&D in design Altium now enjoys a globally diversified earnings base with 43% from the Americas, 38% from Europe, 12% from China and 7% from the Asia Pacific. Almost 50% of Altium's revenue is subscription based.

Altiums revenue rose 16%, on top of the 13% growth experienced in 2015. Earnings before interest, tax, depreciation and amortisation rose 20%, EBIT rose 41%, and Net Profit after Tax rose by 25%. Licence sales volumes were up 20% in 2016 to 5,200 seats and subscribers rose 11% to 31,100. Importantly, the client 'churn' rate declined, meaning fewer existing subscribers let their service lapse and therefore a high proportion of the new subscribers added to the total pool.

While 2016 revenue amount to $93.6 million, management have indicated that 2020 revenues are expected to be $200 million with $150 million of pure PCB revenue and $50 million from acquisitions and other non-core services. The target represents annual revenue growth of just under 21% per annum. We note 40% of licence sales are from start-ups manufacturing products that can be encapsulated by The Internet of Things theme.

Another company, whose shares are owned by The Montgomery Fund and The Montgomery [Private] Fund, is Vita Group. Vita Group has nothing to do with vitamins, as you might expect. The company, run by Maxine Horne, operates 103 Telstra stores. Many of these stores have been acquired at just two times EBIT and EBIT grown spectacularly post acquisition, thanks in part to a very strong combination of sales systems and culture.

Vita Group's underlying EBITDA and NPAT rose 55% and 83% to $62.0m and $35.2m respectively. The result was higher than many 'sell-side' analysts had expected.

Investors should be keeping a close eye on on the individual store performances. This is because average per store EBITDA is currently circa $500,000 and the company has indicated that a target of $1 million per store is not unreasonable. Like-for-like (LFL) revenue and EBITDA growth was 17% and 25% respectively in 2016 demonstrating strong performance of stores that have been folded into the company. Investors should expect further growth from these stores and also from recent and future acquisitions. Vita Group acquired retail stores and Telstra Business Centres for $14.6m in FY16 and $5.7m in FY17 YTD. The annualised EBITDA for the 2016 acquisitions was $6.9m implying the EBITDA multiple for these stores was just 2.1x respectively.

One source of growth we had not anticipated was the expansion of the retail store network beyond 100 stores. We had previously believed VTG was limited by Telstra to 100 stores but since year end Telstra has divested some of its stores and VTG have acquired three.

Thanks to excellent working capital management, operating cash flow rose 39%, and the company enjoys a high accounting earnings to cash flow conversion ratio of 101% (Gross Operating Cash Flow to EBITDA).

There aren't many companies listed in Australia with growth runways that offer both clarity and confidence. There are even fewer that are available at a discount to our estimate of their intrinsic value. While we cannot predict the short term share prices of these businesses, we do believe that Altium and Vita Group represent quality available at a reasonable price.

Vita Group

Altium

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