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Johns Lyng Group (JLG)

Come rain

Recommendation
Hold (Buy)
Price
$5.24
Target (12 months)
$5.90 (previously $7.90)

GICS Sector

Commercial Services and Suppliers

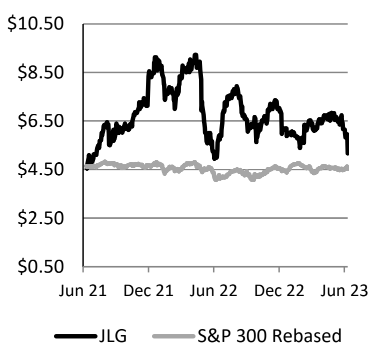
Expected Return	
Capital growth	12.6%
Dividend yield	1.9%
Total expected return	14.5%

Company Data & Ratios	
Enterprise value	$1,365m
Market cap	$1,374m
Issued capital	262.3m
Free float	85%
Avg. daily val. (52wk)	$6.6m
12 month price range	$4.97 - $7.99

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	6.69	6.16	5.03
Absolute (%)	-22.80	-16.15	2.68
Rel market (%)	-21.54	-18.90	-7.99

Absolute Price



SOURCE: IRESS

FY23e earnings guidance

Johns Lyng (JLG) has provided earnings guidance for FY23e. At headline level forecast revenue for FY23e (excluding the soon to be exited Commercial Construction division) has been upgraded by ~$110m to $1.19bn, marking an increase of 10.2% over Feb'23 guidance and representing growth of 47.7% vs. FY22.

CAT: JLG now expects revenue of $350.5m (prev. $240.5m in Feb'23) and EBITDA of $41.0m (prev. $29.0m). Annualising implied CAT work completed from Mar'23 to Jun'23 ($330m) continues to suggest a significant CAT run-rate for JLG (and we note compares to Sep'22 to Feb'23 at $336m annualised). At the recent investor day JLG highlighted it had secured US$78m in Hurricane Ian work in the US and that its engagement with local government continues to progress towards 'standing' (e.g. ongoing) contracts with State governments such as Qld and Vic.

BAU: JLG reiterated its BAU forecast for $837.6m (vs. BPe $847.5m) however underlying BAU EBITDA of $92.2m (excl. a $2.3m bad debt) was softer than our $99.3m. Compositionally we suspect the relative infancy of JLG's USA business (e.g. front loading start-up costs to set up JLG's 'full service' proposition) has driven the majority of the margin compression experienced in 2H23 (-90bps HOH to 10.5%).

Investment view: Downgrade to Hold

Our EPS changes are +2%, -9% and -8% in FY23-25e. Whilst still representing FY23e BAU revenue growth of ~30% YOY (~12-14% organic), we see JLG in the relatively early stages of cycling an elevated period of property claims growth of ~10% p.a. since 2020. As such our Hold recommendation is based on our expectations of a softer domestic demand outlook for JLG heading into El Niño, where we have observed falling property claims values in four of the last six events (with an average decline of -1.6% to the cycle midpoint). Key offsetting considerations to our rating include: (1) JLG's execution in the US and the potential to leverage domestic insurance relationships; and (2) JLG's ability to diversify its revenue exposure to rain events and/or accelerate market share growth in the US through M&A.

Earnings Forecast

Year end 30 June	FY22	FY23e	FY24e	FY25e
Revenue ($m)	895.0	1,240.8	1,092.4	1,169.7
EBITDA ($m)	83.6	111.2	117.3	126.4
Normalised NPAT ($m)	48.0	63.1	65.2	70.7
NPAT to Shareholders (Adj.) ($m)	34.6	46.9	48.5	52.5
EPS Adjusted (cps)	14.2	18.0	18.5	20.0
EPS Growth (%)	53.0%	26.7%	2.8%	8.4%
PE Adjusted (x)	36.9	29.1	28.4	26.2
FCF Yield (%)	1.0%	5.1%	4.7%	5.4%
EV/EBITDA (x)	16.2	12.1	11.3	10.2
Dividend (¢ps)	5.7	9.5	10.5	11.5
Franking (%)	100%	100%	100%	100%
Yield (%)	1.1%	1.8%	2.0%	2.2%
ROIC (%)	25.8%	31.2%	31.8%	34.8%

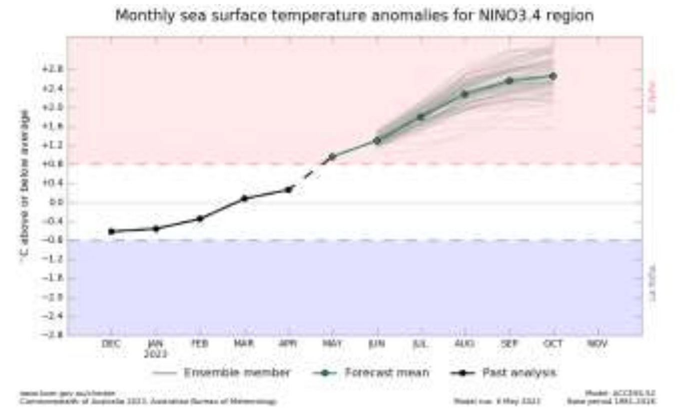
SOURCE: BELL POTTER SECURITIES ESTIMATES

A dry spell

El Niño watch

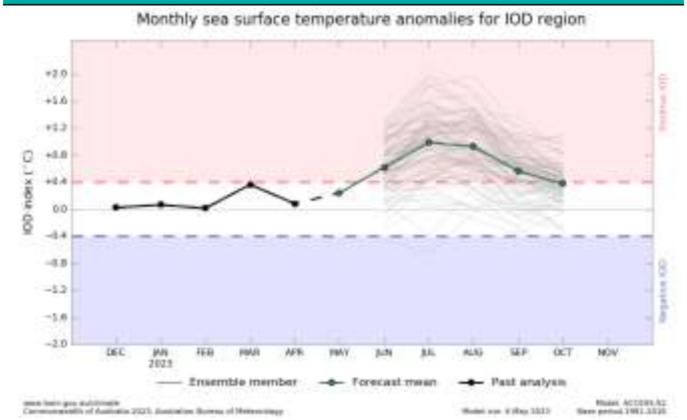
Ocean and atmospheric indicators of La Niña have remained at neutral levels through autumn, however recent forecasting by BOM indicates that El Niño thresholds will likely be met or exceeded by Jun'23. In this note, we visit event predictability, CAT cost and property insurance claims relationships with the Southern Oscillation Index (SOI), and the potential flow through impact to JLG.

Figure 1 - BOM SST model projections - May'23



SOURCE: BOM

Figure 2 - BOM IOD model projections - May'23



SOURCE: BOM

El Niño on domestic BAU

Using incurred property claims as a proxy for sector growth rates, JLG's BAU segment has delivered near double digit percentage point outperformance over the last two years. However, in aggregate we see it being reasonable to expect a softer demand outlook for JLG during the presence of El Niño, where we have observed declining incurred property claims at the mid-point of the El Niño cycle in four of the last six events (versus the baseline year). The average decline across these events has been -1.6% with a range of -12.6% to +13.2%[1].

Figure 3 - Property insurance claims in El Niño years

Johns Lyng Group	Current	2022	Jan'02 - Mar'03	Jun'03 - Jun'05	Jun'06 - Feb'07	Feb'09 - Mar'10	Mar'14 - Apr'16	Jun'18 - Dec'19
El Niño indicators	R10YA	R12M	Moderate	Weak	Weak	Strong	Strong	Weak
Gross incurred property claims ($bn) - annualised average	34.9	46.2	20.4	18.0	18.1	22.7	30.7	36.5
YOY movement mid-cycle (%)		19.8%	-6.3%	-10.8%	5.9%	-12.6%	-0.3%	13.2%

SOURCE: APRA, BELL POTTER SECURITIES ESTIMATES

This compares to average growth in incurred claims of +19.5% and positive growth in four of the last five La Niña cycles, with a range of -5.4% to +59.2%.

Figure 4 - Property insurance claims in La Niña years

Johns Lyng Group	Current	2022	Jun'05 - Jun'06	Feb'07 - Mar'09	Mar'10 - Jun'12	May'16 - Jun'18	Mar'20 - Jan'23
La Nina indicators	R10YA	R12M	Weak	Strong	Strong	Weak	Moderate
Gross incurred property claims ($bn) - annualised average	34.9	46.2	18.0	23.6	31.1	32.4	44.0
YOY movement mid-cycle (%)		19.8%	-5.4%	30.0%	59.2%	6.4%	7.3%

SOURCE: APRA, BELL POTTER SECURITIES ESTIMATES

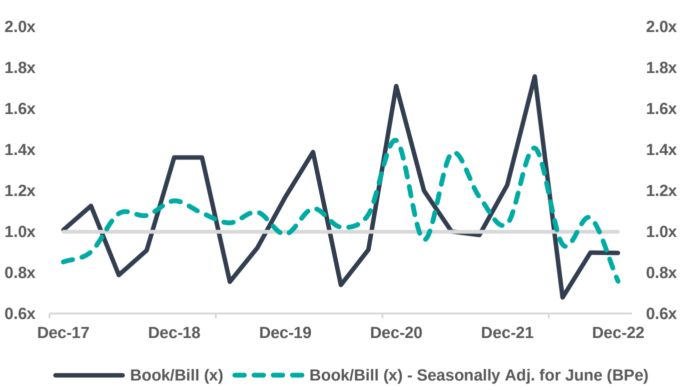
[1] We note that internal water damage arising from weather (e.g. rain) and accident comprises on average >60% of property insurance claims in Australia. JLG's core leverage is to water damage as opposed to losses caused by drought/fire.

How about the current claims backlog?

Unsurprisingly existing data has not yet reflected the potential impacts of an El Niño with short-tail property claims in Australia up +28% YOY as at Dec'22 (R12M basis).

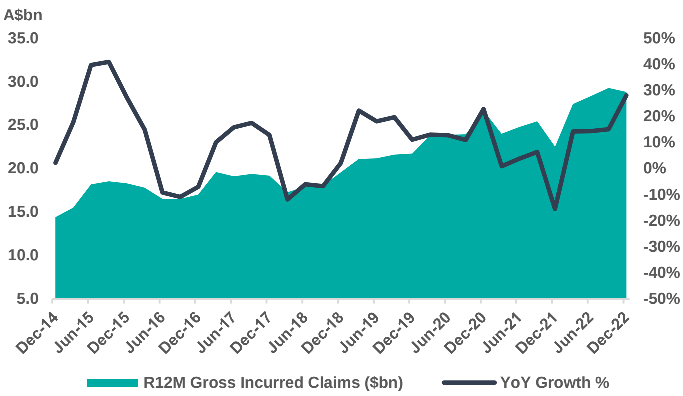
It is also worth noting that cash claims paid by insurers (excl. Allianz) have for a third consecutive quarter exceeded incurred claims (non-cash) post the Mar'22 NSW/SE Qld floods. Whilst we see this pointing to a continued buoyant demand environment for JLG in 2H23e and likely 1H24e, current run-rates would likely see the existing cash claims shortfall/backlog of ~$1.5bn (vs. $5.4bn Mar'22) clear during 1H24e.

Figure 5 - Incurred claims book/bill. Top 10 Insurers ex. Allianz



SOURCE: COMPANY DATA

Figure 6 - R12M Short Tail Gross Incurred Claims - Property



SOURCE: APRA, BELL POTTER SECURITIES

Johns Lyng Group (JLG)

Company Description

Johns Lyng Group Limited (JLG) is an integrated building services group delivering restoration, title management and construction services across Australia and the US. JLG's core business is building fabric repair and contents restoration after damage from insured events including flood, impact and fire. The company has over 1,800 employees with main customers including insurance companies (Suncorp, IAG, Steadfast, QBE, etc), commercial enterprise, government and body corporates.

Investment View and Thesis

Our combined 12m PT is $5.90ps (DCF, Price to Earnings Growth) and we are Hold rated on JLG. Our favourable view is driven by the following:

Category leadership in Australia: As Australia's largest integrated insurance building and disaster recovery services group, JLG benefits from a fragmented competitive set and customers – mainly general insurers – who favour JLG's national reach, multi-disciplinary service offering and capability to respond to loss events rapidly.

Scalable business model: JLG has a strong regional focus that helps the business maintain a panel of over 6,000 sub-contractors across its partnership model. We believe this provides JLG with a unique level of flexibility to scale up during peak weather events, as well as to reduce fixed costs during periods of low activity. In addition, JLG vendors are incentivised through equity interests in both the individual business unit and at Group level.

Transformational US opportunity: Reconstruction Experts (RE) gives JLG a well-established platform within a US$100bn defect/damage insurance market. Near-term growth levers available to JLG include: (1) relationships in Australia with three top-25 US insurers; (2) near-term integration of Make Safe; and (3) RE's US$709m pipeline and significant short-tail backlog.

Defensive growth: The majority of JLG's work is cost-plus with volumes supported by imbedded growth in job registrations with key insurers. Sector demand is also nondiscretionary in nature and we believe largely uncorrelated with the business cycle.

Key Risks

Payment delays and failure to receive payment: Whilst JLG exercises necessary diligence of contracting parties there are risks – such as insolvencies of counterparties – that could impact financial performance.

Panel risk: Being on the panel does not guarantee that JLG's Group Member will be awarded contracts from the panel appointment and financial performance may be impacted if the company is unable to secure future positions or reselection to existing panels.

US execution risk: Realistic impediments to JLG's execution in the US lies within differences between Australian and US markets – e.g. market structure, insurance regulations, customer type, RE's contract structures, labour forces, etc.

Access to labour and project delays: JLG's operations are labour intensive and rely on skilled and qualified labour to grow its business. Accordingly, lack of availability of skilled labour either at all or at budgeted rates may adversely impact financial condition.

Johns Lyng Group
as at 22 June 2023

Recommendation	Hold
Price	$5.24
Target (12 months)	$5.90

Table 1 - Financial summary

Income Statement (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Revenue	568.4	895.0	1,240.8	1,092.4	1,169.7
... Growth %	*69.6%*	*57.5%*	*38.6%*	*-12.0%*	*7.1%*
Total EBITDA	**52.6**	**83.6**	**111.2**	**117.3**	**126.4**
... Margin %	*9.3%*	*9.3%*	*9.0%*	*10.7%*	*10.8%*
... Growth %	*148.9%*	*59.0%*	*33.0%*	*5.5%*	*7.8%*
Depreciation & amortisation	(9.6)	(15.1)	(19.6)	(21.9)	(23.3)
EBIT	43.0	68.5	91.6	95.3	103.1
Net interest	(1.6)	(2.1)	(1.8)	(2.5)	(2.5)
Pre tax profit	41.4	66.4	89.8	92.8	100.6
Tax expense	(11.7)	(18.4)	(26.7)	(27.6)	(29.9)
Tax rate	*28.2%*	*27.7%*	*29.7%*	*29.7%*	*29.7%*
Normalised NPAT	**29.7**	**48.0**	**63.1**	**65.2**	**70.7**
Non-controlling interest	(8.9)	(13.3)	(16.2)	(16.8)	(18.2)
NPAT to shareholders	20.8	34.6	46.9	48.5	52.5
... Growth %	*122.1%*	*66.4%*	*35.5%*	*3.3%*	*8.4%*
Significant items (post-tax)	(2.3)	(9.5)	(2.2)	-	-
Reported NPAT	18.6	25.1	44.8	48.5	52.5

Cashflow (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Gross cashflow	40.9	42.2	122.1	114.2	126.5
Operating cash flow	**28.1**	**25.3**	**99.7**	**84.1**	**94.1**
Finance lease payments	(4.1)	(5.9)	(7.6)	(8.2)	(8.8)
Capex	(1.9)	(5.6)	(20.0)	(10.0)	(10.0)
Payments for intangibles	(0.1)	(1.4)	(1.9)	(1.0)	(1.0)
Free cash flow	**22.0**	**12.4**	**70.3**	**64.8**	**74.3**
Cash payments for acquisitions	-	(171.9)	(18.3)	-	-
Proceeds from issuance	-	225.6	-	-	-
Movement in borrowings	(9.5)	(28.5)	11.5	-	-
Dividends	(9.8)	(13.3)	(19.6)	(26.2)	(28.9)
Other	(6.2)	(0.1)	(8.0)	-	-
Change in cash held	**(3.5)**	**13.7**	**28.6**	**21.9**	**27.3**
Cash at beginning of period	46.8	43.3	57.0	85.6	107.5
Cash at year end	43.3	57.0	85.6	107.5	134.7

Balance Sheet (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Cash	43.3	57.0	84.1	106.0	133.2
Receivables	78.8	174.8	175.5	160.6	175.1
Inventory	0.8	2.8	2.4	2.2	2.4
Property, Plant & Equipment	15.3	26.0	42.5	42.2	41.0
Right of use assets	13.5	18.6	18.3	18.3	18.3
Intangibles (excl. goodwill)	17.5	35.4	34.1	31.8	29.4
Goodwill	30.7	243.9	240.8	240.8	240.8
Other	48.5	91.5	119.0	119.0	119.0
Total assets	**248.4**	**649.9**	**716.8**	**720.9**	**759.2**
Trade payables	99.2	192.1	181.6	163.4	178.1
Debt	17.8	35.3	52.8	52.8	52.8
Lease liabilities	15.3	20.7	20.4	20.4	20.4
Other	42.6	68.8	81.3	81.3	81.3
Total Liabilities	**175.0**	**316.9**	**336.1**	**317.9**	**332.6**
Net Assets	**73.4**	**333.0**	**380.7**	**402.9**	**426.6**
Share capital	64.7	297.5	310.7	310.7	310.7
Reserves	(19.8)	(10.1)	(22.4)	(22.4)	(22.4)
Retained earnings	20.7	32.5	57.5	79.8	103.4
Minorities	7.8	13.1	34.9	34.9	34.9
Total Equity	**73.4**	**333.0**	**380.7**	**402.9**	**426.6**
Net debt/(cash) - incl. leases	(10.1)	(1.0)	(10.9)	(32.7)	(60.0)
Weighted Avg. Shares	224.3	243.9	261.0	262.3	262.3

JLG Group				Year Ending June 30
Share Price:	**$5.24**		**Target Price:**	**$5.90**
No. of issued shares:	**$262.3m**		**Market cap:**	**$1,374.4m**

Segments	FY21	FY22	FY23e	FY24e	FY25e
IB&RS (Incl. Reconstruction Experts)	358.0	586.5	766.6	844.0	947.2
Commercial Building Services	45.7	52.6	63.6	68.4	72.5
JLG BAU - excl. CC	**403.7**	**639.1**	**830.2**	**912.4**	**1,019.7**
IB&RS - CAT	86.5	164.8	350.5	180.0	150.0
Total Revenue (excl. CC)	**490.2**	**803.9**	**1,180.7**	**1,092.4**	**1,169.7**
Commercial Construction	77.8	90.8	60.0	0.0	0.0
Other (unallocated)	0.4	0.3	0.1	0.0	0.0
Group Revenue	**568.4**	**895.0**	**1,240.8**	**1,092.4**	**1,169.7**
... Continuing operations revenues	*490.6*	*804.2*	*1,180.8*	*1,092.4*	*1,169.7*
IB&RS (Incl. Reconstruction Experts)	40.9	66.3	86.9	95.8	108.9
Commercial Building Services	3.5	5.2	6.1	6.8	7.2
JLG BAU - excl. CC	**44.4**	**71.5**	**93.0**	**102.7**	**116.2**
IB&RS - CAT	9.9	18.6	41.0	21.2	17.3
Total EBITDA (excl. CC)	**54.3**	**90.1**	**134.1**	**123.8**	**133.4**
Commercial Construction	2.1	(1.8)	(15.0)	0.0	0.0
Other (unallocated)	(3.8)	(4.7)	(7.0)	(6.6)	(7.0)
Group EBITDA	**52.6**	**83.6**	**112.0**	**117.3**	**126.4**
... Continuing operations EBITDA	*50.5*	*85.4*	*127.0*	*117.3*	*126.4*

Valuation Ratios	FY21	FY22	FY23e	FY24e	FY25e
Underlying EPS pre-NCI (cps)	13.2	19.7	24.2	24.9	27.0
EPS growth (%)	*148.9%*	*48.5%*	*23.0%*	*2.8%*	*8.4%*
Underlying Adjusted EPS (cps)	9.3	14.2	18.0	18.5	20.0
EPS growth (%)	*119.9%*	*53.0%*	*26.7%*	*2.8%*	*8.4%*
Adjusted PE (x)	56.5	36.9	29.1	28.4	26.2
PEG Ratio - Forward (x)	0.5	0.7	1.1	10.1	3.1
EV/Sales (x)	2.4	1.5	1.1	1.2	1.1
EV/EBITDA (x)	25.6	16.2	12.1	11.3	10.2
EV/EBIT (x)	31.4	19.7	14.8	14.2	13.1
FCF per share (cps)	9.8	5.1	26.9	24.7	28.3
FCF yield %	1.9%	1.0%	5.1%	4.7%	5.4%
NTA per share ($ps)	0.11	0.21	0.40	0.50	0.60
P/NTA (x)	46.5	25.3	13.0	10.5	8.8
Book value ($ps)	0.29	1.23	1.32	1.40	1.49
Price/Book (x)	17.9	4.2	4.0	3.7	3.5
DPS (cps)	5.0	5.7	9.5	10.5	11.5
Payout ratio %	53.9%	40.2%	52.8%	56.8%	57.4%
Dividend Yield %	1.0%	1.1%	1.8%	2.0%	2.2%

Performance Ratios	FY21	FY22	FY23e	FY24e	FY25e
EBITDA Margin (%)	10.3%	10.6%	10.8%	10.7%	10.8%
NPAT Margin - pre-NCI (%)	5.2%	5.4%	5.1%	6.0%	6.0%
Net debt/(cash) - excl. Leases	(25.5)	(21.7)	(31.3)	(53.1)	(80.4)
ROE (%)	40.5%	15.0%	16.8%	16.4%	16.8%
ROIC (%)	142.9%	25.8%	31.2%	31.8%	34.8%
FCF Realisation (%)	64.2%	22.6%	97.4%	85.8%	90.8%
OCF + Leases/EBITDA + Leases (%)	49.7%	25.1%	88.8%	69.6%	72.5%

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

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