IVE Group Ltd: Buy

ASX:IGL

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The Automated Bare Knuckle Compounder

Date of Analysis: 10/4/2020. Idea source: Panic, Small cap, (more than 50M shares) Analysis date price: AUD0.53.

Framework outcomes

Good Stocks Cheap: The price is cheap and, remaining so, can still move up 61% to $0.8515.

Growth With Value: The price is cheap and, remaining so, can still move up 331% to AUD2.29.

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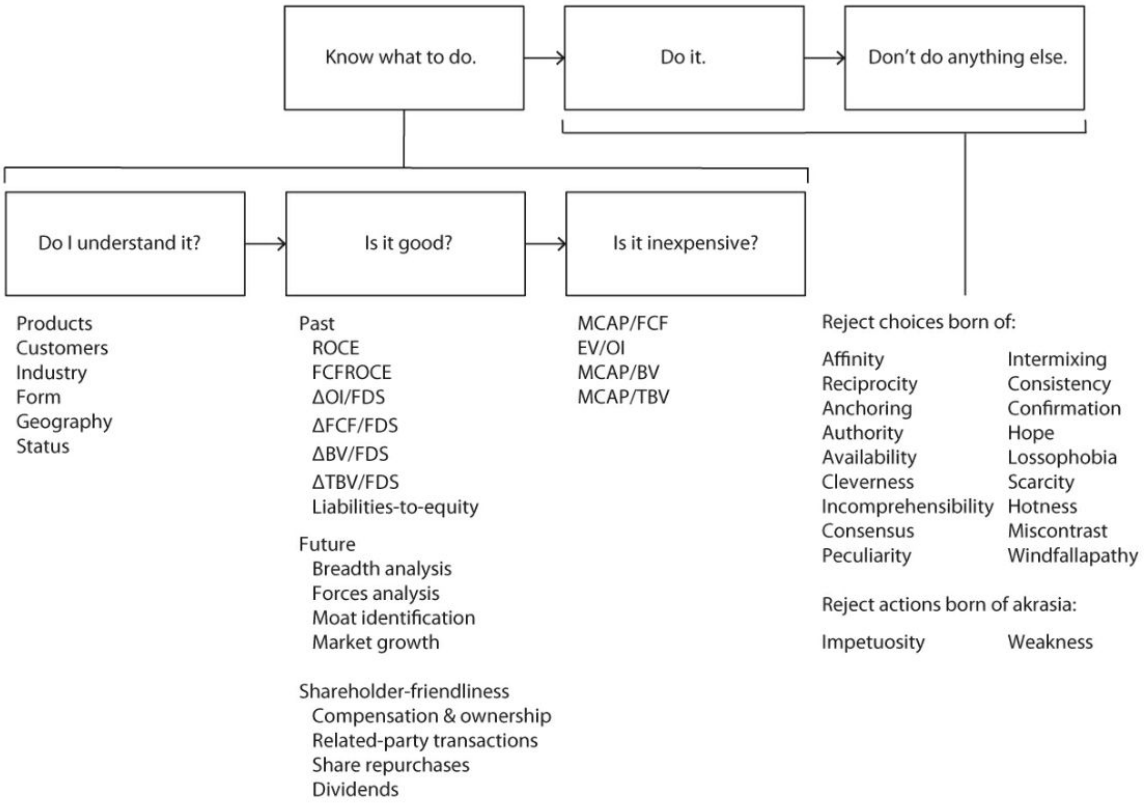
Framework



Marshall (2017), p. 188.

Do I Understand It? Yes:

Understanding Statement

Vertically integrated advertising industry corporation Ive is Austraila's largest, oldest advertising services business which has been constantly acquiring new businesses, although has suffered a significant drop in price due to the plague reducing customers - it is also noted that AASB16 has caused a 5% worse profit outcome in an already poor YOY situation of -28%.

Is it Good? Yes:

To determine if IVE Group Ltd is good, it was analysed from three perspectives:

1. Past performance, to see if they've been good stewards of their capital.
2. If the company's future is bright, considering breadth, forces, monopolies and market.
3. If the company is shareholder friendly, such as whether leaders behave like owners.

1. Does IVE Group Ltd Have Good Average Past Performance? Yes:

Judgement of past performance is based on averages over the past however many periods the analyst chooses to input. Table of averages:

Summary	Benchmark	Average
ROCE with cash, end of period	Should be at least 15%	16.04%
ROCE without cash, end of period	Should be at least 15%	18.36%
FCFROCE end of period, with cash	Should be at least 8%	15.20%
FCFROCE end of period, without cash	Should be at least 8%	17.36%
Δ OI/FDS	Should keep up with inflation, aim for 4%	27.85%
Δ FCF/FDS	Should keep up with inflation, aim for 4%	4.00%
Δ BV/FDS	Should keep up with inflation, aim for 4%	26.11%
Δ TBV/FDS	Should keep up with inflation, aim for 4%	52.45%
L/E	Should be no higher than 2, 7 if otherwise great.	157.79%

Was the performance in the most recent period good? No. Further detail by year is available in the next table.

Item	Average	2019	2018	2017	2016	2015
OIROCE, cash, beginning	24.9%	24.1%	24.8%	25.0%	25.9%	
OIROCE, cash, end	28.5%	26.7%	28.6%	29.8%	28.9%	
OIROCE, no cash, beginning	16.0%	21.4%	19.7%	12.3%	19.0%	7.8%
OIROCE, no cash, end	18.4%	24.4%	21.8%	14.2%	22.7%	8.7%
FCFROCE, cash, beginning	19.4%	14.7%	12.6%	27.7%	22.6%	
FCFROCE, cash, end	15.2%	13.0%	10.0%	13.7%	16.5%	22.8%
FCFROCE, no cash, beginning	22.2%	16.3%	14.5%	33.1%	25.1%	
FCFROCE, no cash, end	17.4%	14.9%	11.1%	15.7%	19.7%	25.4%
Δ OI/FDS	27.9%	17.3%	49.3%	3.4%	206.7%	
Δ FCF/FDS	4.0%	41.1%	-31.8%	31.9%	-8.9%	
Δ BV/FDS	26.1%	-0.8%	7.2%	32.9%	79.0%	
Δ TBV/FDS	52.4%	32.5%	239.4%	-213.7%	-37.7%	
L/E	N/A	158%	N/A	N/A	N/A	N/A
Highest paid employee salary	N/A	1,150				
Highest paid employee salary c	N/A	3.7%				
Highest paid outside director	N/A	105				
MCAP/FCF	N/A	2.363				
EV/OI with cash and cash equiv	N/A	4.616				
EV/OI without cash and cash ec	N/A	4.040				
MCAP/BV	N/A	0.383				
MCAP/TBV	N/A	1.867				

Benchmark
Should be at least 15%
Should be at least 15%
Should be at least 15%
Should be at least 15%
Should be at least 8%
Should be at least 8%
Should be at least 8%
Should be at least 8%
Should keep up with inflation, aim for 4%
Should keep up with inflation, aim for 4%
Should keep up with inflation, aim for 4%
Should keep up with inflation, aim for 4%
Should be no higher than 200%, 700% if otherwise great.
For US companies, should be less than $USD30,000,000
Should be 5% of the lower of FCF or NI
For US companies, preferably less than $USD250,000 and not more than $USD500,000
Should be no higher than 8
Should be no higher than 7, sell if >25
Should be no higher than 7, sell if >25
Should be no higher than 3
Should be no higher than 3

2. Does IVE Group Ltd Have a Bright Future? Yes:

Does IVE Group Ltd Have Enough Breadth? Yes:

Does this company have breadth of customers? Yes:

As Australia's largest advertising business, they have many customers, including large ones

Does this company have breadth of suppliers? Yes:

All they need is office space, printer ink and copy writing staff. There is a need for talent in ad making. They will need to develop/maintain relationships with top universities to get talent, there is also the risk that this talent will leave to form their own firms. However, they would need the capital behind them to achieve the scale of Ive. This is unlikely to happen immediately. Perhaps they could take one mid level client with them.

Does IVE Group Ltd Confront Maximum 1 Strong Force? Yes:

The number of strong forces this company confronts is 1. To consider it further, there should not be more than 1.

The bargaining power of customers is Weak:

Number of customers: The largest customer accounts for only 4% of group revenue.

Improbability of backward integration: Woolworths for example could start its own spam division with 12,000 people to walk the streets of Australia wasting paper on catalogues, but this would duplicate the service of this existing company and be a major pain in the ass.

Switching costs: It comes down to scale. If a national supermarket chain needs national mailbox spam coverage, then they have to go with a business like Ive. Smaller businesses could happily switch. There is a smart catch though, Ive also places staff in businesses to do the marketing/spamming for them from their site. This means these people are more heavily embedded. Switching costs would be higher here since these people behave like staff and would know more about the business through this exposure. It could be easier just to retain the arrangement.

Summary: There will be a 4% revenue consequence if their largest customer leaves them. Their customers are large corporations who need to spam large parts of the population. It would be a significant investment for them to develop a spamming facility the same size as Ive. Smaller spamming businesses may have difficulty meeting the needs of large corporations, which means switching costs would be high for them going to other spam

companies. This particular spammer is smart and has embedded staff in their hosts as well. This means businesses using their service are likely to stick with them.

The bargaining power of suppliers is Strong:

Number of suppliers: There are plenty of ink, paper, office building suppliers.

Improbability of forward integration: None of these basic material suppliers are likely to start a complex ad/spamming business.

Switching costs: They operating complex, large printing faciliites. These will involve machines probably from overseas which require expensive equipment and staff to maintain. It will be a significant consequence to them to change to different machines. This means they are exposed to the whims of the manufacturers of these.

Summary: Until I know more about the nature of their relationship with the printing machines company I have to assume that this supplier (or suppliers) exerts a significant force over them.

The threat of substitutes is Weak:

Wholly different products that perform the same basic function: Internet advertising, for the past 25 years, has been performing the same basic function although somehow these spammers have remained in business..

Doing without: I suspect that if Woolies and JB Hi-Fi did not spam the population every week with their catalogues their businesses would collapse overnight.

Direct substitutes: Google shows that Ive's competitors are Ovato (doing terribly but claims, like Ive, to be Australia's biggest mailbox spammer/print business), Salmat (doing well recently after a number of spin offs/divestments (including to Ive) it seems), GDR Group, Letterbox Distribution, Distro Print, Shopify... LinkedIn also offers ads along with all the other social media suspects. Ovato seems to be the biggest baddie, and blows their own trumpet just as loudly about how great they are. Salmat has the best investor relations page I've ever seen (https://salmat.com.au/investor-relations/). Overall, it turns out there are plenty of competitors in the mailbox spamming and print ad (leaflet, brocure) space.

Summary: Honestly there are plenty of direct substitutes. There are credible different

products serving the same function, via the internet - but it has to be said they're doing their best there with their own online ad/email spamming business. It also has to be said the internet has not killed them off either, which is surprising. I suppose it's because the housewives that read their spam want to hold it in their hands. A brochure at a bank is also handy to have and more of a tangible, memorable promotion to advertise a credit card or whatever than just telling someonne it's great and telling them to go look at a webpage. So, overall, if their substitutes from the internet were going to destroy them, they should've done it by now - also, Ive has joined them. Additionally, it has to be said that it's a family business that's found a way to stay in business through a couple of world wars, a bunch of market crashes and recessions over a century. They appear to know how to substitute others, not be substituted.

The threat of new entrants is Weak:

Barriers to entry; barriers to success: Any idiot can start printing pamphlets from their home laser jet and walk the pavements. It is another deal succeeding at the scale of commanding 12,000 people walking the streets of the nation spamming for Woolworths..

Economies of scale: With 12,000 walkers spamming the populace every day of the week they have the best economy of scale.

Higher switching costs: A couple of switching costs already identified are that if people from Ive already work inside their clients' businesses, and their businesses are large, nationwide and need spam distribution at that scale, there will be switching costs to shift to new entrants of a smaller scale or who will not know the busienss so intimately due to not having spent a long time embedded.

Hard-to-get permits: Nil

Summary: Ive is large. They serve large clients like nationwide supermarkets and banks. They operate in an industry where new entrants can establish themselves with ease, but the scale of Ive would be hard to achieve.

Does IVE Group Ltd Have a Monopoly? No:

Government: No.

Network: No. They have plenty of customers, but it's not like there is a network they've established that no one can function without.

Cost: No.

Brand: No.

Switching costs: No.

Ingrainedness: No.

Market Growing? Yes:

As much as the markets of their customers is growing, theirs is growing. Their market has declined due to the plague recently, which is being fixed by the government.

3. Is IVE Group Ltd Shareholder Friendly? Yes:

Friendly on the Numbers? Yes:

The CEO's salary is AUD1,150 per year. This is 3.67% of the lower of free cash flow or net income. The highest paid outside director gets AUD105 a year. On the numbers, is this a shareholder friendly company? Yes.

Material insider buying at market

Four insiders bought at the bottom in early to mid March, including Geoff Selig buying nearly $1M in shares. It is also observed that Geoff Selig is the top shareholder, owning 7.91% of the business.

Share repurchases

There is no mention of repurchases in the annual report.

Related party transactions

Paul Selig owns a property business which uses the services of Ive although there is an assurance that this is at a competitive rate, the amount is small regardless. Paul also gets an unexplained bonus of $250,000 a year, presumably as he's part of the family owning the business.

Dividends

They have been paying an incredibly high dividend until recently (23/3/20) due to the plague. This is a sign of a mature business.

Shareholder Friendly Overall? Yes:

Overall they are a shareholder friendly business due to high insider ownership, recent large insider transactions at market, minimal related party transactions apart from one indiscretion simply because they're a family business.

Is it Cheap? Yes:

Analysis date price: AUD0.53, cheap price: AUD0.85. The price is cheap and, remaining so, can still move up 61% to $0.8515.

Summary	As at 10/4/2020	Benchmark
MCAP/FCF	2.36	Should be no higher than 8
EP/OI - cash	4.04	Should be no higher than 7, sell if >25
EP/OI + cash	4.62	
MCAP/BV	0.38	Should be no higher than 3
MCAP/TBV	1.87	Should be no higher than 3

Discount Cash Flow Analysis

A discount cash flow analysis (DCF) is mentioned as a common method in How to Value a Business (Cowley, 2019). The below DCF has High Growth Period and Terminal or Stable Growth Period segments. The intrinsic values of each are summed to calculate the share price of the company that is warranted by the anticipated future cash flow, based on the geometric mean of its growth rate. A comparison between this price and the current price is another way to see how cheap the business is currently. For further details on what the below terms and numbers mean, consult Cowley (2019).

High Growth Period

Table 1. Parameters.

Parameter	Value
Investors required return or discount rate	12%
Continuing number of years	4

Arithmetic mean of ending free cashflow	0.20 per share
Compound annual growth rate of same	4%

Table 2. Cashflow for high growth period.

Year into the future	Cash flow per share	Intrinsic value
1	0.21	0.18
2	0.21	0.17
3	0.22	0.16
4	0.23	0.15

Terminal or Stable Growth Period

Table 1. Parameters.

Parameter	Value
Investors required return or discount rate	12%
Constant growth rate for stable period	5%
Cashflow from the last year of high growth	0.23 per share
Starting year of stable growth	5

Table 2. Cashflow for terminal or stable growth period.

From year	Cash flow per share	Intrinsic value
5	0.24	2.20

Table 3. Intrinsic value of the business.

Parameter	Value
Intrinsic value of the business	AUD2.86 per share
Share price at 10/4/2020	AUD0.53
Margin of safety	20%
Margin of safety status	The price is cheap and, remaining so, can still move up 331% to AUD2.29.

From this calculation we can see that, from the perspective of future cashflows, the intrinsic value of the business supports a price of AUD2.86 per share. Note that this is only true if the following assumptions are correct:

1. The business grows for the next 4 years at a high rate of 4% per year.
2. The business grows perpetually thereafter at a rate of 5% per year.

The margin of safety should guide buying decisions in case these assumptions are wrong.

Verdict: Buy

Surprisingly, physical spamming companies still exist and this happy little family business has weathered the internet storm. They've been around 100 years so have already survived a couple of plagues. They should also survive this one, according to the 4 insiders that recently purchased over a million in shares last month.

Checklist:

Sl	Item	Sub Item	Check
1	**Do I understand it?**		**Yes.**
2	**Is it good?**		**Yes.**

2.1		**Has there been good past performance?**	**Yes.**
2.2		**Is the future bright?**	**Yes.**
2.2.1		Is it broad with respect to customers and suppliers?	Yes.
2.2.2		Is there, at most, one strong force?	Yes.
2.2.3		Is there a monopoly?	No.
2.2.4		Is the market growing?	Yes.
2.3		**Is it shareholder friendly?**	**Yes.**
2.3.1		On the numbers, is it shareholder friendly?	Yes.
2.3.2		Overall, is it shareholder friendly?	Yes.
3	**Is it cheap?**		**Yes.**
3.2	Is it cheap according to Good Stocks Cheap?		Yes
3.2	Is the price below the margin of safety from a DCF intrinsic value analysis?		Yes.

REFERENCES

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4. Marshall, Kenneth Jeffrey (2017). Good Stocks Cheap: Value Investing with Confidence for a Lifetime of Stock Market Outperformance. McGraw-Hill Education. Kindle Edition.