Memo: Mader Group (MAD.AX)
October 28, 2021

Introduction to Mader Group

One example of a holding that fits squarely within our focus of undiscovered, undervalued, high-quality companies is a micro-cap company Mader Group (MAD) which trades on the Australian Securities Exchange. We were able to [redacted] for a business that since 2009 has grown its revenues at a 42% CAGR and reaps returns on capital of over 25%.[1]

We are particularly excited about Mader Group's long-term prospects for reasons we will elaborate upon below. It is worth noting that [redacted], Mader Group had [redacted], limited liquidity, and only one covering sell-side analyst, all structural reasons that likely continue to explain its low institutional ownership. Finding compelling opportunities such as this one that are seemingly unknown to the investment community reminds us of the value of our bottoms-up idea generation process and reassures us of the advantages of our investment approach.

Company Background

Mader Group is an Australian-based, asset-light maintenance service provider for heavy on-site mining equipment. A common mine site anywhere in the world has a fleet of heavy mobile equipment such as haul trucks, graders, drill rigs, and excavators that perform essential functions for the site. These heavy machines eventually break down, and unfortunately for the mine site operator, repairing a 30-ton excavator is not as simple as fixing a bicycle. To repair the machine back to working order, if the mine site is already at full in-house maintenance capacity, they must call a maintenance service provider which deploys a diesel mechanic to the site. Maintenance service providers can be broadly separated into two categories: OEMs who manufacture the equipment and who also offer maintenance service (e.g., Caterpillar, Hitachi, Komatsu); and dedicated maintenance service providers (e.g., Mader Group).

From the mine site's perspective, deciding which maintenance provider to call is highly dependent on the stage of the machine's life cycle. If the breakdown occurs during the machine's warranty period, which varies but typically covers the first 5,000 hours of a machine's life, the mine site will contact the machine's OEM who will then send a diesel mechanic to the site. However, given that a machine's life usually spans between 10,000 hours and 25,000 hours (and for some machines up to 100,000 hours), when the machine

(1) Mader Group was founded in 2005; its earliest publicly available revenue data point of $4.5MM is from 2009.

breaks down during the 50-80% of its useful life that occurs after the expiration of its warranty period, the calculus behind who to call for maintenance service changes dramatically, often in Mader Group's favor.

For breakdowns that occur during the latter stage, the important variables that enter a mine site's decision-making process for maintenance service have remained largely constant since Luke Mader founded his namesake company in 2005. Luke began his career as a diesel mechanic for one of the major OEMs where he observed that the ways OEMs were serving their clients' maintenance needs were not very client friendly. For instance, while clients often need their machines fixed quickly, the soonest the OEMs are able to send a mechanic on-site can be at least one week. While over 95% of clients have equipment on site from multiple OEMs and inevitably incur clustered breakdowns among these machines, OEMs only repair their own machines, which means clients have to double, triple, or quadruple their maintenance outreach efforts to repair their fleets. And, because OEMs generate the bulk of their profits from machine sales and spare parts and generally view maintenance service as a necessary evil, they tend to run inefficient maintenance operations which results in unnecessarily high prices charged to clients. Luke saw an opportunity to solve these clients' problems, so in 2005 he quit his job and founded his own company specializing in mine site heavy equipment maintenance with the goal of providing a significantly enhanced value proposition.

MADER

Mader Group has since built an impressive nationally-scaled business by solving each of these problems better than the OEMs do, which has made it the highest value, lowest cost provider of heavy equipment maintenance service for mine site operators. Clients often prefer Mader Group because Mader Group's technicians are brand agnostic and can fix any machine on site from any OEM, often have faster response times than OEMs, and on average charge ~30% less than OEMs post-expiration of warranty periods. To date, 68% of the country's 518 mine sites have come to rely on Mader Group for maintenance service. Although non-OEM competitors exist in the form of smaller, fragmented maintenance service companies and labor houses, Mader Group in comparison possesses a significantly deeper bench of high-quality technicians with wider geographic reach which gives it the advantages of faster response times and the ability to say "yes" to a higher percentage of jobs. For context, Mader Group's next-biggest competitor, founded just one year after Mader Group, only has 200 technicians compared to Mader Group's 1,600 and hasn't grown its technician base anywhere near Mader Group's pace of over 1,000 net new hires since 2017.

Durable Niche Leader

In our view, Mader Group's position as a leader within its niche is likely to endure for many years. This is because of its structurally lower cost base and brand agnostic service compared to OEMs, its dominant lead in quantity of highly-skilled technicians compared to non-OEM competitors, its strong culture as a differentiator and barrier to success compared to competition in both of these groups, and the low probability of existential threat to the mining industry or the way mining is conducted anytime soon.

It is important to address how cyclicality impacts Mader Group's business model. Although profits for most mining-linked companies are cyclical, profits for maintenance service providers are relatively resilient during downcycles. During a commodity downcycle, mine site operators often trim expenses by laying off in-house maintenance technicians and delaying maintenance needs that are not urgent. Operations may persist for a bit, but eventually too many machines break down to continue functioning without maintenance requests. The mine site, with more broken machines and a smaller in-house technician team than usual, is forced to contact a maintenance provider, at which point profit streams to Mader Group would resume. The company's historical results suggest resiliency in revenues and profits across full industry cycles.

In addition to profit resiliency, downcycles have also historically strengthened Mader Group's long-term competitive position and growth outlook, adding an element of anti-fragility to its business model. The company's biggest bottleneck to long-term growth has traditionally been a scarcity of high-quality technicians available in the labor market. Downcycles are important because they become the phase during the industry cycle when labor is most available, as mine sites ordinarily lay off in-house technicians at meaningfully higher rates than during any other phases of the cycle. Evidencing a long-term view, Mader Group takes advantage of these opportunities and recruits unusually high numbers of technicians during these periods, which in turn improves long-term profit opportunity and competitive standing.

Total Addressable Market Opportunity

Looking ahead, we believe the long-term TAM opportunity is significant relative to the company's current size. Domestically, Mader Group continues to win business with new mine sites and expand its wallet share with existing mine sites. Domestic revenues continue to grow at healthy double-digit rates. The company has also recently expanded its on-site services beyond heavy mobile equipment maintenance to include fixed plant infrastructure maintenance which management believes can double the company's long-term domestic profit opportunity. Internationally, Mader Group in our view is in the early innings of a potentially tremendous market opportunity in the U.S. and Canada as measured by run-of-mine production and mining GDP. We estimate the long-term global profit opportunity within existing verticals to be at least 3-5x today's profits. Should Mader Group demonstrate early success in its pursuit of entering and scaling into new machine maintenance verticals (e.g., fixed plant maintenance, oil and gas, rail), we would be excited about the potential of these new segments to unlock additional recurring global profit streams.

In the U.S., the status quo for maintenance service is also OEM-driven and appears just as inefficient as, if not worse than, it is in Australia. Many OEMs here charge even higher prices for maintenance service and the presence of sizable non-OEM maintenance providers is sparse. Mader Group has found early success in rolling out its disruptive business model to U.S. mine sites where annual operating profits have most recently grown +156% year-over-year and in just three years have come to comprise 20% of group profits. Furthermore, as of the latest fiscal year, U.S. operating margin was 23% compared to Australia's of 9% and U.S. return on average assets was 38% compared to Australia's of 20%, evidence to us of the considerable economic value that Mader Group is creating for itself and for its clients. Canadian entry is scheduled to commence by calendar year end. Many existing Australian clients have Canadian operations which the company believes will help jumpstart initial business, a benefit they didn't have when entering the U.S. In addition, new geographic operations have historically reached profitability almost immediately, suggesting that new business wins in Canada will quickly be accretive to the bottom line. Management appears highly focused and optimistic about the long-term potential of its North American operations.

Risks, Management, & Concluding Thoughts

Our biggest questions regarding North America surround Mader Group's ability to expand its client base to mine sites operating within each country's largest commodity segments. Its current U.S. client roster is heavily skewed towards gold and copper sites, and it remains to be seen if Mader Group can succeed in winning clients among the coal and aggregates commodities which comprise the majority of U.S. mining production value. Similarly, the majority of Canadian opportunity exists within the aggregates and oil sands commodities, which Mader Group must prove it can penetrate. Given that all of the above commodities have heavy overlap in core heavy mobile equipment on site, Mader Group's ability to service these sites and client value proposition should continue to be unchanged across commodities and regions.

After 16 years of consistent success, this company has made the journey seem easy, but we recognize that building a great people-based business requires carefully creating and sustaining a culture that attracts talent, maximizes retention, and motivates employees to give their best efforts every day. Top management deserves ample credit for this. We enjoy hearing stories of Luke Mader, CEO Justin Nuich, and other executives making efforts to get to know each of the company's 1,600+ technicians and warmly welcoming them to the Mader Group family. We also sleep well at night knowing that 77% of shares are held by insiders, including 57% owned by Luke Mader, who have aligned interests and are working hard on our behalf to maximize long-term KPIs that should translate well to shareholder value.

As of quarter end, Mader Group's shares were trading at 14x our estimate of Owner's Earnings and at a significant discount to our estimate of intrinsic value. We note that service vehicles, the company's significant asset group, are depreciated over 4-5 years but in practice often have useful lives of 8-10 years, resulting in net profits that we believe understate true economic earnings. With management guiding to a midpoint of +24% annual net profit growth for FY 2022 and most recently reporting Q1 FY 2022 year-over-year revenue and profit growth of over +30%, we feel confident that execution will continue over the coming quarters. We also view the forward-looking risk-reward profile as asymmetric. Should efforts in North America stall, we own a company generating a 6-7% Owner's Earnings yield with significant growth opportunity remaining in Australia and in our view a durable competitive position, suggesting low long-term downside risk. If Mader Group prospers in North America in a big way, we believe the sky is the limit. We think the odds are in our favor that Mader Group will continue to build upon its long track record of success and capture much of the large global opportunity available to them in the years to come.

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