



STOCKTRADES PREMIUM COMPANY SUMMARY

ALARIS EQUITY PARTNERS

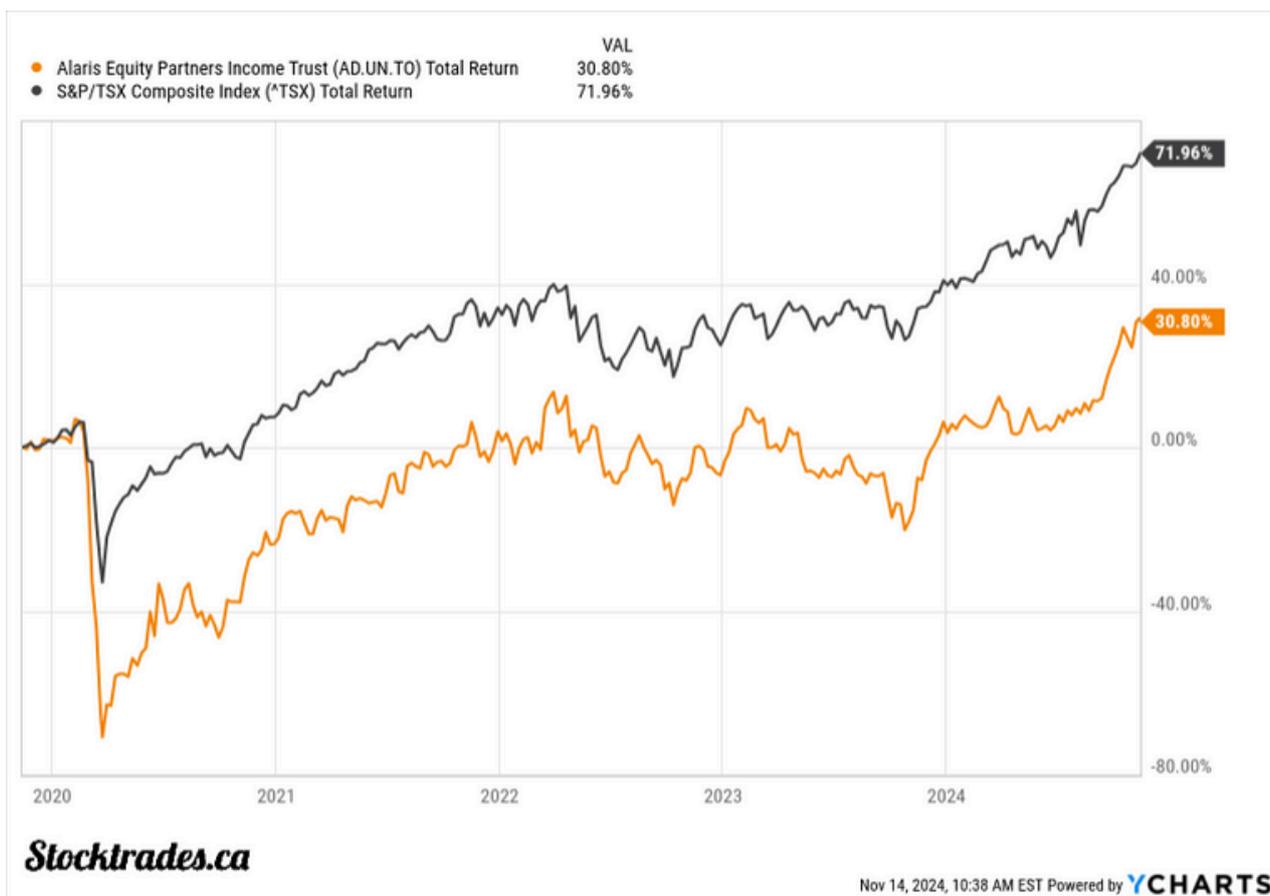
AD.UN.TO

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NOTE: DAN IS LONG AD.UN

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Stocktrades Premium



Alaris Equity Partners Income Trust is an open-ended trust. Through its subsidiaries the trust indirectly provides alternative financing to private companies (partners) in exchange for distributions with the principal objective of generating stable and predictable cash flows for payment of distributions to unit holders of the trust. Distributions from the partners are adjusted each year based on the percentage change of a top-line financial performance measure such as gross margin and same-store sales and rank in priority to the owner's common equity position. Of note, Alaris's business structure and distribution are structured in a way that our screeners do not make accurate representations. So, the company scores N/A in both categories.

Focus Areas	Score (0/100)	Focus Areas	Score (0/100)
Valuation	61	Dividend	37
Profitability	75	Outlook	28
Risk	22	Debt	55
Returns	14	Growth	37
Overall	48		

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- Strong earnings coverage ratio
- Provides excellent value at today's prices
- Starting yield of over 7%, distribution is well covered
- Company has reduced debt by nearly 15% over the last year
- The company is reporting very strong results from its partners despite a rough economy
- Consistent double digit returns on equity and invested capital
- The company has deployed \$130M in new capital over the last year at an average yield of 10%

CONS

- Asset management companies have struggled in recent years
- 1 partner accounts for a double digit percentage of revenue
- 85% of partner revenue comes from the US, subject to currency risk
- As a small-cap asset manager, the company is highly volatile

OVERALL THESIS

With Alaris, we decided to add a company with a higher than average starting yield (8%), which should appeal to those looking for income today. We never advocate yield chasing, but there are times when you can find a nice sustainable high-yielding stock that can also provide investors with additional growth - Alaris fits this description.

The dividend is well covered, and while investors can't expect hyper growth out of the company, there is the potential for outsized capital appreciation. First, there is decent organic opportunity for gains if the company were to close the valuation gap between current and historical valuations. That alone makes it an attractive option. The second is that the company is well-positioned for continued growth. The company took advantage of expanding business in Fiscal 2021 and deployed \$358M in new capital, leading to higher forward run rates. That slowed extensively in 2022 to just over \$155M and in 2023 it slowed even further. However, this was to be expected. The added bonus is that the capital deployed by Alaris over the last year is at much higher yields than during the pandemic.

It is also in an excellent financial position and has delivered double-digit ROIC (16.35%) and ROE (19.9%). Analysts expect revenue growth in the low teens over the next couple of years. The company's Earnings Coverage Ratio (ECR) - a measure of assessing their partners' continued ability to make their contracted distributions, sits at 1.5x, which is in line with last quarter. We won't go in-depth on the ECR ratio; just know that the higher this ratio is, the better. The strong ECR ratio is one of the primary reasons the company is able to increase the dividend even in the midst of a difficult operating environment.

It is also worth noting that Alaris runs a lean operation with little overhead, and most

expenses come from taxes on distributions received. Finally, don't be scared if the company announces capital raises through share issues. This is how the company raises cash to deploy into new income streams. Likely, if the company issues a raise, it has additional income streams it is targeting.

POTENTIAL RISKS

Alaris' success depends on its partners' performance, and so do the dividend payments. Disruptions in partner operations could impact the dividend as it is their only source of cash flow. This is a royalty business, and if the partners struggle, so will Alaris. The ECR is a ratio that Alaris uses to judge the likelihood of a partner being able to pay payments.

The higher the number, the better. Currently, the majority of its partners have healthy earnings coverage ratios. However, considering the economic environment, this can likely change quickly, and investors will need to monitor these coverage ratios on a quarterly basis.

Beta	2
Alpha	-13
Our Risk Rating	Mod*
Max Drawdown	73.3%

Likewise, Alaris does not typically have voting rights with their partners, so if a partner business goes sideways, Alaris has little ability to influence operations. Each business partner will have its own risks, so it is nearly impossible to list them all. Suffice it to say that most businesses were impacted by the pandemic and will be impacted in some way by inflation and rising interest rates. Case in point, one of its struggling companies is a rebar/steel manufacturer that got hit hard by rising commodity prices. It has since recovered, but this is just an example of the risks with the partners.

For its part, the rate of interest on its debentures are likely to tick upwards and impact margins. There is also some diversity and currency risk here as one partner accounts for ~12% of revenue and there is a +/- \$0.02 per unit cash flow run rate swing for every \$0.01 USD to CAD change.

Overall, this is going to be a company that is always sensitive to economic conditions, as it depends solely on its partners, who are highly susceptible to economic conditions themselves, to pay Alaris its distributions.

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VALUATION

	TTM	5 Year Average	Industry Average
P/E	4.5	-	27
P/S	5.28	4.6	2.3
P/B	0.84	0.86	2.64
P/FCF	12.4	8.3	9.9
PEG Ratio (FWD)	N/A	-	-

Alaris is currently trading at attractive valuations. At \$19~ per share, it is still trading at a discount to pre-covid levels and, as of writing, is trading at a ~19% discount to historical valuations and scores a perfect 10 based on Ycharts value metrics. The company's book value now sits at over \$22.80~, highlighting the deep discount this company is trading at on a price to book basis.

Important to note, however, that averages are skewed given the company's change in corporate structure a few years ago. Asset management companies have struggled recently and have been trading at a discount.

While we saw an industry rebound, there has been a multitude of runups and pullbacks. At this point in time, the asset management business is very volatile.

In our opinion, it is only a matter of time before Alaris' valuation rebounds again. Given the structural changes, investors were likely confused and stayed away from Alaris. The investment thesis is now more easily understood with a few years under its belt.

As rates continue to decline, we're seeing a large runup in Alaris's price. As we've mentioned numerous times, the company is especially sensitive to the overall economy. This is primarily due to the underlying businesses it finances. If rates continue to come down and economic activity picks back up, Alaris should be able to realize tailwinds in terms of share price and get back to its typical price-to-book ratio, which is around 0.9~. This still implies double-digit upside from today's share price.

COMPETITOR ANALYSIS

	AD.UN	ONEX	BAM.TO
P/E	4.5	9.8	52
P/S	5.2	6.6	N/A
P/B	0.83	0.74	7.6
P/FCF	12.42	103	32.75

There is no single major competitor for Alaris. That being said, it operates in a highly competitive environment. Any asset manager, like the aforementioned BAM, ONEX, EIT.UN and POW are competitors, as are private equity funds, royalty companies, and other institutional and strategic investors, including the public and private capital markets and senior debt providers. According to the company, the competition in the US is much larger and has *"considerably greater financial resources and more diverse funding structures than Alaris."*

This only considers the competition Alaris faces in securing deals with partners. Each of their partners also has a slew of competitors that could inadvertently impact Alaris if they lose ground.

For this reason, it is unsurprising that a company like Brookfield (BAM.TO) trades at a higher book value multiple. Overall, Alaris trading at a discount to major asset managers is likely due to its small-cap nature and the highly competitive environment. We view this as a strong opportunity to grab an excellent company at a discounted price.

DIVIDEND ANALYSIS

Annual Dividend	FCF Payout Ratio	5 Year Dividend Growth %	Dividend Growth Streak
\$1.36	55%	1.82%	10

If you're trying to make sense of Alaris's historical distribution payout - you are not alone. In September 2020, the company underwent a structural change. Alaris Equity Partners Income Trust and Alaris Royalty Corp merged and began trading as AD.UN.TO. This led to differences in how the distribution was reported and some one-time structural charges, which ended the company's EPS and dividend growth streaks. However, we've left the company's dividend growth streak intact on the chart above because the structural change certainly doesn't erase the company's prior strength in growing the distribution. It may not be "official," but

we believe this is an accurate way to track it.

As a new single entity, the company is starting from scratch to rebuild those streaks. Furthermore, if you're looking at the dividends paid by Alaris on a chart, you might wonder about the big jumps and inconsistencies there. Charts have limitations and don't reflect the change from monthly to quarterly dividends. It also demonstrates a gap between that switch, leading to lower year-over-year dividends paid between 2019 and 2020. However, before all this, Alaris Royalty Corp was a Canadian Dividend Aristocrat with a sustained history of dividend growth.

Since the change, the company has continued its trend of raising the distribution. It announced a 6.5% increase in July of 2021 and another 3.1% raise along with Q3 results in November 2022.

Although the company didn't officially raise the distribution in 2023, it paid out more than it did in 2022. The company was likely being cautious in regards to its partners and the economic difficulties some of them are facing.

Because of this company's sensitivity to the economy, it has delayed dividend growth thus far in 2024. We feel this is prudent and not anything to be overly concerned with. Because of the improving environment, there is a chance Alaris could come in with a dividend raise at the end of 2024, but that is up for debate. Management will ultimately gauge the situation and see if growth is feasible considering the improving situation.

On a forward-looking basis, the annual dividend is \$1.36 per share, and it targets a run-rate payout ratio of 65%-70%. The company expects to achieve 3-5% organic annual cash flow growth, most of which will go towards growing the distribution.

This is a great example where the published numbers only tell part of the story. Alaris was and will continue to be a reliable dividend growth stock. It is also at the center of the company's purpose:

A primary objective of Alaris Equity Partners Income Trust (the "Trust") is to provide Unitholders with stable, predictable, and growing quarterly cash distributions on a tax-efficient basis.

Big picture, the company is still in good shape. As of the most recent quarter, it reiterated that it expects its run rate payout ratio to be within its annual 65-70% targeted range.

RECENT EARNINGS

Earnings Estimates	2024	2025	2026
EPS	N/A	N/A	N/A
Revenue	\$192M	\$176M	\$203M
EBITDA	\$185M	\$149M	\$175M
EBITDA Margin	88%	92%	76%

Alaris posted a strong third quarter. In terms of estimates, it blew them out of the water. However, the important thing to understand about this is that it was primarily due to the early payment of some distributions, and some partners that had been struggling are now able to pay those distributions. It is highly unlikely that the results consistently come in materially higher than expectations, and this is certainly a one-off.

Earnings per unit came in at \$1.37, which is a 4.6% increase on a year-over-year basis. Through the first 9 months of the year, the company has increased earnings per unit by 9.3%, which is a higher than normal growth rate for the company. This is likely due to the rate declines in the United States and the recovery of many of its partners that were having some difficulties in 2023.

The company reported adjusted EBITDA of \$89.5M, which was 12.4% higher than the third quarter of last year. Through the first 9 months of 2024, the company has grown adjusted EBITDA by 6.7% compared to the first 9 months of 2023.

The primary focus of my earnings commentary on Alaris is often the health of its underlying partners. Ultimately, this is what drives the business. Its portfolio continues to get healthier, with 7 of its top 8 partners growing their year-over-year revenue and 6 of the 8 reporting increases in year-over-year EBITDA.

The company now has only 2 partners out of 19 with earnings coverage ratios of under 1x, meaning they don't earn enough to cover the distribution payments required to Alaris. However, it is important to note that one of those partners did end up making its distribution payment this quarter, meaning that the situation is probably improving for them.

It is also important to note that the two partners still facing some difficulties when it comes to payments make up less than 5% of the total run rate revenue for Alaris. Virtually all of its partners that account for double-digit revenue run rates have earnings coverage ratios in excess of 1.2x with growing revenue and EBITDA.

A final note on book value: The company increased book value to \$22.80~ on the quarter, and it currently trades at \$19~ a share. Historically, this company has not traded at book value but has been pretty close. So, I still believe there is upside potential here to go along with a well-covered and high-yielding distribution.

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