under the radar report
SMALL CAPS

ISSUE 584
25 JANUARY 2024

THE STOCK PICKER'S GUIDE

This week we cover Small Caps that are surfing a strong upswing in sentiment in part 2 of our nuclear report, as well as those that have been hit by disappointment. It is abundantly clear that we are in a stock-picking environment where a good handle on a stock's fundamental value is paramount in being able to know the answer to the two most important decisions you have as an investor: when to buy and when to sell.

Boss Energy (BOE) and **Bannerman Resources (BMN)** have returned over 300% and 100% respectively. The software group **Integrated Resources (IRI)** almost doubled after we tipped it in late 2022 and is now back to its initial tip price.

These swings are wild, yes, but all these companies' operations and management have not changed that much over the period in which we have covered them. What does change is the investor's appetite for risk.

Find out why we're taking profits on Bannerman, while we're still bullish on Boss. Find out why, despite the big change in Integrated Research's share price and the fact that the company's growth trajectory remains subdued, there could be big money to be made. A clue is its blue-chip customer base and relatively fixed costs.

When you buy a company on the cheap, the upside takes care of itself. It's the risk, or the downside that you have to be careful about. When a company is generating cash, has no debt, and a big cash balance we're automatically interested. When the market valuation is only double its cash holdings, we're buyers.

Evolution Mining (EVN) has been one of our standout picks over the past nine years because of its superior management. When its stock fell 18% late last week on problems at one of its Canadian mines, yet its cash flow is forecast to improve, you can see why our mining analyst's antenna went up.

Read about these opportunities and more in this week's report.

Richard Hemming
Head of Investments

the issue

NUCLEAR REPORT PART 2

Nuclear power is now in the global energy mix. This week we focus again on the forces behind the rising uranium price and the emergence of uranium juniors.

BANNERMAN ENERGY (BMN)	▼ TAKE PROFITS
BOSS ENERGY (BOE)	SPEC BUY

RESEARCH TIP UPDATES

NAN downgrade from Spec Buy to Hold.

CITY CHIC COLLECTIVE (CCX)	HOLD
COOPER ENERGY (COE)	HOLD
DATA3 (DTL)	HOLD
EVOLUTION MINING (EVN)	SPEC BUY
INTEGRATED RESEARCH (IRI)	SPEC BUY
NANOSONICS (NAN)	HOLD

SUBSCRIBER PICKS

These are the stocks subscribers ask us about. We run our investment ruler over them and give you our Radar Diagnosis.

BEST STOCKS TO BUY NOW

Go online to check out the stocks we rate as offering the best reward for the risk you're taking.

> Evolution Mining's stock got whacked 18% late last week on production issues, but the evidence is that cash flow is strengthening and debt is being reduced.

Peter Chilton

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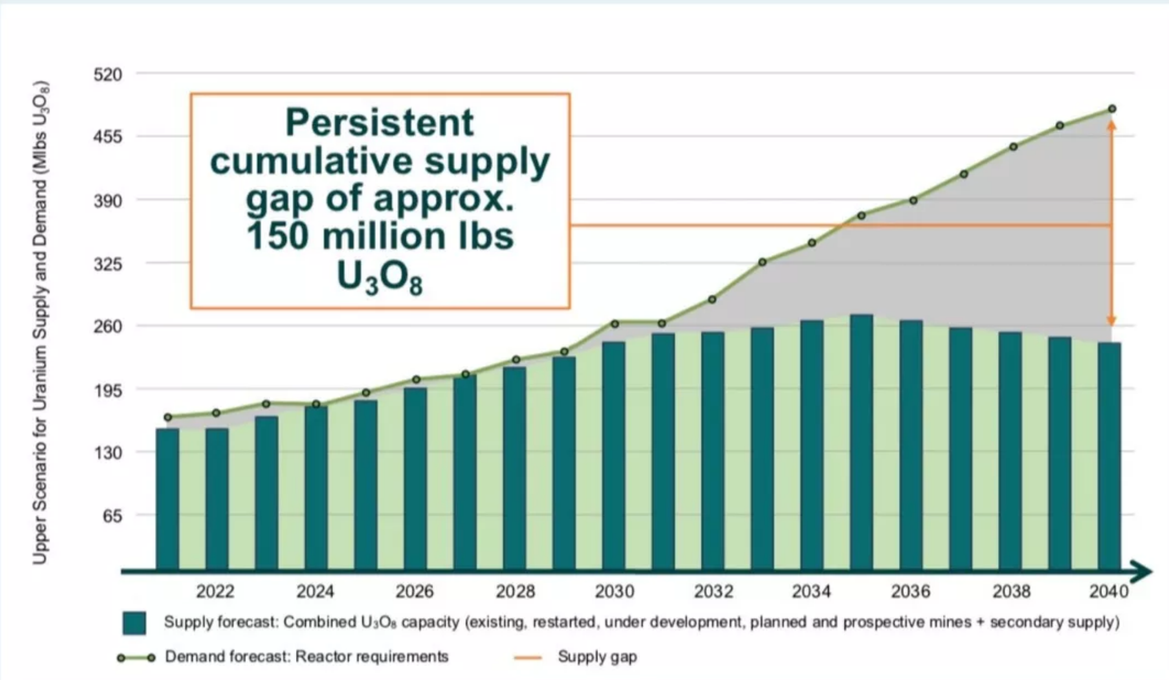
NUCLEAR REPORT PART 2

This week we focus again on the forces behind the rising uranium price, looking at the widening gap between supply and demand. We also highlight the emergence of uranium companies and the importance of judging each on their own merits. We continue to like our favourite stocks in the sector: BOE, PDN and SLX.

THE URANIUM RESURGENCE

Uranium (U3O8) supply and demand historic and forecast.



A lot of new uranium capacity is required to fill projected demand. That demand comes from increases in nuclear power generation. The uranium price has been climbing because nuclear fuel stockpiles are diminishing and uranium production needs to fill the gap. This trend has been exacerbated by geopolitical forces such as the Ukraine war and the dangers of reliance on Russia for enriched uranium.

SOURCE: World Nuclear Association, Nuclear Fuel Report 2023-2040

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NUCLEAR REPORT PART 2 CONT.

KAZAKHSTAN PRODUCTION UNCERTAINTY

There had been a general expectation that a production ramp-up in Kazakstan would take some of the pressure out of the uranium market. However, in last week's note, we pointed to supply shortfalls at Kazatomprom, which manages the uranium out of the country due partly to a shortage of sulphuric acid, used for processing.

The uranium supply shortfall on a global basis is highlighted in the above graphic and is due to a combination of a lack of mining, combined with low enrichment capacity (which the US is belatedly trying to fix) and increasing demand for nuclear power.

Declining uranium resources are not being replenished with new resources quickly enough. Significant capital investment is needed just to maintain current uranium production levels.

BEWARE OF JUNIOR URANIUM STOCKS

With higher uranium prices, the number of junior uranium exploration companies is rapidly increasing, providing increasing options for uranium investors. Some of these are accessing very prospective, largely undeveloped basins or dusting off earlier prospective exploration that was abandoned due to low prices.

However, with regulatory requirements for uranium companies generally more demanding than for most other commodities, lead times to first production for the successful projects are likely to be in years rather than months.

Many companies may be active for a long time before they succeed in generating their first uranium revenue, despite high prices and rising uranium demand. This is a conundrum for the nuclear power industry. The risk is a slow supply response to the current uranium tightness with uranium prices rising much higher.

The success rate of exploration companies is generally very low. Because of regulatory limitations, the hurdles for uranium exploration companies are likely to be even higher, making many of them extra risky propositions for investors.

INVESTMENT SUMMARY

In the absence of any further movement in the spot price, there has been some profit-taking in uranium stocks in North America and Australia. This is inevitable, but important conference calls by Kaztomprom and the Canadian-listed giant Cameco are coming up in the next few weeks.

We are taking profits from some of the higher-risk stocks like **Bannerman Energy (BMN)** but we regard the fundamentals of those closer to production (**Boss Energy (BOE)** in this week's issue and **Palandin Energy (PDN)** last week) very highly and if anything, likely to improve.

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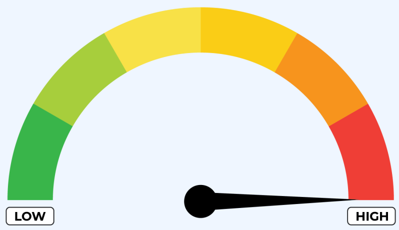
BANNERMAN ENERGY

SECTOR MINING SERVICES **INDUSTRY** URANIUM MINING

RADAR RATING: **TAKE PROFITS**

RISK RATING



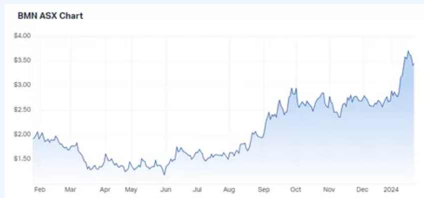
ASX CODE **BMN**

CURRENT PRICE **$3.50**

MARKET CAP $527M

DIVIDEND YIELD 0%*

NET CASH ($M) 37.3M



DATA AS AT INITIAL COVERAGE:

DATE 16 JUNE 2016

PRICE ($) 1.80

AFTER NUCLEAR REPORT

Downgrade from Spec Buy

Bannerman gets full marks for slick presentations, but the latest feasibility study was done over a year ago. Costs would have gone up since then, but the question is by how much. The project still needs financing, likely debt and equity. There is a three-year construction time and a Final Investment Decision is still to come.

This all adds up to the fact that the project has peak uncertainty, but is benefiting from the climbing uranium price. We have almost doubled our money since the initial tip and will be taking profits.

Late last year BMN achieved a crucial milestone of a mining licence for its Etango project in Namibia. A Final Investment Decision is expected in the current half, then it will take at least 3 years to build a project with an initial 15-year mine life, not including exploration potential. The production rate is similar to **Boss Energy (BOE)** at 3.5m pounds a year of uranium oxide (U3O8) and there is potential to double with investment, making it a sizeable mine.

Pre-production capital expenditure was US$317m with cash operating costs, excluding royalties, of US$35/lb (the current U3O8 price is over US$100 a pound).

The project has been technically de-risked but there is a great deal of water under the bridge that needs to flow before it becomes cashflow positive. We're looking at FY28 or even longer. The company has been by no means definitive. Certainly, it won't be before FY30 that it reaches 7mlb/year production.

RADAR RATING: Advanced Etango uranium project in Namibia, a well established uranium province. Project still requires a Final Investment Decision, an update to capital cost and financing.

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BOSS ENERGY

SECTOR MINING **INDUSTRY** URANIUM MINING

AFTER NUCLEAR REPORT

There are numerous uranium miners, but very few that benefit from the increase in the uranium price because they're not in production, or even nearing production. **Paladin Energy (PDN)** – covered last week in issue 583 and Boss are the exceptions, being close to production and cashflow.

In late December BOE confirmed its Honeymoon project, South Australia, is about to start producing at a rate of 2.45m pounds a year uranium oxide (U3O8) and is projected to expand to 3.3mlbs a year.

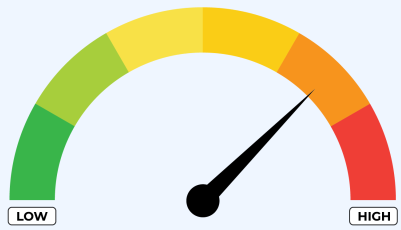
In more positive news, BOE has entered into its first binding sales agreement for 1mlbs of uranium to a major publicly listed US power utility over 7 years from next year.

The company announced late last year that it is purchasing an interest in a second uranium project, acquiring 30% in the Alta Mesa ISR project in South Texas from the operator enCore Energy in the US. The project is expected to restart in the current half at a rate of 1.5mlb a year U3O8 and is utilising standard ISR technology to extract uranium, coupled with a proven ion exchange process.

RADAR RATING: First uranium production from Honeymoon imminent, providing exposure to rising uranium prices. Acquisition of Alta Mesa stake means Boss will become a multi-mine uranium producer with a foothold in the US uranium industry.

RADAR RATING: **SPEC BUY**

RISK RATING



ASX CODE **BOE**

CURRENT PRICE **$5.49**

MARKET CAP $2.24BN

DIVIDEND YIELD 0%*

NET CASH ($M) 325M

DATA AS AT INITIAL COVERAGE:

DATE 16 JUNE 2021

PRICE ($) 1.40

**includes $171m equity raising, but not $154m inventory*

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CITY CHIC COLLECTIVE

SECTOR RETAIL **INDUSTRY** FASHION RETAILER

Research Tip Update

Despite weak sales data, City Chic's improving profitability led to an almost doubling of the share price subsequent to its early November trading update. The stock has fallen 17% which could provide an opportunity to buy into a turnaround.

The company sells fashion wear to plus sized women and made the error of stocking up, effectively doubling inventories in the six months to 31 December 2021 (1H22) in the middle of Covid as supply chains froze. CCX was forced to slash prices in an effort to generate sales to a customer base of predominantly middle-low-income earners, i.e. those feeling the most pain from rising interest rates. This pain has been particularly intense in its major market, the US.

The announcement late last year showed that sales trends in the three months to 30 September were poor, down 36% in Aus/NZ and declining 27% in the US. CCX says that trends are improving, but not appreciably. The company will be cycling weaker numbers from this period (2h24) onwards, however. To be specific, below are consensus forecasts which highlight the growth from acquisition then the decline from excessive discounting and lower demand, as well as the stabilisation. We are also seeing the start of an improvement in gross profit margin (sales minus cost of goods sold).

	FY22	FY23	FY24*	FY25*
Sales ($m)	369	309	227	237
Sales Growth	42.7%	-16.3%	-26.5%	4.4%
Gross Margin	42.3%	15.0%	32.0%	41.5%

*Forecast

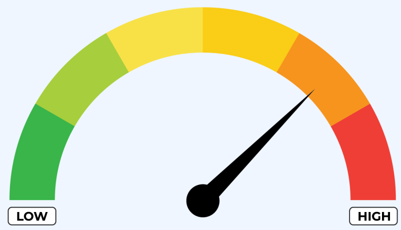
Management is effectively steadying the ship, prioritising profit over volume and has cleared inventory in Australia and this is happening in the US, albeit later due to differing seasonality.

CCX is forecast to be profitable at the operating level (EBITDA) in the current half (2H24), but loss making for the year overall. The company has been through a difficult process, but management has learned from its errors and inventory has fallen from just under $200m at 30 June 2022 to current levels of below $50m. This is a big achievement, especially if we see improvements in gross profit margins.

RADAR RATING: CCX is a beneficiary of improving economic conditions and a hardened management team. The company trades on a forecast PE for FY25 estimates of around 20 times but if the earnings rebound continues quickly reduces to single-digit for the following year. This is a high risk stock, but there is value. Interim result is crucial.

RADAR RATING: **HOLD**

RISK RATING



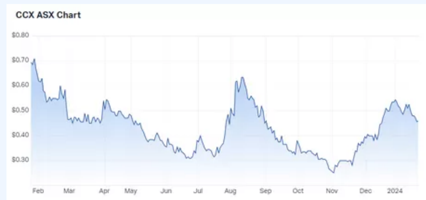
ASX CODE **CCX**

CURRENT PRICE **$0.485**

MARKET CAP $106M

DIVIDEND YIELD 0%*

NET CASH ($M) 10.9M



DATA AS AT INITIAL COVERAGE:

DATE 24 FEBRUARY 2022

PRICE ($) 0.60

Forecast 0 cents

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COOPER ENERGY

SECTOR OIL AND GAS **INDUSTRY** OIL AND GAS PRODUCER

Research Tip Update

Good news and not so good news. Finally, the gas producer appears to be making real progress in solving the issues that were holding back production at the Gippsland Victoria-based Orbost gas processing plant. But more work is needed for the improvements to be continuously sustained. The not so good news is that the cost for old infrastructure decommissioning has blown out and could rise further.

The step change improvement at Orbost follows changes to the H_2S polishing media, expected to have a longer run life. The plant averaged 59 terajoules a day during the periods when both absorbers were in operation, including record daily production of just over 67TJ. Instantaneous rates during the period have exceeded 68TJ, the plant's nameplate capacity, on a number of recent occasions.

Cooper Energy has been able to generate significant cash flow from selling 20TJ/d or around 30% of Sole production into the spot market.

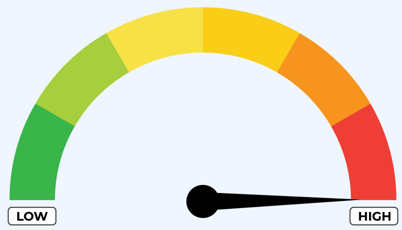
Now for the not so good news. Work on decommissioning legacy infrastructure associated with the Basker Manta Gummy oil project in the Gippsland Basin has been significantly slower than planned and COE announced this week that its mid-case cost estimate has been increased to $240-280m. This was about a third higher than its previous cost estimate made only in mid-December! Not only this, but there are risks that the costs could climb further, according to COE, as the group continues to work out the total costs.

COE seems to be well funded for decommissioning, with a $400m senior debt facility, cash of $83m at 30 Sep and positive operating cash flow. However, this is clearly not a comfortable position, with a risk of more cost blowouts. Decommissioning is the necessary extinguishing of a liability rather than creating wealth for shareholders.

RADAR RATING: Orbost improvements very welcome but infrastructure decommissioning costs remain a risk and will weigh on sentiment.

RADAR RATING: **HOLD**

RISK RATING



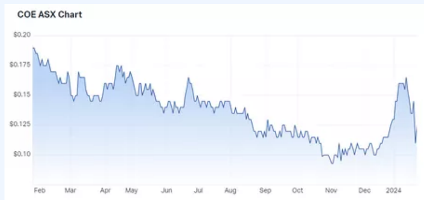
ASX CODE **COE**

CURRENT PRICE **$0.115**

MARKET CAP $317M

DIVIDEND YIELD 0%*

NET DEBT ($M) -75.0M



DATA AS AT INITIAL COVERAGE:

DATE 28 JULY 2017

PRICE ($) 0.24

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DATA3

SECTOR IT SERVICES **INDUSTRY** IT SERVICES

Research Tip Update

The IT consultant has long been one of the highest quality stocks in our small caps universe for a reason. Having tipped Data#3 at 99 cents in 2016 the stock is now well over $9. An interesting time for the newly appointed CEO, Brad Colledge, a veteran employee who takes over on 1 March. The stock has mimicked one of its key partners, Microsoft (US.MSFT), which has also been hitting new highs as excitement about AI fuels the biggest company in the world. We explain why it’s still not time to take profits.

A recent trading update increased first-half profit before tax estimates by 10% to over $30m, implying growth of over 20% over 1H23. This was better received than its FY23 result where DTL dropped close to $6. Now it is more than 50% higher.

We only rarely see opportunities to upgrade. Notably in Covid, we upgraded as part of a quality stock portfolio at the very bottom of the market at $2.94 (Issue 388, 26 March 2020).

The recent trading update points to strong interest income, adding to the significant cash balance, necessary for customer deliveries. FY23 average daily cash balance was $120m, a result of a negative or minimal working capital model, where average collections are 33 days, and suppliers offer DTL preferential payment terms. Net cash can get close to zero at some times, with the first half in negative operating cashflow after a significant build-up at the June year-end.

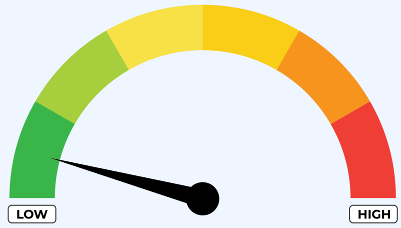
Microsoft and other key partners are developing AI businesses. HP is planning AI-capable PCs, and Cisco is a key enabler in directing and securing all the associated data traffic. Security remains a top concern for large businesses everywhere, and a relationship with Palo Alto will build on already strong security credentials to promote continued growth. Two-thirds of revenues are recurring, and DTL will benefit from a small distributor’s share of revenue derived from up sales of Microsoft’s AI solutions like Copilot.

Management has built a high growth sustainable recurring business. Revenue has more than doubled in the last six years. If you were lucky enough to buy the stock on one of our earlier recommendations, Hold on tight. Otherwise, keep DTL on your watchlist.

RADAR RATING: Management has delivered impressive growth, but a historic P/E ratio of 35x is not cheap even for a high-quality business. Exposure to IT growth trends of digital transformation, cloud, security and AI make DTL a core small cap holding.

RADAR RATING: **HOLD**

RISK RATING



ASX CODE **DTL**

CURRENT PRICE **$9.25**

MARKET CAP $1.44BN

DIVIDEND YIELD 2.6%*

NET CASH ($M) 404.8M

DATA AS AT INITIAL COVERAGE:

DATE 26 MAY 2016

PRICE ($) 0.99

**Forecast 24 cents*
*** Largely held for trade creditors*

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EVOLUTION MINING

SECTOR GOLD MINING **INDUSTRY** AUSTRALIAN GOLD PRODUCER

Research Tip Update

Evolution Mining's stock got hit 18% late last week on production issues at its Canadian mine Red Lake, Ontario, where there is increased uncertainty about the future rate. The mine was part of EVN's growth strategy. But far from damaging the group's prospects as implied by the share price fall, the evidence is that cash flow strengthened during the second quarter (3 months to 31 Dec) and debt is being reduced.

Production guidance for the year is unchanged, despite the downgrade to Red Lake, which implies that elsewhere in EVN's portfolio production is up on expectations. The key is the cashflow, which does not seem to be fully appreciated, hence the fall represents a buying opportunity.

FY24 production guidance remains at 789k ounces of gold and 62.5k tonnes of copper at a cost (AISC) of A$1,340/oz, more than double the gold price of over A$3,000. Second quarter cash flow was almost $80m and we expect to climb in the current half (2H24).

At Red Lake, FY24 production guidance has been cut to 130k ounces from 170k due to handling constraints (temporary) and earth tremors (seismic). The focus is for consistency, which we continue to anticipate, which will be associated with cashflow, although there is increased uncertainty. We think that the production aspirations were too high and are now more realistic.

RADAR RATING: Stronger cash flow coming through as part of the deleveraging strategy, despite the second quarter Redlake production shortfall.

RADAR RATING: **SPEC BUY**

RISK RATING

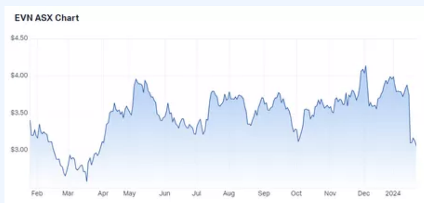
ASX CODE **EVN**

CURRENT PRICE **$3.13**

MARKET CAP $6.19BN

DIVIDEND YIELD 1.8%*

NET DEBT ($M) -2,056M



DATA AS AT INITIAL COVERAGE:

DATE 18 MARCH 2015

PRICE ($) 0.72

**Forecast 5.6 cents*

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INTEGRATED RESEARCH

SECTOR INFORMATION TECH | INDUSTRY IT SERVICES

Research Tip Update

Stock in the software company almost doubled on our recommendation at 32 cents just over a year ago, but has slowly settled all the way back. A trading update in the New Year confirmed Integrated Research's capacity to deliver earnings from its suite of products to a range of customers, despite increased competition.

IRI provides software that manages the multiple platforms that big enterprises use. It enables management to monitor and troubleshoot in real-time, and is particularly well suited to mission-critical services such as banking transactions. IRI's three product suites are termed Collaborate, Transact and Infrastructure – all powered by Prognosis.

Contract value is growing at about 8%, based on the company's guidance of \$39m-\$42m for the six months to 31 December. Although revenue should be slightly lower than 1H23's \$38m. It is encouraging that operating earnings (EBITDA) will rise about 30% to \$11m. The balance sheet is in good nick, with cash at \$21m.

The driver is principally renewals, comprising as much as 90% of the total contract value, with new customers accounting for much of the remainder. Speaking of which, new customer sales were down on the prior period across all product lines. The Americas was strong, particularly in transact and infrastructure, particularly supported by a large (\$10m) 5-year contract renewal with Fiserv, a major US-based financial services company which has been a client for more than 20 years.

The largest business, Collaborate, was relatively stronger in Europe and weaker in Asia, and is the business most threatened by competition.

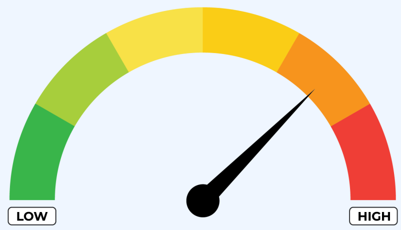
IRI faces strategic challenges, highlighted by its offer of migration assurance, giving customers the ability to move even while committing to long-term contracts. Expenses management is a priority, against increasing costs. Contract length has grown, which gives some comfort about the long-term value of IRI's products, but new business is hard to come by.

While we recognise the challenges IRI faces, solid earnings and strong cash conversion suggests that an enterprise valuation of \$35m is cheap.

RADAR RATING: Integrated Research is combatting competitive threats from cloud services to its on-premise solutions. The market has ongoing doubts, but we think IRI products remain valued by blue chip customers.

RADAR RATING: **SPEC BUY**

RISK RATING



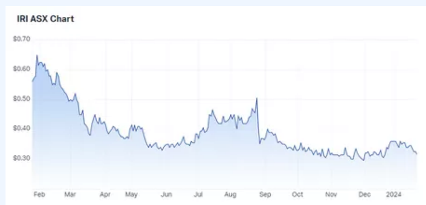
ASX CODE **IRI**

CURRENT PRICE **\$0.31**

MARKET CAP \$54M

DIVIDEND YIELD 0%*

NET CASH (\$M) 18.6M



DATA AS AT INITIAL COVERAGE:

DATE 10 NOVEMBER 2022

PRICE (\$) 0.32

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NANOSONICS

SECTOR BIOTECH **INDUSTRY** MEDICAL STERILISING TECHNOLOGY

Research Tip Update

Downgrade from Spec Buy

Nanosonics has never needed its potentially disruptive Coris system for cleaning endoscopes more than now. Coris is unproven and is yet to be submitted to the US regulator, the FDA, for approval. The company anticipates this to occur in 2024. The present is what counts most and yesterday the company effectively flagged that its cash cow, the Trophon system for sterilising ultrasounds, is in danger of being ex-growth. This led to a 34% plunge in its stock.

The medical device company indicated that its dominance in the giant US market is leading to a maturing of sales, with only 1,100 new Trophon units sold in the six months to 31 December (1H24) – the lowest volume since we have been covering the stock (six and a half years). The drop indicates that cash-strapped hospitals are not upgrading to Trophon2.

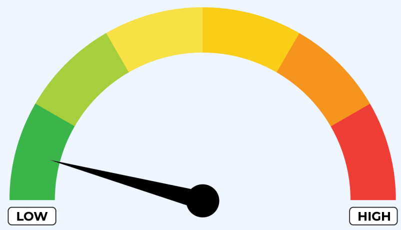
The gross profit margin for FY24 improved slightly to just under 80% from 79%, indicating that management is attacking its cost base. Operating expenses remain elevated at almost $61m for FY24, although at the bottom end of prior guidance ($54.5m FY23) due to Coris. The company said second-half sales should be an improvement on the first half, but nothing more. Certainly, there were no details on Coris.

Earnings estimates have been halved and the pressure is on for the Michael Kavanaugh led management to come up with something positive at the interim result announcement on 26 Feb.

RADAR RATING: News of a severe reduction in profitability is disappointing after positive commentary from the company late last year. We continue to have faith in Coris and are encouraged that the company continues to generate positive cash flow.

RADAR RATING: **HOLD**

RISK RATING



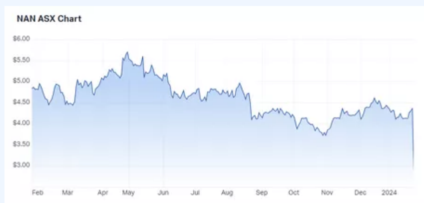
ASX CODE **NAN**

CURRENT PRICE **$2.90**

MARKET CAP $878M

DIVIDEND YIELD 0%*

NET CASH ($M) 112M



DATA AS AT INITIAL COVERAGE:

DATE 27 JULY 2017

PRICE ($) 2.41

under the radar report
SMALL CAPS

ISSUE 584
25 JANUARY 2024

Subscriber Picks

These are the stocks subscribers ask us about. We run our investment ruler over them and give you our Radar Diagnosis.

COMPANY	ASX CODE	DESCRIPTION	MARKET CAP ($M)	NET CASH / DEBT($M)	ENTERPRISE VALUE ($M)	LATEST PRICE ($)*	12-MNTH HIGH ($)	NOTES	RADAR DIAGNOSIS
5G NETWORKS	5GN	Enterprise software	63.3	75	-11.7	0.19	0.25	WebCentral was renamed 5GN in November after selling 2/3 of its domain name business for a premium value of well over $100m. A 2 cent special dividend was paid at the beginning of 2024. The remainder of the domain name business has an equity value of $21m, and 5GN's net cash of $75m+ means the December balance sheet will be crucial for full analysis of the value of the stock and the remaining enterprise and wholesale business	We have covered and owned Webcentral and its antecedents for over 20 years, and sold Melbourne IT from the portfolio in 2017 at over $3. With net cash more than the market cap, 5GN is now potentially a big bargain again. SPEC BUY.
AUDINATE GROUP	AD8	Professional audiovisual embedded systems	1422	90	1332	17.27	17.94	Audinate has delivered the digital transformation of professional audio through its Dante series of products. FY23 USD revenue growth of 40% and 72% gross margins delivered $11m EBITDA, but a valuation at about 20 times revenue is demanding. The company's ambition is to develop its audio business into video, and has broadening distribution and impressive contract wins.	AD8 has raised $70m through a placement and SPP to fund growth acquisitions, including M&A. Interesting and just profitable, but still expensive. WATCHLIST.
POLYNOVO	PNV	Medical device company specialising in wound care	1273.4	46.8	1226.6	1.85	2.71	The burns treatment specialist has built an impressive trackrecord from its polymer film surgical product suite based on its NovoSorb technology, producing a global sales base. But the company remains sub-scale with sales of $65m in FY23 producing an operating loss. A familiar story from the David Williams (chairman) stable where hope is essential. The stock spiked over 10% this week on a 66% increase in sales in FY24 and a forecast bottom line profit (NPAT).	Premature to be popping champagne, but trends are positive. HOLD.
XRF SCIENTIFIC	XRF	Minerals testing	142.2	8.3	133.9	1.03	1.44	Technology for measuring composition & purity of materials for mining. Entered new industries food, plastics and agricultural products and has 3 divisiions: Consumables (mining); Capital Equipment, order book at record levels, and Precious Metals (platinum labware), recurring orders. Exports to Europe, Asia and the Americas. Revenue & earnings growth has impressed; paying dividends; invests in R&D.	Despite the positive earnings trajectory, the shares have been volatile. HOLD.

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99% of all financial news relates to the 40 to 50 biggest companies.
So what about the rest? They're Under the Radar.

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