under the radar report
SMALL CAPS

ISSUE 599
09 MAY 2024

14 STOCKS THAT COULD BE THE NEXT SOUTHERN CROSS ELECTRICAL

The stock of the month is Southern Cross Electrical (SXE). The contractor was only 36 cents when we first rated it buyback in late 2020 and is now over $1.40. SXE has been in all our portfolios and a long-term best buy. This week's news that earnings growth is underpinned by work related to batteries and data centres sent the shares up over 20%.

SXE proves that the combination of contrarian investing and holding a diversified portfolio of small caps can deliver outsized returns. Investing is about the future and this issue is dedicated to giving you stocks that could be the next SXE.

The stocks include the ones we've covered in depth here, as well as our Best Stocks To Buy Now, which are on our website. Some are in the position Southern Cross was in back in 2020 – there is uncertainty about earnings and they have been largely ignored.

If you follow our research and exercise common sense, you'll position your portfolio to increase your wealth over time. My business partner, Caroline Mark, has almost doubled her portfolio's value over five years, which equates to an annual return of nearly 20%. Where else can you get this wealth creation? All she did was follow our research advice and use common sense. Find out about what she has to say in the podcast Shares For Beginners, out next Wednesday!

She has made phenomenal returns from uranium and lithium miners, which have overcome other mining stocks. Remember, your winning stocks have no limits, while your losses are limited to the amount you invest. There is more risk in doing nothing than there is in investing.

One sector I've been looking closely at is medical technology. There has been a great deal of hype in the digital space, but investors have left medical technology stocks largely alone. This is where the opportunities lie because these companies don't have to do much to impress investors.

Caroline had never invested before, and she is a case study (albeit close to home) of what you can do when you combine our research with your own common sense.

the issue

STOCK OF THE MONTH

Sentiment has risen to high levels after news about new contracts for batteries and data centres. The question is whether it is time to take some risk off the table.

SOUTHERN CROSS ELECTRICAL (SXE)	▼ TAKE PROFITS

RESEARCH TIP UPDATES

ACROW LIMITED (ACF)	BUY
ARTICORE (ATG)	▲ SPEC BUY
BIG RIVER INDUSTRIES (BRI)	▼ HOLD
CYCLOPHARM (CYC)	SPEC BUY
HELLOWORLD TRAVEL (HLO)	▲ SPEC BUY
PRAEMIUM (PPS)	▼ HOLD
SOMNOMED (SOM)	▲ SPEC BUY

BEST STOCKS TO BUY NOW

These stocks are quality companies that we believe offer great return potential for the risks faced. Check them out online.

> Caroline had never invested before, but has almost doubled her money in only five years. She is a case study (albeit close to home) of what you can do when you combine our research with your own common sense.

Richard Hemming
Head of Investments

Under the Radar Report

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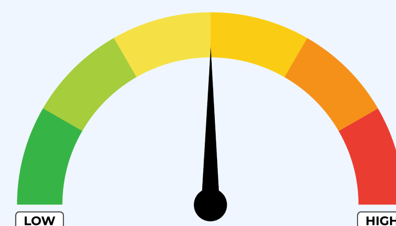
SOUTHERN CROSS ELECTRICAL

SECTOR CONTRACTOR

INDUSTRY ELECTRICAL AND COMMUNICATIONS CONTRACTOR

RADAR RATING: **TAKE PROFITS**

RISK RATING



ASX CODE **SXE**

CURRENT PRICE **$1.42**

MARKET CAP $376M

DIVIDEND YIELD 3.98%*

NET CASH ($M) 65.0M

DATA AS AT INITIAL COVERAGE:

DATE 30 DECEMBER 2020

PRICE ($) 0.365

Forecast 5.0 cents

Stock of the Month

Southern Cross Electrical has been a core stock for Under the Radar Report, in all our portfolios and a long-term best buy. News that earnings are increasing from work related to batteries and data centres this week sent the shares up over 20%. The stock has returned 80% since our most recent buy recommendation. Sentiment has risen to high levels, the question is whether it is time to take some risk off the table.

Downgrade from Buy

What's new?
The electrical services contractor reaffirmed that FY24 earnings should be flat at around $38m, which was expected and that the following year (FY25) growth should resume, with sales of at least $48m, which highlighted strong tailwinds support expectations of further earnings growth in FY26 and beyond. Catching investor imagination was news of more contracts for work on data centres, as well as the $160m contract for the Collie Battery in WA. In addition, in the past two months SXE announced $120m of contracts.

Bull Points
· Diversified work, including data centres
· Strong customer base

Bear Points
· Cyclicality
· Contract

Analysis: SXE has gone from simply being a mining contractor to being able to do future-facing work, such as data centres and batteries.

Australia is the seventh largest data centre provider in the world and the growth outlook is strong. The WA battery contract will drive earnings in FY25.

Earnings tailwinds now include data centres, infrastructure (Western Sydney Airport), energy transition (batteries), as well as mining, with customers including Rio Tinto. On top of this is commercial work, which includes supermarkets.

This provides confidence that the growth anticipated in FY25, FY26 and beyond is sustainable.

Portfolio risk rating: Risk rating of 3. High level of recurring revenue. No debt. EV to EBITDA ratio has virtually doubled after share price rerating since early March 2024.

RADAR RATING: Exposed to growth from future-facing high-growth areas such as data centres and the energy transition as well as growth from its traditional sectors.

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ACROW LIMITED

SECTOR CONTRACTOR **INDUSTRY** CONSTRUCTION SERVICES

Research Tip Update

What's new?
Last week Acrow reiterated FY24 sales and earnings growth of 31% and 40%, with sales at $220m (midpoint) and EBITDA at $74.5m. Contract wins have continued, and the pipeline is up almost 30% on last year.

We're expecting more growth into FY25, driven by Industrial Services, like maintenance for a chemical refinery or power station, as opposed to simply construction, scaffolding, and formwork.

Bull Points
· Strong organic and M&A growth
· In-house engineering

Bear Points
· Could be cuts to government spending or a resources downturn
· Growth through M&A brings integration risk

Analysis: ACF's big achievement has been to develop its own market in Construction as well as Industrial Services, which also involves scaffolding and formwork. The group is in a powerful position to tender for work across a wide variety of industries and sectors in the economy.

Industrial Service serves industrial, oil and gas, and mining sectors with equipment and skilled labour, complemented by scaffolding and formwork.

The company's November acquisition of Queensland-based MI Scaffold has already been a strong contributor, while Benchmark Scaffolding (Qld) was purchased in March.

In the past few months, ACF has secured new major medium to long-term contracts across the Industrial Services at the Ampol Fuel Refinery in Brisbane, the Kidston Hydro Project in North Queensland, and the Abbott Point Coal Terminal in the Bowen Basin.

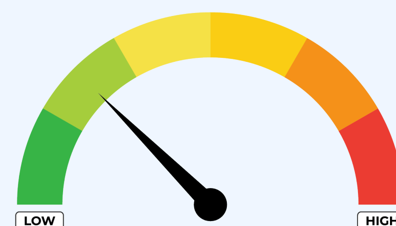
ACF also has in-house Product Development, a driver of growth. Production of its recent new product, Acrowdeck, is being fast-tracked.

Portfolio risk rating: Strong growth profile but trading on moderate cash flow multiple (EV/EBITDA) of around 7.5 times, within the range of comparable contractors.

RADAR RATING: Expanding and diversifying into new sectors, providing growth and reducing risk. Engineering team provides an edge.

RADAR RATING: **BUY**

RISK RATING



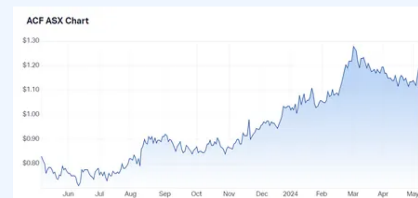
ASX CODE **ACF**

CURRENT PRICE **$1.175**

MARKET CAP $353M

DIVIDEND YIELD 4.6%*

NET DEBT ($M) -63.4M



DATA AS AT INITIAL COVERAGE:

DATE 08 DECEMBER 2022

PRICE ($) 0.575

**Forecast 5.5 cents*

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ARTICORE

SECTOR RETAIL **INDUSTRY** ONLINE RETAILER

Research Tip Update

Upgrade from Hold

What's New?
ATG remains in positive territory from our initial recommendation, but it's been heavy weather. The stock was sold on its interim result following a sharp rise, only to fall again after a third-quarter update, due to disappointment with sales growth. Marketplace revenue fell by 12%, while gross profit grew by 4%.

Bull Points
· Improved earnings
· Reducing costs

Bear Points
· Consumer weakness
· Yet to resume growth

Analysis: Articore remains a work in progress. The company has a great platform with its TeePublic (US) and Redbubble (APAC) digital marketplaces for selling t-shirts and consumer items, where it clips the ticket on millions of sales. The focus is on higher-margin products to improve unit economics. Discipline positions ATG for profitable growth.

The subdued third quarter to 31 March showed improvements with the key profit metric, which includes marketing costs, rise slightly. Gross profit after paid acquisition (GPAPA) rose 2% in constant currency to $21.3m, but there was still an operating EBITDA loss of $2.2m, and an underlying cash outflow of $4.8m. Q3 is the slowest seasonal period. Operating expenditure was 25% lower than the same period a year earlier, which impressed.

The company is aiming for positive cash flow for the full year on the basis of the GPAPA margin at 25% on declining revenue. Operating expenditure for the full year is expected to be as high as $100m, above the current $90m level.

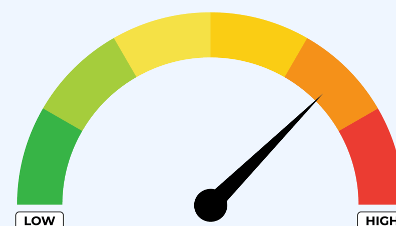
Articore aims to deliver positive underlying cash flow for the full year, which does not suggest a positive outcome in Q4. The importance of reaching underlying positive cash flow is illustrated by the $50m reduction in the net cash balance over Q3, albeit that was affected by seasonal factors. Cash remains just above the June 2023 level.

Portfolio risk rating: A turnaround is a high risk. The cash flow multiple is double-digit, which should reduce if earnings improve as we expect. This is very much a show-me stock, but we have confidence in the founder and CEO.

RADAR RATING: The stock has come back to a valuation where we are comfortable buyers because much groundwork has done for a recovery in earnings.

RADAR RATING: **SPEC BUY**

RISK RATING



ASX CODE **ATG**

CURRENT PRICE **$0.36**

MARKET CAP $113M

DIVIDEND YIELD 0%*

NET CASH ($M) 37.1M

DATA AS AT INITIAL COVERAGE:

DATE 27 APRIL 2023

PRICE ($) 0.40

Previously Redbubble

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BIG RIVER INDUSTRIES

SECTOR SERVICES | INDUSTRY CONSTRUCTION SERVICES

Research Tip Update

Downgrade from Buy

What's new?
Last week in a trading update, the construction supplies group and manufacturer indicated challenging conditions, citing a slowdown in residential housing starts and delays to customer projects. Hardest hit has been Frame & Truss sales, which are made by Big River as well as others, for timber frame residential construction. In contrast, commercial work is performing to expectations, but represents 30% of the sales.

Bull Points
· Cost cutting
· Relatively high return on equity

Bear Points
· Depressed conditions
· Fragmented business

Analysis: The fall in housing approvals in 2023 is having a knock-on effect on construction volumes, from which almost 60% of Big River revenues are derived. About 30% comes from commercial and civil construction, while the balance is from manufacturing.

Everyone understands that there is a housing shortage in Australia, but what we underestimated has been the downturn in the construction industry, squeezed by higher costs.

Big River is leveraged to residential construction and has been busy reducing costs in the wake of a program of small or bolt-on acquisitions.

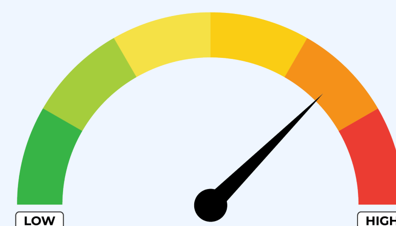
BRI is part of a once sizeable, listed construction materials sector, much of which supplied residential construction. With the recent takeovers of Boral and CSR (achieved or in progress) the companies left will be principally **James Hardie (ASX:JHX)** and **Fletcher Building (ASX:FBU)**.

Portfolio risk rating: Strong balance sheet and high cash conversion, but getting harder to see when earnings growth can be achieved. Cash flow multiple (enterprise value to EBITDA) is mid-single-digit which indicates value, but the impact of building industry malaise in Australia should not be underestimated.

RADAR RATING: Company is doing what it can, but industry conditions remain very difficult. We are holding on for better times, based on a relatively solid balance sheet.

RADAR RATING: **HOLD**

RISK RATING



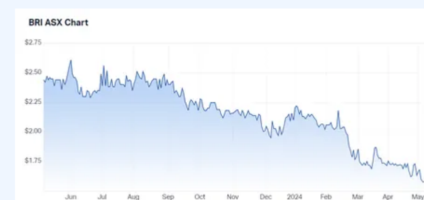
ASX CODE **BRI**

CURRENT PRICE **$1.54**

MARKET CAP $135M

DIVIDEND YIELD 7.1%*

NET DEBT ($M) -16.7M



DATA AS AT INITIAL COVERAGE:

DATE 23 MARCH 2023

PRICE ($) 2.58

**Forecast 11 cents*

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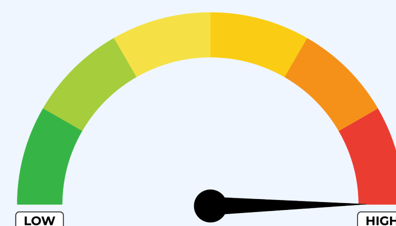
09 MAY 2024

CYCLOPHARM

SECTOR MEDICAL TECHNOLOGY | INDUSTRY RADIOLOGY SERVICES

RADAR RATING: **SPEC BUY**

RISK RATING



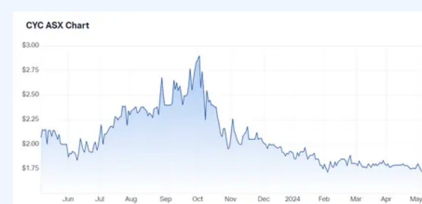
ASX CODE **CYC**

CURRENT PRICE **$1.70**

MARKET CAP $162M

DIVIDEND YIELD 0%*

NET CASH ($M) 11.7M



DATA AS AT INITIAL COVERAGE:

DATE 21 NOVEMBER 2018

PRICE ($) 0.965

Research Tip Update

What's new?
Cyclopharm announced that reimbursement for providers by US regulators Medicare/Medicaid has been delayed from the expected date of determination on 1 April 2024, with a decision now expected on or before 1 October 2024. This impacts the Technegas rollout by six months.

The stock rallied hard, approaching $3 into its approval in late September 2023 by the US drugs regulator, the FDA, for its nuclear medicine solution "Technegas" for identifying pulmonary embolism. We downgraded at that time, last October (Issue 569, 4 Oct 2023) with the stock having returned 206% on our initial tip. But we have been surprised at just how much CYC has fallen from its level back then.

Bull Points
· Niche medical technology
· US rollout

Bear Points
· Question over funding
· Risk of competing technology

Analysis: The delay further adds to investor frustration, but Cyclopharm has an impressive technology and business model. Technegas shows where oxygen is delivered into the bloodstream and into the lung, essential for the diagnosis for respiratory conditions.

Technegas generators facilitate sales of its consumable, the nuclear medicine diagnostic tests. The US charge higher rates than other countries, on top of which the company owns the equipment. Consequently, gross profit margins are 95% on consumable sales.

The market for pulmonary embolism alone in the US is worth US$180m a year and has recently been approved. CYC anticipates that it will achieve a 50% market share over time, which is in line with Europe and APAC.

Revenues in FY23 were $26m, but are expected to rise to over $80m in the next few years, which delivers a bottom line profit of about $25m, or 24 cents a share (if there are no share issues). The company had just under $12m in cash at 31 December, which may be sufficient to support the launch – certainly suspending the dividend was the right move.

Portfolio risk rating: highly speculative and at risk of a capital raising, but there is value because of the potential in the US, which is well within reach.

RADAR RATING: Good value but high risk. The company's technology is in demand and the business model will generate profit growth with sales of the Technegas system.

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SMALL CAPS

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HELLOWORLD TRAVEL

SECTOR TOURISM LEISURE **INDUSTRY** TRAVEL AGENCY

Research Tip Update

Upgrade from Hold

What's new?
As we had anticipated the third quarter would continue to see strong trading and the company reaffirmed that operating earnings for FY24 would be $68m (midpoint) on rising turnover with transaction value up 40%. But this is from a period when travel was only just beginning to recover from the Covid lockdown.

Bull Points
- Earnings growth
- Well-funded balance sheet

Bear Points
- Impact of higher interest rates on demand
- Geopolitical risks

Analysis: HLO has made a number of acquisitions coming out of Covid, using its own resources. Business initiatives include proprietary technologies in ticketing, wholesale, and accommodation platforms, as well as the ResWorld mid-office platform. HLO, like **Flight Centre (FLT)**, has many levers to pull to find growth or offset demand weakness following the Covid rush.

The third quarter earnings (EBITDA) of $14.6m was only a small increase, but underneath this number we were impressed. The company's profitability is being sustained. revenue margin (share of TTV) was 6.3%, and the EBITDA margin of revenue was 29% for the 9 months to date, due partly to the successful integration of Express Travel.

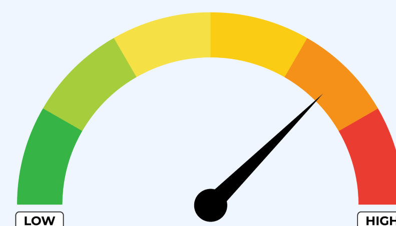
Another factor is continuing strong demand, supported by surveys indicating that travel remains a discretionary expenditure. Demand has continued to recover for inbound services, including entertainment, which supports tours and stage shows, which in Q3 included Taylor Swift. HelloWorld inbound division also works with wholesale clients in 42 countries providing local services to their travelling clients. Cruise demand remains strong.

Portfolio risk rating: FY24 EBITDA at the lower end of the guidance range suggests an enterprise value multiple of under seven times, with a strong balance sheet, is not expensive for the growth. The balance sheet is supported by investment and cash; although current assets are only slightly more than current liabilities.

RADAR RATING: Has used a strong balance sheet to acquire earnings capacity to capitalise on rebounding travel. This creates the opportunity for synergies to build on underlying demand strength, despite general consumer spending pressures.

RADAR RATING: **SPEC BUY**

RISK RATING



ASX CODE **HLO**

CURRENT PRICE **$2.43**

MARKET CAP $391M

DIVIDEND YIELD 4.1%*

NET CASH ($M) 72.7M

DATA AS AT INITIAL COVERAGE:

DATE 09 SEPTEMBER 2021

PRICE ($) 2.15

**Forecast 10 cents*

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SMALL CAPS

ISSUE 599
09 MAY 2024

PRAEMIUM

SECTOR CONTRACTOR | INDUSTRY WEALTH MANAGEMENT SERVICES

Research Tip Update

Downgrade from Buy

What's New?
We upgraded Praemium in December to Buy, having made money trading this stock in the past. The stock is up 20% in five months on a solid interim and the acquisition of OneVue from IRESS.

Bull Points
· Benefits from OneVue acquisition
· Niche positioning

Bear Points
· Powerwrap net fund flows vulnerable
· Large competitors

Analysis: PPS is proving to be a beneficiary of a consolidating industry with a well-timed purchase of OneVue from IRESS, adding $4.1bn in funds under administration and only $1m upfront, with a potential $7m or so only paid on earnings targets, being met.

PPS will have an FUA total of $57bn, including $29bn of non-custodial portfolio administration reporting, where PPS is a market leader.

Sales have been improving, but costs are rising at an even faster rate. The top line is being driven by virtual managed accounts increasing at single-digit rates, while virtual managed accounts as a service are growing at 25%, from a low base.

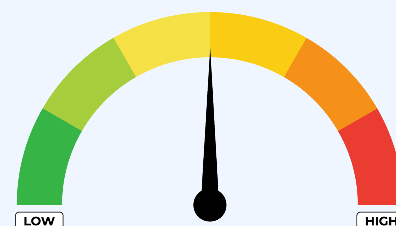
First-half revenue was up 10% to $40m, but revenue margin on FUA was down slightly. Costs rose 19% due to higher IT and risk mitigation costs compounded by general wage inflation. Operating earnings (EBITDA) fell 15% to $9m.

Portfolio risk rating: The cash flow multiple (EV/EBITDA) looks good at 10 times, when you take into account healthy net cash, although FUA needs to stay at current levels. The stock buyback may slow after this acquisition, but management has impressed.

RADAR RATING: We are downgrading PPS to reflect a 20%+ upwards move since upgrading in November 2023, FY24 earnings will be down due to increased investment for growth, and the acquisition of OneVue needs to be integrated.

RADAR RATING: **HOLD**

RISK RATING



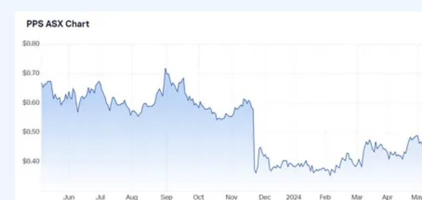
ASX CODE **PPS**

CURRENT PRICE **$0.46**

MARKET CAP $226M

DIVIDEND YIELD 0%*

NET CASH ($M) 41.0M



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DATE 05 JUNE 2019

PRICE ($) 0.33

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SOMNOMED

SECTOR MEDICAL TECHNOLOGY **INDUSTRY** MEDICAL DEVICE SPECIALIST

Research Tip Update

Upgrade from Hold

What's New?
SomnoMed is doing a reset, raising $22.6m in equity at 21 cents a share, from cornerstone shareholders to wipe the slate of its $12.7m debt millstone, reduce costs, and increase manufacturing capacity. The new shares increase shares on issue by 26%.

The third quarter (3q24) showed revenue of $11.5m, up 11% (6% in constant currency) and guidance is for growth of 6-9% and to be breakeven at the operating level (EBITDA); and capital expenditure of $5m.

Bull Points
· Demand for product
· Balance sheet repaired

Bear Points
· Regulatory hurdles remain
· Confidence low

Analysis: The company is surviving partly because there is demand for its product – evidenced by a backlog in orders; and because of the backing of TDM and Australian Ethical – which own almost two-thirds of the company.

This capital raise gives valuable breathing space. Oral-based SomnoDent treats sleep apnoea and is the best product of its type in the market. Even in a tough year, the company has grown its top line.

The manufacturing problems in Manila, Philippines, impacted recent sales, which still grew 11% in the third quarter to $22.5m and guidance for FY24 is still for 6-9% growth, implying about $90m.

The capital raise wipes out $1.7m in interest costs associated with the onerous $11.5m debt facility and enables a $5m cost reduction program (the restructuring charge in FY24 is $3m).

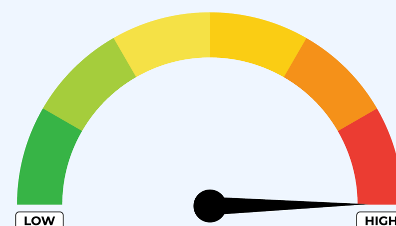
Another issue has been the slow pace at which it is bringing Rest Assure, which is a game changing development, allowing sleep patterns to be monitored. This brings oral devices into the game with the Cpap devices produced by **ResMed (RMD:ASX)**. Rest Assure is still being evaluated and won't be introduced this calendar year but remains a big hope.

Portfolio risk rating: High! This stock has caused investors many problems. The fact that it's alive should give pause, but we think at current levels it's worth a small investment.

RADAR RATING: This has been a difficult stock, but it's still punching. The stock is cheap and has the backing of big investors. What it's also got is big potential in sleep apnoea treatment.

RADAR RATING: **SPEC BUY**

RISK RATING



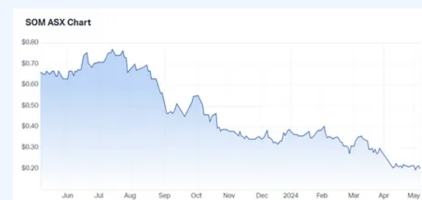
ASX CODE **SOM**

CURRENT PRICE **$0.20**

MARKET CAP $70M

DIVIDEND YIELD 0%*

NET CASH ($M) 14.6M



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DATE 02 OCTOBER 2014

PRICE ($) 2.04

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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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