under the radar report
SMALL CAPS

ISSUE 601
23 MAY 2024

NEW STOCK: A SMALL CAP WITH A BLUE-CHIP PROFILE

We are always looking for stocks that will fortify our members' portfolios. An area that we have had constant success over many years are those companies that might be at the small and micro-cap end of the spectrum, but have the qualities that you look for in blue chips. One of those characteristics is the reliability of income, which is in turn reliant on its customer base.

The new stock this week is a technology company, **XRF Scientific (XRF)** which specialises in mineralogy analysis and has the bluest of blue chip customer bases, which includes BHP, and Rio Tinto as well as industrial giants like Holcim, the global cement manufacturer. The stock's recent weakness provides an opportunity to own a company that produces highly consistent growth.

We're seeing what can happen when we get it right in the past few months on a number of occasions, and this isn't including takeovers! These stocks have delivered multiples on our initial investment. My own portfolio doesn't include wall-to-wall winners. But I'll tell you, a small number of winners eclipses the losers, which is why the portfolio is doing well.

I'm talking about the contractor **Southern Cross Electrical (SXE)**, the technology group **Integrated Research (IRI)** which have both taken off, as has the utilities billings and airport systems specialist **Gentrack (GTK)** which we cover this week. These are classic examples of investing in a value company that is turning into a growth engine. Gentrack has had five earnings upgrades in a row! Many of these stocks have been on our **Best Stocks To Buy Now**. Please regularly look at this list, which we've added to this week.

The market is trading near record levels. The key is to take advantage of this by taking profits in some of those stocks at the big end of town and re-investing where there is value. That's what I'm doing.

Richard Hemming
Head of Investments

the issue

NEW COVERAGE!

Share price weakness provides an opportunity to buy this technology company, which produces consistent earnings per share growth.

XRF SCIENTIFIC (XRF)	BUY

RESEARCH TIP UPDATES

ELDERS (ELD)	BUY
GENTRACK (GTK)	HOLD
HANSEN TECHNOLOGIES (HSN)	▲ BUY
OFX GROUP (OFX)	HOLD
TRAJAN GROUP (TRJ)	▲ 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.

Proving its stripes as a disruptor, Gentrack spiked 22% on Monday on a better-than-expected interim result; a classic example of investing in a value company that is turning into a growth engine. The company has had five upgrades in a row!

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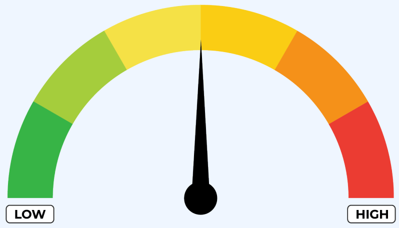
XRF SCIENTIFIC

SECTOR INDUSTRIAL **INDUSTRY** CONTRACTOR

RADAR RATING: **BUY**

RISK RATING



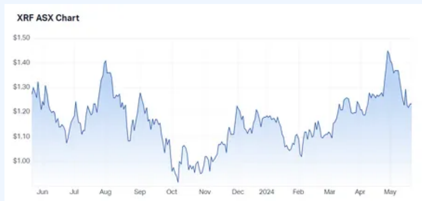
ASX CODE **XRF**

CURRENT PRICE **$1.25**

MARKET CAP $173M

DIVIDEND YIELD 2.8%*

NET CASH ($M) 5.4M



DATA AS AT INITIAL COVERAGE:

DATE 22 MAY 2024

PRICE ($)

**Forecast 3.5 cents*

New Coverage!

Share price weakness provides an opportunity to buy this technology company, which stands out for producing consistent earnings per share growth.

What's new?
Shares have been weaker despite a solid third-quarter profit to 31 March with profit before tax up 15% to $15.2m; and a positive outlook with new products due to be launched in the coming weeks/months.

Bull Points
· Track record of growth
· Recurring earnings
· Dividends

Bear Points
· Competition
· Resources risk

A Small Cap With Blue Chip Qualities
XRF utilises a specialised mineral testing technology, X-Ray Fluorescence for the analysis of commodities such as gold, copper, nickel and iron ore. Customers include numerous mining giants like BHP, and Rio Tinto as well as industrial giants like Holcim, the global cement manufacturer.

Sample preparation is the key before the XRF machine can be used. This includes crushing and grinding; then dissolving in a flux at high temperature to be made into a form put into the XRF.

Unlike other companies, through acquisition, XRF has managed to cover the entire process of mineral sample analysis and is used in both exploration and production. The company itself does not manufacture the actual XRF machine. The strength of this company is the preparation prior to using the machine, which is what the customers are paying for. If you've got a mine, you measure what's coming out of the ground every day.

How sample analysis works:
The process is intensive and carried out by XRF in its entirety, which encapsulates the company's special sauce or intellectual property. The preparation first involves crushing and pulverisation to a fine dust with a controlled particle size. The sample and a chosen flux are then weighed out accurately, which can be done manually or using automated dosing machines. The mixture is then put into a platinum crucible and fused together.

The fusion process involves dissolving a fully oxidised sample in the platinum crucible at high temperatures in the flux, which acts as a solvent. The melted mixture is agitated or mixed and poured into a mould to create a glass disc for XRF analysis.

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XRF analysis provides end customers such as BHP with the grades and mineralogy, crucial to the actual mineral processing.

Divisional Analysis
Half the earnings come from Consumables; the remainder from Capital Equipment & Precious Metals.

Consumables involves the manufacture of chemicals for laboratories, the primary products being lithium borate fluxes. These have a high melting point to fully dissolve the sample, but not so high that it causes volatilisation. The purity of the flux is very important in minimising sample contamination. The choice of the flux depends on the acidity of the sample. There are a number of additives that can be added to the flux, such as oxidants.

XRF produces fluxes in different types, such as beaded, granular or powder. The different types can impact factors such as melting rates.

Capital Equipment makes laboratory jaw crushers as well as general laboratory equipment, high-temperature test and production furnaces and automated fusion equipment. Laboratory-manufactured items include dual-action fine crushers, which can reduce samples by up to 55 times their original size, drying ovens and pressing and pelletising equipment.

XRF produces both gas and electric fusion machines, which use borate fusion for XRF sample preparation.

Precious Metals produces platinum labware and precision platinum products for producing specialised laboratory equipment that can withstand high temperatures, corrosion and oxidation. Products include platinum crucibles, dishes and moulds.

Portfolio Risk Rating: The growth of XRF's sample preparation technology is linked to the continual need for mineral exploration and new mine developments to supply the global demand growth for metals and other commodities. XRF's products are also essential for measuring quality in industrial processes to improve productivity and reduce downtime and waste.

Revenue, profit before tax, earnings and dividends have increased every year over the last five years and we expect this to continue. Trading on a cash flow multiple of under 12 times and on a PE of 18 times, the stock is not cheap, but the consistency of earnings and dividends makes it very good value.

RADAR RATING: Track record of dividend growth reflects the ongoing growth of the industries it serves globally. Its technologies and diversification have enhanced its competitive edge.

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ELDERS

SECTOR CONSUMER STAPLES **INDUSTRY** FOOD

Research Tip Updates

What's New?
Elders' mid-year earnings to 31 March was announced this week, but were flagged in an update in early April (Issue 596). We are encouraged by the reaffirmation of earnings (EBIT) forecasts for FY24 to 30 September at $130m (mid-point), prompted by a recovery in business conditions from a sharp downturn late last year.

The stock will go ex an 18 cents dividend, 50% franked, on 28 May.

Bull Points
· Diversified agricultural services
· Dominant market position

Bear Points
· Cyclical
· Weather sensitivities

Analysis: As previously noted after the trading update last month (Issue 596) the rural services company's earnings highlight the cyclicality of business, as lower livestock prices meant lower sales commissions.

Operating earnings (EBIT) for the first half was $38m, $15m below the comparable figure for 1h20, pre-Covid. When you factor in acquisitions, this is a disappointing performance.

However, we do have faith in the company, which has delivered operationally over time, reflected in phenomenal returns over the past decade of 26% a year.

The strategy now is to grow retail and wholesale outlets, boosted by acquisitions, most recently in Tasmania (Knight Frank).

Net debt is mainly inventory financed from its livestock business, where the loans are secured against livestock under ELD control. Secured corporate debt is only $94m, against cash of $38m.

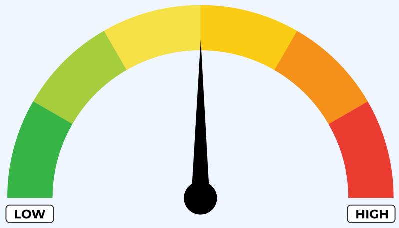
The current reduced profitability will at some point end. The imperative being to make adequate money in poor years; great money in good years.

Portfolio Risk Rating: The cash flow multiple is the high single digits (EV/EBITDA) which is fair for a business with such a commanding position and potential for profit margin improvement. The stock is a good diversifier for most portfolios and provides income.

RADAR RATING: Has delivered underlying growth over the medium term, but the agricultural cycle has been a headwind in FY23 and FY24, which will show earnings declines. A long-term asset for a diversified portfolio, with a cyclical upside.

RADAR RATING: **BUY**

RISK RATING



ASX CODE **ELD**

CURRENT PRICE **$8.40**

MARKET CAP $157.4M

DIVIDEND YIELD 4.2%*

NET DEBT ($M) -356M

DATA AS AT INITIAL COVERAGE:

DATE 10 JULY 2013

PRICE ($) 0.80

Forecast 36 cents

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GENTRACK

SECTOR INFORMATION TECH **INDUSTRY** SPFTWARE

Research Tip Updates

What's New?
Proving its stripes as a disruptor, Gentrack spiked 22% on Monday on a better-than-expected interim result (to 31/3/24) with FY24 revenue guidance (to 30 Sep) increasing almost 20% from at least $170m to $200m producing operating earnings (EBITDA) of $23.5-26.5m, up 12% on FY23.

Bull Points
· Disrupting existing market
· Strong balance sheet

Bear Points
· Long sales lead times
· High expectations

Analysis: Gentrack is a classic example of investing in a value company that is turning into a growth engine. The company has had five upgrades in a row, with FY24 revenue guidance going from $130m to $150m to 170m and is now at $200m! The share price boost reflects investors cottoning on to the twin growth opportunities from water and energy utilities upgrading their billing and CRM systems; as well as airports upgrading their systems in the wake of the destructive Covid. Gentrack's Veovo business now services 160 airports and is now targeting the higher margin tier 1 space.

Investors were impressed because, alongside better-than-expected historic growth, GTK is increasing investment in R&D and has a growing pipeline.

Revenues for the period were $102, $86.5m of which came from utilities; up 17%; while Veovo was $15.5m, up almost 50%. When you exclude the one-off income from insolvent UK customers, utilities rose 60%.

Growth is coming from both new business and upgrades to g2.0, which involves Salesforce and AWS. Annual recurring revenues are forecast to keep growing; in the half ARR rose 44% to $65.4m.

International delivered NZ$8m in revenue, coming from nowhere. GTK has co-developed a system designed to automate electric power load shifting, with Australian energy retailer Amber.

Portfolio Risk Rating: The company is expensive on any metric but is exploiting a sweet spot where energy utilities and airports need to upgrade their technology systems with an attractive tech stack and value proposition. The institutions are on board and the brokers are salivating.

There is a low financial risk but the stock now trades on a cash flow (EV/EBITDA) multiple of 25 times next year's forecast.

RADAR RATING: The momentum is there with earnings tailwinds increasing expectations with every result. Now is not the time to get off.

RADAR RATING: **HOLD**

RISK RATING

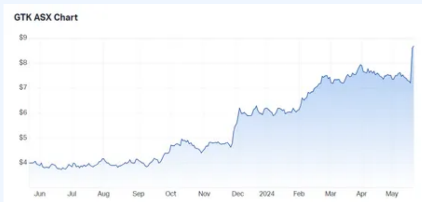
ASX CODE **GTK**

CURRENT PRICE **$8.64**

MARKET CAP $487M

DIVIDEND YIELD 0%*

NET CASH ($M) NZ$39.3M



DATA AS AT INITIAL COVERAGE:

DATE 16 JUNE 2022

PRICE ($) 1.30

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SMALL CAPS

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HANSEN TECHNOLOGIES

SECTOR INFORMATION TECH **INDUSTRY** SPFTWARE

Research Tip Updates

Upgrade from Hold

What's New?
Hansen shares have declined almost $1 or 17% since the interim result in February indicating concern about the acquisition of Powercloud in Germany.

Bull Points
· Blue chip customers
· Long-term contracts

Bear Points
· Competition increasing
· Powercloud integration risks

Analysis: HSN has shown steady global growth which attracted the attention of private equity in 2022. Since that deal did not materialise, HSN has continued its organic and acquisition-led strategy.

Then we come to Powercloud, a cloud-native business with new technologies like virtual power plants and electric vehicles. The acquisition will cost €30m ($49m), initially €$17m followed by a working capital injection of €13m to return the business to profitability.

The sell-off has been due to concern over reduced profitability following regulatory changes related to Powercloud.

Guidance is for organic single-digit organic revenue growth, on top of Powercloud sales. Forecast earnings (EBITDA/sales) margin will reduce from 30% to 26% as a result of losses at Powercloud, which management put at $8m. But the acquisition is expected to be EBITDA accretive by the end of FY25.

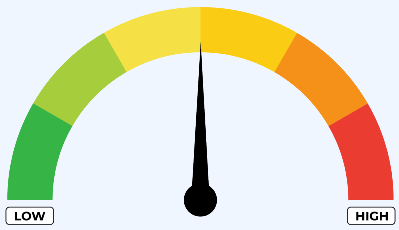
The interim profit performance was very good Revenue grew 12% to $168m, leading to a bottom line (NPAT) increase of 21% to $20m, for earnings per share of 13.3 cents before amortisation of intangibles. A 46% franked 5-cent interim dividend was paid (flat) and we forecast a slight increase in the final.

Portfolio Risk Rating: The company trades on a high single-digit cash flow multiple (EV/EBITDA) which is reasonable for a company with a strong balance sheet and potential growth from Powercloud not priced in. Integration risks could be significant, however.

RADAR RATING: A recent acquisition and organic product development suggests that Hansen is more competitive than feared, as new entrants with customer information systems attempt to build market share. Modest organic revenue growth remains consistent, which investors could value higher in future.

RADAR RATING: **BUY**

RISK RATING



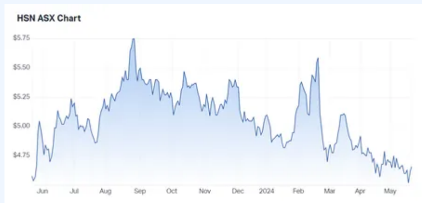
ASX CODE **HSN**

CURRENT PRICE **$4.57**

MARKET CAP $948M

DIVIDEND YIELD 2.4%*

NET CASH ($M) 8M



DATA AS AT INITIAL COVERAGE:

DATE 20 MARCH 2019

PRICE ($) 3.01

**Forecast 11 cents*

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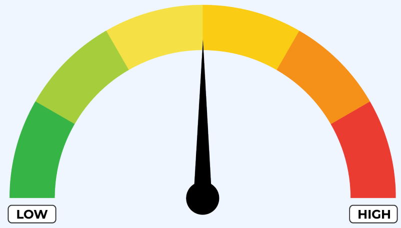
OFX GROUP

SECTOR FINANCIALS **INDUSTRY** WEALTH

RADAR RATING: **HOLD**

RISK RATING



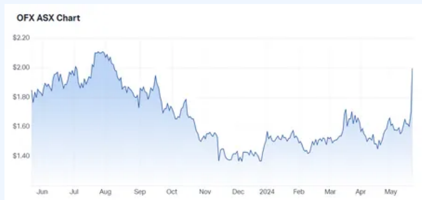
ASX CODE **OFX**

CURRENT PRICE **$2.0**

MARKET CAP $475M

DIVIDEND YIELD 0%*

NET CASH ($M) 25.9M



DATA AS AT INITIAL COVERAGE:

DATE 14 APRIL 2022

PRICE ($) 2.43

Research Tip Updates

What's New?
OFX's FY24 results to 31 March this week has sent the stock up over 15% on excitement about the resumption of growth. Net operating income was up 6% while operating earnings (EBITDA) of $65m was up 3%, or 8% if you exclude Paytron, an acquisition completed in July.

Bull Points
· Multiple revenue growth drivers
· Strong balance sheet

Bear Points
· Increasing competition
· Expansion risks

Analysis: With a buyback underway, and a confident medium and long-term outlook in an almost limitless global forex market, OFX offers long-term growth as a disruptor in an underserved market segment. If the stock consolidates, look for an opportunity to buy lower.

We are encouraged by improving fundamentals, although the company has an operating (EBITDA) loss of $2m for the period partly due to the integration costs of Paytron. The net operating margin was up, albeit only slightly on improving growth in transactions per active client and new client revenue.

Over two-thirds of business is in B2B, where revenues of $146m were supported by margin expansion and an increase in transactions. Consumer revenue was down 4.4% due to a decline in higher-value customers. US transaction volumes were up 20% & revenues up 14%, while UK revenues climbed 19% and Europe grew from a low base.

The company has new-found flexibility. Debt is being repaid and a buyback is ongoing. A new corporate platform will be launched in the next few months. B2B revenue growth was 22%, and 65% of revenues are generated outside Australia. OFX is targeting EBITDA margins of up to 30%, and growing net operating revenue of 15% pa at these margins.

Portfolio Risk Rating: A cash flow multiple (EV/EBITDA) of 7x is not unreasonable for a company with OFX's growth record and potential in the huge global forex transfer market.

RADAR RATING: After a strong second half, investors will want earnings growth momentum to continue. The potential market is very large, and the valuation is reasonable.

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TRAJAN GROUP

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Updates

Upgrade from Hold

What's New?
This month Trajan downgraded the revenue and earnings forecast, in line with our view in March (Issue 590) that the measurement specialist's forecasts were ambitious. The shares have so far bounced 37% in the wake of the news, but remain well below their 12-month high of $1.91. FY24 revenue is to be close to $155.5m (midpoint), below previous guidance of $163m, while earnings (EBITDA) should be $16.5m (midpoint), well below previously anticipated $22.3m.

Bull Points
· Global sales
· Founder led

Bear Points
· Has not developed a scale
· Complex to manage

Analysis: The stock bounced because demand climbed 14% in the six months to 31 March, with April showing a similar trend and shipments in May and June expected to lift.

Unfortunately, a 10% lift in output was insufficient to match order book demand, hence the revenue shortfall. At least TRJ has the sort of problem it wants for a change. Orders have been moved to FY25.

There is no indication that market share or long-term demand in the Pharmaceutical sector has fundamentally changed. Elsewhere demand for Capital Equipment remains strong.

In the smaller Disruptive Technologies division, demand is high for microsampling tools and is expected to breakeven in FY25.

Acquisition integration has been a problem but seems to be finally occurring and we expect a $10m boost to cash flow from property sales and a further $1m a year to earnings (EBITDA) from cost-cutting. No capital-raising activity is planned.

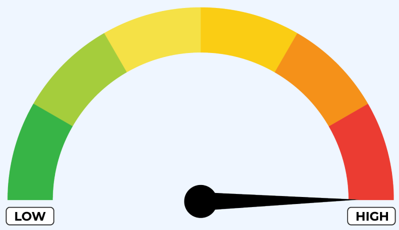
Portfolio Risk Rating: Demand is strong and growing with the key to growth addressing production deficiencies and further cost reduction.

Finally, momentum is going in the right direction, but TRJ is not out of the casualty ward. This is only for an investor who can afford the risk.

RADAR RATING: Strong revenue run rate in relatively defensive medical, environmental and food areas, but business is fragmented. Turning around but high risk. We derive confidence from being founder-led.

RADAR RATING: **SPEC BUY**

RISK RATING



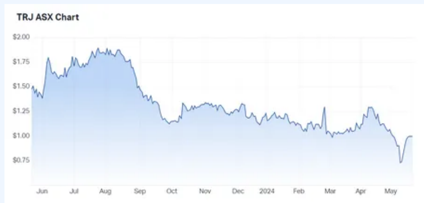
ASX CODE **TRJ**

CURRENT PRICE **$1.0**

MARKET CAP $152M

DIVIDEND YIELD 0%*

NET DEBT ($M) -36.7M



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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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