under the radar report
SMALL CAPS

ISSUE 605
20 JUNE 2024

NEW COVERAGE: AI-MEDIA

AI is indeed ubiquitous. Or is it? Everywhere you hear about it, but the ability to profit from it has been overhyped…Until now! Under the Radar Report exists to hunt for stocks that can make a meaningful difference to your portfolio and to give you portfolio management advice, enabling you to harness those stock-picking ideas into an asset that will stand the test of time – your own portfolio.

Investors routinely get excited. That's fine. What you don't want to do is overpay. That is the core of our philosophy. What you also want to do is ensure that the company won't need to raise money, despite having its foot on growth prospects.

In **AI-Media (AIM)** we have found such a company, simply because it is in the middle of a transition. The labour costs are far too high, but the most recent result showed the potential that is on offer. This company specialises in captioning and transcription services for broadcasters. This means live events, whether they're sport or political. It's an exciting story and one in which investors are watching closely.

The stock price moved this week, but we would not be chasing it too hard, certainly not over 40 cents. Don't worry if you miss out. We've got more opportunities coming your way in the next four weeks.

We have our Best Stocks To Buy Now and our pipeline of stocks coming up. One stock in this issue is **Cooper Energy (COE)**. We know it very well and for the first time I can honestly say that the gas producer has a strong handle on its business and the risk is declining. Check it out, but it's another at the risky end of the spectrum.

You want to diversify your portfolio by size and sector, as well as including some that are paying healthy dividends. Not all your investments will fire at once, but once you create an asset, it's inevitable that your winners will outpace the rest if you're including some quality small caps.

Richard Hemming
Head of Investments

the issue

NEW COVERAGE!

The broadcast captioning and transcribing specialist is in the early stages of a disruptive journey, trading well under 1 times sales, it has fallen a long way from its IPO multiple in 2020 of 5 times.

AI-MEDIA (AIM)	SPEC BUY

GAS SPECIAL REPORT

Gas prices on the East and West Coasts are poised to benefit from increasing demand and reducing supply. Small Caps are often the way to benefit from industry thematics.

COOPER ENERGY (COE)	SPEC BUY
STRIKE ENERGY (STX)	HOLD

RESEARCH TIP UPDATES

5G NETWORKS (5GN)	SPEC BUY
QUICKSTEP (QHL)	HOLD

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.

> **AI-Media's latest result showed the company's LEXI technology record captioning results better than humans for the first time.**
>
> **Under the Radar Report**

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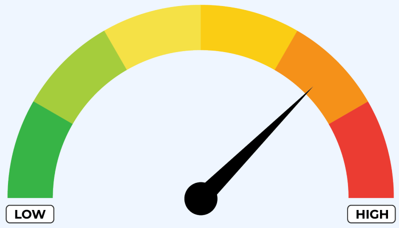
AI-MEDIA

SECTOR TELECOMUMMICATIONS **INDUSTRY** MEDIA

AI-Media: Taking off
The broadcast captioning and transcribing specialist is in the early stages of a disruptive journey, going from a human service business with a bit of technology to a tech business with a bit of human services. Trading well under 1 times sales, it has fallen a long way from its IPO or float multiple in 2020 of over 5 times.

RADAR RATING: **SPEC BUY**

RISK RATING



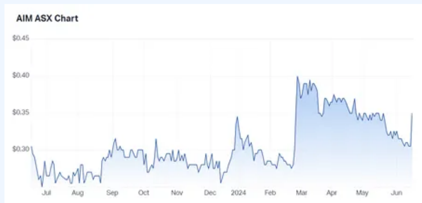
ASX CODE **AIM**

CURRENT PRICE **$0.34**

MARKET CAP $71M

DIVIDEND YIELD 0%*

NET CASH ($M) 11.7M



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DATE 19 JUNE 2024

PRICE ($)

New Coverage!

What's new?
AI-Media's stock has declined almost 25% since its interim result in February eroding much of the gain on the announcement and providing an opportunity to buy into a stock that has a great future as a disruptor in captioning.

The interim result was notable for technology revenues growing 38% delivering 34% gross profit, with the company transitioning towards the higher margin subscription as a service (SaaS) model and consequently producing free cash flow (operating cash flow minus investment) in the most recent half (1h24).

Bull Points
- **Technology is fast improving**
- **Cash flow positive**
- **Operating leverage**

Bear Points
- **Fragmented market**
- **Key customer risk**
- **Data protection & privacy**

Aiming to be an AI tech titan
AI-Media was listed on the ASX in September 2020 raising just under $66m at an offer price of $1.23. An intensely competitive market in captioning and rising costs has seen the stock deteriorate by 75% since listing.

Investors remain wary of a company whose labour costs remain at two-thirds of current sales. The story reminds of Netflix, which initially mailed out DVDs. Founders Randolph and Hastings were able to establish a superior business model from the group's membership, once internet streaming came along, the distribution costs being taken out of the system.

When AI-Media floated the company had purchased ACS, which generated $20m of revenue from human captioning. The company then bought the US group EEG in 2021 for US$40m, which gave it exposure to captioning technology, with its LEXI automatic captions.

Fast forward to today and the company's sweet spot is delivering 98% plus accuracy on its iCap gateway network or technology platform in near real-time (a couple of seconds delay) captioning for broadcasters, whether they're Channel 9, Foxtel, NBC or the NFL & NBA.

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The latest result showed the company's LEXI product record captioning results better than humans for the first time; the group was free cash flow positive and new customers were added.

The earnings trend is positive

The results are summed up by this table. Services revenue (human transcription) is down 7%, while higher margin Tech revenue, which includes LEXI, is up 38%. Tech gross profit margin is much higher at 83% versus the Services GP margin of 44%.

A$m	H1FY24	H1FY23	Variance	Growth %
Services revenue	17.1	18.4	(1.3)	(7%)
Tech revenue	15.6	11.3	4.3	38%
Total revenue	**32.7**	**29.7**	**3.0**	**10%**
Services gross profit	7.5	8.1	(0.6)	(7%)
Tech gross profit	12.9	9.6	3.3	35%
Gross Profit	**20.5**	**17.7**	**2.8**	**16%**
GP margin %	*63%*	*60%*	-	-

Yet the stock remains in the doldrums!

Labour costs remain at 65% of sales, a legacy of the contracts that involve human captioning. The gross profit margin on this activity is 40%, while the Tech margin is 70% for hardware and 80% - 90% for software.

Much of the marginal increase in labour costs were of sales people in North America and EMEA.

Operating earnings (EBITDA) for the first half (1h24) were $1.9m. If you exclude redundancy costs, for FY24 this figure should be an improvement on last year's $3.9m, being closer to $5.5m.

The key to profit growth is technology

Services revenue should continue to decline at 10% but Tech revenue should shoot the lights out, because the value proposition for broadcasters seems compelling, based on the technology being at least at the standard of humans. The cost to a very large broadcaster in the US using human captioning is US$60-70 an hour, (A$100/hour) while LEXI costs US$8.80/hour.

On top of that, the new version LEXI 3.0 has improved functionality, via its offer of redundancy for a system failure (LEXI DR) such as when the internet goes down, now no longer requiring human intervention.

Assuming this it's possible the company could grow revenues at 20% over time, which will boost gross profits even more because it comes on top of gross profit margin expansion.

Portfolio Risk Rating: The current valuation is not excessive on the premise of revenue growth and cost containment. Risk is high because AIM is in transition. We are encouraged by free cash flow and net cash.

RADAR RATING: This is a high-risk holding. The share price spike this week highlights that the stock has been oversold in the short term. Over the next 12 months, progress on the sales front combined with cost containment is all-important in improving profitability.

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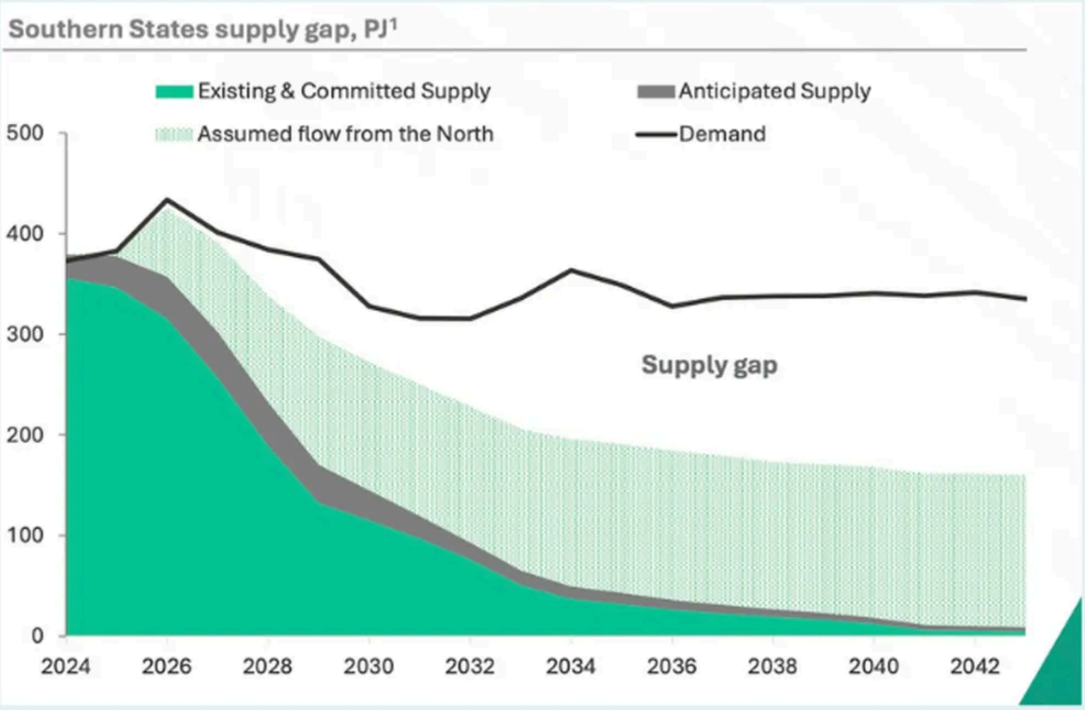
GAS SPECIAL REPORT: SMALL CAPS IN PRIME POSITION

Gas prices on the East and West Coasts of Australia are poised to benefit from a combination of increasing demand and reducing supply. Small Caps can often be the best way to benefit from industry thematics. Below we go into more detail, then we get to the stocks: Cooper Energy (COE) and Strike Energy (STX).

WE'RE ALMOST OUT OF GAS!

Forecast gas supply shortfall in NSW, Victoria and South Australia when compared to anticipated demand (y-axis is petajoules).



The shortfall creates an opportunity for gas producers and new gas projects. The shortfall will create upward pressure on gas prices, which benefits Cooper Energy (COE) being a producer on the Eastern Seaboard. A similar phenomenon is happening on the West Coast and benefits Strike Energy (STX).

SOURCE: AEMO

Rising electricity usage driving gas demand

The Australian Energy Market Operator (AEMO) is forecasting a 16% increase in electricity demand in the National Electricity Market (NEM) by 2030. Similar drivers are occurring on the West Coast, which includes rising usage from EV adoption, battery usage and data centres, being supercharged by the AI phenomenon. Gas is a beneficiary within the generation mix because of its flexibility in backing up renewables.

Gas generation is required to balance the electricity market

Over the same period to 2030, AEMO expects penetration by renewables to increase to 82% of the NEM, equivalent to an additional 34 gigawatts of renewable energy.

Continued on next page...

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GAS SPECIAL REPORT CONT.

Over 90% of today's coal generation is expected to end by 2035, which will require a replacement in terms of both long-duration firming, and short-duration energy storage. Batteries only last a matter of hours, as does pumped hydro. Gas does not rely on weather and can last indefinitely, although it is expensive.

Gas has multiple uses & is difficult to access
Gas currently meets about 27% of Australia's energy demand, but only half is used for electricity generation. The remainder is used for heating and as a feedstock in the production of chemicals, which include fertilisers. Importantly, substitutes are possible, but only if they're economic.

Gas supply is problematic. New discoveries are small and hurdles to production are higher than ever, in no small part due to environmental concerns.

AEMO warning of gas shortages from 2028
Given the importance of gas in firming generation, access to supply will be crucial. However, gas production from Bass Strait, Victoria, is falling due to resource depletion. As a result, ExxonMobil is planning to close one of the two remaining gas plants at its Longford facility in South Gippsland during 2028. The Longford processing plant is the largest source of gas to Australia's southern states.

AEMO has warned of potential gas shortages from 2028. This would make southern states even more reliant on supplies from Queensland. However, there is likely to be a limit to how much Queensland can supply because of pipeline capacity constraints.

Investment Conclusion
East Coast contracted gas prices been increasing this year and there is expected to be increasing convergence with higher LNG import prices. Further, possible LNG imports for the domestic market would reinforce the LNG import parity trend. Moreover, this is also occurring on the West Coast. This provides a market opportunity such as **Cooper Energy (COE)** and **Strike Energy (STX)**.

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COOPER ENERGY

SECTOR ENERGY **INDUSTRY** OIL AND GAS

Gas Comment

What's New?
This month the company updated its Gippsland Basin (Victoria) activities and its strategy for achieving growth at its smaller 50% owned Otway Basin (Victoria) operations (East Coast Supply Project).

FY24 guidance is very encouraging considering past disruption, for total production is 60.5-64 terajoules equivalent a day (TJe/d), with a total production of over 70 TJe/d by the end of FY25. At its Orbost processing plant (Gippsland Basin) COE is targeting 58 TJ/day in coming months and 62 TJ/day by the end of FY25.

The decommissioning of the depleted BMG wells (Gippsland Basin) is complete. The expected final cost is $280m, though may go higher.

Bull Points
• Increasing production
• Undersupplied East Coast gas markets

Bear Points
• Expansion risk
• Competition from LNG gas imports

Analysis: Cooper has had a difficult history getting production in line with targets at its Orbost processing plant in the Gippsland Basin. Finally, after almost a decade, there is evidence of stability and that COE can supply the East Coast Australia, taking advantage of good market conditions. The group's East Coast Supply Project is potentially the largest gas supplier in Victoria with a resource potential is greater than 350 bank cubic feet, and with processing at the underutilised Athena plant.

Athena (50% owned) gives potential to achieve 3x its current production rate, significantly boosting profit margins. The plant was purchased from BHP and has been operating at 20TJ/d and has a 150 TJ/d capacity.

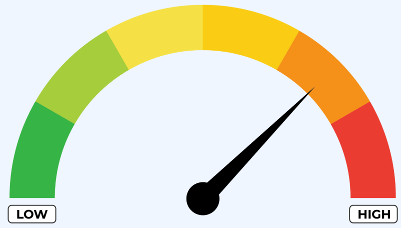
In addition to its Casino, Henry and Netherby fields in the Otway Basin, there is significant exploration potential. COE can also target third-party access to its processing plants, storage and peaking gas products.

Portfolio Risk Rating: Risk is declining as Orbost improves on top of $10m in annual cost savings and positive gas trends. On valuation grounds has potential but proven reserves need to increase.

RADAR RATING: Moving to a growth phase on top of which there is exploration potential to exploit the East Coast gas market.

RADAR RATING: SPEC BUY

RISK RATING



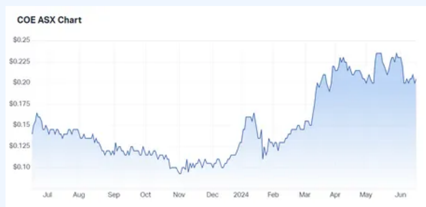
ASX CODE **COE**

CURRENT PRICE **$0.21**

MARKET CAP $547.8M

DIVIDEND YIELD 0%*

NET DEBT ($M) -164.7M



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PRICE ($) 0.24

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STRIKE ENERGY

SECTOR ENERGY **INDUSTRY** OIL AND GAS

Gas Comment

What's new?
The Walyering gas field in the Perth Basin WA achieved payback in late May 2024, only 8 months after first production in September 2023. At South Erregulla (Perth Basin) Strike Energy is investigating a development. The Final Investment Decision target for the West Erregulla project (Strike 50%) is in the next quarter.

Bull Points
- Rising gas WA gas prices
- A gas producer

Bear Points
- Exploration risk
- Rising costs

Analysis: The stock is in the doldrums owing to exploration problems (see Issue 587 in mid-February when we downgraded) in South Erregulla; on top of which the market is focused on cost blowouts at the **Beach Energy (BPT:ASX)** owned neighbouring project Waitsia.

Recent announcements have not reduced concerns, but the company has enough potential to encourage us to hold on, boosted by a rising WA gas price.

The Walyering gas field is a high-margin, low cost and early payback project. In the eight months to late May, the field delivered $47m in gross income. The payback is one of the fastest in recent history for a greenfield Australian oil and gas project.

At South Erregulla, the situation is not nearly as clear and is undergoing a Resources and Reserves review. The probability is for a scaled-down development impacting existing sales contracts.

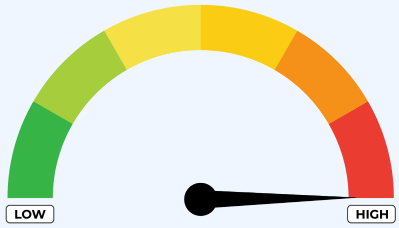
The good news is that the WA gas price is above historic averages due to declines in some domestic-only gas supplies. The maximum quarterly WA spot price averaged $9.34/GJ. The Australian Energy Market Operator (AEMO) believes there is a risk of a substantial WA gas supply shortfall in the near term and continuing for most of the next decade.

Portfolio Risk Rating: High. While Walyering is a gas producer, there is uncertainty in South Erregulla and West Erregulla following a geological setback; costs are forecast to rise. The company remains in a precarious position, but gas prices are going up.

RADAR RATING: Largest holder of Perth Basin gas deposit where prices are going up but there are big risks on the cost front.

RADAR RATING: **HOLD**

RISK RATING



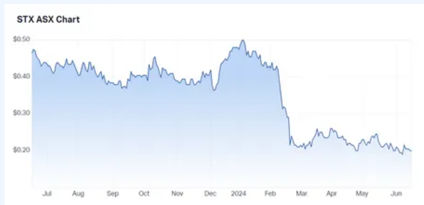
ASX CODE **STX**

CURRENT PRICE **$0.20**

MARKET CAP $572M

DIVIDEND YIELD 0%*

NET DEBT ($M) -22.4M



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5G NETWORKS

SECTOR SERVICES **INDUSTRY** DATA NETWORKS

Research Tip Update

What's New?

Following the successful sale of the majority of its Webcentral domains and hosting business in late 2023, 5GN completed the sale of its remaining minority stake for an additional $20m cash, simplifying the business. The resignation of the CFO in September introduces some uncertainty.

Bull Points
• Discount to net assets and net cash
• 2500 enterprise & wholesale customers

Bear Points
• Loss making
• CFO leaving

Analysis: 5GN has its own nationwide highspeed data network with points of presence in Australian capital cities, and racks in its own data centres. The incremental margin on revenue through this vertically integrated network is healthy. The final sale of Webcentral allows focus on this business.

A second-half turnaround in interest receivable, vs $2m payable in the first half, should cover operating losses, but the business needs to accelerate revenue growth to cross breakeven.

The cash situation remains healthy but there are some wrinkles. As a result of the final Webcentral sale, there is now $78m cash on the balance sheet, against which there is a provision of $14m for tax on the first sale consideration, with about $6m due to be paid in the next 12 months. The interim accounts indicated that the “eligibility and deductibility” of losses on the sale of other businesses could offset some of the first $14m.

The $78m in cash doesn't include the $6.7m expense of the 2-cent dividend paid in February, but this is neatly offset by the $6.5m release of a warranty provision.

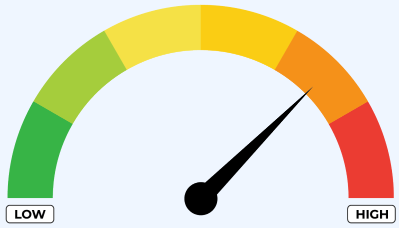
Contracted revenues from Webcentral as part of the initial sale have been reduced by a quarter to $9m over five years. Underlying interim revenue was $22m. Networking and cloud hosting and other direct costs were 61%, while staff costs were almost 50%, hence the $2m operating loss.

Portfolio Risk Rating: While the operations have commercial risks, and are sub-scale, the financial risks are substantially eliminated thanks to the cash backing. The risks that management does not make good use of the cash are reduced by the CEO's 18% stake. The successful Webcentral sale demonstrates capability.

RADAR RATING: 5GN has sold the balance of its Webcentral holding for more cash, now providing substantial cash and net asset backing. The challenge is to develop the business towards sustainable profitability.

RADAR RATING: **SPEC BUY**

RISK RATING



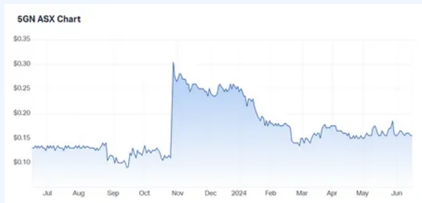
ASX CODE **5GN**

CURRENT PRICE **$0.155**

MARKET CAP $334.6M

DIVIDEND YIELD 0%*

NET CASH ($M) 78M



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QUICKSTEP

SECTOR MATERIALS **INDUSTRY** MANUFACTURING

Research Tip Updates

What's new?
The largest division, Aerostructures, is transitioning production to the next phase of multi-year orders, providing clear demand to FY29 for F-35 Strike Fighters and C-130 Hercules components. The company is contracting to Lockheed Martin.

The engineering initiatives relating to drones is progressing.

Bull Points
- Aerostructures winning work
- Profit margins improving

Bear Points
- Sales are too low
- Debt

Analysis: Quickstep has long-term agreements with Lockheed, Northrop Grumman and Marand, but is yet to deliver meaningful sales when compared to its costs base. This latest announcement does deliver some hope, however. Sales sit just shy of $100m but the company employs 280 people in Australia and offshore.

In Development Engineering new sales contracts are small but encouraging and include components for an additional 20 Volanti drones (worth $430K) and an additional $300K follow-on contract for engineering services in support of TB2 Aerospace LLC (following on from an initial $500K contract). A $925K Commonwealth Department of Science, Industry and Resources space grant has been finalised.

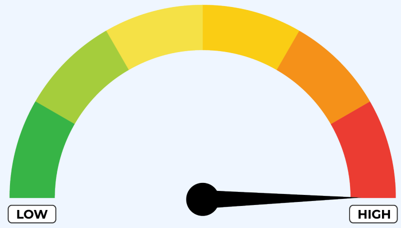
In the Services business (which includes maintenance), Quickstep the company is taking advantage of the demand for Australian capability in both the commercial airline and defence, driven by costs and delivery efficiencies and carbon footprint reductions.

Portfolio Risk Rating: High. Positives include 3-5 year Aerostructures contracts reaffirmed, but revenue guidance remains below $100m. Operating earnings marginally positive but there is debt and the prospect of near-term volume reductions.

RADAR RATING: Core Aerostructures business is washing its face. Waiting for meaningful growth in Services and Engineering. Outlook improving.

RADAR RATING: **HOLD**

RISK RATING



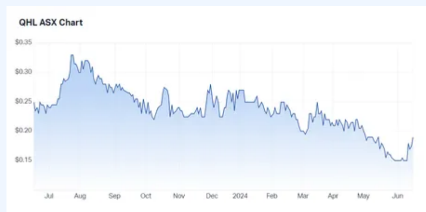
ASX CODE **QHL**

CURRENT PRICE **$0.19**

MARKET CAP $13.6M

DIVIDEND YIELD 0%*

NET DEBT ($M) -7.2M



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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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