under the radar report
SMALL CAPS

ISSUE 607
04 JULY 2024

KICK OFF THE NEW FINANCIAL YEAR WITH A NEW SMALL CAP

We have a pipeline of new stocks coming your way because what we are seeing is a number of quality Small Caps trading on valuations that are cheap. What does quality mean? These companies have growth opportunities through innovation and disruption, have strong balance sheets, and at the very least, a line of sight to positive earning and cash flow. They don't need to raise money.

We've watched the early childhood education and care provider, **Embark Early Education (EVO)** for a while now (from when it was known as Evolve Education) and we've been impressed with centre acquisitions in the current period, which isn't reflected in the share price, trading on a single-digit PE and a dividend yield of over 5%. Management has done this before and has skin in the game. Retail investors are in the best position to take advantage.

The last point is important. When stocks are small, it is hard to obtain enough for the bigger players in the market like fund managers. As individual investors we do not need to get much of a foothold to make a material difference.

When a stock like this performs at the earnings level, these fund managers are forced to buy, because the fundamentals are too good. As a retail shareholder you benefit from increasing earnings growth and then you get the double whammy from an earnings multiple expansion. This has happened too many times for me to remember, but a recent one that comes to mind was the utilities software specialist **Gentrack (GTK)**, which has returned 622% since we first recommended it as a buy two years ago.

You don't need many Gentracks delivering 600% plus in 2 years to give your portfolio the returns you deserve. All you need is one or two.

Richard Hemming
Head of Investments

the issue

NEW COVERAGE

Not only are we are seeing strong growth in revenue and earnings on an absolute basis as centres are added, but importantly revenue and earnings are also growing on a per centre basis.

EMBARK EARLY EDUCATION (EVO) — BUY

RESEARCH TIP UPDATES

After the big buying we saw on Strike Energy (STX) last week, could fellow gas producers Comet Ridge (COI) or Cooper Energy (COE) be next?

ARN MEDIA (A1N)	HOLD
CENTAURUS METALS (CTM)	HOLD
COMET RIDGE (COI)	SPEC BUY
GR ENGINEERING (GNG)	HOLD
PEOPLEIN (PPE)	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.

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EMBARK EARLY EDUCATION

SECTOR CONSUMER DISCRETIONARY **INDUSTRY** RETAIL

We've watched the early education provider for a while and we've been impressed with centre rollout in the current period, which isn't reflected in the share price, trading on a single-digit PE and a dividend yield of over 5%. Management has done this before and has skin in the game. Retail investors are in the best position to take advantage.

New Coverage!

What's new?
At its trading update in June the company said that for the four months to 30 April, revenues rose 15.7% on the same period last year and centre earnings (EBITDA) grew 20%. By 19 May the growth rates had increased further. Not only are we are seeing strong growth in revenue and earnings on an absolute basis as centres are added, but importantly revenue and earnings are also growing on a per-centre basis.

Bull Points
· Proven management
· Net cash
· Dividend yield (paid quarterly)

Bear Points
· Heavily reliant on Government childcare subsidy
· Labour is the major expense
· Sensitive to the economic cycle

CEO with skin in the game and a strong track record
A recovery story, a recapitalisation story, a roll-up story, a CEO who has done it before and is the largest shareholder, all bundled into one buying opportunity. The early childhood education provider is growing off a small base of centres, just as its management did 15 years ago with G8 Education, which is now worth close to $1bn, almost 10 times the value of Embark Early Education.

We think CEO Chris Scott can do it again. He owns 16.4% and is the largest shareholder of EVO, which has less than the 38 preschool centres G8 owned when he commenced there. He built that up to 500 and the stock climbing from $0.43 to $3.59 as a result of earnings (EBIT) increasing from $3m to $160m.

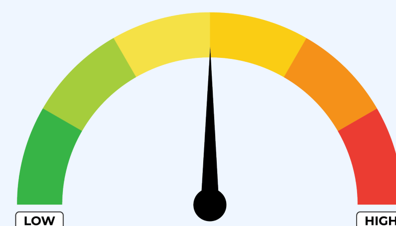
Centre acquisitions have recommenced
After zero acquisitions last year (CY2023) EVO has made nine in the first half of this year, plus there are four under conditional contract, which equates to 38% growth, putting the total centres so far at 33. The $25m cost has been funded internally and there is the prospect of more, with a number being under negotiation.

The centres are earnings per share positive, being acquired on a forecast EBITDA multiple of 4 times, which compares to EVO's multiple of 5 times.

Continued on next page...

RADAR RATING: **BUY**

RISK RATING



ASX CODE **EVO**

CURRENT PRICE **$0.70**

MARKET CAP $113M

DIVIDEND YIELD 5.6%*

NET CASH ($M) 27M

DATA AS AT INITIAL COVERAGE:

DATE 03 JULY 2024

PRICE ($)

**Forecast 3.9 cents*

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History

· **2014**: Established and listed for the purpose of acquiring early childhood education centres and home-based education licences in New Zealand.
· **2018**: Operating 129 early childhood centres in New Zealand but facing competition from new entrants and stagnant Government funding at a time of rising costs.
· **2018**: Chris Scott acquired 19%; appointed to the board in November.
· **2019**: Major capital raising to repay debt and fund a new strategy of acquiring centres in Australia. New management and directors appointed with Chris Scott made CEO. 10 centres acquired in Australia.
· **2020-21**: Covid lockdowns. Acquire a further 13 centres in Australia. Raised further capital.
· **2022**: Exited New Zealand, selling centres to private equity; focus on Australia. Debts repaid, dividends resume.
· **2023**: Redomiciled to Australia and delisted from the NZX, ended the year with 24 early childhood centres in Australia, no debt and $26m cash.
· **2024**: Has purchased 9 more centres with 33 in total and more in the wings.

Earnings Drivers & Risks

Centre occupancy and new centres bought for reasonable prices are both crucial to getting maximum leverage out of the cost base.

With the bulk of revenue coming through the Commonwealth Government childcare subsidy, any reduction in the funding model poses a major risk. However with the current focus on cost of living pressures, any changes which would push up the cost of childcare for working parents seems unlikely in the foreseeable future. Furthermore, the funding per student is based on household income, so as income falls then funding increases which provides some counter-cyclical protection for families and hence for the childcare centres themselves. Access to staff is a challenge and can limit enrolments given the need to meet government mandated staff to student ratios.

Investment Summary

EVO is turning its operations around and has made a great deal of progress in the past five years. The company can now focus on making attractive acquisitions and optimally running the business. Earnings are on the increase through both centre acquisitions and higher occupancy with the results coming through in fully franked quarterly dividends.

Portfolio Risk Rating: The stock trades on a forecast high-single-digit PE and is delivering a dividend yield of over 5% (fully franked). The risk is largely regulatory but there is an experienced and incentivised management running the group. The availability of shares is not an issue for retail investors, but is for institutions. When the liquidity improves we expect a PE multiple re-rating.

RADAR RATING: It's early days in the Australian growth story, but with a solid foundation of centres and earnings, combined with strong management experience, the prospects for ongoing growth in the business look promising.

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ARN MEDIA

SECTOR TELECOMUMMICATIONS **INDUSTRY** MEDIA

Research Tip Update

What's New?
After failing to persuade **Southern Cross Media (SXL**) to engage in a complicated transaction to takeover and swap radio assets, ARN is considering its position based on a 14.9% SXL stake. Both stocks sold off from nearly $1 when this deal was proposed, to near 60c recently.

Bull Points
· Valuation
· Revenue recovery potential

Bear Points
· Uncertainty over proposed SXL transaction
· Advertising revenue weakness

Analysis: ARN's FY24 revenue was up 1% in the year to date to April, defying weakness in domestic media, with **Seven West Media (SWM)** forecasting third-quarter TV advertising revenue down 11%, and **Nine Network (NEC)** expecting free to air TV advertising revenue down 13% in the second half.

Having guided to 2-4% operating cost growth in FY24, the key to A1N's HY24 results will be sustaining profitability, after operating earnings (EBITDA) fell from $92m in 2022 to $72m in 2023.

We expect A1N to wait for SXL's FY24 results before making another acquisition move. The withdrawal of private equity firm Anchorage from the proposed bid was due to deteriorating TV advertising and increases uncertainty.

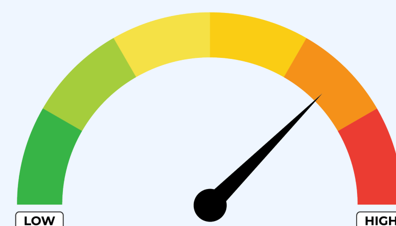
There is potential for A1N's earnings (EBITDA) to increase 50% to $105m, with the addition of 60% more shares, if there is a successful SXL bid, so there is a great deal at stake. A1N needs to exit the Hong Kong outdoor business, which has just won a major transit contract.

Portfolio Risk Rating: The stock is very cheap now and has low financial risk, with net debt of around one times historic earnings (EBITDA). Even with a potential double-digit decline in FY24 EBITDA, a historic cash flow multiple (enterprise value/EBITDA) of less than 5 times in a depressed market. We have downgraded FY24 dividend expectations to 5 cents from 7.1 cents, which should be affordable.

RADAR RATING: The potential for a substantial recovery in radio advertising revenue should eventually deliver earnings growth.

RADAR RATING: **HOLD**

RISK RATING



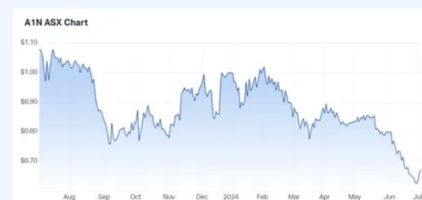
ASX CODE **A1N**

CURRENT PRICE **$0.675**

MARKET CAP $208M

DIVIDEND YIELD 7.4%*

NET DEBT ($M) -74.7M



DATA AS AT INITIAL COVERAGE:

DATE 10 JULY 2013

PRICE ($) 1.12

**Forecast: 5 cents*
PORTFOLIO:
The Under the Radar Report Portfolio holds 8000 shares, about 3% of the portfolio.

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SMALL CAPS

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CENTAURUS METALS

SECTOR METALS_MINING **INDUSTRY** NICKEL

Research Tip Update

What's New?
The Jaguar sulphide nickel project in Northern Brazil remains early stage, having completed feasibility studies, but production is forecast to be significant at 18.7k tonnes a year at low cost initially because it's open pit (US$3.57/lb). First production is targeted for 2H 2027.

The project's life of mine CO2 footprint is forecast to be lower than 94% of global nickel output, a sought-after attribute for the Class-1 nickel specification for the EV battery market.

Bull Points
· Low carbon footprint vs Indonesian battery grade
· Non-China-related nickel source

Bear Points
· Production still about three years away
· Form of funding still needs to be determined.

Analysis: Jaguar is currently one of the largest undeveloped nickel sulphide projects in the world. The JORC Mineral Resource Estimate is 109.2m tonnes at 0.87% nickel containing 948.9k tonnes metal. The JORC Proved and Probable ore reserve is 63.0m tonnes at 0.73% nickel with 459.2k tonnes contained nickel.

The project is becoming a reality but is still at the funding stage, with a preference for minority equity investment at the project level in order to minimise dilution, in parallel with project financing and debt funding.

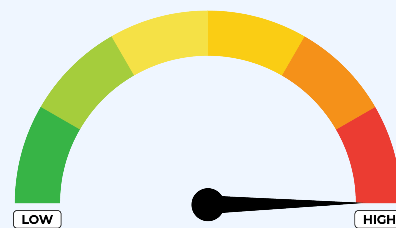
Centaurus also has two early-stage projects in the Province. At Jambreiro iron ore, a study is underway to investigate the production of a high-quality Direct Reduction (DR) iron concentrate following interest from offtake partners. Boi Novo is a copper/gold exploration project.

Portfolio Risk Rating: Strong cash position to support value engineering and pre-development activities through to a final investment decision. Needs funding beyond this.

RADAR RATING: Relatively rare undeveloped sulphide nickel project with scale. Valuation upside as the project is developed plus premiums for quality/low carbon footprint.

RADAR RATING: **HOLD**

RISK RATING



ASX CODE **CTM**

CURRENT PRICE **$0.415**

MARKET CAP $223M

DIVIDEND YIELD 0%*

NET CASH ($M) 29.4M

DATA AS AT INITIAL COVERAGE:

DATE 30 OCTOBER 2013

PRICE ($) 0.89

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COMET RIDGE

SECTOR ENERGY **INDUSTRY** OIL AND GAS

Research Tip Update

What's new?
Comet has been awarded a $5m Queensland Government grant to carry out a pilot test at its Mahalo Gas Hub gas project in the Bowen Basin. In addition, Comet has been selected by the government as preferred tenderer for an additional gas block nearby.

Bull Points
· Two east coast gas projects
· Infrastructure

Bear Points
· Construction risk
· First production still two years away

Analysis: There are two projects in Queensland, next door to each other, the main one being the Mahalo gas hub. The award is a vote of confidence by the Qld Govt to accelerate the production of gas for a market that is desperate for supply.

A pipeline from the hub joins the reserve to the domestic and export markets. The hub is located only 14km away from another gas hub, owned privately (by a company called Denison). If it gets connection to this hub, production could be accelerated to 2026, prior to when pipeline owner Jemena plans to operate, from 2027.

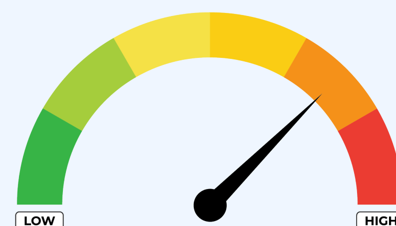
The Jemena 80km pipeline provides capacity for expansion and a study has been completed for connection to the Mahalo Gas Hub and the Mahalo joint venture (Comet 57.1%, Santos 42.9%). The ambition from 2027 is to link Mahalo gas production with the east coast and export markets via Gladstone.

Portfolio Risk Rating: Queensland Government support for Comet to get its gas projects into production. Projects still need to be funded but very bankable in current tight gas market.

RADAR RATING: Future gas production from two, long-life Bowen Basin, Queensland, projects. Strong gas demand with rising prices, valuation uplift as developed.

RADAR RATING: **SPEC BUY**

RISK RATING



ASX CODE **COI**

CURRENT PRICE **$0.19**

MARKET CAP $205M

DIVIDEND YIELD 0%*

NET CASH ($M) 10.1M

DATA AS AT INITIAL COVERAGE:

DATE 21 JULY 2022

PRICE ($) 0.18

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GR ENGINEERING

SECTOR INDUSTRIAL **INDUSTRY** CONTRACTOR

Research Tip Update

What's New?
Our decision to pull back to hold in GR Engineering almost two years ago has proven to be correct, but the company continues to provide evidence of its quality. Late in May GNG provided FY24 earnings (EBITDA) guidance of $50-51m, up 14%. The company has cut revenue guidance by 18% to $422m from over $500m.

Bull Points
· One of the leaders in the mineral processing field
· Experience in most commodities

Bear Points
· Weaker environment for commodities
· Risk of project delays

Analysis: Earnings (EBITDA) margins vary depending on contract type and the timing of the contract, which may affect revenue recognition. For FY24, the revenue decline does not prevent EBITDA rising because this is due to an increase in EBITDA margin to 12%. In FY23, the EBITDA margin was 8%, a typical historical level.

This is a quality contractor, with the core business forecast to deliver earnings growth and visibility is extremely good based on the contracted and near-term pipeline of work, ongoing early contractor involvement work and the high level of study work across a broad range of commodities.

GR Engineering recently added to its contracted work pipeline, winning a $71m engineering, procurement and construction contract with **Liontown Resources (LTR)**. The contract is for two paste plants at the Kathleen Valley lithium project, WA.

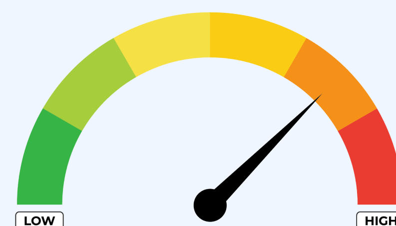
The company expects additional contract awards in the current half.

Portfolio Risk Rating: Contractor with net cash and good order book. Capital light business model. Low prospective PE ratios, similar to peers, reflecting less certain outlook. We would want the pipeline of work to strengthen before upgrading the recommendation.

RADAR RATING: Macro environment for new resources projects has slowed, but long-term outlook, particularly for critical minerals is solid. Well placed for a pickup but could experience near-term margin contraction.

RADAR RATING: **HOLD**

RISK RATING



ASX CODE **GNG**

CURRENT PRICE **$2.14**

MARKET CAP $360.5M

DIVIDEND YIELD 8.7%*

NET CASH ($M) 48.2M

DATA AS AT INITIAL COVERAGE:

DATE 02 OCTOBER 2013

PRICE ($) 0.58

**Forecast 19 cents*

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PEOPLEIN

SECTOR INDUSTRIAL **INDUSTRY** CONTRACTOR

RADAR RATING: **HOLD**

RISK RATING

ASX CODE **PPE**

CURRENT PRICE **$0.825**

MARKET CAP $86.6M

DIVIDEND YIELD 7.3%*

NET DEBT ($M) -80.3M

DATA AS AT INITIAL COVERAGE:

DATE 22 JULY 2021

PRICE ($) 4.36

Forecast 6.1 cents

Research Tip Update

What's New?
We were right to down to downgrade late last year at over $1 (Issue 578) since when the stock has fallen to current levels around 80 cents. The first half (1h24) 1% increase in revenue resulted in earnings margins (EBITDA) decline from 5.4% to 3.4% Net profit after tax and amortisation fell by 34% on 1h23 to $13.7m. The margin contraction from taking on lower margin more reliable work, plus less permanent recruitment fees, especially in technology.

Bull Points
· Strong market position
· Strong (adjusted) cash conversion

Bear Points
· Soft operating conditions impacting margins
· Balance sheet position deteriorating

Analysis: Three years ago, when we first tipped PPE, key earnings contributors were from high-margin health and IT business. In its quest for growth, the group has made acquisitions, skewing earnings towards lower-margin businesses.

Weak business confidence and an improvement will be required before margins recover and earnings grow, in FY25 or even FY26.

Net debt of $80m is a concern, having increased from $34m in the six months to 31 December. Another soft half and PPE's debt covenants will be looking less comfortable, especially interest coverage ratio. The company has good cash conversion which helps and may get a boost in June like last year by cash collections coming in early.

In the previous half, billed hours were down just over 1%, with growth in Industrial Services offsetting reductions in the higher-margin Health and Professional Services sectors.

The Healthcare & Community segment (nursing) recorded a 6% fall in revenue and a 35% drop in EBITDA as the higher-margin private sector pulled back on spending, reducing billed hours during the half period. However, NDIS activity is increasing with opportunities to expand geographically.

Portfolio Risk Rating: There is risk around the dividend, reflected in the take-up of the dividend reinvestment plan of only 8%. The low market cap means a capital raise would be very dilutive although you have Pereninial Value, Perpetual and QVG on the register so they could do it.

RADAR RATING: Decline in business confidence across many sectors is leading to reduced margins. Balance sheet pressure is increasing, FY24 result in August will be an important barometer.

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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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