under the radar report
SMALL CAPS

ISSUE 610
25 JULY 2024

12 BEST SMALL CAPS TO BUY NOW

After the 24% rise of the manufacturer minnow Quickstep (QHL) on Tuesday, the stock has almost doubled since our note a month ago (Issue 605) and highlights how you don't need much good news to boost a stock that has been ignored. With 280 employees on its books and customers in global giants Lockheed Martin and Northrop Grumman, the carbon fibre and defence specialist is a good example of a big company trading in a Small Cap.

Make no mistake, Quickstep is high risk, which is a factor we clearly outline. This week we include the stocks that we regard as less risky but with similarly big return potential – they're our **12 Best Stocks To Buy Now**.

Quickstep has had a tough time due to rising costs and its stock rebounding from lows. Quickstep is not alone. The rebound is occurring alongside the climbing US small cap index, the Russell 2000, which is up 15% since the start of the year, which compares to our own S&P/ASX Small Ords return of 6%.

Investors are realising that value exists in the broader market. But it is not a case of a rising tide lifting all boats. Investors jumped into Quickstep because its sales line is growing and its costs are reducing. Though there remains some distance before we are confident of sustainable profitability, Quickstep is moving in the right direction.

We pick stocks on the basis of our belief in growing sales, a line of sight on positive earnings and secure funding on the one hand; and on the other, they have to be good value. We do not look for momentum. In fact, many stocks we choose are down on their luck, sentiment-wise, which means we're not paying much for the future.

Picking stocks has enabled us to produce an average return of 82.6% over the past 12 years on almost 300 different stock recommendations. This return rises to 90.8% if you only include our Best Buys.

The combination of Small Caps and Value delivers such good returns that you can't afford to miss out.

Richard Hemming
Head of Investments

the issue

RESEARCH TIP UPDATES

Resources

ARGOSY MINERALS (AGY)	HOLD
LAKE RESOURCES (LKE)	▼ HOLD
NORTHERN STAR RESOURCES (NST)	BUY

Industrials

NANOSONICS (NAN)	HOLD
PACIFIC CURRENT (PAC)	▼ HOLD
QUICKSTEP (QHL)	HOLD

BEST STOCKS TO BUY NOW

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

> Northern Star Resources (NST) is the largest producer in the Kalgoorlie region and we forecast 20% production growth to 2m ounces a year by 2026. If you're going to invest in gold, this is a good place to start.

UTRR Mining Analyst, Peter Chilton

Published by Under the Radar Report Ltd
655A Darling St, Rozelle, NSW 2039
Telephone 1300 100 343 Email radar@undertheradarreport.com.au

Head of Investments Richard Hemming, Publisher Caroline Mark
ABN: 65147404662. AFSL: 409518.
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ARGOSY MINERALS

SECTOR METALS_MINING **INDUSTRY** LITHIUM

Research Tip Update

What's new?
Argosy's first sales contract for 20k tonnes of battery quality lithium carbonate this week was quickly overshadowed by its decision to mothball its small 2k tonne a year Rincon lithium project in Argentina and concentrate on plans to expand the project to 12k tonnes a year in order to make it more economic. The stock price fell almost a third as a result but from very low levels.

In late May, China-based Amperex Technology Limited (ATL), a world-leading lithium-ion battery producer, made a $5m strategic investment in Argosy through a placement at 14.6 cents, almost 3 times the current share price.

Bull Points
- Producing a saleable product
- Significant resources for expansion

Bear Points
- Lacks scale, behind schedule
- Long lead time for an expansion

Analysis: The expansion is positive but the negative market reaction was due to the increasing time to positive cash flow, not to mention the immediate shock of suspending operations.

Argosy is around 18 months behind where it should be. Although progress is being made, the uncertainty keeps ratcheting up. The company has signed a sales contract, but we don't know how close Rincon is to full production of 2k tonnes a year of lithium carbonate. In mid-2022, the company said it expected to reach steady-state production that year. As sustained, continuous production has only recently been achieved, at a level still below the plant's nameplate capacity, we infer the project is 18 months behind schedule.

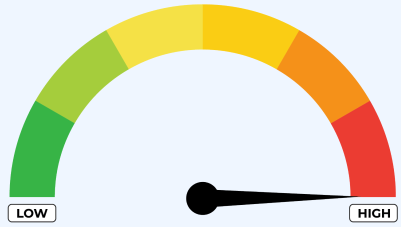
Although Argosy and ATL have discussed strategic cooperation opportunities and synergies, Argosy is continuing its strategic partner process to secure funding for a planned 10k tonnes a year expansion via prepayment (or similar) investment associated with long-term offtake arrangements from a tier 1 counterparty in the EV/battery supply chain.

Portfolio Risk Rating: Took longer than planned to overcome commissioning difficulties and the expansion to 12k tonnes a year needs to be funded; long 4-year lead time.

RADAR RATING: Appeal of expansion potential and leverage to lithium price recovery. Given the size of its landholding, could be an M&A target.

RADAR RATING: **HOLD**

RISK RATING



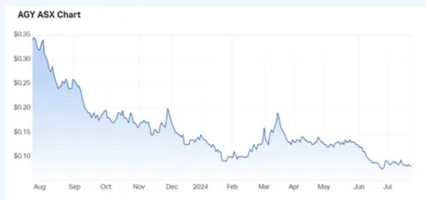
ASX CODE **AGY**

CURRENT PRICE **$0.05**

MARKET CAP $73M

DIVIDEND YIELD 0%*

NET CASH ($M) 9.3M



DATA AS AT INITIAL COVERAGE:

DATE 19 MAY 2022

PRICE ($) 0.40

Published by Under the Radar Report Ltd
655A Darling St, Rozelle, NSW 2039
Telephone 1300 100 343 Email radar@undertheradarreport.com.au

Head of Investments Richard Hemming, Publisher Caroline Mark
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LAKE RESOURCES

SECTOR METALS_MINING **INDUSTRY** LITHIUM

Research Tip Update

What's new?
Shares hit hard following the collapse of lithium prices in late 2022 due to short-term oversupply. However, Lake has continued to actively advance its Kachi project, in Argentina.

Test work for its Direct Lithium Leach (DLE) process has delivered higher recoveries, reducing capital costs. LKE has also cut operating costs and is looking for a partner.

Bull Points
• Globally significant lithium resource
• 25k tonnes a year of lithium carbonate production

Bear Points
• Substantial capex of US$1.38bn
• Production 4 years away

Analysis: Despite the weak share price, the company has achieved a great deal in developing its Kachi lithium project. The ion exchange DLE technology to extract lithium carbonate has many advantages over evaporation ponds, including faster production, higher recoveries and a lower environmental footprint. Technology partner, Lilac Solutions, has improved lithium recovery to over 90% on salar (salt flat) brines, reducing core extraction equipment costs by up to 50% and reagent costs by 10%.

LKE is in detailed discussions to secure equity investment and offtake agreements.

The company is implementing cost initiatives to halve its headcount and expenditure, without impacting progress.

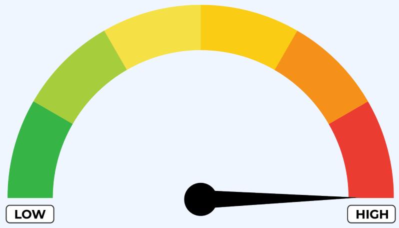
The group is selling non-core assets and lithium tenements at Paso de Jama, Olaroz, Cauchari and Ancasti, located in Jujuy and Catamarca Provinces.

Portfolio Risk Rating: Net cash, with the boost from $16.5m equity raisings at $0.07 a share in March 2024. The strategic partnering process expands available funding options. Costs cut.

RADAR RATING: Globally significant long life (25 years) undeveloped lithium project. Funding route uncertain, adding risk. Lithium recovery and patience are needed.

RADAR RATING: **HOLD**

RISK RATING



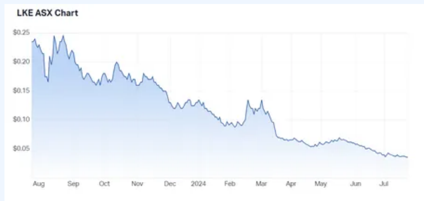
ASX CODE **LKE**

CURRENT PRICE **$0.036**

MARKET CAP $60.1M

DIVIDEND YIELD 0%*

NET CASH ($M) 32.3M



DATA AS AT INITIAL COVERAGE:

DATE 30 JUNE 2021

PRICE ($) 0.335

Published by Under the Radar Report Ltd
655A Darling St, Rozelle, NSW 2039
Telephone 1300 100 343 Email radar@undertheradarreport.com.au

Head of Investments Richard Hemming, Publisher Caroline Mark
ABN: 65147404662. AFSL: 409518.
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ISSUE 610
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NORTHERN STAR RESOURCES

SECTOR METALS_MINING **INDUSTRY** GOLD

Research Tip Update

What's new?
Northern Star has upgraded its resources and reserves. Resources are now 1,064m tonnes at 1.8g/t gold after mining depletion, an increase of 7% or 3.9m ounces to 61.3m ounces. Reserves (those resources that can be developed to produce gold) are up 3.5% at 431m tonnes at 1.5g/t gold, or 0.7m ounces to 20.9m ounces.

Bull Points
• Growing gold production
• Low resource discovery cost of A$31/oz

Bear Points
• Pogo (Alaska) reserve grades lowered

Analysis: This news confirms the success of the company's exploration programme involving $150m expenditure for the 12 months to 30 June. Extra ounces have been added at a low discovery cost of A$31/oz.

Behind the scenes, the exploration effort is more than just adding extra ounces to the resource tally. Exploration is primarily geared to advancing operational, development and discovery projects that are providing long-term growth across the company's three production centres at Kalgoorlie, Yandal (both in WA) and Pogo (Alaska).

At the Kalgoorlie Super Pit, the 3.3m ounces added to resources and 1.0m ounces added to reserves are high margin, being close to existing mine infrastructure, on top of boosting production. The aim is to boost annual production at the pit by over 38% from 650k ounces to 900k ounces in FY29.

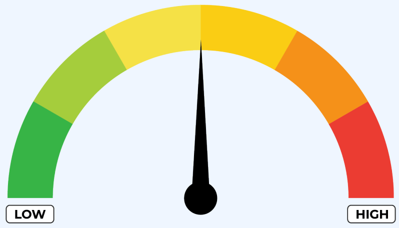
Other exploration highlights include a significant increase in the mineral resource at Red Hill at Kanowna Bell (WA) from 0.7m ounces to 1.9m ounces and a maiden ore reserve of 0.6m ounces. The recent Hercules discovery, 35km from the Fimiston processing plant, has continued to deliver exceptional results including 16m at 18.7g/t gold.

Portfolio Risk Rating: Low. Australia's largest domestically owned gold company. Strong cash flow and earnings from diversified, long-life, low-cost, proven gold projects.

RADAR RATING: Well-managed gold producer with 20% production growth to 2m ounces a year by 2026. The largest gold producer in the globally significant Kalgoorlie region.

RADAR RATING: **BUY**

RISK RATING



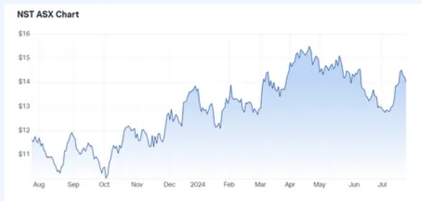
ASX CODE **NST**

CURRENT PRICE **$14.275**

MARKET CAP $16.1BN

DIVIDEND YIELD 2.5%*

NET CASH ($M) 174M



DATA AS AT INITIAL COVERAGE:

DATE 25 JULY 2024

PRICE ($) 0.83

Forecast 35 cents

Published by Under the Radar Report Ltd
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Telephone 1300 100 343 Email radar@undertheradarreport.com.au
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ISSUE 610
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NANOSONICS

SECTOR HEALTHCARE | INDUSTRY EHEALTH MED TECH

Research Tip Update

What's new?
In a trading update this month, full-year sales are now expected to be $170m, up a meagre 2.4% on FY23, but there was a return to growth in the second half with 2H24 sales of $90.4m up 7.1% on the 2H23.

NAN has made a De Novo submission for its potentially disruptive Coris system to the US regulatory authority, the FDA. A new study shows that Coris outperforms manual cleaning in biofilm removal in endoscopes.

Bull Points
- Free cash flow generation
- Coris has potential

Bear Points
- Low growth rate in the installed base
- Sentiment is poor

Analysis: As reported previously the first-half result saw sales down 2.5%, hence a second-half return to growth in volume and revenue was encouraging. There is also the potential for a new income stream from Coris; a submission to the FDA is an important step.

While Trophon unit sales were better 2H on 1H, the sales trend is still challenging with unit sales down 12.7% yoy to 3,850 units and down 9.0% 2H on 2H to 2,130 units. Volumes were down in both sales of new units and replacement units, reflecting capital budget constraints at hospitals, particularly in North America.

The total installed base continues to grow which is arguably the most important metric as it is the source of both consumables/service revenue and future replacement sales. Consumables/service revenue in the half made up 70.8% of revenue so is the major driver of sales along with the number of procedures undertaken by customers. The total installed base now stands at 34,580 units and has grown at 5.3% a year growth over the past three years.

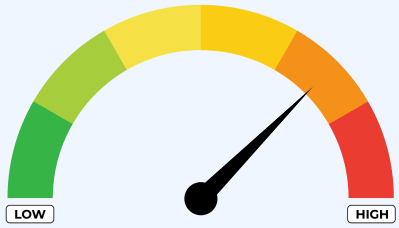
It is the growth in the installed base and the steady growth in consumables revenue that gives investors comfort when holding this stock through recent volatility. As the installed base and consumables income grow, the operating leverage in the company increases leading to expanding EBIT margins over time.

Portfolio Risk Rating: The capital sales environment is currently challenging, the PE looks high and there is no dividend. However, as the installed base grows, we are encouraged with NAN to generate free cash flow, no debt and a considerable cash balance.

RADAR RATING: We are holding on as it goes through a tough sales period and market expectations are reevaluated. The balance sheet is very strong and generates a cash flow positive. Sales growing and Coris has future potential.

RADAR RATING: **HOLD**

RISK RATING



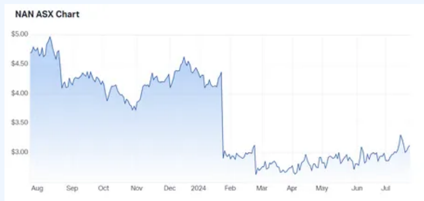
ASX CODE **NAN**

CURRENT PRICE **$3.10**

MARKET CAP $960M

DIVIDEND YIELD 0%*

NET CASH ($M) 118M



DATA AS AT INITIAL COVERAGE:

DATE 27 JULY 2017

PRICE ($) 2.41

under the radar report
SMALL CAPS

ISSUE 610
25 JULY 2024

PACIFIC CURRENT

SECTOR FINANCIALS **INDUSTRY** WEALTH

Research Tip Update

What's new?
PAC intends to return $275m of surplus capital to shareholders via an off-market buy-back, to be voted on by shareholders in September/October.

The transaction to appoint **GQG Partners (GQG)** as external investment manager to PAC was completed. Paul Greenwood resigned as CEO and will join GQG. Acting CEO appointed.

Sold a portion of its stake in Pennybacker Capital for US$35.2m. Agrees to sell its entire stake in Carlisle Management Company to Abacus Life Inc. for US$61.2m.

Bull Points
• Large capital return pending
• Ex-capital return valuation attractive

Bear Points
• FUM shrinking as investment manager stakes sold
• Unclear what the future holds

Analysis: The GQG transaction externalises investment management and sells stakes in Proterra, Cordillera and Avante for US$71m. The recent sale of PAC's stake in GQG Partners raised A$257m. In aggregate, the sales generated A$370m of cash.

Paul Greenwood's move to the GQG makes sense, allowing him to continue doing the work he was doing at PAC. Existing non-exec director Michael Clarke has been appointed acting CEO although there was no detail around whether a search is underway for a permanent appointment.

The proceeds from the Pennybacker sale will be staggered, with US$4.8m on completion and US$15.2m on each of the first and second anniversaries. The Carlisle sale proceeds come in the form of US$49.7m in Abacus bonds and 1.37m shares of Abacus common stock.

Ownership adjusted funds under management (FUM) at 31 March was US$10bn (A$15bn). Adjusted for the sales of the five managers, that figure falls to US$7.8bn, based on the numbers as at 30 June 2024.

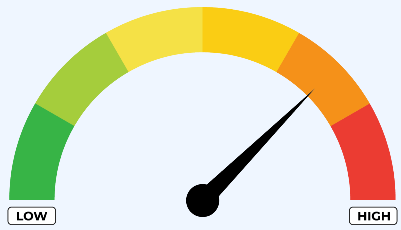
Portfolio Risk Rating: PAC has an ex-capital return market cap of $285m with a residual FUM of A$12bn. That market cap to FUM metric looks very attractive, trading at half the level of other listed fund managers (GQG, RPL, MFG, PTM).

The strategy to close the valuation gap between the holdings and the share price has seen a large quantity of effective FUM sold. PAC still owns stakes in six fund managers.

RADAR RATING: There appears to be more value remaining in the residual fund managers. Holding on for potential for further sales at a premium.

RADAR RATING: **HOLD**

RISK RATING



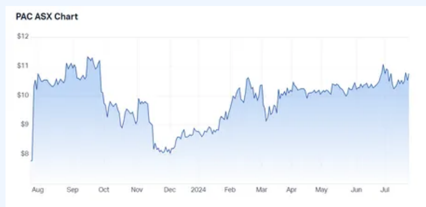
ASX CODE **PAC**

CURRENT PRICE **$10.635**

MARKET CAP $561M

DIVIDEND YIELD 3.1%*

NET CASH ($M) 63.3



DATA AS AT INITIAL COVERAGE:

DATE 27 APRIL 2016

PRICE ($) 4.40

**Forecast 34 cents*

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655A Darling St, Rozelle, NSW 2039
Telephone 1300 100 343 Email radar@undertheradarreport.com.au
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SMALL CAPS

ISSUE 610
25 JULY 2024

QUICKSTEP

SECTOR MATERIALS | INDUSTRY MANUFACTURING

Research Tip Updates

What's new?
QHL rose 24% on Tuesday and is almost double on our note just over a month ago (Issue 605) on news FY24 sales will be $99m, ahead of the $94-$96m previously guided. There was little guidance on earnings except that operating earnings (EBITDA) will be positive. The restructure of the work-shift pattern has reduced headcount by a fifth.

There was also an update on the contract terms with Lockheed Martin for the C-130 Hercules program to cover volumes, pricing, and input costs. Discussions have commenced in the next contract period from 2030.

Final purchase orders for the next round of the F-35 Joint Strike Fighter program are expected from Northrop Grumman later this month for FY25&26.

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, and this announcement shows that it is delivering meaningful sales compared to its, cost base, which includes employing 280 people in Australia and offshore.

This is an important vote of confidence by the defence heavyweights mentioned above for the Bankstown-based manufacturer.

The current contracts ensure QHL should be cash flow positive but more are needed to ensure that the group is profitable at the bottom line.

The company's restructuring reduces the cost base but just as importantly gives QHL more focus, combining the carbon fibre business in the US with its other activities in the region as a single entity.

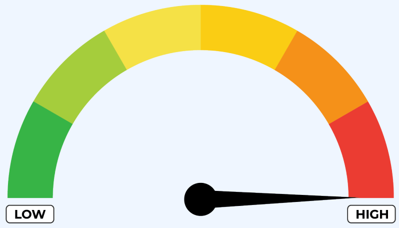
The drone business gives QHL real potential on the sales line, being a genuine growth area utilising QHL's military connections.

Portfolio Risk Rating: High. Positives include 3-5 year Aerostructures contracts reaffirmed, and it's a big positive that contracts are forecast at over $100m. Operating earnings are marginally positive but there is debt.

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

RADAR RATING: **HOLD**

RISK RATING



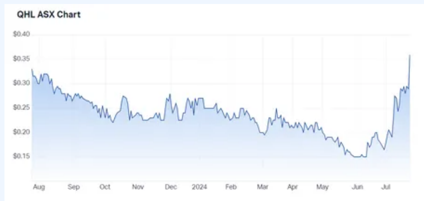
ASX CODE **QHL**

CURRENT PRICE **$0.345**

MARKET CAP $25M

DIVIDEND YIELD 0%*

NET DEBT ($M) -7.2M



DATA AS AT INITIAL COVERAGE:

DATE 09 FEBRUARY 2016

PRICE ($) 1.40

Published by Under the Radar Report Ltd
655A Darling St, Rozelle, NSW 2039
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BUY WHEN THE PRICE IS RIGHT

The stocks on this list are quality companies that we believe offer great return potential for the risk faced.

ACROW FORMWORK (ACF) — BUY

INDUSTRY	CONTRACTOR	Expanding and diversifying into new sectors, providing growth and reducing risk. The engineering team provides an edge.
MARKET CAP	$335M	
DIVIDEND YIELD	4.8%	
12 MONTH HIGH	$1.35	
PRICE @ 2024-07-24	$1.14	

ALLIANCE AVIATION (AQZ) — BUY

INDUSTRY	CONTRACT AVIATION SERVICES	Expanding the aircraft fleet will deliver growth. Revenue diversified through contracted FIFO, contracted wet lease, charters and aviation services.
MARKET CAP	$484M	
DIVIDEND YIELD		
12 MONTH HIGH	$3.54	
PRICE @ 2024-07-24	$3.11	

COUNT (CUP) — SPEC BUY

INDUSTRY	WEALTH	We still remain positive on CUP, and suggest subscribers continue to accumulate small positions opportunistically for yield and now potentially a higher growth rate. The major acquisition of Diverger creates new opportunities for synergies and revenue growth.
MARKET CAP	$106M	
DIVIDEND YIELD	6.1%	
12 MONTH HIGH	$0.73	
PRICE @ 2024-07-24	$0.61	

EMBARK EARLY EDUCATION (EVO) — BUY

INDUSTRY	RETAIL	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.
MARKET CAP	$114M	
DIVIDEND YIELD	5.5%	
12 MONTH HIGH	$0.78	
PRICE @ 2024-07-24	$0.72	

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BUY WHEN THE PRICE IS RIGHT

HANSEN TECHNOLOGIES (HSN) — BUY

INDUSTRY	SOFTWARE
MARKET CAP	$900M
DIVIDEND YIELD	2.5%
12 MONTH HIGH	$6.06
PRICE @ 2024-07-24	$4.43

A recent acquisition and organic product development suggest 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.

KAROON ENERGY (KAR) — SPEC BUY

INDUSTRY	OIL AND GAS
MARKET CAP	$1432M
DIVIDEND YIELD	
12 MONTH HIGH	$2.00
PRICE @ 2024-07-24	$1.79

Oil price leverage has increased with production growth of over 20%.

LASERBOND (LBL) — SPEC BUY

INDUSTRY	MANUFACTURING
MARKET CAP	$82M
DIVIDEND YIELD	2.6%
12 MONTH HIGH	$0.92
PRICE @ 2024-07-24	$0.71

Business development focus with increased capacity and capabilities being added. Global opportunities. Technologies enable better cost outcomes for its clients.

LYNAS RARE EARTHS (LYC) — BUY

INDUSTRY	RARE EARTHS
MARKET CAP	$5501M
DIVIDEND YIELD	
12 MONTH HIGH	$7.58
PRICE @ 2024-07-24	$6.01

Large-scale, existing rare earths producer that is positioning itself to invest in the US and supply the US market. Well placed for rare earth price recovery.

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BUY WHEN THE PRICE IS RIGHT

MACH7 TECHNOLOGIES (M7T) — SPEC BUY

INDUSTRY	**EHEALTH MED TECH**
MARKET CAP	**$140M**
DIVIDEND YIELD	
12 MONTH HIGH	**$0.99**
PRICE @ 2024-07-24	**$0.58**

Mach7 is growing in maturity as it embraces the subscription business model, delaying the benefits of operating leverage, but increasing them over time. The stock is growing off a very small base and it's easy to generate a cashflow based valuation of over $1.30.

NZME (NZM) — BUY

INDUSTRY	**MEDIA**
MARKET CAP	**$152M**
DIVIDEND YIELD	**7.6%**
12 MONTH HIGH	**$1.04**
PRICE @ 2024-07-24	**$0.97**

Cash flow multiple (EV/EBITDA) of 3 times is still very cheap, on stable earnings due to leading advertising market share.

SILK LOGISTICS (SLH) — SPEC BUY

INDUSTRY	
MARKET CAP	**$106M**
DIVIDEND YIELD	**2.17%**
12 MONTH HIGH	**$2.47**
PRICE @ 2024-07-24	**$1.30**

Direct exposure to the critical import sectors of the economy. While the Silk's businesses can be low margin, the majority of revenue is under contract. SLH has the scale and scope to maintain pricing power.

XRF SCIENTIFIC (XRF) — BUY

INDUSTRY	**CONTRACTOR**
MARKET CAP	**$212M**
DIVIDEND YIELD	**2.3%**
12 MONTH HIGH	**$1.57**
PRICE @ 2024-07-24	**$1.54**

The 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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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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Editor Richard Hemming, Publisher Caroline Mark
ABN: 65147404662. AFSL: 409518.
Website www.undertheradarreport.com.au