under the radar report
SMALL CAPS

ISSUE 611
01 AUGUST 2024

OUTLOOK IS THE KEY

We cover eight stocks in depth, another eight in our subscriber picks and 12 Best Buys (see online) as we ramp up to one of the most important reporting seasons we've had for some time, which for most companies is their performance for the six months to 30 June. Why is that? Because expectations for stocks are all over the place. Picking winners and recognising losers has never been more important.

Overall, expectations are quite low, with median expectations for earnings per share to be slightly lower than last year, which was boosted by the end of Covid-related lockdowns. In an economy where growth is extremely hard to come by, every company's outlook is the key.

You invest in select small caps partly because they are not hostage to the wider economy. They have a small capital base from which to grow. On our estimates, Small Cap industrials trade at a 20-30% discount to their bigger counterparts; off the bat you get more bang for your buck. This only occurs if they're walking the walk, which is what reporting season is about.

Silk Logistics (SLH) is Australia's third biggest logistics company and, hence is heavily tied to the domestic economy. Yet growth is heavily based, not on the economy, but on the scale Silk has achieved from three acquisitions, giving it the ability to command prices previously unavailable. Progress is never linear, but this result will indicate whether the founder-led management is delivering.

The contractor **SRG Global (SRG)** has returned 30% in the past 12 months and 22% a year over the past three. One reason has been consistent profitability and the recent upgrade in earnings augurs well for its full-year result. But as I keep saying, it's about the price you pay. We still think that SRG is good value, which is why we're replacing **Lynas Rare Earths (LYC)** in our Best Buys with SRG.

Speaking of Lynas, we are releasing a Special Report on Commodities Analysis on Friday, which includes stock-specific advice.

We are here to ensure that you make the stock decisions to ensure your portfolio grows over time, no matter what the economic conditions.

Richard Hemming
Head of Investments

the issue

RESEARCH TIP UPDATES

ARAFURA RARE EARTHS (ARU)	HOLD
HANSEN TECHNOLOGIES (HSN)	BUY
LYNAS RARE EARTHS (LYC)	▼ SPEC BUY
MEDADVISOR (MDR)	HOLD
MEDICAL DEVELOPMENTS (MVP)	SPEC BUY
SILK LOGISTICS (SLH)	BUY
SOLVAR (SVR)	▲ SPEC BUY
SRG GLOBAL (SRG)	BUY

SUBSCRIBER PICKS

These are the stocks subscribers ask us about. We run our investment ruler over them and give you our Radar Diagnosis.

BEST STOCKS TO BUY NOW

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

> **Work in hand exceeds $2bn, while SRG's opportunity pipeline is impressive at $6.5bn… with exposure to mining, government spending, energy transition and infrastructure, which includes hospitals.**
>
> **Under the Radar Report**

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ARAFURA RARE EARTHS

SECTOR METALS_MINING **INDUSTRY** RARE EARTHS

Research Tip Update

What's New?
This month Arafura succeeded in debt & equity funding its Northern Territory-based Nolans rare earths mine. US$775m (A$1,192m) in debt was secured from export credit agencies & commercial lenders. ARU is raising $27m in equity at 16 cents a share ($20m placement and $7m retail SPP).

Bull Points
· Major debt funding milestone
· Acute rare earths supply gap

Bear Points
· Production is almost four years away
· Electric vehicle rollout has slowed

Analysis: This is a world-class project, with a price tag to match. Expected project capital US$1.2bn. The equity raising was small but significant. The final Investment Decision is expected in the next few months, which we suspect will be towards the end of the year, on top of which will occur a major equity raise of US$793m. Following this will be a 37-month construction period.

Total debt now totals more than US$1 billion, including facilities that are designed to ensure a long life through to first production and ramp up to 4,440 tonnes of NdPr oxide a year.

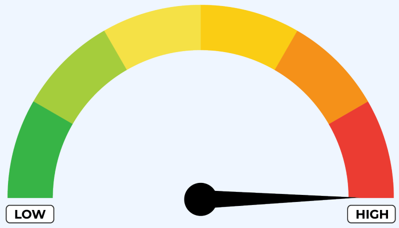
A major impetus for the project is government support for critical commodities, which is in line with ambitions to become self-sufficient (not reliant on China). In May the US Government imposed import tariffs on Chinese products including rare earths and tariffs on permanent magnets (from 2026). This supports the diversification of supply chains for auto and wind equipment makers.

Portfolio Risk Rating: Risk has reduced with the debt funding milestones in conjunction with the offtake support from customers and Nolans' fully permitted, shovel-ready status. A long way to go, but big potential.

RADAR RATING: To bring on a significant, non-China source of rare earths to a market looking increasingly for supply independence from China. Re-rating upside.

RADAR RATING: **HOLD**

RISK RATING



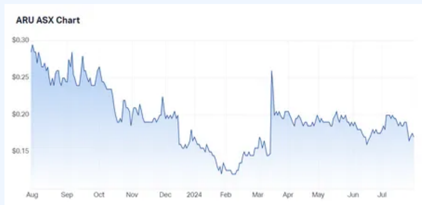
ASX CODE **ARU**

CURRENT PRICE **$0.17**

MARKET CAP $393M

DIVIDEND YIELD 0%*

NET CASH ($M) 69M



DATA AS AT INITIAL COVERAGE:

DATE 15 JUNE 2023

PRICE ($) 0.335

*After capital raising

under the radar report
SMALL CAPS

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HANSEN TECHNOLOGIES

SECTOR INFORMATION TECH

Research Tip Updates

What's New?
Andrew Hansen will return to the CEO role replacing Graeme Taylor.
Restructured into two verticals: Energy & Utilities and Communications & Media to support scale and growth.
7-year renewal contract with SSE, a leading supplier of electricity and gas in the UK and Ireland.

Bull Points
· Blue chip customers
· Long-term contracts

Bear Points
· Competition increasing
· Powercloud integration risks

Analysis: Andrew Hansen handed over the CEO duties to Taylor in June 2023 so that Hansen could focus on strategic growth initiatives. Close to 12 months later he's stepping back into the top management role in the company his family founded. We view this as positive because of Hansen's experience in utility billing software, which is important in a complex industry with multiple sources of generations and changing consumption.

Long-term clients like SSE will be comforted; which as it happens, upgraded its contract with additional revenue of $2.8m. The catalyst was Hansen's Customer Information System, which supports smart metering and quoting for EVs, solar, battery and heat pumps.

HSN invests ($21m in FY23) to ensure its product & service remains relevant. There has been ongoing takeover activity in the sector with more deals this week. These include Octopus Energy's (part owned by **Origin Energy (ORG)**) Kraken acquiring Australian billing reconciliation software provider Energetiq.

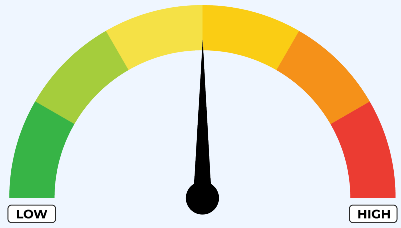
HSN has a strong balance sheet (net cash), generates good cash flows, and blue chip customers, invests heavily and operates in a sector undergoing transformation, which relies heavily on software billing systems. Operating earnings (EBIT) have grown 10% a year over the past five years and similar rates of growth are expected over the next few years.

Portfolio Risk Rating: Trades on a high single-digit cash flow multiple (EV/EBITDA) which is reasonable. Potential growth from Powercloud. Integration risks could be significant.

RADAR RATING: A recent acquisition, organic product development and contract renewals are very positive. Revenue growth remains consistent, which investors could value higher in future.

RADAR RATING: **BUY**

RISK RATING



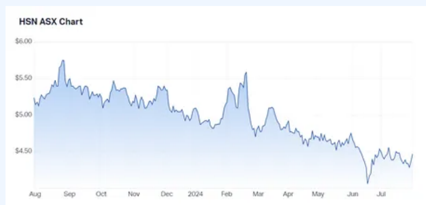
ASX CODE **HSN**

CURRENT PRICE **$4.51**

MARKET CAP $909M

DIVIDEND YIELD 2.2%*

NET CASH ($M) 8M



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PRICE ($) 3.01

**Forecast 10 cents*

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LYNAS RARE EARTHS

SECTOR METALS_MINING **INDUSTRY** RARE EARTHS

Research Tip Update

Downgrade from Buy

What's New?
In late June the rare earths miner said it's commencing production of heavy rare earths (HRE) separated dysprosium (Dy) and Terbium (Tb). A circuit reconfiguration will produce these products for the first time, breaking the Chinese monopoly; a first step in an expanded suite of HRE products, processed at the company's Mt Weld (WA) orebody and giving Lynas first mover advantage outside of China.

Dy and Tb are important inputs to high-performance magnets used in electric vehicles and electronic devices.

Bull Points
· Expanding non-China rare earths producer
· Government actions have been supportive

Bear Points
· China dominance may slow rare earths price recovery
· Some growth initiatives are still at an early stage

Analysis: Heavy rare earths, defined by their higher atomic weights, are less common than light rare earths and in shorter supply. They are a valuable addition to Lynas' portfolio.

Mt Weld contains a broad range of rare earth types, the main ones being neodymium and praseodymium (NdPr), both light rare earths (LRE). HRE is mined but currently sold as a lower-value SEGH mixed compound.

Dy and Tb production will involve the reconfiguration of solvent extraction circuits at its Kuanton plant in Malaysia, providing the capacity to separate up to 1,500 tonnes of SEGH a year. The first production is expected in mid-CY25. The configuration allows LYC to process its ionic clay deposits in Australia & Malaysia.

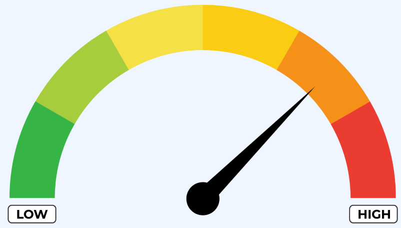
LYC is progressing pre-construction activities for its US rare earths processing facility. Both the US and Malaysian plants will accept third-party feed.

Portfolio Risk Rating: High net cash and profitable, despite low rare earth prices. Operations proved technically, reducing growth risk. Governments are supportive of non-China supply.

Radar Rating: A leading non-China producer with leverage to rare earths price recovery. Growth through expansions, overseas projects and increased product range.

RADAR RATING: **SPEC BUY**

RISK RATING



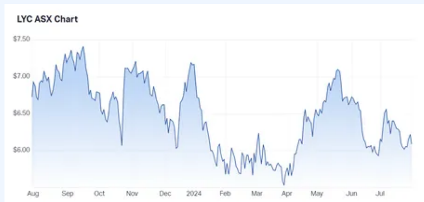
ASX CODE **LYC**

CURRENT PRICE **$6.28**

MARKET CAP $5.69BN

DIVIDEND YIELD 0%*

NET CASH ($M) 513.5M



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MEDADVISOR

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Update

What's New?
After announcing a vendor's stock was being released from escrow (5% of shares on issue) MDR's stock has taken off after a strong fourth quarter report (to 30 June) where revenues increased 32%; US was up 34%; ANZ was up 27%. FY24 revenue up 24.6% to $122m, in line with guidance.

Gross margin was just under 61%, in line with last year, which implies a recovery in the second half. Cash on hand was $15.6m, more than double the last reported. The company is profitable at operating earnings (EBITDA) and at the bottom line (NPAT) in FY24. The AI initiative THRiV (US) was almost half of the fourth quarter revenue (versus 3% in 4q23).

Bull Points
· Upgrading earnings
· Growth in the US & Australia

Bear Points
· Regulatory risks
· Management of rapid US growth

Analysis: The big excitement is the US AI initiative THRiV platform, which delivers higher profit margins and returns.

In the ANZ, transaction fees for vaccination programs have been implemented from March, which assisted revenue growth, on top of which were additional health programs with pharma.

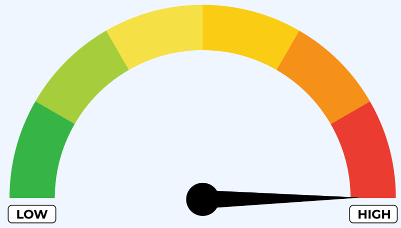
There have been two lots of escrow for the one party (a vendor into MDR) – 12 months ago and last week; 5% of shares on the issue each time. They haven't sold so far and they couldn't sell much on the market if they wanted to; it would have to be placed with a broker. This wouldn't normally be a bad thing because it would be placed to institutions, which are generally long-term holders & it increases the free float. It's only a negative if they're selling because the business is deteriorating, which isn't the case.

Portfolio Risk Rating: MDR has strong momentum across its key markets, and a valuation of less than 2 times sales, is not unreasonable for a software business. The US business is currently more of a specialised marketing platform than the stickier and more embedded Australian business linking pharmacies to patients to prescriptions. A substantial investment is planned to unify the platforms. Momentum is there and our valuation has moved higher.

Radar Rating: A quick winner for subscribers since we recommended it in February. Too soon to take profits, and a long-term growth story may be emerging. But there are a lot of shares outstanding, so some consolidation would be expected after a sharp run.

RADAR RATING: **HOLD**

RISK RATING



ASX CODE **MDR**

CURRENT PRICE **$0.53**

MARKET CAP $291M

DIVIDEND YIELD 0%*

NET CASH ($M) 15.6M

DATA AS AT INITIAL COVERAGE:

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MEDICAL DEVELOPMENTS

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Update

What's New?
The green whistle analgesic (brand name Penthrox) manufacturer and distributor is raising $10m in equity capital, underwritten by Bell Potter. $5.55m has been raised from institutions, while $4.5m is being raised from a combination of retail and institutions in a non-renounceable entitlement (1 for 7.35) at 38 cents a share.

The retail offer will open on 2 August (Friday) and close on Thursday 22 August. You will be notified of eligibility via email or letter, along with an acceptance form.

The raising is targeted for growth expenditure and follows the sell-off after MVP's third-quarter numbers came out in late June.

Bull Points
- Global Potential
- Growing revenue

Bear Points
- Burning cash
- Capital requirements

Analysis: Medical Developments has disappointed, but our thesis of new management and a product with global potential hasn't changed. Moreover, a raise that is fully underwritten means it is a reasonable deal.

The raising occurred after investors took fright in late June when the third quarter showed a cash outflow of $5.2m versus cash on hand of $10.7m. If you excluded one-offs of working capital increase ($2.5m); clinical trial expenditure ($1.1m) and restructure expense ($0.5m) the company spent $1.1m during the period.

The reason you buy MVP is sales potential and the company forecast cashflow breakeven by the end of FY25, which this raising should secure, without too much dilution (shares on issue increase about 14%).

Management's forecast assumes Penthrox sales grow about 20% in FY25 on a reduced cost base; although revenues are volatile.

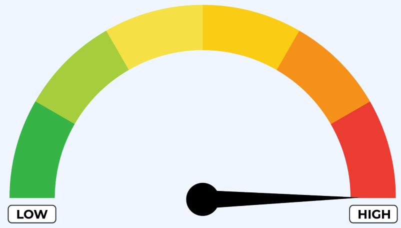
The problem for MVP has been distribution; which new international partners are expected to improve alongside direct domestic distribution.

Portfolio Risk Rating: The company is cashed up and the share price has fallen quickly. If you are in it, it is sensible to buy more in our view. This is what institutions are doing, which includes Fidelity (8.4%).

Radar Rating: The valuation is less than 1 times revenues is good for a medical devices company if ongoing losses are staunched.

RADAR RATING: **SPEC BUY**

RISK RATING



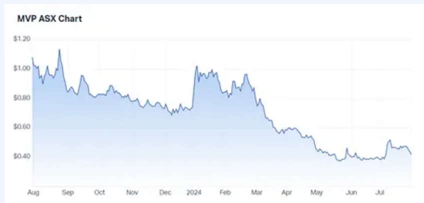
ASX CODE **MVP**

CURRENT PRICE **$0.42**

MARKET CAP $36M

DIVIDEND YIELD 0%*

NET CASH ($M) 12M



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SILK LOGISTICS

SECTOR INDUSTRIAL **INDUSTRY** CONTRACTOR

Research Tip Update

What's New?
The logistics provider's shares have rebounded 20% in the past four weeks. With its full-year results to come later this month, we go through what we'll be looking for.

Bull Points
· Acquisitions will support top-line growth
· Cashflow positive

Bear Points
· FY24 low growth
· Highly cyclical business

Analysis: Silk is about to announce its full-year results, where the key will be the performance of acquisitions – they've built up a formidable logistics business and we want to see the benefits of scale – or size – which means top-line growth magnified at the bottom line.

This isn't forecast to happen yet, hence the outlook is the key. Operating earnings (EBIT) are forecast to increase by 7% at $36m on sales growth of 16% at $550m. We want to get a sense that this will go the other way.

A key is the port logistics division because of the Secon acquisition (Victoria Ports), whose bulk equipment operations only came online in recent months and are ramping up. This business won't hit its straps until well into the current year (FY25) with the quantum of investment the key to understanding the upcoming result.

Warehouse occupancy was 73% last half; want to see an improvement and that it can rebound back to its historic average of over 80%.

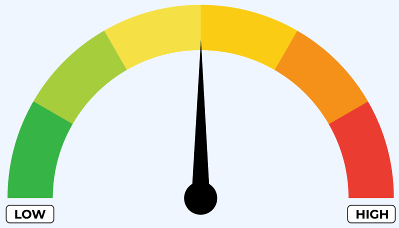
We forecast a full-year dividend of 5 cents (interim 2.8c), implying 2.2 cents, which is achievable.

Portfolio Risk Rating: While this is a cyclical stock, it is also in a growth phase, which we argue reduces cyclicality. The balance sheet is strong, it's paying dividends and trades on a low double-digit PE.

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

RADAR RATING: **BUY**

RISK RATING



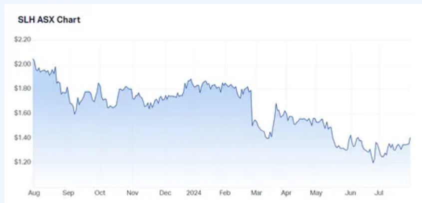
ASX CODE **SLH**

CURRENT PRICE **$1.43**

MARKET CAP $115M

DIVIDEND YIELD 3.5%*

NET DEBT ($M) -34.8M



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PRICE ($) 1.74

**Forecast 5 cents*

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SOLVAR

SECTOR FINANCIALS **INDUSTRY** LENDERS

Research Tip Update

What's New?
$15m on-market share buy-back to be conducted over 12 months; 7% of shares on issue.

Revised profit guidance up slightly for FY24, from $27.5m (midpoint) to $28.5m. Declaring a 5-cent fully franked final dividend.

Strategic update: creating a commercial lending business to add to its existing automotive finance. Will cease new lending into NZ from August 2024.

Bull Points
· Underlying profitability
· Dividend Yield

Bear Points
· Regulatory threats
· Interest rate increases

Analysis: Management has proven over time it can grow the automotive business, but commercial lending is much less specialised and consequently more competitive, with the big banks also fighting over market share. The commercial lending business will be expanded by breaking it out into a dedicated business unit. Existing commercial lending through Automotive Financial Services represents 28% of the total loan book and targets industry segments.

Go Car Finance in NZ has been a positive contributor but moved to a loss in the first half (1H24) due to the challenging macro conditions and higher funding costs. These two factors have created an uncertain outlook. The capital will be better deployed into Australian growth opportunities, particularly given the relatively high funding costs in NZ. $9.2m of goodwill and intangibles associated with the NZ business will be written off.

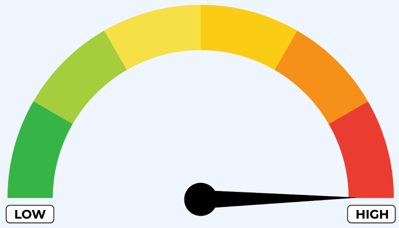
The NZ business has $139m of loans and uses $73m of drawn funding so that leaves $66m of capital to be released and redeployed into Australia which will happen gradually as loans roll-off.

Portfolio Risk Rating: The stock trades on a PE of 8x, a forecast yield of 9% and a 40% discount to book value; investors are already pricing in some substantial loan losses, providing some protection. This remains a high-risk holding.

RADAR RATING: Bad debts have not peaked, but the loan book pays a high interest rate to mitigate the risks. Redeployment of capital into Australia should improve average returns over the next 2-3 years. Keep positions small in case bad debts deteriorate significantly and in case of adverse findings by AU and NZ regulators.

RADAR RATING: **SPEC BUY**

RISK RATING



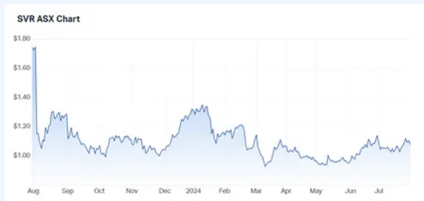
ASX CODE **SVR**

CURRENT PRICE **$1.11**

MARKET CAP $227M

DIVIDEND YIELD 9.7%*

NET CASH ($M) NET ASSETS: $374M



DATA AS AT INITIAL COVERAGE:

DATE 04 MAY 2017

PRICE ($) 1.44

**Forecast 10.5 cents*

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SRG GLOBAL

SECTOR INDUSTRIAL | **INDUSTRY** CONTRACTOR

Research Tip Update

What's New?
The contractor has been one of our outstanding performers, returning 30% in the past 12 months and 22% a year over the past 3. One of the reasons has been consistent increases in profits and last week SRG upgraded FY24 guidance for operating earnings (EBITDA) to close to $100m, underpinned by new contracts.

Also encouraging was news that cash conversion (accounting earnings (EBITDA) producing operating cashflow) was 115%; and that recurring earnings are now 70% of the total.

Bull Points
· Improving earnings quality
· Contract diversification reduces 'lumpiness'

Bear Points
· Return on capital still needs to improve
· Still a low-margin business overall

Analysis: Reasons for success include diversity by sector and geography. SRG is a specialist in numerous areas, increasing the likelihood of repeat business.

This month SRG announced contracts valued at $225m with existing clients in the Health, Building and Resources sectors. New wins in the final quarter (4q24) were $500m, boosting earnings in future years.

Work in hand exceeds $2bn, while SRG's opportunity pipeline is impressive at $6.5bn. The company has exposure to broader macro-economic growth drivers such as energy transition and infrastructure, which includes hospitals.

SRG is well funded for further growth; guidance for FY25 is for operating earnings (EBITDA) growth of 10%.

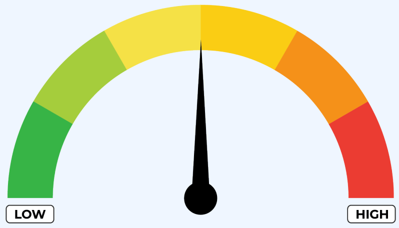
Portfolio Risk Rating: Still good value, trading on a prospective rolling PE of around 13 and a cash flow multiple (EV/EBITDA) of 6 times, which is at the low end.

We like the stock; and would buy more if already owned due to its growth prospects.

RADAR RATING: Continuing to deliver new contract wins and earnings upgrades. Margins and return on capital raising. High level of recurring earnings with Tier 1 clients.

RADAR RATING: **BUY**

RISK RATING



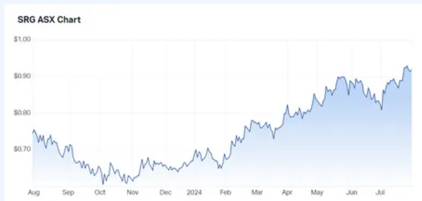
ASX CODE **SRG**

CURRENT PRICE **$0.92**

MARKET CAP $479.6M

DIVIDEND YIELD 4.9%*

NET CASH ($M) 17.8



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PRICE ($) 0.52

Forecast 4.5 cents

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Subscriber Picks

These are the stocks subscribers ask us about. We run our investment ruler over them and give you our Radar Diagnosis.

COMPANY	ASX CODE	DESCRIPTION	MARKET CAP ($M)	NET CASH / DEBT($M)	ENTERPRISE VALUE ($M)	LATEST PRICE ($)*	12-MNTH HIGH ($)	NOTES	RADAR DIAGNOSIS
AMERO INTL	3DA	3D printing	208.7	26	182.7	0.39	0.5	Produces titanium and niobium alloys for 3d printing in aerospace. Aiming to become the largest US domestic producer of Niobium C103; commissioning an atomiser in the US. Offtake agreement subject meeting required standard. Raised $20m at 33 cents; expects to be EBITDA breakeven in CY25.	Addressable market still a work in progress. Hurdles before profitable. WATCHLIST.
ARCADIUM LITHIUM	LTM	Lithium producer	1774.2	-110.6	1884.8	4.79	11.57	The merger between Allkem (Australian) and Livent (US) is one of the world's largest producers; combining hard rock with brines. The group has high technology to produce different products for batteries and otherwise.	If you are looking for a relatively safe exposure to lithium, this stock or Pilbara Minerals (PLS) is your best bet. HOLD.
CLARITY PHARMACEUTICAL	CU6	Biotechnology - radiopharmaceutical	1903.9	152	1751.9	6.11	6.57	Sentiment high on radiation therapy stocks; similar to Telix Pharma (TLX.ASX) which rose on early clinical trials. Encouraging data plus there is diagnostic application. Cashed up; has raised $121m at $2.55	A great deal of anticipation in an exciting sector, but also cashed up. WATCHLIST.
DE GREY MINING	DEG	Gold developer	2844.9	867.2	1977.7	1.19	1.45	Pilbara based, WA, gold developer. Large gold resource and large production scale for the future. Production intended in around 2 years. Still needs to raise further funds and there are processing complications.	May underperform until production gets closer. Has metallurgical issues. HOLD.
FRONTIER DIGITAL VENTURES	FDV	Online classifieds marketplace	190.6	14.5	176.1	0.43	0.63	Online classifieds for property and automobiles in parts of Latin America, Africa and Asia. Has been steadily growing revenue over a number of years and delivered its first profit in 2H23. Using its market leading positions to push into ancillary services. Forecast to be profitable next year but low margin for a digital business although more scale will help.	A long way from being REA or CAR. HOLD.
IMRICOR MEDICAL SYSTEMS.	IMR	Medical technology - cardiac treatment	117.7	30.7	87	0.58	0.83	Commercialisation taking time, but information flow has been increasing for this specialist in imaging (MRI) & ablation procedures (treating rhythmic problems) for the heart. Raised $35m equity this month at 52 cents, although heavily dilutive, boosting shares on issue by 40%.	Not yet commercialised but cash buys it valuable time. Very high risk. HOLD.

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SYRAH RESOURCES	**SYR**	Graphite producer	263.9	**-194.5**	458.4	0.26	0.93	The biggest graphite producer listed on the ASX, with operations in Africa and a downstream procesing plant in the US. Graphite is a widespread commodity, but the quality is very important for batteries.	Graphite demand relatively weak; plus there is potential new supply. AVOID.
YANCOAL AUSTRALIA	**YAL**	Thermal coal producer	9150.4	**1404**	7746.4	6.93	7.52	Major thermal coal producer in the Hunter Valley, NSW. Low growth but low capital requirements and strong cash flow, when coal prices are strong. Chinese interests are heavy on the register.	Stock availability an issue, but only for fund managers. Remains value. HOLD.

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