under the radar report
SMALL CAPS

ISSUE 612
08 AUGUST 2024

FUNDAMENTALS REIGN SUPREME

Amid all the big moves on the market, which included elements of panic, two results stood out this week: those of contracting group Caterpillar Inc (CAT.NYSE) and Uber Technologies (UBER.NYSE). Both rallied yesterday, UBER by 11%, on strong financial results. The takeout is that fundamentals matter.

This is the key to long-term investing and looking through the whirlwind of panic and greed has never been more important. What you want to own are stocks that have a line of sight on earnings growth; don't need to raise capital and are great value. You can find these at all ends of the market, but there is no doubt that by sheer weight of numbers, you will find more of them at the small end. The key is hunting (hard!), which is what we are here to do.

I was talking to senior managers at a small cap we're releasing research on next week because the company has a great deal going for it: growing revenue, it's profitable and doesn't need cash. Plus, it's cheap, which brings me to my next point. They complained that no one was noticing. My response: you keep hitting your numbers as you're doing and investors won't have a choice.

All the spin in the world doesn't compare to growing profits. The recent sell-offs have been a combination of fear of recession, offshore capital moving out of Japan and an appreciation that the AI hype from corporates needs to be backed up with growing profit margins. We are also seeing investors getting out of stocks that have been aggressively bid. There has been widespread selling but when the dust settles, investors will hunt for value, which is highlighted by the buying I mentioned above in UBER & CAT.

By hunting for value you insulate your wealth against market mayhem. In this report we include an analysis on one of our Best Buys, **Mach7 Technologies (M7T)** which shows that the company is making big progress; we also include analysis on **Karoon Energy (KAR)** in the oil sector which I think is much better value than **Woodside Energy (WDS)**. **Reckon (RKN)** is also worth checking out for those looking for a profitable company with growth potential, pays dividends and trades on a single-digit PE.

Because we focus on not paying much for quality you can be sure to find stocks Under the Radar, which can deliver big returns for your portfolio.

Richard Hemming
Head of Investments

the issue

OIL ANALYSIS: GO SMALL IN OIL!

In contrast to most other commodities, the demand growth trajectory for oil is slowing. According to the International Energy Agency, oil demand growth is expected to plateau towards the end of the current decade to 2030. The key is supply.

KAROON ENERGY (KAR)	SPEC BUY

RESEARCH TIP UPDATES

BEAMTREE HOLDINGS (BMT)	HOLD
CLOVER CORP (CLV)	HOLD
MACH7 TECHNOLOGIES (M7T)	SPEC BUY
RECKON (RKN)	SPEC BUY
STRIKE ENERGY (STX)	HOLD

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.

> **Right now the best indicator of the future oil price is the current price, which favours smaller producers like Karoon Energy (KAR) because they have fewer constraints and more flexibility.**

UTRR Mining Analyst, Peter Chilton

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OIL ANALYSIS: GO SMALL IN OIL!

We do not see demand increasing over time. The key to the oil price is supply, which will be dictated by economics. The best indicator of the future is the current price, which favours smaller producers like Karoon Energy (KAR) because they have less constraints and more flexibility.

OIL POISED IN YEAR OF ELECTION

5-year USD oil price chart in US (West Texas Crude)

This year's US election will have a big bearing on sentiment for the oil price. If Donald Trump wins there is a high likelihood of increased supply, which could be a negative for the price. The US has the equivalent of about 20 Woodsides. There is great capacity. The other X-factor is the Middle East. Then there is the Russia/Ukraine war and OPEC. Oil price predictions are near impossible. The current price is the best indication of the future.

SOURCE: Trading Economics

OIL ANALYSIS Cont.

Slowing demand trajectory

In contrast to most other commodities, the demand growth trajectory for oil is slowing. According to the International Energy Agency, oil demand growth is expected to plateau towards the end of the current decade to 2030.

Energy transition creates alternatives

Slowing growth is becoming more pronounced as the energy transition gathers pace, with the increased use of EVs, Hybrids, emerging clean energy technologies and efficiency policies.

Expanding North American oil supply

This increase in supply will depress the oil price, all things being equal. In recent years there has been a strong revival in oil & gas production in North America, while there has also been a shortfall in crude and oil products in Asia, creating new trade routes in the global oil market.

Geopolitical impacts are additional considerations

Offsetting this, however, are constraints on supply due to war. This includes wide-ranging sanctions on Russia and attacks on tankers transiting the critical Red Sea shipping corridor, all further factors impacting oil flows and supply security.

Recent oil prices in a lower trading price range

The oil price does not look like reaching its 2022 high of US$120 a barrel anytime soon. Over the last 12 months, prices have been fairly volatile, forming a wedge with declining highs and rising lows. Oil recently peaked at around US$84, before dropping to close to US$70/barrel.

The US election – potential implications for the oil market

The forthcoming US election could have an impact on global oil supply and prices, with the Trump camp committed to the oil and gas industry and the Biden/Harris administration strongly supportive of the energy transition, with climate legislation such as the Inflation Reduction Act and environmental protections.

INVESTMENT CONCLUSION: GO SMALL IN OIL!

Bigger oil companies are going to suffer because there are simply fewer big new oil projects due to a lack of funding from banks and investors. US oil companies are talking a big game, but the world is changing and oil is not as crucial as it once was. If you do invest in the sector, low cost smaller producers are the best way of getting meaningful exposure. Read our note on **Karoon Energy (KAR)**.

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KAROON ENERGY

SECTOR ENERGY **INDUSTRY** OIL AND GAS

Oil Comment

What's New?
Production at the Who Dat Joint Venture (KAR 30%), offshore Louisiana, Gulf of Mexico, has reached a new high of 43k barrels of oil equivalent per day (boepd) in the last quarter and has the potential to increase over the coming months with drilling of Who Dat East. Drilling of the Who Dat South well is planned to commence in the coming weeks.

Bull Points
· Dividend paying oil producer
· Potential growth at Neon and Who Dat

Bear Points
· Volatile due to oil price
· Natural well decline at Bauna, Brazil

Analysis: With the company's growth in production and cash flow, there has been pressure from shareholders for the commencement of dividends. The company has now finalised a dividend policy to pay 20-40% of underlying net profit after tax (NPAT), subject to market conditions and board approval, applied from the 2024 half-year results.

Karoon has also launched a US$25m share buyback driven by the view of the board that the current share price does not accurately reflect the value of the company's assets.

The latest guidance for CY24 is unchanged with expectations for 7.5-9 million barrels from its Brazil operations and a net revenue interest in 3-3.5 million barrels of oil equivalent at its Who Dat operations. This comes to a total of 10.5-12.5 million barrels of oil equivalent.

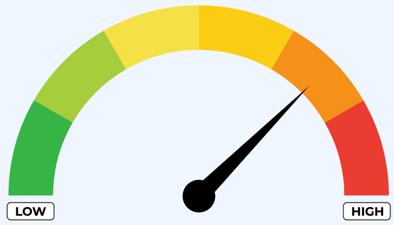
Production at the Bauna Field, offshore Brazil, has continued to be impacted by a blockage in the SPS-88 well. Well intervention to restore normal production has been held back due to delays to regulatory environmental approvals. If the SPS-88 intervention is delayed to 2025, Bauna 2024 production will likely be in the lower half of current guidance.

Portfolio Risk Rating: Karoon now has two well established oil producing assets generating positive cash flow. Strong margins with unit operating costs of US$10.5-15/boe in CY24.

RADAR RATING: The purest ASX listed oil stock for oil price leverage. Leverage increasing as the company scales up due to production growth and new projects.

RADAR RATING: **SPEC BUY**

RISK RATING



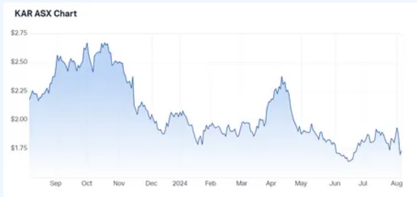
ASX CODE **KAR**

CURRENT PRICE **$1.73**

MARKET CAP $1374BN

DIVIDEND YIELD 4.7%*

NET DEBT ($M) -US$67.8M (A$103.7M)



DATA AS AT INITIAL COVERAGE:

DATE 21 JANUARY 2021

PRICE ($) 1.10

**Forecast 8 cents*

BEAMTREE HOLDINGS

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Update

What's New?
The unaudited FY24 result highlighted 21% sales growth to $27.6m, driven by international business and 95% customer renewals. The company is improving profitability, albeit marginally so; and was cashflow breakeven in the second half.

Bull Points
· High recurring revenue
· Global reach

Bear Points
· Earnings fragmented
· Low revenues

Analysis: The detail isn't there, which is important with this e-health company, but our confidence is increasing.

The company has built up an array of products and services for hospitals and does business around the world, but we are not confident that it will meet its own $60m ARR (annual recurring revenue) target by FY26, which is more than double its current run-rate; although the company says it will.

Revenues were boosted by non-recurring items ($3.9m in FY24 v $1m in FY23). Recurring revenues grew by 9% to $23.7m.

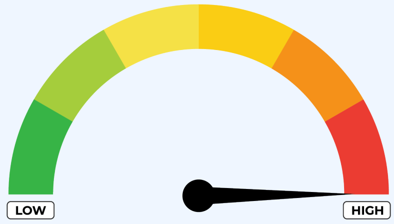
Cash now stands at $5m, down from $8.8m at the same time last year. We need more evidence from detailed financial statements on cash flow to determine that BMT can achieve sustainable growth, i.e. not need to raise equity capital.

Portfolio Risk Rating: BMT has achieved revenue growth as expected of over 20% but profitability has not been substantially improved. There remains the risk of capital raising.

RADAR RATING: Ambitious targets for growth over the next two years. Quality of growth is questionable, hence very high risk.

RADAR RATING: **HOLD**

RISK RATING



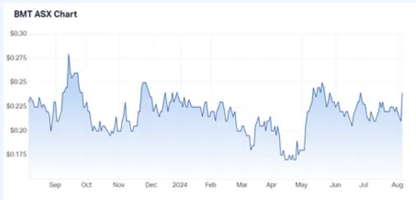
ASX CODE **BMT**

CURRENT PRICE **$0.235**

MARKET CAP $69M

DIVIDEND YIELD 0%*

NET CASH ($M) 5.0M



DATA AS AT INITIAL COVERAGE:

DATE 31 DECEMBER 2020

PRICE ($) 0.35

CLOVER CORP

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Update

What's New?
Clover has yet to recover from a disappointing interim result where revenue declined 40% and is due to report full-year results in late November. The company is not sitting on its hands, however, having established a new division in Ecuador where a state-of-the-art facility has been completed and has recently commenced production. The facility is in a major fishing port which allows efficient sourcing and extraction of fish oil and adds security to Clover's supply chain through vertical integration.

Bull Points
· Vertically integrating the supply chain
· Potential from new products and markets

Bear Points
· Demand headwinds
· Input cost inflation

Analysis: Clover now produces its own fish oil, improving its prospects for growth, based on its expertise in the encapsulation of fish oils for infant formula, pharmaceuticals, nutraceuticals and food products. Ecuador should produce half of CLV's oil requirements and reduce costs.

Over the last three halves, the gross margins have declined from just over 31% to below 27%. FY24 expectations are for $65m revenue; a 2% lift in gross margin translates to $1.3m in earnings; very significant for a company with an $83m market value.

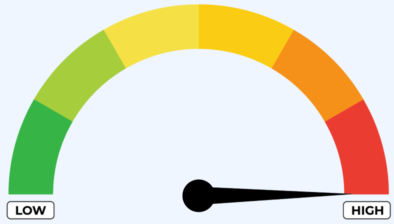
The key to Clover is the Omega-3 fatty acid, a chemical compound involved in the structure and function of cell membranes, particularly in the brain and eyes. There are three types: alpha-linolenic acid (ALA), docosahexaenoic acid (DHA) and eicosapentaenoic acid (EPA). ALA is found in plants, whereas DHA and EPA are found in algae and fish. DHA and EPA can be synthesised from ALA by the human body or directly through diet. Omega-3 is in breast milk and later life benefits include a slower decline in brain and eye function.

Portfolio Risk Rating: We pulled back our recommendation to hold given a drop in demand from the infant formula market in China. The move to capture more of the margin in the supply chain is an important step but we'll wait for commentary at the full-year result.

RADAR RATING: There are positive regulatory tailwinds globally but China is a setback. Clover is a long-established player and earnings are leveraged to volumes.

RADAR RATING: **HOLD**

RISK RATING



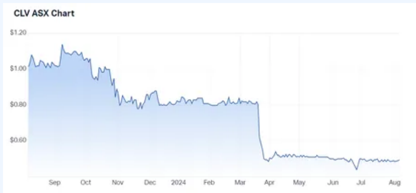
ASX CODE **CLV**

CURRENT PRICE **$0.50**

MARKET CAP $85M

DIVIDEND YIELD 0%*

NET CASH ($M) 5.5M



DATA AS AT INITIAL COVERAGE:

DATE 07 JANUARY 2012

PRICE ($) 0.30

MACH7 TECHNOLOGIES

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Update

What's New?
In the March and June quarterly reports, M7T reported sales orders of $7.4m and $4.4m respectively, for FY24 total revenue of $61.3m, in keeping with the guidance of over $60m. The shares have been weak but as we show, the key is to look through recent quarter sales numbers. Moreover, the signs are there, with a 3-year subscription renewal with DocPanel worth $2m, a significant increase on the former contract.

Bull Points
· Subscription business model
· Strong growth rate

Bear Points
· Costs growing at the same rate as income
· Contract sales volatile quarter to quarter

Analysis: Quarterly sales orders are volatile and the most recent two quarters have underwhelmed. A better metric is the trailing twelve-month sales number which continues to grow strongly. For the past four years sales orders have doubled from $27.5m in FY21 to $61.3m in FY24; an annual growth rate of over 30%.

Sales can be for contracts delivered over a number of years, hence take a couple of years to be reflected as cash received. In FY24 the company recorded cash receipts of $35m, somewhat analogous to the sales order number for FY22. The strong orders recorded over the past two years bode well for cash receipts.

Costs, mostly staff, continue to grow although operating cash flow has been positive for five years, hence growth has been self-funding. Cash sits at $26m and there is no debt.

The value of a company is the present value of its future cash flows, which M7T is locking in, albeit with some re-investment for growth. For FY24, operating cash flow was $3.1m and free cash flow was $2.8m. The enterprise value (market cap less net debt) of $117m is underpinned by cash generation and cost control.

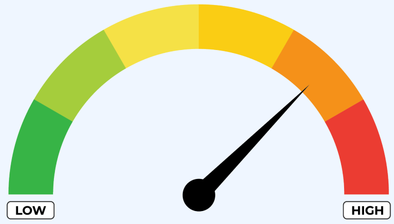
The opportunity for growth remains very large with a fragmented market and a wide array of potential customers; a strong sales pipeline in many regions, but this needs to translate to increasing cash flow.

Portfolio Risk Rating: The transition from upfront sales to a subscription model takes time but is occurring. M7T is still a small business with annual cash receipts of $35m but there are sales contracts for growth.

RADAR RATING: Growing in maturity with a subscription model and potential to for higher cash flows. Doesn't require funding and has a large cash balance.

RADAR RATING: **SPEC BUY**

RISK RATING



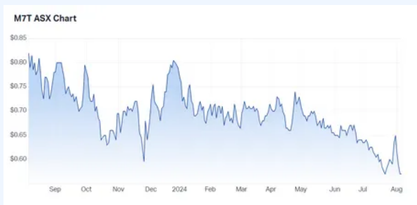
ASX CODE **M7T**

CURRENT PRICE **$0.58**

MARKET CAP $140M

DIVIDEND YIELD 0%*

NET CASH ($M) 26M



DATA AS AT INITIAL COVERAGE:

DATE 02 JUNE 2022

PRICE ($) 0.61

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RECKON

SECTOR INFORMATION TECH

Research Tip Update

What's New?
The first half result to 30 June underwhelmed with legal services failing to take off. Revenue up 1% to $28.4m delivered operating earnings (EBITDA) up 6% at $11.7m; while the profit before tax was lower at just under $4m (1h23 $4.1m). The interim dividend was maintained at 2.5 cents (for those on the register on 16 August). There won't be a final, as the company's policy is to only make one payment a year. The balance sheet was strengthened with the repayment of $3.8m of debt; net cash is now $0.9m.

Bull Points
- Good value
- Potential for legal division

Bear Points
- Accounting is very competitive
- Large competitors

Analysis: The result highlighted the cash flow coming from the Business Group (accounting software) but was disappointing on the legal services side, which has big potential but didn't deliver. We don't think it's time to panic but the company needs to show top-line sales growth from legal services.

Reckon is a business in transition. In its core accounting business, customers are being moved from desktop products to the cloud, with the objective to retain as many as possible through competitive services. We were pleased that growth has resumed on this front with 4k new users to 109k, but overall revenue growth undershot expectations. There are reasons for optimism, however.

The core legal services group (cost recovery, scan & print) had poor sales in the fourth quarter of CY23 which translated to lower installations this year. Sales momentum has improved but remains below the 10% aimed for. Sales were $6m but need to get to $10m to be cash flow positive, hence there is some way to go. The market is big, however, with a market in workflows of US$74m and in billing workflows of US$70m, which expands to US$280m if you include additional integrations over the next two years.

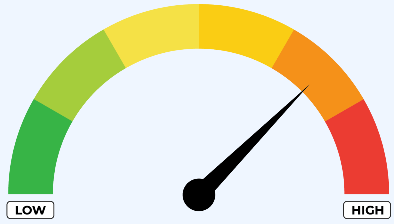
We are impressed with Reckon because its business efficiency is improving, which translates to a strong operating cash flow of $11.3m, while investment in development costs fell slightly to $7m, accounting for the reduction in debt. Sales is the key and the company is experiencing growth on its legal platform and is putting boots on the ground in key markets – UK & US.

Portfolio Risk Rating: Low financial risk but is a company in transition and sales growth remains elusive. Dividends while you wait for growth.

Radar Rating: Dividends while you wait for growth. Transition from desktop to cloud & US/UK legal business needs to show stronger growth. Patience needed.

RADAR RATING: **SPEC BUY**

RISK RATING



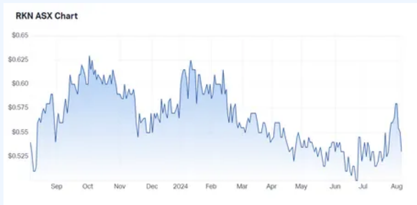
ASX CODE **RKN**

CURRENT PRICE **$0.53**

MARKET CAP $60M

DIVIDEND YIELD 4.7%*

NET CASH ($M) 1M



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PRICE ($)

** Forecast 2.5 cents*

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STRIKE ENERGY

SECTOR ENERGY **INDUSTRY** OIL AND GAS

Research Tip Update

What's New?
The West Erregulla project in the Perth Basin (WA) Strike 50%, operator, Warrego Energy 50%, has received environmental (EPA) approval for gas development. Concurrently, Australian Gas Infrastructure received EPA approval for the associated West Erregulla processing plant and pipeline.

In the third quarter revenue for the company (from Walyering) increased by 13% to $20m on the prior quarter and is ramping up.

Bull Points
· Walyering production ramping up
· Exploration potential

Bear Points
· WA gas market has softened
· Peaking plant increases capital intensity

Analysis: This is a major derisking event for the West Erregulla project and we are moving towards the green light (financial investment decision). Strike has a substantial 3,500 km2 position in the Perth Basin with continuing active exploration to expand resources further.

Results from the Erregulla Deep_1 well, which was spudded in late June 2024, are imminent and processing arrangements with Australian Gas Infrastructure are being finalised. An 87-terajoule-a-day gas plant (moderate size) is proposed with a pipeline connection to the Dampier to Bunbury Natural Gas Pipeline.

At South Erregulla, the energy regulator (AEMO) is due to decide any day now whether STX has been awarded capacity for the power plant. The reserves of 37 petajoules support a project life of greater than 25 years.

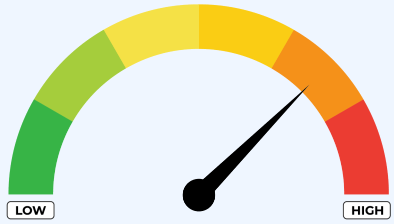
At Walyering production in the past 12 months was positive, albeit smaller than its other projects, at 25TJ/d of sales gas and 185 barrels of condensate, equivalent to 2.4PJe (petajoule equivalent).

Portfolio Risk Rating: Financing terms agreed with Macquarie for a 5-year $153m package for its Perth Basin Gas Acceleration Strategy. Walyering is now cash generative. Two projects close to green light.

RADAR RATING: Largest holder of gas reserves in the Perth Basin, with ongoing exploration ongoing. Many exploration and development catalysts are ahead.

RADAR RATING: **HOLD**

RISK RATING



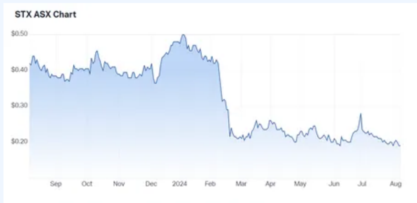
ASX CODE **STX**

CURRENT PRICE **$0.19**

MARKET CAP $544.4M

DIVIDEND YIELD 0%*

NET DEBT ($M) -30



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PRICE ($) 0.325

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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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