under the radar report
SMALL CAPS

ISSUE 614
22 AUGUST 2024

REPORTING SEASON UPDATE: OUTLOOK IS THE KEY

So far so good! We like what we see and investors are buying value. But you need to do your research. One of our Best Buys, Hansen Technologies (HSN) was initially sold off 7% yesterday morning after the release of its FY24 result on confusion over guidance, which was then resolved by the conference call, causing the stock to finish up 8% on the day.

Integrated Research (IRI) is turning its business around and once again paying out dividends. The group does have a blue chip customer base, but growth is not assured. We're making money on our initial tip price but there's still some way to go. Similarly, **Retail Food Group (RFG)** is at a crossroads, but the signs are there that it's thriving, not simply surviving.

The Small Cap world is full of idiosyncrasies, but the more you understand what you're buying, the more money you stand to make. Read about the details of the results in this issue, but the key point is that in-depth research into small caps can deliver big returns; and also, that this same research can save you from making even big mistakes. The key is knowing what to look for.

Investing in stocks is all about knowing what is priced in at any given time – also known as expectations. Stocks are governed by sentiment and by fundamentals. The former can easily be seen in the share price, while the latter needs a much deeper understanding. On the one hand, you're looking at financial metrics, involved with the intersection of the profit & loss, the balance sheet and the cash flow statement. On the other, you're looking at the people running the show, their strengths and the ability of the business to withstand the competitive pressure and to actually grow. How strong is the customer base is an important factor for every company, big or small, and is something our team discusses at length.

What we are doing is investing in businesses where the risks are reduced, but the potential is maximised through valuations that aren't stretched. This happens often in companies at the small end, which is where the individual investor has a distinct advantage.

Richard Hemming
Head of Investments

the issue

RESEARCH TIP UPDATES

A wide variety of companies as usual, with differing risk profiles. HSN is a big company trading in a small cap and definitely worth checking out.

ARTICORE (ATG)	SPEC BUY
ENERO (EGG)	SPEC BUY
HANSEN TECHNOLOGIES (HSN)	BUY
INGENIA COMMUNITIES (INA)	HOLD
INTEGRATED RESEARCH (IRI)	▲ SPEC BUY
PILBARA MINERALS (PLS)	HOLD
RETAIL FOOD GROUP (RFG)	SPEC BUY

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.

Hansen Technologies' initial weakness was caused by confusion on guidance, but it emerged that operating earnings were ahead of guidance, driven by stronger revenues. The business is doing well and the investors are buying.

Under the Radar Report

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ARTICORE

SECTOR CONSUMER DISCRETIONARY **INDUSTRY** RETAIL

Research Tip Update

What's New?
FY24 results showed continued revenue declines, but a sharp improvement in profitability led to a turnaround of $48m to positive FY24 operating cash flow of $1m, from EBITDA of $10m, up from a $32m operating EBITDA loss in FY23.

Bull Points
· Improved gross profits
· Significantly reduced expenditure

Bear Points
· Consumer demand weak
· Revenue growth unclear

Analysis: We remain buyers based on growth potential and improved efficiencies under founder-led management improving profitability.

Gross profit after paid acquisition (GPAPA) grew $10m to $108m. A driver was better optimisation of the sales funnel and working capital efficiencies (supply chain management) reducing the cost of goods.

ATG has also reduced its cost base by almost a quarter or $31m. Profits improved despite a 10% decline in revenue to $423m. Payroll costs and IT costs were rationalised; brand marketing was minimised.

Redbubble led the way through optimising paid marketing. Sales were down 17%, but GPAPA rose 5% to $69m. US-based Teepublic achieved GPAPA of $39m, up 24% at $39m on sales up 3%; driven by 48% repeat purchases, up from 30% in FY20.

Founder Martin Hoskings sees ATG as a long-term leader in linking creative artists with customers. Long-standing artists represent a significant proportion of sales, even as new artists are gaining share. Expectations are for ATG to expand beyond the two existing marketplaces in the coming months.

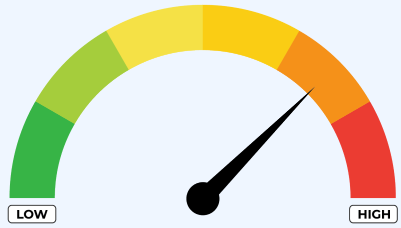
The outlook is mixed. While optimisation of the sales funnel continues, operating expenditure is to be flat at $96m-$100m, delivering GPAPA margins of 24%-26%. This was disappointing, but includes investment in sales growth. Even sales growth delivers substantial earnings improvement.

Portfolio Risk Rating: Has delivered significant earnings improvements since Hosking's return; positive operating cash flow through a focus on unit economics. His stake in the business reduces risk, by maintaining a proprietary eye.

Radar Rating: The underlying business has demonstrated substantial progress. Consumer demand is still weak, but the underlying fundamentals remain interesting.

RADAR RATING: **SPEC BUY**

RISK RATING



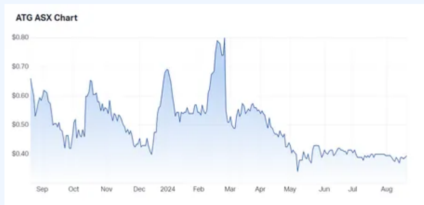
ASX CODE **ATG**

CURRENT PRICE **$0.34**

MARKET CAP $96M

DIVIDEND YIELD 0%*

NET CASH ($M) 37M



DATA AS AT INITIAL COVERAGE:

DATE 27 APRIL 2023

PRICE ($) 0.40

previously Redbubble

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ENERO

SECTOR TELECOMUMMICATIONS **INDUSTRY** MEDIA

Research Tip Update

What's New?
The full year (FY24) result was well flagged (see issue 602, 30 May 2024) but still messy, including big one-off costs, but also glimmers of hope amid a weak second half. Net revenue was just shy of $190m, down 21.5%, or down 6.5% on a "like for like" basis, which excludes sales written off from the 51% owned OB Media. Operating earnings (EBITDA) was $37m.

The statutory or reported loss was $44.2m, due to non-cash write-offs of intangibles & fair value relating to acquisitions ROI DNA and Get IT, purchased in FY22/23. Net profit after tax before one-offs was $10.3m, up 7.0%, producing EPS of 11.3 cents and a final dividend of 2 cents (FY24 5 cents v FY23 11 cents).

Bull Points
· Market leading
· Blue chip clients

Bear Points
· Unresolved sale of 51% owned OB Media
· Weak revenue

Analysis: The 51% owned OBMedia is Enero's kryptonite, being at once a boost to profits and now a huge drag, which Enero is trying to offload – which it now seems to indicate could happen sometime early next year, based on due diligence work by interested parties.

Revenues declined in OB Media by 8% on a like-for-like basis (about half in reality after direct marketing activities were pulled back) but the fourth quarter saw an improvement on the prior quarter.

The US business Hotwire is struggling. US revenues declined 36% to below $93m, with the election putting the brakes on spending.

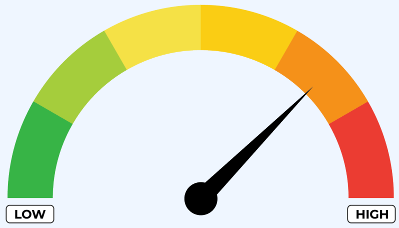
The revenue and earnings trends are for single-digit declines in the key Technology, Healthcare & Consumer businesses. Enero is doing its best to reduce costs, but it's a labour-based business.

Portfolio Risk Rating: The big positives are cash conversion (98%) and a strong balance sheet with over $40m in net cash, and $25m after contingent considerations and lease liabilities. The company does have a blue chip customer base but as we are seeing, it's higher risk when economic uncertainty rears its head. You are not paying much for this stock, however, trading on a single-digit forecast PE and on a cash flow multiple of five times.

Radar Rating: The trend has been negative, but the value is there, trading on a single-digit forecast PE and on a dividend yield. High risk, only for those members who can hang tough.

RADAR RATING: **SPEC BUY**

RISK RATING



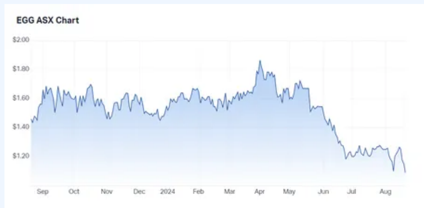
ASX CODE **EGG**

CURRENT PRICE **$1.095**

MARKET CAP $99M

DIVIDEND YIELD 3.7%*

NET CASH ($M) 43.7M



DATA AS AT INITIAL COVERAGE:

DATE 13 JULY 2012

PRICE ($) 0.60

Forecast 4 cents

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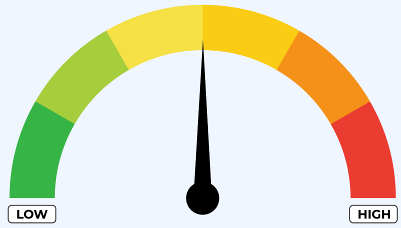
HANSEN TECHNOLOGIES

SECTOR INFORMATION TECH

RADAR RATING: **BUY**

RISK RATING



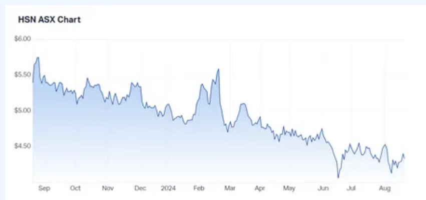
ASX CODE **HSN**

CURRENT PRICE **$4.47**

MARKET CAP $909M

DIVIDEND YIELD 2.2%*

NET DEBT ($M) -24.5M



DATA AS AT INITIAL COVERAGE:

DATE 20 MARCH 2019

PRICE ($) 3.01

**Forecast 10 cents*

Research Tip Updates

What's New?
FY24 core profit impressed with revenue up 13% at $353m, or 7.3% excluding the Powercloud acquisition (5 months). Operating earnings (EBITDA) was down 7% at $92.4m. Cash EBITDA (includes capitalised costs like R&D) declined 2% at $76.9m, while profit after tax halved to $21.4m producing 10.4 cents in earnings per share.

The shares have been weaker, trading close to $5.80 this time last year due to concern over the A$49m acquisition of German based Powercloud. Indeed, on the open after the FY24 announcement HSN was down 7%, subsequently rallying almost 2% post the investor call.

Bull Points
· Blue chip customers
· Long-term contracts

Bear Points
· Competition increasing
· Powercloud integration risks

Analysis: The initial weakness was caused by confusion on guidance, but it emerged that operating earnings were ahead of guidance, driven by stronger revenues. The business is doing well, but there is more volatility on licence fees than anticipated (which are 100% margin), which are likely to be $28-32m next year vs $36m in FY24.

German based Powercloud cloud-native with new technologies like virtual power plants and electric vehicles. Has required substantial investment but delivered to expectations with revenue of $18.4m and an earnings (EBITDA) loss of $8.4m. Guidance for $5m losses in FY25 seems conservative with $13m in cost out already completed.

Overall FY25 guidance is for 8% improvement on the cash EBITDA, underpinned by organic revenue growth of 5-7% and reducing Powercloud losses. HSN also noted higher investment in sales and marketing to take advantage of opportunities.

Strong earnings margins (EBITDA/sales) at 30% FY24, guided to 28% in FY25 (Powercloud lower margins).

Portfolio Risk Rating: Strong balance sheet (low debt), good cash flow, blue chip customers, invests heavily and operates in a sector undergoing transformation, which relies heavily on software billing. Operating earnings has grown 10% a year over the past five years and similar rates of growth are expected over the next few years. The M&A pipeline remains strong.

Radar Rating: Founder-led and working hard on Powercloud to create new growth. The much larger core business is cash-generative and is still growing.

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INGENIA COMMUNITIES

SECTOR REAL ESTATE **INDUSTRY** AGED COMMUNITIES

Research Tip Updates

What's New?
A stunning turnaround, returning 12% the past year, operating at the intersection of an ageing population and the housing crisis, and overcoming a blowout in costs and construction delays in FY22 & FY23.

FY24 Revenues up 20% at $472m, delivering a 17% rise in operating earnings (EBIT) at $125.7m. Adjusted earnings per share (which excludes a goodwill write-off) was 23.3 cents, up 14%, from which it paid distributions of 11.3 cents, the final being 6.1 cents. Including the goodwill write-off statutory profit was down 78% at $14m.

The company is now headed by a new team of CEO John Carfi and CFO John Mitchell, whose focus is on boosting the contribution from development profits.

Bull Points
- Strong demand drivers
- Pipeline of development sites

Bear Points
- Costs are rising
- Capital intensive

Analysis: A combination of demand from an ageing population, rental income (99% occupancy) and a bank of development sites. The new CEO is intent on doubling the development contribution, which entails risk.

Four divisions: rental (earnings up 13.8% in FY24% at $45.3m – 26% of divisional earnings) which benefits from inflation or CPI-linked rises; development, up 40.0% $59.2m – 34% of earnings, which benefits from price rises and growth in settlements; rental from retirement homes (gardens), down 12.8% at $11.6m – 6.5% of earnings; holiday rentals (caravans, camping), up 4.6% at $56.9m, 32% of earnings.

A big driver over time has been development profits from the land lease scheme, which is heavily subsidised by the government (rental relief). Ingenia's customers own the property and obtain rental relief, while Ingenia owns the land and shares in the profit upon sale.

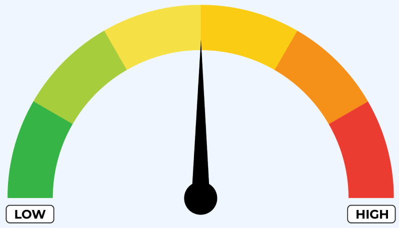
On the development front, in FY24 INA achieved 462 settlements, up 24%, while INA has a pipeline of over 5,300 development sites and build times at 22 weeks have stabilised, having blown out to over 6 months in FY22/23. The company has adequate funding capacity, with undrawn debt and a cast of just over $200m.

Portfolio Risk Rating: This is a proven business model, it is vulnerable to supply constraints, cost increases and interest rate rises. Momentum from favourable tailwinds, but the return on capital for investors is low but predictable.

Radar Rating: Momentum is strong and the company has low exposure to troubled aged care markets. New management.

RADAR RATING: **HOLD**

RISK RATING



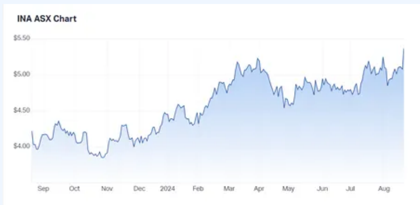
ASX CODE **INA**

CURRENT PRICE **$5.29**

MARKET CAP $2.1BN

DIVIDEND YIELD 2.9%*

NET DEBT ($M) -616M



DATA AS AT INITIAL COVERAGE:

DATE 21 JANUARY 2013

PRICE ($) 1.62

*Forecast 12.5 cents

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INTEGRATED RESEARCH

SECTOR INFORMATION TECH **INDUSTRY** SECURITY DATA SERVICES

Research Tip Updates

Upgrade from Hold

What's New?
The performance management and analytics provider delivered a much better-than-expected 2-cent dividend for FY24, from earnings per share of 15.6 cents. Revenues of $83.3m and earnings (EBITDA) of $24.6m were both in line with guidance, which was revised sharply upwards in May (Issue 600); while cash stands at over $30m.

There is a lot going on beneath the surface, with some mixed messaging and a new CEO Ian Lowe, commencing at the start of October.

Bull Points
· Boosting margins
· Robust balance sheet

Bear Points
· Competitive environment
· Slow turnaround

Analysis: Stock in the software company almost doubled on our recommendation at 32 cents in late 2022 and has been as high as 98 cents, which is where the stock looks fairly valued. The recommencement of dividends, the removal of debt and the steady performance of pro-forma (accrual adjusted) revenues are evidence the business is strengthening. However, the persistence of churn of its key Collaborate business (revenues down 9%) as customers migrate from IRI's desktop product onto cloud services provided by some competitors, highlights problems with sustainable growth.

IRI provides software that manages the multiple platforms for big enterprises, enabling systems monitoring in real-time, and is targeted at mission-critical services such as banking transactions. Product suites are Collaborate, Transact (financial services) and Infrastructure – powered by its Prognosis platform.

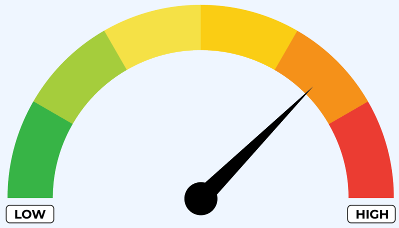
The focus is on bigger customers with more complex needs and to look for acquisitions to grow, utilising its strong balance sheet. After a strong FY24 year on the renewals front, the book is now softer and weighted towards the second half, skewing towards Transact and Infrastructure clients. On the other hand, IRI said that new business and upsell are better than this time last year, weighted to Collaborate.

Portfolio Risk Rating: Undervalued, trading on a mid-single-digit PE, a big cash position, a blue chip customer base and the recommencement of dividends. New management will need to deliver a plan to meet growth targets.

Radar Rating: The stock has come off and the value on offer offsets the strategic uncertainty. In a position to grow, not reflected in the price.

RADAR RATING: **SPEC BUY**

RISK RATING



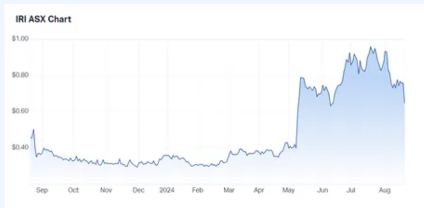
ASX CODE **IRI**

CURRENT PRICE **$0.595**

MARKET CAP $112M

DIVIDEND YIELD 3.5%*

NET CASH ($M) 31.9M



DATA AS AT INITIAL COVERAGE:

DATE 10 NOVEMBER 2023

PRICE ($) 0.32

**Forecast 2 cents*

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PILBARA MINERALS

SECTOR METALS_MINING **INDUSTRY** LITHIUM

Research Tip Updates

What's New?
Pilbara has made a scrip-based $560m takeover offer for ASX-listed Latin Resources (LRS), which owns the hard rock lithium project Salinas in Brazil. The company would increase Pilbara's resources by 20% and target 1m tonnes a year of lithium concentrate by late next year. The offer is 0.07 new PLS shares for each Latin share held and is recommended by the board.

Bull Points
· Production expansion
· Diversified asset base

Bear Points
· Lithium market is still depressed
· Uncertain earnings outlook

Analysis: The move is opportunistic but makes sense. Latin owns a Tier 1 undeveloped lithium asset, with exploration upside, in a proven mining jurisdiction at close to a potential low point in the lithium market. The fact that a nearby competitor, Sigma Lithium (Nasdaq: SGML) is already in production with a similar project, provides additional confidence.

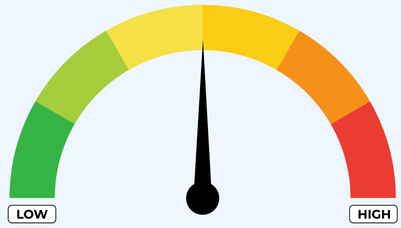
Latin's progress has been compared with Sigma's whose market cap is US$1.14bn, which is operating its Grota do Cirilo project about 60km to the south of Latin's tenements. Sigma began operations in 2023 at 270k tonnes a year of lithium concentrate with an expansion to 520k tonnes a year planned for the first quarter in CY25.

Portfolio Risk Rating: Profitable even in the current depressed lithium market. Strong net cash. Expanding cash flow from rising production. Long mine life with substantial resources.

RADAR RATING: World's largest hard rock lithium producer. Latin acquisition adds a growth project, following the Pilgangoora expansion. Leveraged to the lithium price recovery.

RADAR RATING: **HOLD**

RISK RATING



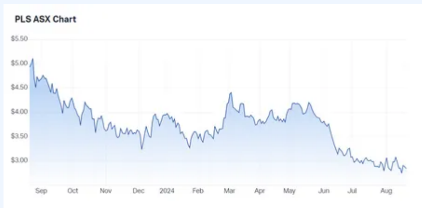
ASX CODE **PLS**

CURRENT PRICE **$2.94**

MARKET CAP $8.6BN

DIVIDEND YIELD 0%*

NET CASH ($M) 1.6BN



DATA AS AT INITIAL COVERAGE:

DATE 02 DECEMBER 2017

PRICE ($) 0.75

**FY24 forecast 0 cents*

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RETAIL FOOD GROUP

SECTOR CONSUMER DISCRETIONARY **INDUSTRY** RETAIL

Research Tip Updates

What's New?
In the wake of the **Guzman y Gomez (ASX.GYG)** IPO in early June, RFG's stock spiked a third from just over 6 cents to over 8 cents and has settled back near the mid-point. The FY24 result this week was encouraging, with RFG's new, young management team delivering 13% growth in sales to just shy of $115m for a flat net profit after tax and adjustments at $13.3m amid challenging economic conditions. The company is changing its name to Savora Brands.

The franchise owner has two divisions, the main one being Café, Coffee & Bakery (CCB) with brands Donut King, Gloria Jeans (café), Brumby's (bakery) and Beefy's (pies). The smaller division is Quick Service Restaurants (QSR) with brands Crust (pizzas), and Rack'em Bones (ribs).

Bull Points
· Returning to growth
· Low capital requirements

Bear Points
· Retail slowdown
· 2.5bn shares on issue

Analysis: RFG operates almost exclusively through franchises and has an average transaction value of under $10. The profit driver is the bigger Cafe business (CCB – 90% of sales), which has been making up for sluggish sales of Crust Pizza (QSR 10% of sales).

CCB benefits from lower price points. Sales growth was 13% to $114.7m, producing 18% earnings (EBITDA) growth. QSR struggled due to declining Crust sales, although earnings have been held steady due to a reduction in costs. Sales declined almost 10% to $17.3m delivering $4.4m.

RFG is producing healthy cash flow, with cash from operations at +$17.8m, more than enough to pay for the acquisition of the Beefy's Pies business ($5.5m). The focus is now on growth and RFG is investing in multi-site operations.

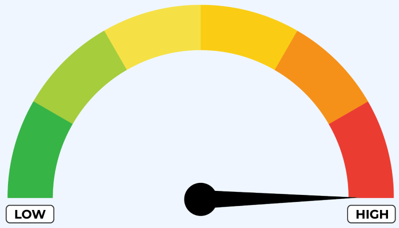
The business strength has improved with franchisees improving in profitability – average weekly sales were up over 5% during the period, driven by CCB where the company is now focused on only five brands, versus previously closer to 10. The group has 741 trading outlets, a net increase of 42 over the period and is forecast to grow through Beefy's and a focus on multi-sites.

Portfolio Risk Rating: High but underpinned by value, both in the price of the stock and in the business. The café businesses with less than $10 ticket prices are affordable treats. The business has improved with strong cash flow and cash flow conversion (77%). All we need now is growth!

Radar Rating: Stabilised earnings and balance sheet. The company can grow through increased outlet numbers on top of a network optimised through the struggles of the last few years, and product extensions.

RADAR RATING: **SPEC BUY**

RISK RATING



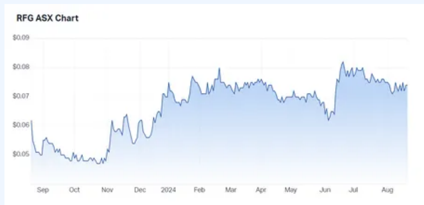
ASX CODE **RFG**

CURRENT PRICE **$0.07**

MARKET CAP $180M

DIVIDEND YIELD 0%*

NET DEBT ($M) -5.1M



DATA AS AT INITIAL COVERAGE:

DATE 17 DECEMBER 2020

PRICE ($) 0.085

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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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