under the radar report
SMALL CAPS

ISSUE 629
05 DECEMBER 2024

SMALL CAP DIVIDEND PORTFOLIOS DELIVER

With only 12 stocks you can build a portfolio that is better diversified than the domestic market benchmark index (S&P/ASX 200) and is able to absorb some poor performers and deliver an average annual return of 24%. A result that is more than twice as good as the 9.4% return from the S&P/ASX All Ords Index.

This is what our last three Small Cap dividend portfolios have delivered - **Portfolio-13** (Feb 2023) **Portfolio-14** (Oct 2023) and **Portfolio-15** (May 2024). We have been generating these portfolios for eight years now and our average return across all 15 portfolios is 13.1% versus the All Ord's 6.8%. It's not an accident.

Their performance has been accelerating, but over the long-term, our results highlight that a portfolio supported by strong dividends works no matter the share market.

We deliver analysis on our dividend portfolios, but for mine, the key is diversification among profitable companies bought at value prices. Financials are over 40% of the benchmark index, while in our past three portfolios, their weighting is less than half of that at 25%. Moreover, the sectors are wide – financials, manufacturing, contracting, retail, services, media, mining services, gold, and construction– and no one sector is over-represented.

The big growth has come from price, not dividends and we are always looking to recycle capital, hence our recent take profits recommendations on **SRG Global (SRG)** and **Catapult International (CAT)**. We looked at taking profits on **Paragon Care (PGC)** covered in this report, but the transition the company is going through is mid-stream and founder-led management has a great deal of incentive (owning 57%).

Fear not! We have come up with two new buy recommendations in two weeks in **Vysarn (VYS)** and **Intelligent Monitoring Group (IMB)** and we are big fans of the deal **Northern Star Resources (NST)** and its acquisition. Our team continues to scour the earth, hunting for new stocks and new dividend portfolios, which we will unveil.

Life is about excitement, so welcome to Under the Radar Report!

Richard Hemming
Head of Investments

the issue

THE DIVIDEND REPORT

In our small cap dividend series we show you how to build a portfolio of Small Caps that can grow your wealth, all the while you're getting paid!
7 Reasons why dividend portfolios outperform
+ Dividend tables

RESEARCH TIP UPDATES

Check out the deal $NST is doing and why we see value in $TRS. We are ceasing coverage on $CCX.

CITY CHIC COLLECTIVE (CCX)	HOLD
DATA#3 (DTL)	HOLD
NORTHERN STAR RESOURCES (NST)	BUY
PARAGON CARE (PGC)	HOLD
SOMNOMED (SOM)	▼ HOLD
THE REJECT SHOP (TRS)	▲ SPEC BUY

BEST STOCKS TO BUY NOW

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

The key is to have enough stocks to absorb your losers and come out well ahead, while not so many that you can't keep track of them.

Under the Radar Report

Published by Under the Radar Report Ltd
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DIVIDEND PORTFOLIO REVIEW: 7 TAKEOUTS FOR 8 YEARS OF BIG PERFORMANCE

A Strategy For All Seasons

Find out how our most recent three portfolios – Portfolio-13 (Feb 2023) Portfolio-14 (Oct 2023) and Portfolio-15 (May 2024) have delivered an average annual return of 24% versus the S&P/ASX All Ords return of 9%.

BELOW ARE THE 7 TAKEOUTS FOR 8 YEARS OF BIG PERFORMANCE

1. 12 STOCKS CAN DELIVER STRONG RETURNS

The big takeout is that with only 12 stocks you can build a portfolio that is better diversified than the domestic market benchmark index (S&P/ASX 200) and is able to absorb some poor performers and deliver an average annual return of 24%.

Financials are over 40% of the benchmark index, while in our past three portfolios, their weighting is less than half of that at 25%. Moreover, the sectors are wide – financials, manufacturing, contracting, retail, services, media, mining services, gold, and construction– and no one sector is over-represented.

The key is to have enough stocks to absorb your losers and come out well ahead, while not so many that you can't keep track of them (and you are in danger of becoming the market).

2. DIVIDEND GROWTH IS A KEY DRIVER

The dividend cash returns all exceed the initial dividend yield. In Portfolio-13 the cash return is 12%, which added to the price return gives you a total return of 32%. This result was helped by a large special dividend from **A2B** before it was taken over last May, delivering a return of 28%.

Small Caps benefit from operating leverage and dividends reduce your risk.

The market is rewarding consistency and dividends deliver on that because these companies are profitable. Less than 30% or 10 of the 35 companies in the three Vintages lost ground.

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DIVIDEND PORTFOLIO REVIEW

3. YOU DON'T NEED TAKEOVERS

We've been running these portfolios for over seven years and almost 1 in 4 stocks has been taken over, which is 25%. Of the nine stocks in Portfolio-1 (January 2016) only three haven't been taken over! But deal flow has been slow in the past two years. Of the 35 stocks we tipped, one has been taken over: the taxi services company **A2B Australia** (28% return) while another has been made a takeover offer last month – **Silk Logistics (SLH)** which has so far returned almost 90%.

These have been positive returns, but the biggest returns have come from better-than-expected earnings. The financial services group **Count (CUP)** and the contractor **SRG Global (SRG)** have more than doubled in the most recent Portfolio-15 (May 2024). The two investments in **Southern Cross Electrical (SXE)** in Portfolios 13 and -14 (February and October 2023) are not far behind.

You are investing in Small Caps on the basis of growth at value prices. While this does not always happen, the potential is there and dividends de-risk your investment.

4. NO TURNOVER!

Over the seven years we've been running these portfolios, the stock performance has been consistent. Dividend-producing small caps purchased at value prices do not need to be sold as often as stocks that rely on momentum. In fact, for most of these stocks, their performance improves over time as they achieve superior operating leverage, where sales grow off a largely fixed cost base.

Big performers over time include the contractors **SRG Global (SRG)** and **Southern Cross Electrical (SXE)** as well as car parts provider **Infomedia (IFM)** aluminium products manufacturer **Capral (CAA)** as well as New Zealand radio station owner **NZME (NZM)**.

5. STRONG BALANCE SHEETS MATTER

We aim to identify companies with strong balance sheets and the capacity to increase dividends over time, from existing earnings, which has protected the performance of these portfolios from the worst consequences of the bear market caused by increasing interest rates.

Fundamentals are more important than ever – which means a strong balance sheet and positive cash flow. Weak balance sheets are even more important to avoid, as banks hesitate about refinancing without injecting more equity. We saw this when the Blue Chip pathology services group **Healius (HLS)** did an emergency equity capital raise late last year to reduce debt, which increased its shares on issue by almost 30% and from which it has not recovered. Small Caps can be even more vulnerable and experience has shown us which ones to avoid.

Many smaller companies are not dependent on general economic conditions to grow their business, either because they are winning market share, or because they service sectors that are less affected by the constraints of interest rates and economic growth. By definition, stocks paying dividends from underlying earnings that deliver market-beating yields are not expensive, which means they already have the valuation parameter on their side.

DIVIDEND PORTFOLIO REVIEW

6. THE SECRET BENEFIT OF DIVIDENDS

Reinvesting dividends is one strategy, but income also provides cash for new investments. We guide you in both.

Averaging down is a technique to increase your exposure to stocks where the fundamentals are robust, but sentiment has turned against particular unfashionable situations. This is something that takes experience and analysis. Under the Radar Report has consistently demonstrated that patience can deliver great results as long as you continue to pay attention to individual company prospects.

When stocks fall, our analytical antennae quiver. It is imperative to identify and understand fundamental factors that are not part of the market view as represented by the share price.

7. BUY CHEAP, BE PATIENT

The three portfolios showcased here highlight the benefits of stock picking. Put another way, not simply buying the index.

The most important determinant of your returns from any investment is the price you pay. In all but the rarest of cases, our returns will always be better if we have paid a lower price. Investors must be careful to be patient; let prices come to us, and like London buses, there is always another stock around the corner.

Portfolio-13: 32.9% Return: launched February 2023

This portfolio has absorbed weaker performers, delivering share price appeciation on top of dividends.

SMALL CAP DIVIDEND PORTFOLIO: Feb 2023

Small Cap dividend paying stocks we recommended in February 2023

COMPANY (CODE)	Recommendation price @ 16 Feb 2023	Dividends paid ($)	Cash yield	Price @ 4 Dec 2024	Price return	Total Return	Current recommendation
ACROW FORMWORK (ACF)	0.71	0.103	14.5%	1.07	50.7%	65.2%	Spec Buy
AUSWIDE BANK (ABA)	5.92	0.65	11.0%	4.49	-24.2%	-13.2%	Spec Buy
CAPRAL (CAA)	8.09	1.05	13.0%	10.35	27.9%	40.9%	Hold
GALE PACIFIC (GAP)	0.31	0.01	3.2%	0.14	-56.5%	-53.2%	Hold
ARN MEDIA (A1N)	1.22	0.135	11.1%	0.69	-43.4%	-32.4%	Hold
MYSTATE (MYS)	3.97	0.46	11.6%	4.12	3.8%	15.4%	Hold
NICK SCALI (NCK)	10.2	1.43	14.0%	14.62	43.3%	57.4%	Hold
NZME (NZM)	1.055	0.167	15.8%	0.95	-10.0%	5.9%	Buy
PACIFIC CURRENT (PAC)	7.31	0.76	10.4%	10.76	47.2%	57.6%	Hold
SOUTHERN CROSS ELECTRICAL (SXE)	0.705	0.11	15.6%	1.54	118.0%	133.6%	Hold
SRG GLOBAL (SRG)	0.765	0.085	11.1%	1.33	73.2%	84.3%	Take Profits
AVERAGE			11.9%		20.9%	32.9%	
				Portfolio Annualised return		17.29%	
S&P/ASX All Ords Index (XAO)	7,621			8,728		14.5%	
				XAO Annualised return		5.8%	
S&P/ASX Small Ords Index (XSO)	2,933			3,209		9.4%	
				XSO Annualised return		5.2%	

Portfolio-14: 29.4% Return: launched October 2023

This portfolio has benefited from a takeover of A2B but even more so, from the groth of contractors, SRG & SXE.

SMALL CAP DIVIDEND PORTFOLIO: Oct 2023

Small Cap dividend paying stocks we recommended in October 2023

COMPANY (CODE)	Recommendation price @ 5 Oct 2023 ($)	Dividends paid ($)	Cash yield	Price @ 4 Dec 2024	Price return	Total Return	Current recommendation
A2B AUSTRALIA (A2B)	1.64	0.65	39.8%	n/a	-11.3%	28.4%	*Taken Over
ACROW FORMWORK (ACF)	0.84	0.09	10.2%	1.07	27.4%	37.6%	Spec Buy
ARN MEDIA (A1N)	0.87	0.05	5.5%	0.69	-20.7%	-15.2%	Hold
BIG RIVER INDUSTRIES (BRI)	2.26	0.08	3.3%	1.30	-42.5%	-39.2%	Hold
CAPRAL (CAA)	8.90	0.35	3.9%	10.35	16.3%	20.2%	Hold
CENTREPOINT ALLIANCE (CAF)	0.25	0.03	11.2%	0.31	22.0%	33.2%	Spec Buy
DATA3 (DTL)	6.78	0.26	3.8%	7.58	11.8%	15.6%	Hold
HELLOWORLD TRAVEL (HLO)	2.57	0.11	4.3%	2.02	-21.4%	-17.1%	Spec Buy
NICK SCALI (NCK)	10.81	0.68	6.3%	14.62	35.2%	41.5%	Hold
NZME (NZM)	0.84	0.08	9.9%	0.95	13.8%	23.7%	Buy
SOUTHERN CROSS ELECTRICAL (SXE)	0.79	0.06	7.6%	1.54	95.8%	103.4%	Hold
SRG GLOBAL (SRG)	0.62	0.05	7.3%	1.33	113.7%	121.0%	Take Profits
AVERAGE			9.4%		20.0%	29.4%	
					Portfolio Annualised return	25.1%	
S&P/ASX All Ords Index (XAO)	7,118			8,728		22.6%	
					XAO Annualised return	8.9%	
S&P/ASX Small Ords Index (XSO)	2,643			3,209		21.4%	
					XSO Annualised return	18.3%	

Portfolio-15: 13.1% Return: launched May 2024

This portfolio has returned 13% in less than six months! Benefited from takeover offer of SLH, but even more so from re-rating of SRG.

SMALL CAP DIVIDEND PORTFOLIO: May 2024

Small Cap dividend paying stocks we recommended in May 2024

COMPANY (CODE)	Recommendati on price @ 15 May 2024	Dividends paid ($)	Cash yield	Price @ 25 June 2024	Price return	Total Return	Radar Rating
ACROW FORMWORK (ACF)	1.19	0.03	2.5%	1.07	-9.7%	-7.2%	Spec Buy
AUSWIDE BANK (ABA)	4.04	0.11	2.7%	4.49	11.1%	13.9%	Spec Buy
COUNT (CUP)	0.56	0.02	4.1%	0.77	36.6%	40.7%	Hold
DATA3 (DTL)	7.78	0.13	1.7%	7.58	-2.6%	-0.9%	Hold
ELDERS (ELD)	8.28	0.36	4.3%	7.70	-7.1%	-2.7%	Buy
GR ENGINEERING (GNG)	2.24	0.10	4.5%	2.28	1.8%	6.2%	Hold
HELLOWORLD TRAVEL (HLO)	2.43	0.06	2.5%	2.02	-16.7%	-14.2%	Spec Buy
INFOMEDIA (IFM)	1.59	0.02	1.3%	1.36	-14.5%	-13.2%	Hold
NORTHERN STAR RESOURCES (NST)	14.57	0.25	1.7%	16.04	10.1%	11.8%	Buy
NZME (NZM)	0.79	0.03	3.4%	0.95	20.3%	23.7%	Buy
SILK LOGISTICS (SLH)	1.49	0.01	0.9%	2.08	39.6%	40.5%	Hold
SRG GLOBAL (SRG)	0.85	0.03	2.9%	1.33	55.9%	58.8%	Take Profits
AVERAGE			2.7%		10.4%	13.1%	
				Portfolio Annualised return		25.51%	
S&P/ASX All Ords Index (XAO)	8,150			8,728		7.1%	
				XAO Annualised return		13.5%	
S&P/ASX Small Ords Index (XSO)	3,046			3,209		5.3%	
				XSO Annualised return		10.10%	

under the radar report
SMALL CAPS

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CITY CHIC COLLECTIVE

SECTOR CONSUMER DISCRETIONARY **INDUSTRY** RETAIL

Research Tip Update

We are ceasing coverage on CCX.

What's New?
A trading update was delivered at the AGM last week for the first 20 weeks of FY25 showing trading revenue down 4.8% and guidance maintained for $142-160m, but the company is tracking towards the lower range. This is up from FY24's $132m; while operating earnings of $14.5m (midpoint) versus a loss of $9.4m in FY24.

The market reacted negatively the stock is now below 10 cents, well below the 15 cents a share $25m stay in business capital raise done in June and highlights just how difficult the predicament the plus-sized fashion retailer is in. The company has $10m in cash no debt and aims for profitability in FY25, which we are not expecting. The stock is trading at a discount to retailers, based on its mid-single-digit cash flow multiple, but there are much higher risks, being loss-making and capital-constrained.

Portfolio Risk Rating: The hard work on costs has been done, with the cost of doing business almost halved and the balance sheet has been strengthened. Despite all this, the company remains loss-making on current sales run rates.

Bull Points
• Leading presence in ANZ
• Emerging sales in North America

Bear Points
• Aggressive competition
• Difficult market conditions

Analysis: This is the last chance saloon. CCX has experienced the retail heights but has too often fallen prey to retail depths. If the company achieves break-even in FY25 there will be a positive re-rating. But we're not holding our breath. The big positive is net cash of $10m, but the breakeven point is $150m on our numbers (see Issue 606 in June) and that won't be achieved this year or possibly next. The operating leverage of reaching this figure was behind our hold rating, but now the risks are higher because sales are not coming through the doors.

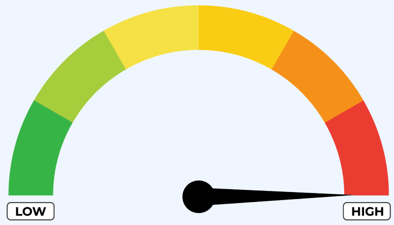
The key period is the next five weeks – Black Friday, Christmas, Boxing Day – in the short term and we expect cash levels to increase as inventory is run down. The company expects sales to be weighted to the second half due to the Northern Summer, hence momentum will be crucial.

Over the longer term, the strategy is to boost stores in Australia from 77 to 120 over the coming years and to focus on partnerships via Amazon in the US, where there is no store presence.

RADAR RATING: The founder and CEO Phil Ryan has his back firmly against the wall. We are holding on the basis that he works his retail magic, having done the hard work on costs. HOLD & CEASE COVERAGE.

RADAR RATING: **HOLD**

RISK RATING



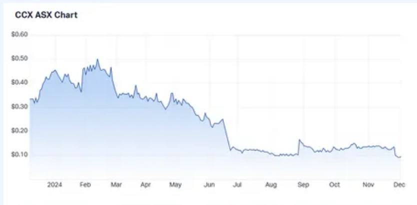
ASX CODE **CCX**

CURRENT PRICE **$0.105**

MARKET CAP $36M

DIVIDEND YIELD 0%*

NET CASH ($M) 10M



DATA AS AT INITIAL COVERAGE:

DATE 24 FEBRUARY 2022

PRICE ($) 0.60

under the radar report
SMALL CAPS

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05 DECEMBER 2024

DATA#3

SECTOR INFORMATION TECH **INDUSTRY** SECURITY DATA SERVICES

Research Tip Update

What's New?
The stock has under-performed this year but has been one of our stand-out Core holdings. Profit before tax guidance for the first half (1h25) is $32m (mid-point), up from $30.8m in the same period a year ago, highlighting slowing growth.

Portfolio Risk Rating: Valuation has softened but the forecast PE remains well over 20 times. Opportunities to buy DTL at a reasonable price are rare. A substantial component of its business is relatively low-margin software sales, but 67% of revenue comes from recurring contracted payments. We think DTL is a core portfolio holding.

Bull Points
• Direct exposure to large company and government recurring IT spend
• Well-managed & conservative balance sheet

Bear Points
• Competition increasing
• Employees a substantial cost component

Analysis: DTL's business involves critical capabilities central to large organisation capabilities. Some clients will internalise their operations, and some IT services DTL currently profits from will become commodities or prices will fall. However, the evolution of underlying technology ensures that there is a constant need for innovation, and DTL augments the ability of its large clients to scale up.

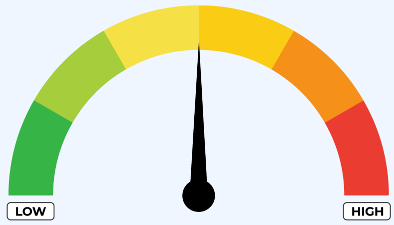
Moreover, while cyber security is now a foundation of customer service, AI, the Internet of Things, 3D printing and digital transformation remain sources of substantial growth. Strong partnerships with key AI players like Microsoft, Dell and HP, will ensure DTL participates in the implementation for customers.

FY24 results had shown continued stable growth, with profit before tax up 17% to $63m, producing the same rise in earnings per share to 28 cents. The bottom line benefitted from substantial interest income, earned on the average daily cash balance of $217m, up 80%. This represents DTL customers' payments held for some time before it is paid to its technology partner suppliers. The 90% payout ratio delivered a full-year dividend of 25 cents, which is forecast to be maintained.

RADAR RATING: Management has delivered impressive growth, but a historic P/E ratio of 27x is not cheap even for a high-quality business. Exposure to IT growth trends of digital transformation, cloud, security and AI support a premium valuation nevertheless.

RADAR RATING: **HOLD**

RISK RATING



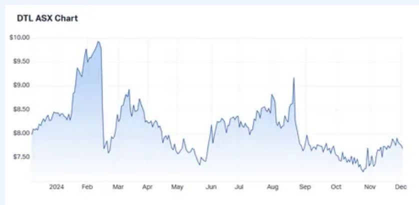
ASX CODE **DTL**

CURRENT PRICE **$7.43**

MARKET CAP $1.19BN

DIVIDEND YIELD 3.5%*

NET CASH ($M) 276.4M



DATA AS AT INITIAL COVERAGE:

DATE 26 MAY 2016

PRICE ($) 0.99

Forecast 26 cents
***** Largely held for trade creditors***

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NORTHERN STAR RESOURCES

SECTOR METALS_MINING **INDUSTRY** GOLD

Research Tip Updates

What's New?
The gold producer is acquiring ASX-listed **De Grey Mining (DEG)** in an all-script transaction where each De Grey shareholder receives 0.119 new Northern Star shares. The implied value is $2.08/share and values De Grey at $5bn. NST has fallen 8% on the announcement, but remains one of our best-performing stocks, having returned 21% in the past 12 months and almost 30% a year over the past 10 years!

The main asset of De Grey is its undeveloped Hemi gold project in the Pilbara, WA plus $187m cash. Hemi has 13.6moz gold and 6.0moz gold in resources and reserves respectively. The estimated development cost is $1.3bn.

Portfolio Risk Rating: There is risk on the acquisition, but a greater risk not doing anything. This is a core portfolio position that can grow. NST looks good value, trading on a forecast PE ratio of 15 times, close to peers.

Bull Points
• Long-term growth secure
• Relatively low-cost producer

Bear Points
• Single commodity
• Pogo (Alaska) has underperformed

Analysis: In our recent note last week (Issue 628) we focused on the growth of the Kalgoorlie Super Pit. This deal represents value for NST because it cements growth beyond Kalgoorlie and at current gold prices this will be earnings per share positive. There is a risk because production is 5 years away, but NST is big enough to absorb this risk. This ensures the big gold producer's future.

This will be a big mine, projected to produce 530k ounces a year, boosting NSTs by a quarter to 2.5m ounces a year from the current targeted level of 1.8-2.2moz a year. Hemi underground and regional deposits could facilitate higher production. Costs will be in the first half of the global gold cost curve and there is significant exploration potential, evidenced by the number of juniors in the area, which have been coming up with discoveries.

Capital costs are projected at $1bn and there is a risk that costs could increase. Production will be facilitated by the construction of a big 10m tonnes year plant.

RADAR RATING: Northern Star reaffirms its position as the largest Australia-domiciled gold producer with Hemi, which adds ~25% to gold production over the medium term.

RADAR RATING: **BUY**

RISK RATING

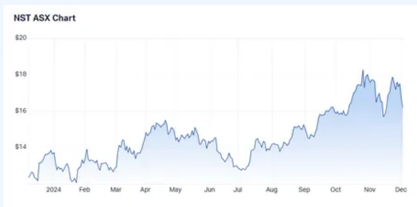
ASX CODE **NST**

CURRENT PRICE **$16.14**

MARKET CAP $18.4BN

DIVIDEND YIELD 0%*

NET CASH ($M) 148M



DATA AS AT INITIAL COVERAGE:

DATE 18 MARCH 2015

PRICE ($) 0.72

Forecast 54 cents

Published by Under the Radar Report Ltd
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PARAGON CARE

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

Research Tip Updates

What's New?
At the AGM in late November, there was more detail on the integration following the merger in June with another med-tech wholesaler CH2 Holdings. FY25 revenue guidance, comparable to FY24 proforma numbers, is $3,704m, up 11.2%; and includes CH2 pharmacy wholesaling, its contribution being $2,825m, up 13.4%.

The stock has more than doubled since we first recommended it in mid-2021 (Issue 448) prior to which it was on our watch list for two years (Issue 342) but it's been a bumpy ride.

Portfolio Risk Rating: There is anticipated growth but the stock trades on a market multiple, trading on a PE of 20 times, and on a cash flow valuation (EV/EBITDA) of 10 times, which reflects the transition from growth to a potential core holding. There remains integration risk. Debt levels are being monitored with net debt / EBITDA at over 3 times on a historic basis (uncomfortable) but are forecast to fall to below 2 times.

Bull Points
- CH2 distribution growth in Asia
- Merger synergies

Bear Points
- Merger integration risk
- Competitive wholesale markets

Analysis: A reverse takeover by CH2 (Clifford Hallam), the merged group being led by CH2 CEO David Collins and Chair Peter Lacaze, who now own 28.5% each, ensuring that they are highly motivated. In Australia, there are four main pharmaceutical wholesalers. EBOS with 40% market share, **Wesfarmers (WES)** subsidiary API with 30%, ASX listed **Sigma Healthcare (SIG)** with 20% and CH2 with close to 10% and the potential to grow via Paragon Care infrastructure.

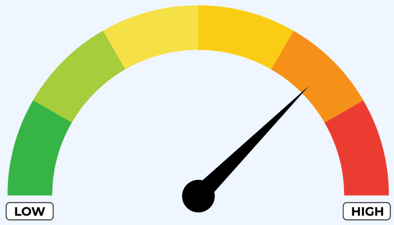
In 2018, CH2 was appointed as a Community Service Obligation distributor for Australian community pharmacies and became a full-line wholesaler; in 2021 CH2 acquired Sigma's hospital pharmacy division. Revenue grew quickly, and earnings margins were thin, but operating earnings growth was impressive through EBITDA/sales doubling from 0.7% to 1.4%.

The merger aims to accelerate an expansion of CH2 products into New Zealand and Asia using Paragon Care infrastructure. In Asia, Paragon has networks in Korea, Japan, Vietnam, the Philippines, Thailand and China. In addition, increased sales are expected for Paragon Care healthcare equipment, due to CH2's distribution.

RADAR RATING: Future earnings growth from expansion of CH2 products and capabilities into New Zealand and Asia leveraging off Paragon Care infrastructure.

RADAR RATING: **HOLD**

RISK RATING



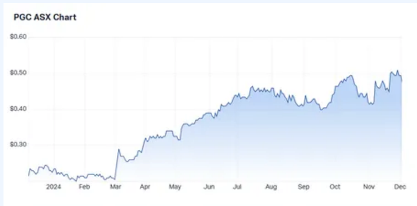
ASX CODE **PGC**

CURRENT PRICE **$0.48**

MARKET CAP $819.4M

DIVIDEND YIELD 0%*

NET DEBT ($M) -176.7M



DATA AS AT INITIAL COVERAGE:

DATE 27 MAY 2021

PRICE ($) 0.23

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.
Website www.undertheradarreport.com.au

under the radar report
SMALL CAPS

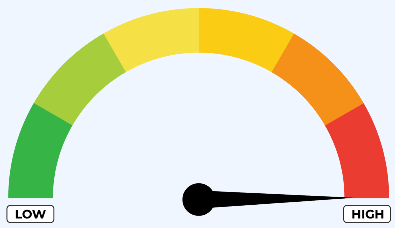
ISSUE 629
05 DECEMBER 2024

SOMNOMED

SECTOR HEALTHCARE **INDUSTRY** EHEALTH MED TECH

RADAR RATING: **HOLD**

RISK RATING



ASX CODE **SOM**

CURRENT PRICE **$0.445**

MARKET CAP $85M

DIVIDEND YIELD 0%*

NET CASH ($M) 15.2M

DATA AS AT INITIAL COVERAGE:

DATE 02 OCTOBER 2014

PRICE ($) 2.04

Research Tip Update

Downgrade from Spec Buy

What's New?
SomnoMed has spiked almost 60% on upgraded revenue expectations and news relating to its sleep monitoring system Rest Assure. The stock has more than doubled since our buy recommendation in May (Issue 599). FY25 revenue is now expected to be $5m higher at $105m, up 15% on the prior year, which was up 10% on FY23. Operating earnings (EBITDA) are now forecast at over $7m, up from $5m and compared to -$2.5m in FY24. We assume capital expenditure remains at $3-4m. The med-tech is aiming for FDA approval for Rest Assure in 2026, and is undertaking a study to validate efficacy (that it works) and aims for submission of a US-based clinical study late next year.

Portfolio Risk Rating: High, even for a growth stock! This stock has caused investors many problems. The fact that it's alive should give pause & profit margins are still too low, but it still looks good value and has big cash reserves.

Bull Points
• Demand for product
• Balance sheet repaired

Bear Points
• Regulatory hurdles remain
• Confidence low

Analysis: SomnoMed is showing that where it counts – the sales line – the company is delivering. The company's dental-based sleep apnoea treatment has a niche market, but one that is growing and only now is being accessed. The market is highly fractured, but SomnoMed has the best product in the market, as evidenced by its global approval. The positive move indicates that if Rest Assured does come closer to approval, bigger gains should occur.

There have been problems with distribution over time, but we have confidence in new management led by co-CEOs Karen Borg & Amrita Blickstead, as well as a largely new board. They have complimentary experience, Borg on the commercial side – US, Europe & APAC; and Blickstead on the manufacturing front. The company now has a new CFO Ye-Fei Guo who has experience in private equity.

Rest Assure could be a game-changing development, allowing sleep patterns to be monitored. This brings oral devices into the game with the **ResMed (RMD)** CPAP devices.

Earnings margins remain a big concern. The guidance indicates 6.6%, but the company has claimed gross profit margins of 60% in the past. We are seeing improvement as sales climb.

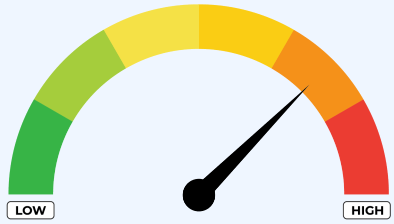
RADAR RATING: This has been a difficult stock, but it's still punching. The stock is cheap and has the backing of big investors. What it's also got is big potential in sleep apnoea treatment, but we are exercising caution after its re-rating.

THE REJECT SHOP

SECTOR CONSUMER DISCRETIONARY **INDUSTRY** RETAIL

RADAR RATING: **SPEC BUY**

RISK RATING



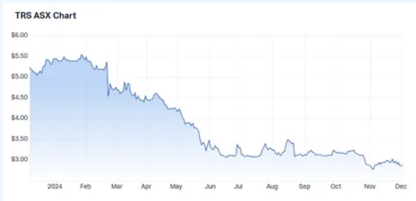
ASX CODE **TRS**

CURRENT PRICE **$3.01**

MARKET CAP $107M

DIVIDEND YIELD 0%*

NET CASH ($M) 49.9M



DATA AS AT INITIAL COVERAGE:

DATE 24 OCTOBER 2018

PRICE ($) 2.51

**Forecast 5 cents*

Research Tip Update

Upgrade from Hold

What's New?
We have been buyers at lower levels but we're down on our spec buy recommendation in May. The retailer confirmed first-quarter sales growth at its AGM in October, without quantifying the improvement. The company continues to open new stores, with up to 5% growth in FY25 and underperforming stores are also closing.

Portfolio Risk Rating: The downside is limited by the clear downmarket positioning, dividends and cash reserves. TRS continues to buy back stock as well as paying a 10-cent interim dividend, although no final dividend was paid. The target minimum payout ratio of 60% should ensure an interim FY25 dividend can be paid. The stock looks valuable but is at high risk being a retailer. Keep positions small i.e. less than 2% of your portfolio.

Bull Points
- Strong balance sheet
- Value positioning

Bear Points
- Low-income customer financial pressures
- Cost pressures

Analysis: With almost 400 stores TRS is an important source of lower-priced branded products in an era of higher perceived inflation, even if price pressures in some categories have now eased. Merchandise improvements are focused on a new homewares range, and improving and growing seasonal business, long an important source of customer interest and traffic.

Sales focus has been on holiday and special event product ranges, and the current second quarter to 31 December with both Halloween and Christmas, is critical in determining FY25 performance. Increasing the store network and themed offerings are succeeding in growing sales, but the company is also focused on reducing costs to improve gross profit margin.

TRS has a strong balance sheet with $50m cash. Other current assets include $146m inventory at cost, offset by only $60m trade debtors, the other major liabilities are next year's lease payments ($81m). If the inventory sells as planned, it delivers a markup of over 50%.

FY24 results were near the top of revised expectations, sales were up 4.1%, lower than inflation. EBIT of $5.4m on a pre-AASB 16 basis was down 41% and reflected a $14m loss in the second half illustrating dependence on a good first half. FY24 operating cash flow after lease payments was down from $14.7m to $3.1m, mainly due to a one-off reversal in tax payment flows. EPS was down 55% at 12 cents.

RADAR RATING: A strong balance sheet and sales are now growing, while costs are being contained, increasing operating leverage. High risk.

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BEST STOCKS TO BUY

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

ACROW FORMWORK (ACF) — SPEC BUY

INDUSTRY	**CONTRACTOR**
MARKET CAP	**$325M**
DIVIDEND YIELD	**5.6%**
12 MONTH HIGH	**$1.35**
PRICE @ 2024-12-04	**$1.07**

Formwork is on a strong growth path including internally developed proprietary products and processes. Industrial Services is one third of revenue targeting recurring business, and is expected to grow through M&A.

AIRTASKER (ART) — SPEC BUY

INDUSTRY	**SOFTWARE**
MARKET CAP	**$143M**
DIVIDEND YIELD	**0%**
12 MONTH HIGH	**$0.38**
PRICE @ 2024-12-04	**$0.32**

Funding growth from earnings and media partnerships. Robust Australian earnings now needs to be translated to the bigger international business.

ALLIANCE AVIATION (AQZ) — SPEC BUY

INDUSTRY	**CONTRACT AVIATION SERVICES**
MARKET CAP	**$440M**
DIVIDEND YIELD	**0%**
12 MONTH HIGH	**$3.40**
PRICE @ 2024-12-04	**$2.74**

Balance sheet and cashflow are limiting factors, despite strong operating fundamentals. Rerating likely when close to free cash flow positive with enlarged E190 fleet utilised.

ELDERS (ELD) — BUY

INDUSTRY	**FOOD**
MARKET CAP	**$1.355B**
DIVIDEND YIELD	**4.7%**
12 MONTH HIGH	**$9.97**
PRICE @ 2024-12-04	**$7.69**

The agricultural cycle has been a headwind, but ELD is a long-term asset for a diversified portfolio. Well positioned for potential cyclical upside.

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BEST STOCKS TO BUY

ENERGY ONE (EOL) — SPEC BUY

INDUSTRY	**SOFTWARE**
MARKET CAP	**$165M**
DIVIDEND YIELD	**1.1%**
12 MONTH HIGH	**$5.95**
PRICE @ 2024-12-04	**$5.30**

A niche in an active market. Delivery of organic revenue growth has been held back at the bottom line in FY24 by investment for future prospects, and the potential for further medium-term growth is good.

HANSEN TECHNOLOGIES (HSN) — BUY

INDUSTRY	**SOFTWARE**
MARKET CAP	**$1.123M**
DIVIDEND YIELD	**1.8**
12 MONTH HIGH	**$5.71**
PRICE @ 2024-12-04	**$5.52**

The founder led business is working hard on Powercloud, which will create new growth opportunities if it can be successfully turned around. The much larger core business is cash-generative and is still growing.

KAROON ENERGY (KAR) — SPEC BUY

INDUSTRY	**OIL AND GAS**
MARKET CAP	**$1.097M**
DIVIDEND YIELD	**5.9%**
12 MONTH HIGH	**$2.42**
PRICE @ 2024-12-04	**$1.37**

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

MEDADVISOR (MDR) — SPEC BUY

INDUSTRY	**EHEALTH MED TECH**
MARKET CAP	**$165M**
DIVIDEND YIELD	**0%**
12 MONTH HIGH	**$0.59**
PRICE @ 2024-12-04	**$0.30**

Early stage with ambitious targets. This is high risk but high reward and based on big pharma's demand for the marketing pipeline MDR provides.

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BEST STOCKS TO BUY

NORTHERN STAR RESOURCES (NST) — BUY

INDUSTRY	**GOLD**
MARKET CAP	**$18.19B**
DIVIDEND YIELD	**3.4%**
12 MONTH HIGH	**$18.32**
PRICE @ 2024-12-04	**$15.82**

Northern Star reaffirms its position as the largest Australia-domiciled gold producer with Hemi, which adds ~25% to gold production over the medium term.

NZME (NZM) — BUY

INDUSTRY	**MEDIA**
MARKET CAP	**$179M**
DIVIDEND YIELD	**7.7%**
12 MONTH HIGH	**$1.04**
PRICE @ 2024-12-04	**$0.96**

We maintain our positive recommendation because the stock is cheap on current earnings, is well-positioned to benefit early from NZ economic growth and pays dividends.

XRF SCIENTIFIC (XRF) — SPEC BUY

INDUSTRY	**CONTRACTOR**
MARKET CAP	**$260M**
DIVIDEND YIELD	**2.4%**
12 MONTH HIGH	**$1.79**
PRICE @ 2024-12-04	**$1.85**

Exposed to materials testing, which is essential for global mining and industrial users. Capital light model, high margins, self-funding growth.

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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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