STOCKS DOWN UNDER

27 NOVEMBER 2020

Small Cap Stocks Down Under

"I have never let my schooling interfere with my education."

- Mark Twain (1835 - 1910), American author

HARMONEY CORPORATION

An IPO out of harmony

VIVA LEISURE

Viva profits

HOMECO DAILY NEEDS REIT

Not a daily need

HARMONEY CORPORATION

An IPO out of harmony

Stocks Down Under rating: ★★★★

ASX: HMY
Market cap: A$ 328M

52-week range: A$3.15 / A$3.55
Share price: A$ 3.31

Headquartered in Auckland, New Zealand, Harmoney Corporation is one of the latest financial companies to list on the ASX. The company mainly specialises in online direct personal loans in New Zealand and is using the proceeds from the IPO to expand its presence in Australia. This is a fast-growing company in an area where we see significant demand post-pandemic. Harmoney's stock has taken a bit of a dive since its IPO on 18 November 2020, but we think this IPO has got some legs.

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VIVA LEISURE

Viva profits

Stocks Down Under rating: ★★★★

ASX: VVA
Market cap: A$ 232M

52-week range: A$0.66 / A$3.31
Share price: A$ 3.03

Headquartered in Sydney, Viva Leisure is certainly no Viva Las Vegas. Instead of drinking and gambling the company owns and operates health clubs throughout the east coast of Australia, New Zealand and India. With all the news of multiple successful vaccine trials, many investors have been switching over to companies that should benefit from a return to normal. Sure, Viva will certainly benefit, but they are already seeing a recovery now, before any vaccine has become available.

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ASX: HDN
Market cap: A$ 659M
Dividend yield: 5.5% (0% Franked)

52-week range: A$1.31 / A$1.40
Share price: A$ 1.36

On 23 November 2020, HomeCo Daily Needs REIT listed on the ASX for the first time at an initial price of $1.33 per unit. The HomeCo listing is a spinoff of Home Consortium, a REIT listed on the ASX on 11 October 2019. The assets Home Consortium is spinning off consist of convenience malls and large-format retailers. This new trust has a current Net Tangible Asset value per share of $1.33. Yet, the company's first day on the market saw the stock rise less than 1%, despite its 5.5% dividend yield. This is unusual when compared to many of HomeCo's peers who are trading at a premium. So, what's going on?

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Share price chart

Source: Tradingview

Harmoney with money

Harmoney focuses on online-based three to five year personal loans up to NZ$70,000 and A$70,000 in Australia (notice the difference in currencies). The company has seen its total loans grow at an annual rate of around 86% over the last couple of years and we believe its major expansion into Australia is likely to supercharge that. The company derives its income from two main streams: fee income and interest income.

Fee income saw steady growth from NZ$23m to NZ$27m during FY20. The majority of this 17% year-over-year growth was derived from Australia rather than New Zealand. This is not overly surprising as we believe the main source of growth in the company's loan book will be Australia, not New Zealand. As fee income is both consistently the largest source of Harmoney's income and the least subject to fluctuations, we believe fee income is most likely to match with the company's loan book originations. Since the majority of loan book growth is from Australia, we expect the majority of fee income growth will be too.

Interest income fluctuates based on the rate at which borrowers payoff loans early and the company's ability to maintain a stable loan book. Since Australia is still a relatively new and untapped market for Harmoney, it was no surprise to see the company's interest income grow from NZ$5,000 in FY19 to NZ$907,000 during FY20. Repeat customers, the company has found, are 40% less likely to force the company to write off their

loans. Therefore, it was an important note the company made when they said 65% of total loans during FY20 were from repeat customers. There will always be a delay in the results from this division as the increase in the loan book will take time to sufficiently generate interest income for the company. In our opinion, this division is more important for Harmoney and we believe it is where a significant amount of the company's future growth will be generated. It will just take some time to catch-up.

The IPO

Harmoney's IPO really should be considered a failure. After issuing shares at $3.50, the stock began the week by dropping 3.8% to $3.35 at Monday's close, only its second full trading day. However, despite the company's share price drop, Harmoney disclosed an interesting new investor on the day of the IPO; Heartland Group Holdings.

The Heartland Group is a New Zealand financial services group we wrote about on 20 August 2020. We believe the company is one of New Zealand's more interesting growth banking plays. The fact that the Heartland Group has decided to purchase 8.4% of Harmoney's shares in its IPO is a very bullish signal, in our view.

Loan origination, it's all about the geography

The majority of Harmoney's operations are currently based in New Zealand and the company began its expansion into Australia back in FY18. FY20 saw the company's reach expand to almost 50,000 customers across Australia and New Zealand.

Growth in the company's loan book in New Zealand over the last few years has been steady and consistent at an average annual growth rate of 27% between FY17 and FY19. However, FY20 saw a slight decline in New Zealand's loan book growth at 22% after reaching $421m.

Starting in FY18 at $42m, Australia has provided a significant portion of the Harmoney's loan book growth with 65% annual growth between FY18 and FY20 to NZ$114m. Based on the company's focus on Australia and $70m raised from the IPO, we expect this division will continue to provide the bulk of the company's growth. This is mostly due to the significant difference in both population size and economic wealth generated in Australia versus New Zealand. Australia simply has a wealthier and much larger consumer base.

No time for a loan just buy

Harmoney has already released its results for the four months ending October 2020 and they were highly encouraging. As the Australian and New Zealand economies have begun to open up, the company has been experiencing stronger demand for its loans. While the company's loan book was 1% smaller than forecasted in the prospectus, this was entirely due to a weaker Australian Dollar versus the New Zealand Dollar. In constant dollar terms, the loan book actually beat prospectus forecasts.

Despite the Australian Dollar's weakness, the company still managed to beat its forecasts for total income by 2% and cash Net Profit After Tax by 52%, growing to NZ$27m and NZ$1.6m, respectively.

While COVID-19 has prevented any long-term predictions for the company's performance, we remain confident that Harmoney is in perfect harmony with its growth. The company is trading well below its IPO price and we believe this is a temporary market overreaction due to the current shift in market sentiment towards other sectors. The market is currently in a weird state of flux and we believe this is why Harmoney has been hit since its IPO. It's a four star rating from us.

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Share price chart

Source: Tradingview

I came, I saw, I trained

Founded in 2004, Viva Leisure (Viva) operates 309 facilities across 11 health club brands. The company's main operations are based on the East Coast of Australia, branded as its Club Lime brand.

The Club Lime brand is mainly based in the Australian Capital Territory where it has 41 of its total 79 facilities. Club Lime is the company's central brand and has four sub-brands covering women's only fitness, swimming facilities and personal training.

As of 21 August 2020, Viva took control of Australian Fitness Management, absorbing the company's Plus Fitness Group and its over 200 clubs located across the ACT, NSW, VIC, SA, WA, New Zealand and India. This acquisition cost $18m plus a $2m deferred payment subject to performance metrics. While we will be watching this acquisition closely, the company's latest update on 19 October 2020 has strongly indicated that the acquisition is being absorbed smoothly.

The COVID-19 recovery is real

One of the more interesting aspects of Viva is that the company shows both its total visits during CY20 and the last 30-days average visits on the front page of its website. This is how we are able to tell that the average daily visits during CY20 was 12,813 as of 24 November 2020. Comparing this to the last 30-day average daily visits of 20,015 shows that people are really starting to go back to their pre-COVID-19 routines. Net member growth over the last three months has been 7,002. Over the last 30 days the daily visits have been on a strong upward trend. On 10 November alone, the company reported 25,000 visits across the entire network.

So how does this all compare to pre-COVID-19? Unfortunately, the company does not have a historical archive that we can view. However, utilising archive.org, we were able to see the statistics on 1 March 2020. During the first 60 days of CY20, the average daily visits number was 15,205. Net member growth was 15,370 over the prior three months. While the company has not seen its member growth recover to pre-COVID-19 levels, we believe the more significant figure is how daily average visits has reached levels higher than before health clubs were shutdown.

No mirage here

The stock may have broken its pre-COVID-19 high, but so has the club's performance. We believe this strongly indicates that Viva does not need to wait for a vaccine, the company is already seeing its operations recover. One of the main reasons behind the company's recovery success is that for the first time since 23 March 2020, 100% of the company's health clubs in Australia are open again, although some with restrictions. We believe all of this indicates a strong bullish signal for Viva.

The market is currently expecting Viva's FY21 EBITDA to grow 252% from $6.1m during FY20 to $21.4m FY21. However, this expectation is exclusively due to the company rebounding from its COVID-19 business shutdown. Therefore, we believe it would be more realistic to look at the Compounding Annual Growth Rate (CAGR) of 52.5% the market is expecting between FY21 and FY23. This compares to EV/EBITDA multiples for FY21, FY22 and FY23 of around 17x, 10x and 8x, respectively. In other words, we believe there is a substantial disconnect between expected growth and valuation, making this stock very attractive right now.

We don't believe Viva is strictly a reopening play, although it certainly fits the bill. The company has some real wind under its wings and we believe this is not just an investment that will benefit investors in the short-term, but the long-term as well. It's a strong four stars from us.

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Share price chart

Source: Tradingview

Opening up the book

Upon HomeCo's listing on the ASX it had a total of 17 properties valued at around $844m with an occupancy rate of 98%. The trust's properties are spread across Perth, Brisbane, Sydney, Melbourne and Adelaide.

The Weighted Average Lease Expiry (WALE) for HomeCo's property book is a solid 8.4-years. For our regular readers this won't come as a surprise but when it comes to long term WALEs we are always sceptical. Looking deeper into the trust's leases reveals that 80% of the leases expire during and after 2025 and therefore, the trust's WALE of 8.4-years is a good indication of the overall portfolio.

Solid acquisition but nothing special

On 23 November 2020, the trust announced the acquisition of the Marsden Park Shopping Centre in Syndey. The acquisition cost $48m and was fully funded by debt. We believe this property is a strong acquisition for the trust with a WALE of eight years and the property being anchored by a Coles and Woolworths lease. The property has also returned to normal, pre-COVID-19 levels of foot traffic with October seeing a 19% increase versus the corresponding period.

After the cost of this acquisition the trust is left with $215m of debt funded liquidity and a total debt facility of $500m. The trust has stated that it plans on using this $215m of liquidity to purchase additional properties with similar characteristics, such as long term WALEs.

Anything of importance left from the listing?

Despite listing HomeCo on 23 November 2020, Home Consortium still maintains a 27% stake in HomeCo. These shares are currently in a long state of escrow that lasts until the close of the market on 23 November 2021. Investors should place this date on their calendars for a number of reasons, including the company potentially looking to offload its HomeCo shares. To be clear, Home Consortium's management has made no indication that this will happen, but a lot can happen in a year and we believe this remains a risk investors need to be aware of. This is especially true since the second largest shareholder, HSBC Custody Nominees only controls 7% of shares outstanding.

You can thank the RBA

We really don't think HomeCo is anything special as a REIT, even at a 5.5% dividend yield. But with the Reserve Bank of Australia keeping interest rates at 0.01% for the foreseeable future, we don't believe it is wise to say anything overly negative about a relatively solid, long-term REIT with a 5.5% yield. We believe the trust is really only worth its Net Tangible Asset Value of $1.33 per unit and it is already trading at a slight premium to its Net Tangible Asset Value of 2 % as of market close on 26 November 2020.

While a premium of 2% might not seem like that big a deal, even after the current REIT rally there are still trusts trading at significant discounts to Net Tangible Assets, with better prospects and a similar dividend yield. These past couple of months we have written about a number of different REITs producing a year-to-date performance of 13%. One example that comes to mind is Blackwall Property Trust (ASX: BWR), which we wrote about back on 14 August 2020. Despite Blackwall already rallying 10% since we wrote about it last, the trust is still trading at a discount to Net Tangible Assets of 7%. Based on the current market, but taking into account the RBA's monetary policy stance for the foreseeable future, HomeCo is a three-star stock for us.

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