18 DECEMBER 2020

Small Cap Stocks Down Under

> *Never lend books, for no one ever returns them; the only books I have in my library are books that other folks have lent me.*

- Anatole France (1844 - 1924), Nobel prize winning writer

PLENTI GROUP

Plenty to like about this Tech savvy lender

ELANOR INVESTORS GROUP

Everything you're looking for in a real estate fund manager

THORN GROUP

Transformation to a Digital Model Sparks a Turnaround

PLENTI GROUP

Plenty to like about this Tech savvy lender

Stocks Down Under rating: ★ ★ ★ ★

ASX: PLT
Market cap: A$ 169M

52-week range: A$1.00 / A$1.44
Share price: A$ 1.02

Based in Sydney, Plenti Group is a small loans company that uses its user-friendly technology platform to connect consumers with its lending offerings. Its products include automotive, renewable energy and personal loans. Plenti sources it funds from various places, including retail “funders”. It then turns around and offers interest-bearing loans, while leaning on an efficient, technology-based operating model. From its early days as strictly a peer-to-peer lender, Plenti has gathered funds from banks, fixed income funds and even a superannuation fund, strengthening its financial backbone. Since its $280m September 2020 IPO, Plenti Group shares have declined in value creating, what we believe is, an attractive entry point for new investors.

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Stocks Down Under rating: ★ ★ ★ ★

ASX: ENN
Market cap: A$ 215.2M
Dividend yield: 5.3%

52-week range: A$0.65 / A$2.18
Share price: A$ 1.77

Based in Sydney, Elanor Investors Group is a ‘pure play’ real estate funds manager and investor. Its managed funds target Australian and New Zealand properties that have attractive risk-return profiles and are focused on four key sectors — retail, commercial, healthcare and hotel/travel/leisure (HTL). We like the diversified nature of the managed funds platform. The group’s discretionary retail exposure is limited while commercial, healthcare and HTL investments are located in well-established regions with room for growth. The shares have recovered nicely off their March 2020 bottom, but remain down 15% year-to-date. Given the track record of growth and active pipeline in all investment sectors, the rally in this stock looks poised to continue.

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ASX: TGA
Market cap: A$ 72.8M
Dividend yield: 2.1%

52-week range: A$0.029 / A$0.29
Share price: A$ 0.185

Headquartered in Sydney, Thorn Group is a financial services company that provides consumer and commercial financing solutions. As a leader in Australia’s household goods rental market since 1937, it leases a range of kitchen appliances, washers and dryers, computers, furniture, fitness equipment and more. The business serves as an alternative to buying and owning for folks that find it more economical to lease. The shares have long been a thorn in investors’ side. A year ago, Thorn Group settled a $25m class action lawsuit related to past lending practices at its now closed Radio Rentals stores. But with this now in the rear-view mirror and the stock having advanced 26% year-to-date, the company looks to be on the comeback trail. A transition to an online-only consumer leasing model, cost reductions and a declining debt load are good reason for investors to buy (rather than lease) Thorn Group shares.

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Share price chart

Source: Tradingview

Efficient online lending platform

Plenti is not your average small lending company. Its product categories focus on three main markets; automotive, renewable energy and other personal loans. The group does offer traditional fixed-term, unsecured loan products, though, that consumers use for various purposes, such as home improvement, medical expenses or debt consolidation. So too does it offer car loans to both individuals and commercial customers for new and used vehicles. But it also offers exposure to the alternative energy space through its renewable energy lending program, which helps Australian households buy and install things like solar panels and batteries.

What also makes Plenti a bit different is its online-first business model. Considered a financial technology ("fintech") company, Plenti's main competitive advantage lies in its ability to leverage its in-house technology to grow revenues and maintain a lean cost structure. People are attracted to the simple process to obtain competitive loans and good service all from a convenient mobile app or website. They see the value and so do we.

Strong loan book growth

Thanks to its robust technology platform, Plenti's loan portfolio has had a strong credit performance. This means its credit losses related to customers unable to pay them back have been low. The number of borrowers in loan deferral and those that are 90-plus days late on their payments are both trending lower. Plenti has exhibited industry-leading credit performance metrics as evidenced by its minimal 0.42% 90-plus days arrears figure. Its focus on lower-risk prime borrowers certainly helps.

The group demonstrated strong growth in its loan book during the six months to September 2020. The value of the loan portfolio was 42% above where it was one year prior at $435m (and also a tad above the group's prospectus). Plenti's loan portfolio has increased in every interim period since its 2015 inception and has grown at an average 61% rate over the last three years.

Loan originations were up 33% in the first half of FY20 and Plenti generated record volumes in July, August and September. The streak of record originations was then stretched to four months in October.

Although personal loan demand was negatively impacted by the onset of the pandemic, things are now looking up. Meanwhile, the personal and renewable energy businesses have done well amid increased consumer demand for home improvement projects, including solar panelling.

Well positioned for an automotive sales recovery

Car lending has also been driving growth as Australians have shunned public transportation in favour of cars. The credit warehouses have been very supportive of this growth. They increased Plenti's credit limit from $50m in 1HY19 to $150m in 1HY20—and upsized it to $275m in November 2020. Warehouse money funded Plenti's new car loan product that was launched at the beginning of the year. The success of this new offering was the big reason behind 323% growth in car loan originations in 1HY20. We see the car business continuing to grow nicely.

We like the fact that Plenti is leveraged to the recovery in Australia's automotive market. The country's $33bn auto lending market is undergoing seismic structural, regulatory and technological changes. Banks and other traditional lenders are exiting the business because they can't keep up with the pace of technological change and the compliance demands. Meanwhile, consumers are shifting their car buying and financing activity online. These trends clearly favour a company like Plenti Group.

Also encouraging is the recent insider buying in the shares. Recently appointed Director Susan Forrester wasted little time in acquiring 76,950 shares on 19 November in an on-market trade valued at nearly $100k. A few days later, also in an on-market trade, Director Mary Ploughman, bought 20k shares to add to her 450k Plenti stock options. Also noteworthy on the key shareholders front, leading auto listings company Carsales. Com Ltd owns a 6.4% stake in Plenti Group.

Aside from these votes of confidence, we like Plenti Group for its consistent loan book growth and credit performance. Its position in the rapidly evolving automotive lending market is especially compelling—and is plenty reason for us to recommend the shares. Four stars.

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Diversified funds line-up generates consistent income

Elanor Investors Group provides investments and funds management services to a range of investors. It makes money by collecting performance fees and gains on the sale of co-investments and balance sheet assets.

Its managed funds have acquired many unique assets across Australia and New Zealand in the retail, commercial, healthcare and HTL spaces. Its investment process involves seeking strategically located assets with quality tenant covenants. The group's largest managed funds are the Elanor Commercial Property Fund and the Elanor Retail Property fund which together account for approximately 42% of funds under management (FUM). It manages 10 other unique funds, including the Elanor Luxury Hotel Fund, Elanor Healthcare Real Estate Fund, Elanor Wildlife Park Fund and the Waverly Gardens Fund. Several syndicate funds round out the platform.

The group's investments in retail property are very much at the non-discretionary end of the spectrum, which we like in this economic environment. The Elanor Retail Fund collected 78% of April through June rents as at 31 July 2020, a reflection of its high weighting of non-discretionary tenants. Those investments that fall into the discretionary category tend to be located in value-added town centre properties.

Strong track record of FUM growth

Growth in FUM has been strong over the years advancing nicely in each year since the IPO. Since listing in July 2014, FUM has grown at an annual rate of 64% through 30 June 2020.

Elanor delivered a solid FY20 result as FUM increased 22% to $1.69bn and balance sheet investments rose 20% to $203m. Listed FUM more than doubled to $709m led by the strength of the Elanor Retail Property Fund and the Elanor Commercial Property Fund. The growth was also driven by the establishment of a new managed funds platform, which had a combined asset value of $180.3m. This led to a 43% jump in funds management income to $21.5m.

Core earnings, however, declined 12% to $15.4m due to second half weakness caused by the pandemic. Co-investment distributions fell 22%. Elanor decided to suspend its distribution in 2HY20 due to the uncertain COVID-19 environment and stapled securities on issue increased 20%. So, shareholders received 41% less income per security. But all things considered, it was a good result for the company.

We also favour Elanor's conservative balance sheet. Gearing is at a manageable 30% and there is plenty of capital to fund the group's future growth plans. This includes $23m in cash and $84m in co-investment capital, which is expected to be 'recycled' to cash in FY21. The latter portion of the growth capital is associated with co-investments in the Elanor Luxury Hotel Fund and the Elanor Metro & Prime Regional Hotel Fund. With an active pipeline across its sector focuses, shareholders can expect that these funds will put to good use.

Auburn Central sale reduces retail exposure and improves fund

On 19 November, the Elanor Retail Property Fund announced the $129.5m sale of shopping centre Auburn Central, a 48-store property anchored by Woolworths and Big W Discount Department Store. The sale occurred at a 4.9% premium to book value and resulted in a 24.5% return for the fund. This transaction had a major impact on the fund's gearing, which fell from 44% to 17% after it used most of the proceeds to repay $94.1m of debt. Net tangible assets (NTA) per share also improved significantly from $1.34 to $1.41.

The Auburn Central sale is a great example of the type of value that Elanor's management teams can create in its portfolios. The company certainly has a decorated history of strong investment returns having generated an average total realised return of 20% since listing in 2014.

In summary, Elanor Investors Group has a 'capital lite' co-investment strategy and a solid funds management platform that can continue to produce strong growth. We expect the group to continue to execute on its differentiated real estate strategy and for its shareholders to reap the rewards. So four stars from us.

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Share price chart

Source: Tradingview

Transformation to an online-only model is a positive

Thorn Group has two divisions — Consumer Leasing and Equipment Finance. The Consumer Leasing business rents a wide variety of household products including audio-visual equipment. This is the group's main revenue source. The smaller Equipment Finance segment leases equipment to small and medium-sized enterprises (SMEs). With many of Australian SMEs struggling to do well in the post-pandemic economy, Thorn's tax-effective credit options represent a valuable lifeline.

At the onset of the COVID-19 pandemic, management temporarily closed its Radio Rental stores only to later decide to close the stores permanently. We think this was a good move. At the time, the Radio Rentals business was still reeling from a class action lawsuit and an impaired reputation. Absent these stores, the optics are much better for Thorn Group.

The decision to close Radio Rentals locations, which were finalized in May 2020, also removed many overlapping parts that the physical stores shared with its online counterpart. Now operating exclusively as an online business, the Radio Rentals brand is more in tune with the modern consumer. Customers are onboarded digitally making for a more efficient process and a leaner cost structure. The group also plans to expand its product offerings and enhance its digital platform to make for a more user-friendly experience.

Stronger balance sheet supports dividend and buy backs

In its most recent quarterly report, management acknowledged that its Business Finance division was facing some challenges. This stemmed from lower cash repayments from customers amid the tough pandemic-related operating environment. The group entered discussions with warehouse funding lenders to determine relief options. Through 30 September 2020, the group's credit quality metrics had all improved from both 31 March 2020 and 30 September 2019.

We like the recent developments around the company's balance sheet. In the second quarter, it repaid $21.3m of debt funding as well as $2m of its $10m corporate debt facility. The debt facility was then fully repaid during the interim period. It also completed a capital raising. With the balance sheet recapitalised, Thorn Group now has lower interest expenses, can generate stronger cash flow and could obtain additional debt funded if needed.

Meanwhile, an improved cash position gives the company greater flexibility to pursue growth opportunities. As at 30 June 2020, Thorn Group's cash balance increased 45% from the previous quarter to $71.8m and was $79.5m as at 30 September. With $54.1m of free cash, Thorn's directors chose to pay an unexpected $24.2m special dividend as part of its capital strategy. It also announced that it is considering an off-market share buyback program in the $15m to $25m range. More details on the buy back are expected this month.

Unfortunately, just as Thorn Group had been making good progress with its new capital management strategy, a substantial shareholder, Forager Funds, ran interference. On 4 November, Forager disclosed that the voting power of its nearly 50m Thorn Group shares had been reduced from 15.4% to 13.0% through the Forager Australian Shares Fund.

Nearing breakeven

On 27 November, Thorn Group reported first half results that showed a significant improvement in its bottom line. It posted a net loss of $1m compared to a net loss of nearly $25m in the same period last year. What's even more impressive is that it did so despite a 45% drop in revenues to $57.8m. This was the result of aggressive cost cutting, which led to $40m in savings from store and logistics network closures as well as headcount reductions. The business is on pace to be more or less breakeven in FY21, which would be remarkable improvement over FY20's $81m loss.

Overall, we think Thorn Group has reached an inflection point and we like the momentum in the business. With a new CEO, a new Board of Directors and a revamped line-up of majority shareholders, the company seems to be heading in the right direction. Like many industries, the future of household and enterprise leasing will be automated, mobile-first and AI-driven — and Thorn Group is in a better position to be part of that revolution. Four stars from us.

Pitt Street Research Pty Ltd

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Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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