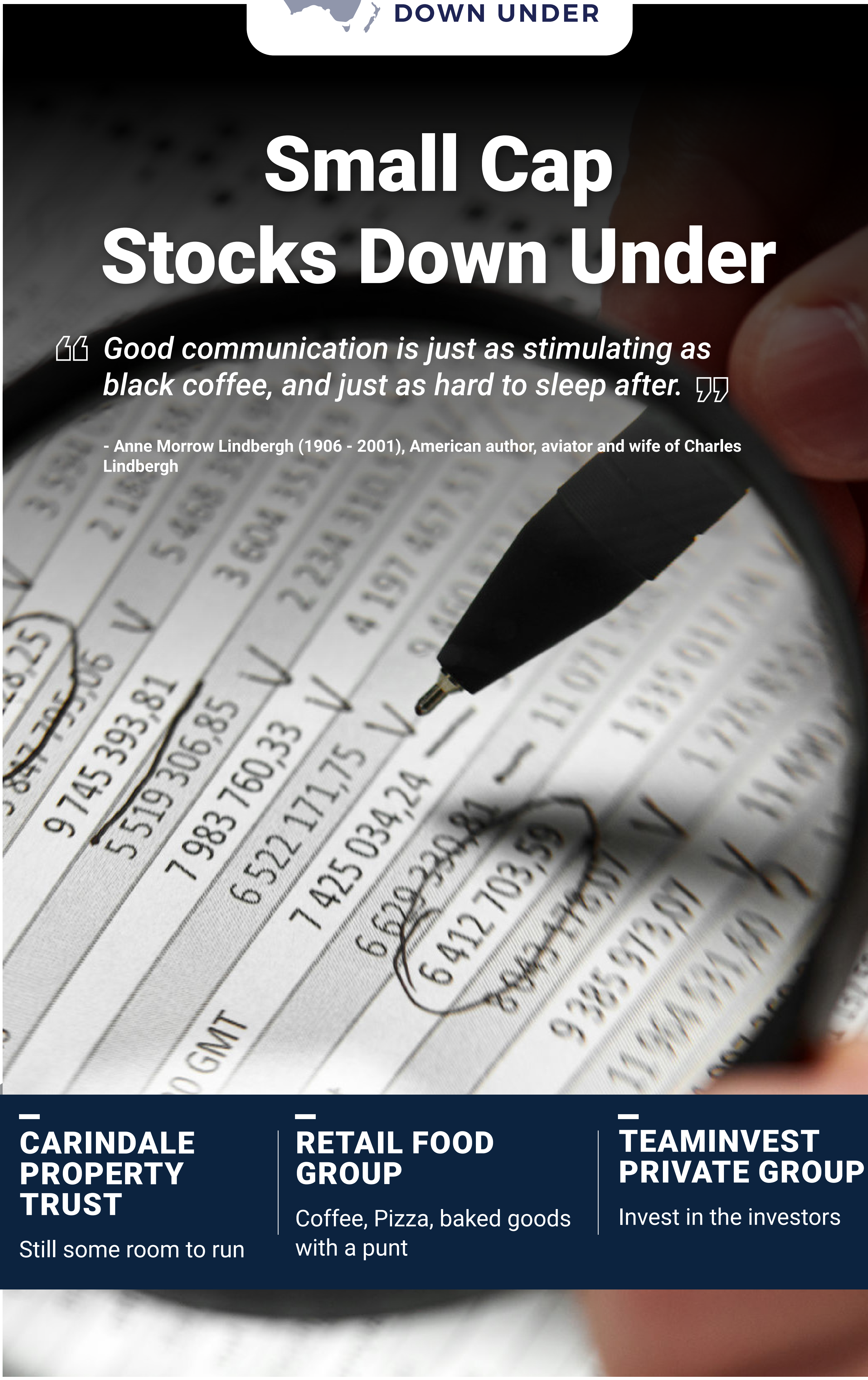
STOCKS DOWN UNDER

19 FEBRUARY 2021



Small Cap Stocks Down Under

Good communication is just as stimulating as black coffee, and just as hard to sleep after.

- Anne Morrow Lindbergh (1906 - 2001), American author, aviator and wife of Charles Lindbergh

CARINDALE PROPERTY TRUST

Still some room to run

RETAIL FOOD GROUP

Coffee, Pizza, baked goods with a punt

TEAMINVEST PRIVATE GROUP

Invest in the investors

CARINDALE PROPERTY TRUST

Still some room to run

Stocks Down Under rating: ★★★ ★

ASX: CDP
Market cap: A$ 302M
Dividend yield: 5% (0% Franked)

52-week range: A$2.56 / A$5.82
Share price: A$ 4.22

This is our third article on Carindale Property Trust and the situation is remarkably different from the last time we wrote about the stock, back in September 2020. The share price is 38% higher as the market realised dividends are back on the table and another devaluation was unlikely. Carindale is a rather unusual Real Estate Investment Trust (REIT) as it only owns two properties, which are situated in Brisbane's south-eastern suburbs, approximately 12km from the CBD. Despite the rally, with dividends back on the table and the potential for a positive revaluation, we think this stock still has room to run.

READ MORE

RETAIL FOOD GROUP

Coffee, Pizza, baked goods with a punt

Stocks Down Under rating: ★★★★

ASX: RFG
Market cap: A$ 168M

52-week range: A$0.025 / A$0.105
Share price: A$ 0.075

Headquartered in Bundall, Queensland, the Retail Food Group is Australia's largest franchise owner reaching over 17m Aussies each year. The company has had some hard times the last few years, but FY20 finally showed strong movement in its turnaround plan generating an EBITDA profit of $3m. This company still harbours risks going forward, least of all an ACCC investigation, but we believe it has strong brands and its valuation smashed to point where value is finally emerging.

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Stocks Down Under rating: ★★★★

ASX: TIP
Market cap: A$ 82.5M

52-week range: A$0.50 / A$0.84
Share price: A$ 0.72

Headquartered in North Sydney, the Teaminvest Private Group is a value-based private equity firm. The firm is not one to make snap decisions and follows the teachings of Benjamin Graham and Warren Buffett to invest in profitable, private companies with a minimum operating history of four years. Despite this tried-and-tested approach, the market has not shown this company much love. So, has the market got this one wrong or right?

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Share price chart

Source: Tradingview

Show me the property

Carindale owns two properties approximately 12km from Brisbane's CBD. The main property is the Westfield Carindale and the second is the Sundry property, right next door. These properties are so close together that they are actually managed as one, the only difference is Carindale owns 50% of the Westfield and 100% of the Sundry property. We believe it is important to clarify, though, that from a valuation perspective, Carindale shareholders are basically just owning the Westfield property stake. This is due to Carindale's total property value being almost exclusively derived from the Westfield property's share.

The Westfield property services an area with approximately 700,000 people and even during the worst of Australia's COVID-19 outbreak never saw its leased percentage drop below 97%. Compared to the prior two-year average of 99% leased, we believe a 2% drop is not even a significant blip on the radar compared to the damage the pandemic has caused our economy. Despite this small drop and volumes rebounding to 90% of FY19's by July, the trust was still forced to take a 14.5% property devaluation during FY20. This reduced the Net Tangible Asset value per share from $8.01 on 31 December 2019 to $6.33 on 30 June 2020.

As announced during its latest update on 5 November 2020, 91% of stores are trading and 1QY21 saw volumes remain at 90% of 'normal.' The centre remains 97% leased and management was able to collect 96% of gross rental billings during the four months to 31 October 2020. To summarise, COVID-19 was only a minor blip on the radar for Carindale's operations and the recovery has been strong and fast.

The main reason for the price crash: distributions

Due to concerns over COVID-19, management decided to suspend the dividend for 2HY21. We believe this is the main reason for Carindale's share price crash, down to 45% of its Net Tangible Asset value per share. Back on 27 August 2020, when we first wrote about this stock, we predicted that due to the strong performance during the pandemic, dividends were likely to return during FY21. Subsequently, on 5 November 2020 management announced a 1HY21 dividend payment of $0.115 per share. Importantly, this is still a decline of approximately 67% from its historical range of between $0.35 and $0.40 per share. However, we believe management is just being cautious and we expect the dividend will rapidly climb back to 'normal' levels from here.

FY21 revaluation?

With Australian property prices having rebounded rather sharply since November we believe it is likely that Carindale's 14.5% asset devaluation was premature. We certainly believe the caution taken by management in terms of both the dividend and the valuation of the property shows both proper management and strong governance. We also believe it is likely that FY21 could see the Net Tangible Asset Value per share recover a portion of its devaluation from FY20. The current low interest rates in Australia only increase this likelihood, in our view. The RBA has hinted that it will keep rates low for the foreseeable future. In this macro environment we believe a sizable revaluation is likely in the short to medium term.

Still room to run

All in all, we believe Carindale is a solid REIT with a lot of potential. The stock may have recovered to $4.22 from when we first wrote about it, but that is still a 32% discount to Net Tangible Asset Value per share. Yes, we realise the dividend still has a way to go before its back to 'normal', but we believe this is likely to happen by the end of FY22 at the latest. Additionally, based on the current macro environment, we expect a revaluation of Carindale's property.

To summarise, this sounds like a solid four-star stock to us.

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Source: Tradingview

Who is Retail Food Group?

Each year Retail Food Group's brands interact with over 17m Australians generating over 70m customer transactions. To put this in another light, given the 25.5m Australians living here, this company touches 67% of Australia's population on an annual basis, no small feat. Chances are, if you are reading this in Australia, you have made a transaction with this conglomerate in the last few weeks.

So, what is the Retail Food Group? It is Australia's largest multi-brand retail food and beverage franchise owner. The company's brands include: Donut King, Brumby's Bakery, The Coffee Guy, Michel's, Gloria Jean's, Di Bella, Crust, Pizza Capers and Cafe2u.

The word franchise is often used to describe many of the companies that we know and love. For example, McDonalds (NYSE: MCD) does not own the majority of their stores. With 38,695 locations worldwide it would be extremely difficult to manage each one from a central corporate location. This is where the franchise model comes into play. While all franchise agreements are unique, they mostly have the same general characteristics. Companies like the Retail Food Group and McDonalds sell a store design, brand and support in exchange for certain exclusivity rights, an annual franchise fee and a small percentage of annual profits. An important part of the exclusivity rights is the guarantee that the franchise will keep to the menu set by corporate and purchase its materials and products from corporate. Most franchise-based corporations have a manufacturing and distribution arm to supply its franchisees with the food, products, supplies, etc. The Retail Food Group is no exception.

FY18: the year the trouble began

Through a combination of increased competition and incompetent management decisions, Retail Food Group's troubles truly emerged during FY18. During that year, total revenue may have rose 7%, but EBITDA dropped from $105m to negative $354m. We are not going to discuss this decline, as the company initiated a turnaround plan that, as of FY20, finally seems to be working.

The transformation plan has currently been in operation for approximately the last 20-months with a focus on debt reduction, corporate execution and an overhaul of the way the franchise network operates at the corporate level. One of the main ways was the shuttering of unprofitable franchises and no new domestic openings during FY20.

We certainly believe management has showed strong progress towards returning the Retail Food Group to its former glory. The most significant data point for us is that, despite COVID-19, the company returned an EBITDA profit of $32.3m during FY20, compared to an EBITDA loss of $130m during FY19. It is important to note, however, that the majority of this $130m EBITDA loss is mainly due to a significant impairment charge during FY19 of $108m.

The company generated this operational result primarily from its Australian franchise divisions, which are broken down into: bakery café, coffee retail and QSR (the Quick Serve Restaurants Crust and Pizza Capers). These three divisions generated EBITDA of $25.7m or 72% of total EBITDA. The remaining 28% was generated by Di Bella Coffee, its wholesale and distribution division, and international franchises.

Don't attract the gaze of the ACCC

One big risk surrounding Retail Food Group is an ACCC investigation announced on 15 December 2020. The ACCC alleges that the company acted "unconscionably and engaged in false, misleading and deceptive conduct when it sold or licensed 42 loss-making corporate stores to incoming franchisees between 2015 and 2019." These charges are rather serious especially since it is also alleged that the company withheld certain profit and loss information and at times lied about financial situations.

Management was quick to respond and released a statement and, while not an admission, stated that these sales occurred under senior managers who are no longer with the company. Improvements to the franchise model are a key part of management's turnaround plan and we believe they have shown strong momentum over the last 20 months. The risk here arises from the closing statement "it is not currently possible for the RFG to quantify the financial implications of the outcomes being sought by the ACCC." These allegations are serious and while we believe it is likely a settlement will emerge as part of the turnaround, the magnitude of such a settlement is unknown.

Coffee, Pizza, baked goods with a punt

Due to the COVID-19 situation and the Retail Food Group being in full turnaround mode, the company hasn't issued any FY21 guidance and there are no brokers covering the stock. So, we need to resort FY20's results to get a sense of the company's valuation, which is not ideal. On that basis, i.e. backward looking, Retail Food Group is currently trading at an EV/EBITDA and EV/Revenue of 9x and 1x, respectively, which is not too expensive assuming the company can stay the course.

However, there are still two main investment risks going forward: the turnaround and the ACCC investigation. Any company in the midst of a turnaround runs the risk that a critical part of the turnaround fails and until we have clarity on the cost of the ACCC investigation, there remain a lot of unknowns.

However, we believe that the current valuation allows for potential upside if management continues to perform strongly. This one is certainly riskier than average and therefore not suitable for all investors, but for those willing to take the risk, it's four stars.

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Share price chart

Source: Tradingview

The method

Teaminvest is a private equity company with a rather intensive set of criteria for an investment. The company must be profitable, have operated for at least four years, have revenue greater than $2.5m per year, show strong return on equity, and be willing to be mentored by Teaminvest Private. It is important to mention that the requirement to be mentored is not unique to Teaminvest; most private equity firms insist on being more active participants than other forms of investment. On top of these specific qualifications, management also looks for companies with "moats." This is a term popularised by Warrant Buffet and Benjamin Graham that refers to a business with a strong characteristic that helps add an additional barrier to entry for competitors or allows greater value extraction from customers.

In addition to the stringent investment conditions, management also has a five-step investment process: analysis by company management, investment committee analysis, SMaRT meeting, due diligence and ongoing oversight post investment. During management's initial analysis, three main aspects are considered: the financial performance, the business model and growth prospects, and the performance of management during interviews.

The review by the investment committee is more in-depth. The investment committee consists of seven Teaminvest shareholders, one member of the board and the CEO and CFO. This committee not only reviews the financial performance, business model and growth prospects, but also how the investment would fit within

Teaminvest's current portfolio and skill set. This committee also assesses if it is possible for Teaminvest to make an investment with its current resources. The SMaRT meeting consists of a six-hour, one day, marathon session where selected Teaminvest shareholders are able to question the company's management during two sessions and then participate in a round table discussion. Only if a company passes through this stage can due diligence begin. The fifth and final stage occurs after an investment is made when Teaminvest's management team handles and looks after its portfolio of companies. One important point that this company has made clear is that it looks to invest in companies where existing management will stay in place and the daily operations of the company will not be forced to alter drastically.

Our readers may be wondering why we took the time to go over Teaminvest's investment process in such detail. When making an investment in a group like this, not only are you investing for access to private companies you would not otherwise have access to, but you're also investing in the investment and management skills of the employees of Teaminvest. It is important to fully understand how they make their investment decisions, so you are not surprised by the future investment and management decisions they make. Teaminvest is a long-term, value based, private equity firm. Management looks for stable companies and investors should not be looking for any quick gains here.

The portfolio

As of FY20, the latest release of this information, Teaminvest had a portfolio of ten companies across two main divisions: engineering and services. In total, these companies generated $141m in revenue during FY20, a 4% increase. This revenue generated $17.1m in EBITDA, a 137% increase due to the fact that seven portfolio companies not only managed to increase EBITDA at a rate greater than 40%, but six now earn more EBITDA than Teaminvest did during FY17. While both divisions saw sharp EBITDA growth during FY20, the engineering division, with its 114% increase in EBITDA to $7.7m, was the best performer. Services generated $5.9m in EBITDA representing a 63% growth year-over-year.

Engineering consists of three wholly owned companies: Coastal Energy, Icon Metals and Graham Lusty Trailers. These companies generate revenue from the engineering and installation of architectural metalwork, manufacturing semi-trailers, and overhead and underground electrical network development.

Services consists of five wholly-owned and two partly-owned companies: Automation Group, Colour Capital, Teaminvest Private Insurance Services, Eastcoast Traffic Control, Valuestream Investment Management, Teaminvest Private Residential and Multimedia Technology. These companies are involved in franchise management, traffic control, residential construction, IT hardware distribution, financial services and industrial automation technology (acquired in September 2020).

The first quarter of FY21 was just as strong as FY20, although the divisions basically switched performance. Engineering generated $2.7m in EBITDA during 1QY21 for a year-over-year increase of 71%. Services generated $1.6m in EBITDA during 1QY21 representing a year-over-year increase of 134%.

Combined, 1QY21 saw a 90% increase in EBITDA year-over year to $4.3m as another six companies increased quarterly EBITDA by over 40% compared to 1QY20. The Automation Group is excluded due to its acquisition during September 2021.

Growing profitably

Teaminvest has, what we believe to be, strong investment criteria that are truly beginning to show their merits as EBITDA profitability continues to advance. Despite the company seeing 63% growth during FY20 and 90% during 1QY21, using FY20's results for our EV/EBITDA and EV/Revenue ratio analysis we get 12.6x and 0.9x, respectively, which is very reasonable.

We would like to point out one major risk factor though. Teaminvest's stock has almost no trading liquidity. Over the last three months the average daily volume was only 40,000 shares, or around $28,000 using yesterday's closing price of $0.72.

Despite this lack of volume, we believe investors interested in private equity investments, Teaminvest is an excellent choice. We believe the company's lack of awareness among the general investment public is the reason for its dramatic undervaluation compared to its growth rate. 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.