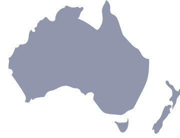

STOCKS DOWN UNDER

5 MARCH 2021

Small Cap Stocks Down Under

"No research without action, no action without research."

- Kurt Lewin (1890 - 1947), German-American social psychologist

PRIMEWEST
A little too prime

UNIVERSAL STORE
Let's get trendy

ASPERMONT
Digging up some caution

PRIMEWEST

A little too prime

Stocks Down Under rating: ★★

ASX: PWG
Market cap: A$ 527M
Dividend yield: 2.1% (100% Franked)

52-week range: A$0.63 / A$1.46
Share price: A$ 1.30

At Stocks Down Under we spent a lot of time during 1HY21 writing about REITs, that is, Real Estate Investment Trusts. Today we're looking at a Claytons REIT called Primewest. It's the Trust you have (in your portfolio) when you're not having a Trust. You see, Primewest doesn't own real estate directly, but instead manages and creates funds made up mostly of retail and office properties portfolios. Despite the direct exposure to property investment, the quality of Primewest's property portfolios is arguably even more important than that of a REIT. So how does this management company stack up?

READ MORE

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Market cap: A$ 493M
Dividend yield: 0.7% (100% Franked)

52-week range: A$4.19 / A$6.90
Share price: A$ 6.75

Fashion… everybody has their own, but not every fashion is universally accepted. For the trendy, fashion-focused men and women between the ages of 16 and 35, Universal Store is here to help. With 65 physical stores and an expanding online presence, this Sydney-based chain is dedicated to keeping today's youth on-trend. Since its listing on 16 November 2020 at $3.80 per share, this stock has also been on-trend as it provided shareholders with a 78% capital gain. The question is, can this stock keep up with the times?

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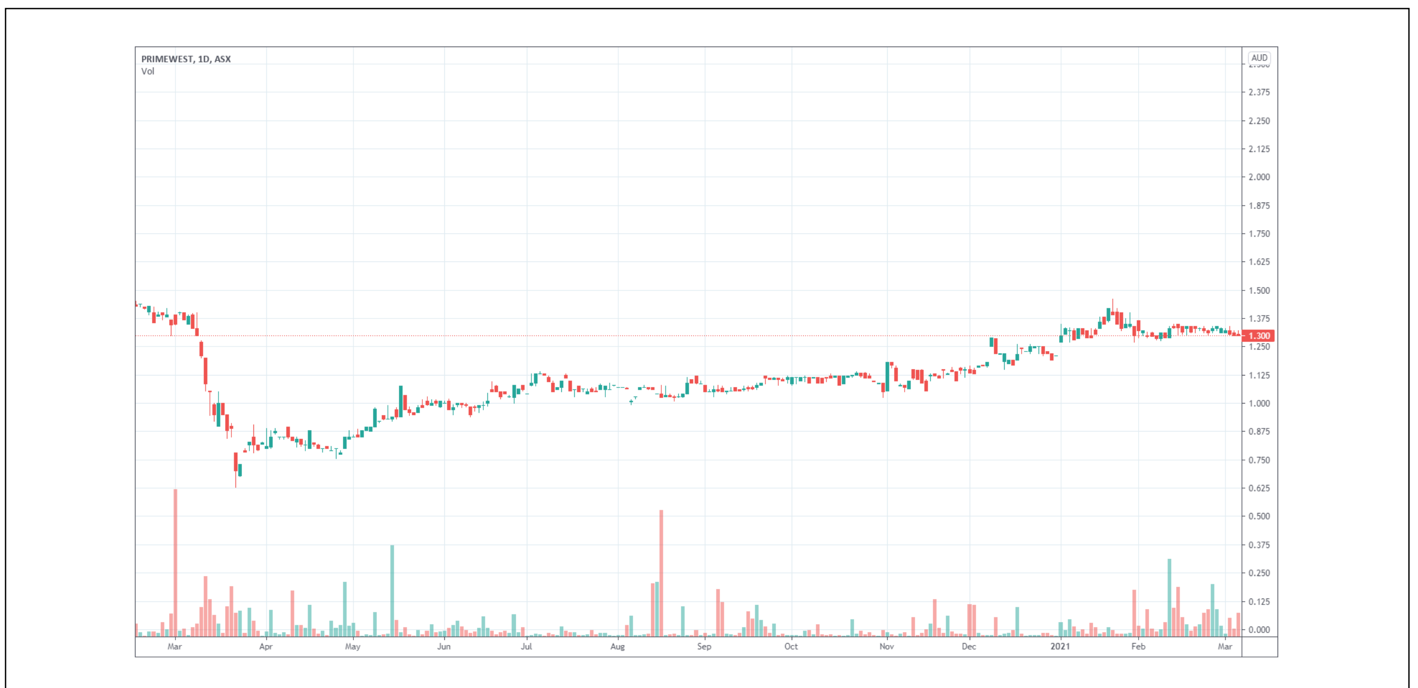

Source: Tradingview

Got property on my mind

Back on 8 May 2019, The Sydney Morning Herald reported on some new research by HSBC, which found Australians think about the property market on average 2.5 hours a week. Yes, there are 168 hours in a week, but when you compare this to, say, the amount of time spent at the gym (1.1 hours) or speaking to parents (0.9 hours), this amount of time becomes much more impressive.

But that's not all. Australia has, what HSBC calls, 'property extremists' comprising approximately 6% of the population. They spend over seven hours a week on research. This research rate places Australia as the seventh most property obsessed nation in the world. When it comes to actual property investments, The Australian Taxation Office found that during the FY18 tax year, 20% of Australian households owned a rental property. These 2.2m investors span the age range with around 40% under 50-years old, and only 28% over 60 years old. But what about those property-interested Australian investors who can't afford a direct investment?

This is where Primewest's business model comes into play. Primewest is in the business of developing and managing listed (6% of the portfolio), unlisted (76%), mandated institutional (15%) and 3rd party asset management (3%) Australian property funds. Primewest's total Assets Under Management of $4.9bn, as

of 1HY21, run the gamut between retail (41%), office (37%), industrial (9%), agricultural (6%) and other (5%). These funds provide investors with an opportunity to own Australian property without being forced to shell out the time to manage the property and, in the case of the listed funds, the capital to do so themselves.

Let's manage some assets

So, Primewest's business is the development and management of property funds. This places the company in a separate class from Real Estate Investment Trusts (REITs) because it does not have direct ownership and exposure to the properties in its managed portfolios. However, don't think that this company is entirely separate from its portfolios. Primewest's earnings are heavily linked to the quality and performance of the properties under its control.

During FY20, the company's $35.4m in revenue was generated entirely from the fees it earned from funds management. If the company's managed properties start to underperform significantly, investors will be more likely to withdraw their funds and remove themselves from consideration concerning future Primewest funds. And the greater the amount of Assets Under Management, the higher Primewest's funds management revenue will be.

So how has Primewest's total Assets Under Management performed? Reasonably well we think. Between 2HY20 and 1HY21, management accumulated an additional $400m (8.9% growth) in Assets Under Management through $376m in acquisitions and $22m in the positive revaluation of property values. As the property market continues its post-COVID-19 recovery, we expect interest in property funds to continue to grow.

It's all about the growth

During FY20, Primewest generated EBITDA of $22.5m, representing a solid margin of 68.8%. Through an expected combination of Assets Under Management and property revaluation growth during FY21, the market is expecting Primewest to increase this margin to 73%, generating $25.4m. This would represent a growth rate of 12.8% year-over-year, with the rate of growth expected to increase to 17% during FY22.

We believe Primewest's stock is in a situation where we feel the market is still looking back to FY20's EBITDA growth of 90% year-over-year and is extrapolating this growth forward. However, this growth was due to the company listing during November 2019, allowing Primewest to increase its Assets Under Management by 15% during the year combined with $5.6m in performance fees compared to FY19's $0 in performance fees. This high growth rate is not a repeatable action, in our view, and we believe the market has not yet fully revalued this company accordingly.

While the company's respective EV/EBITDA ratios for FY21 and FY22 of 18x and 14x are not extraordinarily high, we believe they still represent an overvaluation when factoring in the expected FY21 dividend of only $0.02 per share.

All-in-all we believe Primewest is a solid company in an interesting sector. However, based on an analysis of its future earnings, expected dividend and lack of potential to drastically surprise the market, we think the market is currently overvaluing the company. This is definitely one to watch, but for now, its two stars from us.

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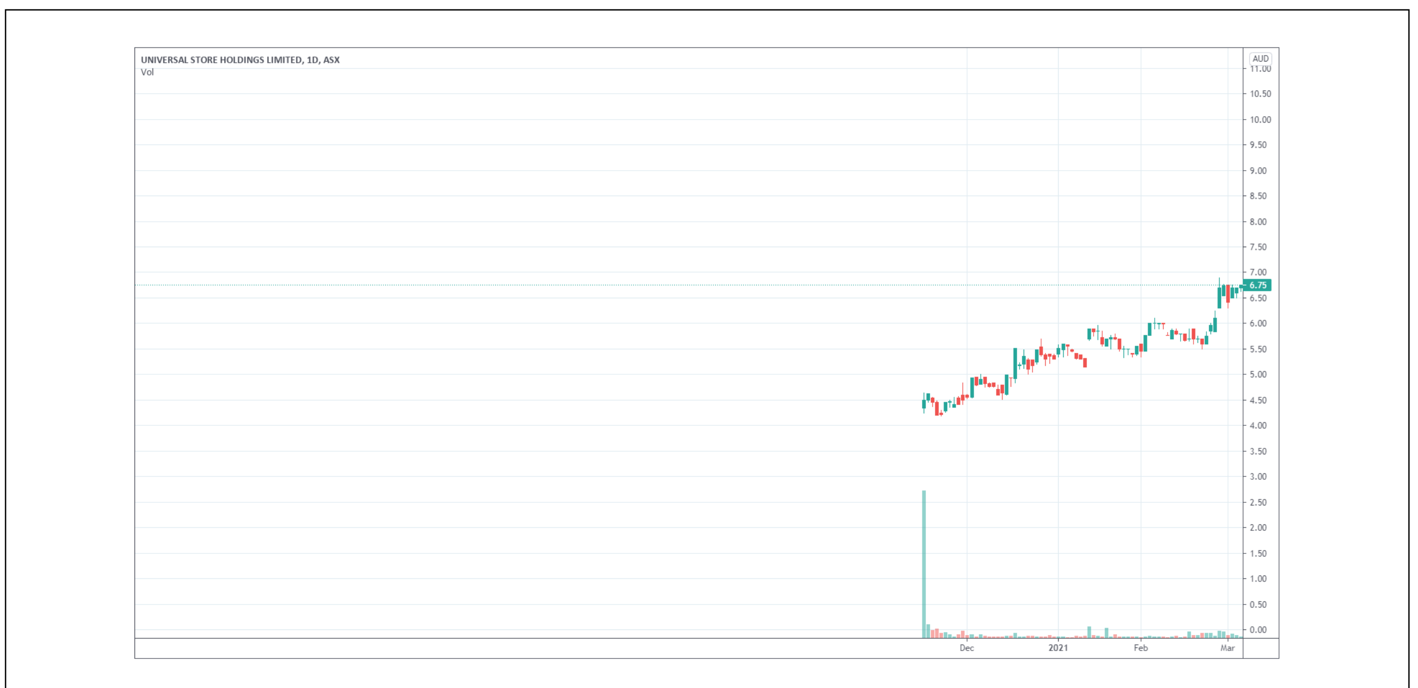

Source: Tradingview

Dance like everybody is watching

What do young people want? The ever-elusive question that is asked over and over again in the media and by parents is, in part, the basis of the fashion industry. We are not here to answer what young people want, but we can tell you a little about the increasing importance of fashion in their lives. A study by researchers at the University of Missouri and Columbia University published in 2012 on young adults found that they think their appearance is far more important than their health. A different study published by YMCA England in 2017 found that 52% of children between the ages of 11 and 16 often worry about their appearance. This study found a further 36% to be of the mindset that they would do ‘whatever it takes’ to look good.

These statistics are quite concerning and we want to be clear that this report is in no way suggesting profiting from unhealthy body practices. In fact, we believe the Universal Store offers investors a way to do quite the opposite by providing an opportunity for men and women between the ages of 16 and 35 to feel better about their appearance without having to do whatever it takes.

The breakdown

Universal Store has two sale funnels: its physical stores and its online store. Total revenue generated during 1HY21 was $118m, representing 23.3% year-over-year growth. This revenue generation was split between bricks-and-mortar store sales at $104m (16.1% growth) and online sales at $14m (128.3% growth).

While online sales growth of 128% is certainly impressive, we believe the fact that online is now 11.8% of total sales is far more impressive. Remarkably, Universal Store opened no new physical venues during 1HY21, while in 1HY20 it opened six. The company's online presence is still mostly in the development phase. However, recent improvements have included personalised analytics and continued investment in offerings such as ship-from-store and click-and-collect.

Private-label brands are the future of margin

Private-label brands are an essential part of any modern retail chain operation. The perfect example of this is America's Target Corporation (NYSE: TGT - not the Aussie brand – that's different). Starting in 2019, Target management succeeded in a massive turnaround of both its margin, store operation and online presence, which caused the stock price to go from US$66 to US$174 in less than three years. Target's current market capitalisation is US$87bn, so a return of 186% is far more difficult to achieve than a company like Universal Store with its $493m market capitalisation. Since the turnaround, Target is considered a major competitor and threat to both Walmart (NYSE: WMT) and Amazon (NASDAQ: AMZN) in the United States.

One of the main aspects that allowed for this massive turnaround was Target's focus on its private-label brands. The company managed to increase their desirability among consumers and, therefore, drastically increase its overall margins. This is one of the few universal (pun intended) truths in retail, because private-label brands offer significantly stronger margins than third-party brands.

Universal Store management recognises the importance of private-label brands and it was an important part of the brand strategy articulated in the 2020 prospectus. In fact, the company already has a robust private-label offering when it comes to women's products. Privately branded products represented 30% of FY20's revenue, offering margins of 68% compared to third-party products whose margins were only 56%. We believe 30% is far too small a percentage of total revenue, but there is hope because its female-focused offerings generated 78% of total private-label revenue.

The female-dominated nature of its private-label brands would not be ideal if this were not being addressed, but it is. Now that management has nailed down the method of launching, developing and marketing a private-label brand, it is focusing on the male side of the equation. These private-label brands are still in the early stages, however. With the success management has had in developing female-focused private label brands, we are confident they will successfully expand into the male section. In our view, this expansion is vital to the company's future. We believe private-label expansion will be the lynchpin in management's ability to increase its EBITDA margins from the current disappointing level of 20% (1HY21).

Valuation is always in vogue

Universal Store had a strong result during 1HY21 and is clearly doing a lot right. As Australia continues to loosen restrictions on going out and as schools and universities begin in-person classes, we believe the company's target consumers will focus more on their outward appearance. This is one of the reasons we question the market's expectation that growth in EBITDA for FY21 and FY22 will only be 7.7% in both years, especially ahead of the launch of new, male-focused, private-label products. With a current FY21 EV/EBITDA valuation of 10.8x, we believe there is room for significant upside if we are right, and not a substantial amount of downside. It's a hip and trendy four stars from us.

ASPERMONT

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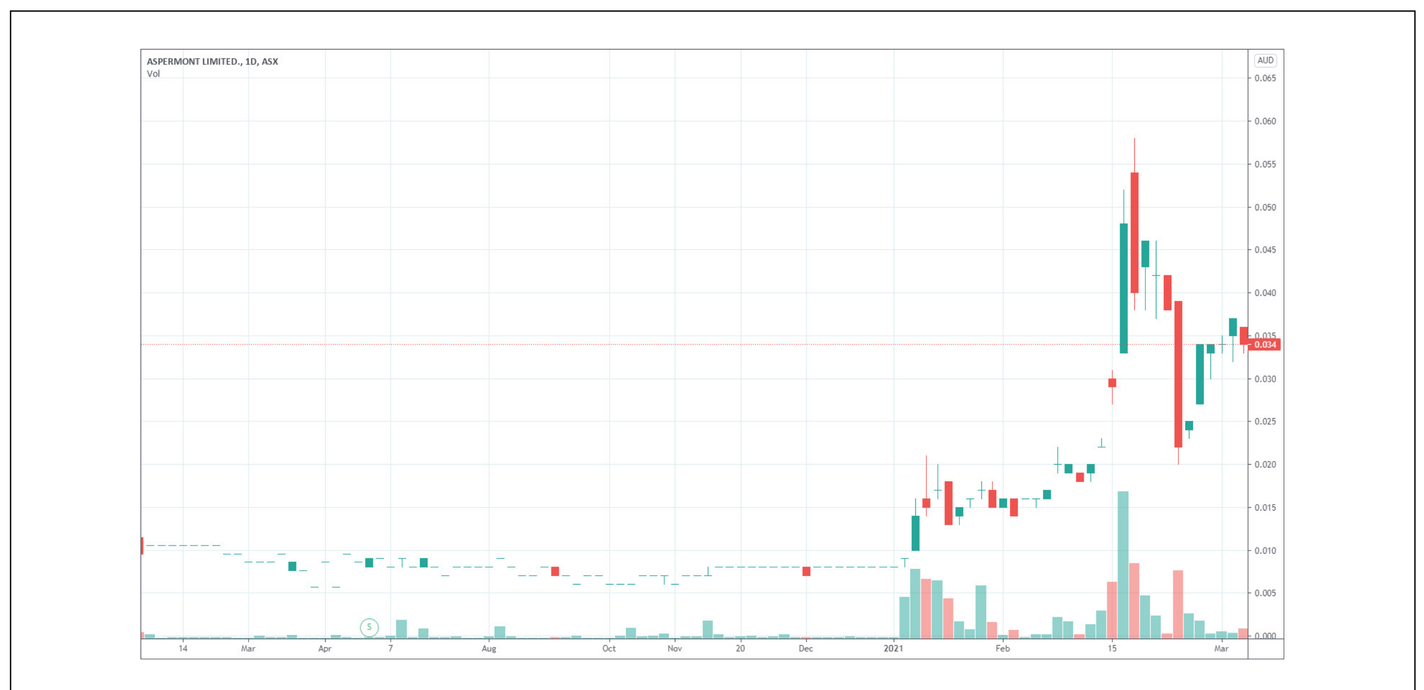

Source: Tradingview

Digging for knowledge

You hear quick, bullet-point analyses of the resources industry on the news all the time. The price of oil fell because of this, iron ore is likely to do that. But for those of you who read our Resources Stocks Down Under publication, you know that that the resources industry is far more complicated and technical that it appears at first brush. For those involved in the industry, keeping up with the latest developments, even in their own country, can be challenging at times. This is where a publishing house like Aspermont comes in, although, we would contend that your first stop should always be Resources Stocks Down Under.

Aspermont produces a combination of academic and journalistic style periodicals, reports and events with some of its library publishing for over 200-years. To clarify quickly, no, this company has not been around for over 200-years. Aspermont listed on the ASX back in 2000 and it is not uncommon for periodicals to change hands over the years in the publishing industry. This is how a company far younger than 200 years old can own a publication great than 200 years old.

Resources are back in fashion. According to Google Trends, worldwide web searches of resource news over the last five years peaked at the end of 2017. However, as commodity prices have started to rebound and iron

and gold miners have begun to smash out the profits, the number of search results worldwide for resources news started to trend upward during the beginning of January 2020. So far in 2021, this trend has continued with interest reaching a five-year high between 7 February and 13 February 2021. With interest in finance also reaching recent highs, we believe the fascination with resources is unlikely to go away anytime soon. This indicates to us that interest in Aspermont's publications and events is likely to see a similar increase.

A publisher for the new era

As has been the headline for the last decade, print media is a dying industry. Fortunately for investors, Aspermont's management has realised its situation and, over the last five years, has wholly recreated its business model for the new, digital age. This turnaround has led to a slowdown in the company's decline, with FY20's $15.2m in revenue representing a 7% year-over-year decline. More importantly, however, gross profit only declined by 0.4% year-over-year to $8.9m during FY20. Usually, when a company has finalised a turnaround, we prefer to look forward, not backwards. However, in an infamous industry like media, we are certainly more sceptical and cautious than we normally would be, at least until we see significant proof of success.

The transformation's main headline was transitioning from a print publisher to a digital media and marketing business. To quote Aspermont's FY20 full-year report, "as of today, Aspermont's business model has changed to such an extent that the company bears little resemblance to the one it was five years ago." To this, we say 'good for them,' because the old business model was not one that could survive. The business' main focus now revolves around selling digital subscriptions and creating online and live industry events. Part of this was the 28 October 2020 launch of Aspermont's Future of Mining 365 platform. This platform is a year-round virtual exhibition whose purpose is to connect industry product and service suppliers with the global mining sector's decision-makers. This exhibition is directly linked to two of its publications: Mining Magazine and Australia's Mining Monthly. This is just the latest example of how Aspermont is trying to create value for its subscribers.

Still a lot to prove, but getting there

Aspermont seems to have improved its offerings in a way that has encouraged both user retention and signups. The company has experienced a healthy 33% annual growth rate in its digital user base between FY17 (1.1m) and FY20 (3.7m). At the same time, the renewal rate has increased from 73% during FY16 to 85% as of FY20. We believe these successes are due in large part to the turnaround creating significantly more value for subscribers while also allowing for that easy, digital access. In fact, FY20 finally saw the Net Retention Rate rise above 100%. This means that the growth in revenue from its existing customer base more than offset any losses due to customer churn.

Aspermont is certainly executing with, what we view as, a high degree of success, but we believe an overabundance of caution is warranted with this industry. This is especially the case for companies that are not currently profitable, like Aspermont. Additionally, we believe the current 6x FY20 EV/Revenue ratio does not offer enough of a buffer for its industry risk. In fact, following the recent price spike, we think the stock is way overvalued.

If you are like us, you might have done a double-take when we said 6x FY20 EV/Revenue. The company has historically traded at a valuation closer to between 1x and 2x. That all changed when its share price suddenly shot up to $0.04 from $0.008 on 16 February 2021. The ASX thought this was so unusual it issued a price and volume query to Aspermont. The company responded, citing a few reasons, such as its listing on a few foreign exchanges and new corporate advisors' appointment. However, what this really comes down to is nobody knows, and unfortunately, that does sometimes happen with low volume, low priced stocks.

However, until the company either proves it can generate a profit or returns to a substantially lower valuation, we believe the best course of action is to stay on the sidelines for now. When it comes to the markets, it's always better to be late than dead wrong. It's two 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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