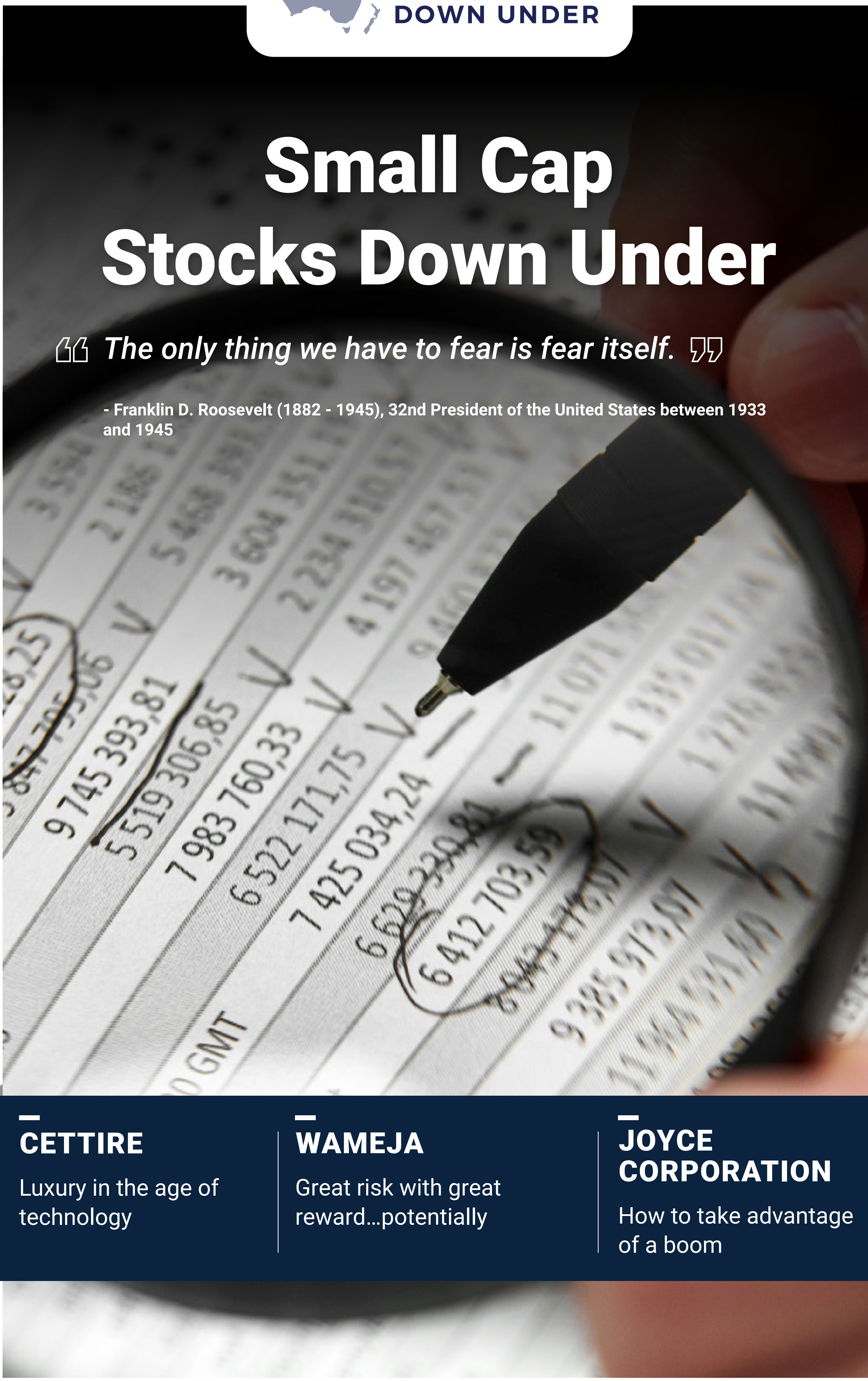
STOCKS DOWN UNDER

9 APRIL 2021



Small Cap Stocks Down Under

"The only thing we have to fear is fear itself."

- Franklin D. Roosevelt (1882 - 1945), 32nd President of the United States between 1933 and 1945

CETTIRE

Luxury in the age of technology

WAMEJA

Great risk with great reward…potentially

JOYCE CORPORATION

How to take advantage of a boom

CETTIRE

Luxury in the age of technology

Stocks Down Under rating: ★★★★

ASX: CTT
Market cap: A$ 557m

52-week range: A$0.45 / A$1.58
Share price: A$ 1.52

The phrase 'personal luxury goods' is enough is make many investors tune out, and for good reason. The market is perceived to be dominated by ancient brands and impossibly high entry barriers, so how is any newcomer meant to get in? The Cettire Group has paved a way. Cettire is a global online retailer carrying the personal luxury goods market successfully into the technology age. They offer a large selection of luxury products, radically impacting a traditionally brick-and-mortar market. And the customers seem to like it. Cettire is forecasting a cool $70m in revenue for FY21.

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52-week range: A$0.066 / A$0.15
Share price: A$ 0.105

Headquartered in Millers Point, New South Wales, Wameja is a company mired in a holding pattern. It is currently in a contractual agreement with Mastercard to sell all outstanding shares. This agreement was entered into 10 September 2020 at £0.08 per share due to its primary listing on the London Stock Exchange (LSE). But a current case of potential indemnity given by Wameja to Seamless, back in 2019 after they purchased Wameja's core business has been enacted and slammed the breaks on this acquisition. So, where are we now?

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Share price chart

Source: Tradingview

Wealth is health

Many of us have never bought high-end apparel, but it's a huge market. Think AU$460 billion globally in 2019. Only 12% of this has gone online so far, but that percentage is growing fast. While eight out of the nine most valuable luxury brands are based in Europe, wealth is shifting from these roots to a new growing base in Asia. This seismic shift means firms must adapt to new consumers who want more variety than the core luxury products offered.

In 2019, Chinese customers accounted for an impressive 90% of the global growth in personal luxury goods and are expected to account for 46% of the market by 2025. While high-end stores have traditionally used brick-and-mortar stores to heighten exclusivity, this approach has left a clear gap in the market in a digitalised world. Cettire intends to fill it.

Cettire group was the brainchild of CEO Dean Mintz, a technology entrepreneur from Melbourne who retains 66% of the company. He had the idea that a portal for luxury goods would work in a way no one had been able to do since the founding of Amazon. His secret to success was designing the platform to integrate seamlessly with suppliers' systems, so their inventory and products are available in real-time. Consequently, Cettire has been profitable from its launch in 2017 in terms of delivered margins (gross margins plus fulfilments costs) and remained resilient throughout the COVID-19 pandemic. How successful is this platform? Well, in FY20, revenue was $22.9m and the prospectus has them doing $70m in FY21. You read that right. Such has been the momentum coming out of COVID that the directors of Cettire were willing to put their names to that forecast.

In the first quarter of 2020, the world was falling apart, and the personal luxury goods industry fell 25%. Cettire didn't feel this however, with a rising EBITDA from minus $0.94m FY19 to $1.11m in the black in FY20. And it got even better in 1HY21 with an EBITDA of $3.6m on revenue of $40.5m. Keep in mind that 1HY21 includes the Christmas season. In fashion retailing, that's where virtually all the action is. Now, the prospectus forecast was for $70m revenue and a $1.9m loss at the EBITDA line, but that loss was solely because Cettire's marketing budget was being increased fivefold to $11m. Such is the company's willingness to invest in its growth.

The power of the online world

The physical store's role is evolving into a customer engagement tool as the wave of digitalisation increases. Think Apple Store or Nespresso Store as one leg of a multi-channel strategy. Being a technology platform, Cettire uses minimal labour, has no physical footprint and a high degree of automation. By reducing costs in ways physical stores can't, they enjoy margins of 28%, which is a significant mark-up when sourcing from 3rd parties. While older customers may prefer physical stores, younger generations are more comfortable with online shopping. 57% of Cettire customers are between the ages of 18-34 and by 2025 these generations are expected to increase personal luxury good demand by 55%. As the disposal income of that and subsequent generations increase, we believe Cettire will profit big time. It's worth noting that both women's and men's fashions are available at Cettire.com and only 59% of customers are women.

Chanel, Prada, Saint Laurent, Dolce and Gabbana. Doubtless, you've heard of those brands. They scream luxury and yet they can all be bought from Cettire.com by anyone. Alongside 1,300 other brands that collectively speak for 160,000 products available. The personal luxury goods market may be focused on exclusivity and rarity, and therefore highly fragmented, but consumers love the ability to find them all in one place. It's the reason Chadstone was successful as the go-to shopping destination for Melbournians back in the day. In fact, think of Cettire as the Chadstone of global online fashion. Growth is far from over yet for them, though. Cettire now has customers in over 53 countries.

The underdog

Cettire Group came into the market a week before Christmas at an IPO price of $0.50 in a transaction that raised $40m in new capital and allowed existing shareholders to sell $25m worth of stock. The company retained $38m in cash as of December 2020. The initial reception for Cettire on ASX was cautious for a week or so. After this early wariness, the stock took off and has continued trending upwards to a high of $1.36 earlier in March 2021.

You may think you've missed the upside of this one. We suspect after the great 1HY21 result that the stock might surprise again. At the moment, Cettire is trading at only 7x FY21 forecast revenue. That's inexpensive when you compare it to that online success story called Afterpay, currently on a revenue multiple in excess of 40x. The product is premium, but the multiple is still in the discount bin. Four stars.

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Share price chart

Source: Tradingview

The acquisition by Mastercard

On 10 September 2020, Wameja shareholders received some excellent news. The company's remaining outstanding shares were set to be acquired by Mastercard (NYSE: MA) for £0.08 per share. Yes, that's right, we are talking about Mastercard, the US$361bn credit card company. From the get-go, this acquisition (Scheme Implementation Agreement) seemed extremely likely to succeed. On the same day it was announced that two of Wameja's largest shareholders, i.e. Lombard Odier Asset Management (Europe) that owns 23.5% and First Sentier Investors (Australia) at 5.1% stated their support for the deal. Additionally, all directors in the company have agreed to vote in favour of the Mastercard offer. However, Mastercard placed three main conditions on the deal, which we will briefly outline below.

The first condition is the cancellation of all existing employee and executive options and performance options. This is being done by management through the offer of financial consideration while the performance options in question all expired on 30 September 2020 without having vested.

The second condition is the simplification of Wameja into one company. In order to do this, management transferred its business holdings from Wameja Investments to the main company and eliminated any other subsidiaries.

The last condition is rather interesting and unusual. Upon completion of the Scheme Implementation Agreement, Wameja must have €4m in cash on hand. The reasoning behind this requirement is not entirely clear to us. However, it is important to note that as of the end of 1HY21, Wameja is in compliance with this condition as cash on hand was $8m, or €5.2m. This also reduces the total purchase cost to Mastercard from its current cost of approximately $182m (£0.08 is currently $0.14) to $178m, or $0.14 per share.

A Seamless break

If this deal is as solid for shareholders as it sounds, what's the holdup? To explain that, we have to go back a couple of years to 25 July 2019. This was when Seamless Distribution Systems AB, a Swedish company listed on the Nasdaq Stockholm exchange, completed its purchase of Wameja's core business. Before this transaction, Wameja was called eServGlobal, providing financial and telecommunications service providers to achieve greater simplification and efficiency when billing clients and processing other financial transactions. Its software offerings included digital wallets, remittance, recharge services and much more. The total purchase price was €2m and the company changed its name to Wameja. As part of this purchase, Wameja provided Seamless with financial protection regarding the third-party software used by its platform connected to the Botswana Telecommunications Corporation.

On 23 October 2020, Seamless requested an audit of the third-party intellectual property by Wameja, to which the company is currently complying. According to management's latest update on this issue, they stated, "the potential for a legitimate material claim under the indemnity in the SPA is very low". However, "the Potential Indemnity Claims have not been resolved and remain as an impediment to the Scheme proceeding." Basically, until this issue is resolved, the Mastercard acquisition is on hold.

Great risk, but the potential for great reward

At this time, we believe an investment in Wameja would be for only one purpose, to take advantage of the proposed acquisition by Mastercard for £0.08 per share. Based on the exchange rate on $1.80 per GBP this translates to a price per share of $0.14, compared to its current share price of $0.105. This would leave investors with a potential profit of 33%, subject to the acquisition going through and the exchange rate staying stable.

Outside of the potential acquisition, we believe Wameja has no true value. Mastercard is only acquiring the company to consolidate its ownership in HomeSend global payment hub, of which Wameja currently controls approximately 34%. This joint venture is far from profitable and we are not confident that Wameja will be viable long enough to see it become profitable. To put it simply, Wameja has no current operations and is just hemorrhaging cash after its core business was sold to Seamless in 2019.

Relying on management's assertion on 18 March 2021 that the risk of a material claim was "very low," we believe it is just a matter of time before the issue is resolved and the acquisition is complete. However, there is, unfortunately, no available timeframe for when this will happen and there is still the chance of a legitimate claim arising. This could very well cause Mastercard to back out of its acquisition.

An investment in Wameja at this time would equate to an educated throw of the dice with the potential for an approximate profit of 33%. For those interested in this type of investment, this in is four stars. But be aware that the risks are high. If the acquisition gets pulled, you will likely lose it all.

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Share price chart

Source: Tradingview

I'm bored. I want a new kitchen

One of Australia's extended lockdown's more unexpected results is the resurgence of home renovations, especially kitchens. It seems, when people were locked down in their homes, they did not like what they saw. We are not sure if people had never used their kitchens before, but many decided they were not up to snuff when they became forced to. According to Hipages, demand for carpenters, electricians, painters and builders surged by as job orders for kitchen renovations jumped by 79% across Australia on a year-over-year basis.

So, where are we now? On 29 November 2020, the HomeBuilder program was extended until 31 March 2021. This program offered a $15,000 grant for new builds and substantial renovations (1 January 2021 and 31 March 2021), increasing the property price cap for new building contracts in New South Wales and Victoria to $950,000 from $850,000 as well as a few other provisions. The moral of the story, renovation demand is still going strong.

KWB is a solid match with Bedshed

Unlike most companies that we review, Joyce has two different revenue figures. As we will go over in the next section, the company divested one of its investments during 1HY21. Therefore, it has reported revenue from continuing operations and 'official' revenue statistics. We will be focusing on revenue from continuing operations and ignore the 'official' revenue results. Past performance offers no guarantee of future results, but they are one of the main ways we can attempt to determine a company's future performance. Revenue and Profit Before Tax from continuing operations was $52.9m and $12.5m during 1HY21, respectively.

KWB is 51%-owned by Joyce and represents their retail kitchen and wardrobe showrooms division. For those who are completely immersed in the world of online shopping, these showrooms allow customers to see sample setups of the products offered in person.

KWB provides the vast majority of both revenue and profit. During 1HY21, this division's revenue grew 11.5% to $40.7m while Profit Before Tax was 8.3m, representing 48% growth year-over-year. This division has continued to grow its margins impressively as management has continued to streamline the division's installation and sales process. Management has also announced that they will be expanding this division's showrooms, with one commencing trading in Artamon, NSW, this year. Additional showrooms in Sydney are also planned for FY22.

Joyce's second division is split into two parts, company-owned stores and franchise operations. Joyce owns 100% of this division, which sells beds, mattresses and accessories, like nightstands. This division was also boosted by the home renovation boom driving its total revenue growth of 35% ($12.2m) and interest in new franchises. Like KWB, margin growth has been a focus of management as Profit Before Tax rose 232% during 1HY21 to $4.2m. The majority of this growth came from the company's directly owned stores.

If it does not work, shut it down

Last year, Joyce decided to divest its 46% in Lloyds Online Auctions business for $3.8m. There is no connection to the famous Lloyds of London. Management decided that the company was not providing a consistent rate of return and, therefore, did not fit within its portfolio parameters. As equity investors, we all know how hard it can be to admit when we are wrong and we believe it is a strong sign that management is clearly willing to cut an investment when it no longer fits.

Execution and valuation done right

Before we dive into the company's valuation, there is one risk we need to mention. Joyce's stock has very little trading volume. Over the last three months, only 9,200 shares were traded each day on average. This creates substantial liquidity risk and if things go south, investors could have trouble getting out of the stock.

There are no market consensus estimates available for Joyce and the company doesn't give any guidance. However, management has said they expect growth to be forthcoming during the rest of the year. This will be driven by KWB's continued showroom and margin expansion, Bedshed's new online store gaining traction as well as a continued increase in new franchise operations and both divisions continuing to ride the renovation boom.

We believe Joyce has some strong businesses that have strong future growth potential. We have been quite pleased with how management has been using the renovation boom to drive margin growth and expansion as well. The company is currently trading at a trailing 12-month EV/EBITDA ratio of 3.4x. Compare this to the company's overall growth potential over the next few years, and we believe this is easily a four-star stock, despite the liquidity risk.

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