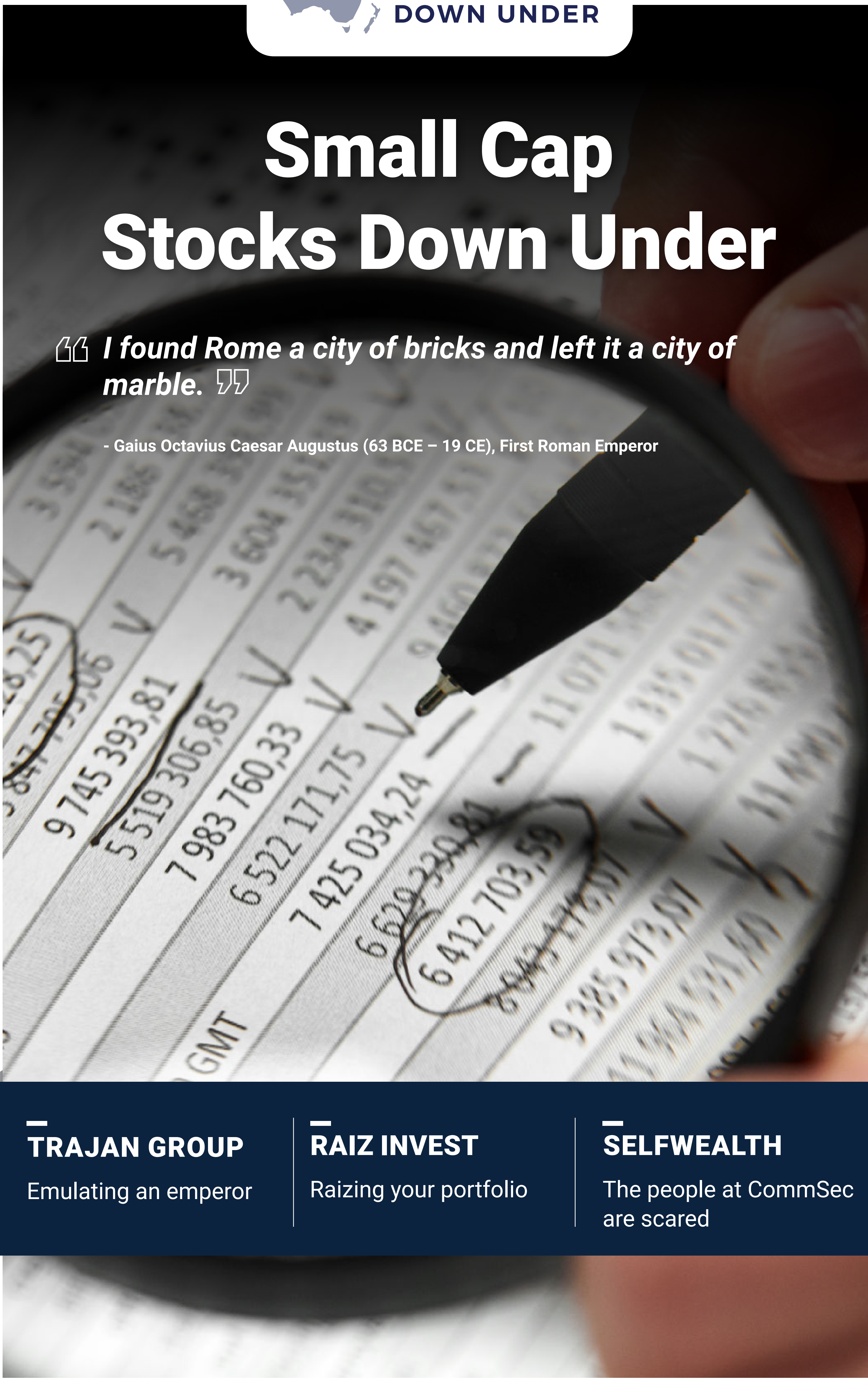

Small Cap Stocks Down Under

I found Rome a city of bricks and left it a city of marble.

- Gaius Octavius Caesar Augustus (63 BCE – 19 CE), First Roman Emperor

TRAJAN GROUP

Emulating an emperor

RAIZ INVEST

Raizing your portfolio

SELFWEALTH

The people at CommSec are scared

TRAJAN GROUP

Emulating an emperor

Stocks Down Under rating: ★★★★

ASX: TRJ
Market cap: A$442M

52-week range: A$1.82 / A$3.60
Share price: A$3.26

Headquartered in Ringwood, Victoria, the Trajan Group is one of the many product testing companies that chose to list during FY21. The company develops, manufactures and supplies products and equipment used in biological, environmental and food quality testing. Trajan began trading on 7 June 2021 after raising $90m at $1.70 per share. Shareholders must be rather happy, as the stock has quickly climbed above $2.20 where it seems intent on staying. With FY21's results smashing estimates, we believe FY22 is well on its way for a repeat event.

READ MORE

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Raizing your portfolio

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ASX: RZI
Market cap: A$152M

52-week range: A$0.695 / A$2.20
Share price: A$1.72

Headquartered in Sydney, Raiz Invest is on a mission to help Australians build savings outside of Superannuation through the company's mobile financial services platform. It allows investors to round-up their daily purchases and invest them automatically. The application also allows for recurring and lump sum deposits. The app has grown quickly and so has the company's stock. Despite the choppy market causing some investors to become skittish, we think Raiz has caught on to a trend that's here to stay.

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Market cap: A$90.9M

52-week range: A$0.30 / A$0.795
Share price: A$0.375

When we last looked at SelfWealth on 25 June 2020, the Melbourne-based company that operates a low-cost share trading platform, the stock was $0.505 per share and we called it two stars. We liked the platform and were impressed by its strong growth, but we thought the stock had gotten a little too expensive. We were right. By 26 August 2021 SelfWealth was back at $0.30. However, we've changed our mind on SelfWealth. We now think it's now headed higher from where it is today.

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Share price chart

Source: Tradingview

The beginning of an empire

Founded in 2011, the Trajan Group shares a name with, what many considered to be, the Ancient Roman Empire's second most successful and competent emperor. While we don't know if founders Stephen and Angela Tomisch named the company after the emperor, his reign was famous for its expansion and stability, two things every investor wants in a company.

How does the Trajan Group plan on emulating the emperor? The company has developed a suite of biological, food and environmental testing products sold worldwide. Unsurprisingly, FY21 was a strong year for the company as COVID-19 and its subsequent infrastructure and mining expansion drove demand for its products significantly higher. However, the company was already well into expansion mode prior to COVID-19.

Always great to beat the prospectus

If investors hate one thing, it's a company whose results don't match what they promised in the listing prospectus, that is, unless they beat them. Not only did Trajan beat its prospectus forecasts during FY21, it gave them a stomping. However, before we dive into the results, it is important to remember that Trajan is a global company with five manufacturing sites across the United States, Australia and Malaysia and general and sales operations across Australia, the United States, Asia and Europe. In fact, approximately 90% of Trajan's annual revenue was generated outside of the Oceania region. This brings currency risk for Trajan, which is why the company shares two metrics: standard and currency adjusted results. We believe currency adjusted tells a better story as the company is in growth mode and like-for-like figures are the best way to tell how strong that growth is.

During FY21, Trajan increased its revenue to $76.6m, up 6.6% compared to the FY20. However, on a constant currency basis, we get a much better indication of FY21's success as the numbers tell us that revenue grew 16%. According to management, the reason for this growth was simple as 18 out of Trajan's top 20 customers increased business across most of Trajan's product lines. In other words, the business saw growth across the board.

This helped push gross profit margins from 37% to 40.2%, which in turn helped adjusted EBITDA (excluding IPO related expenses of $4.4m, share-based payment expenses of $1.9m and PPP loan forgiveness of $1.3m) increase 89% year-over-year to $10m. Revenue beat prospectus forecasts by 2.6%, certainly respectable. Gross profit margins matched the prospectus forecasts, but management heavily underestimated just how far they could push Trajan's EBITDA growth, as FY21's adjusted EBITDA result smashed prospectus forecasts by 5.2%.

We would be slightly weary of these strong results, if the currency-adjusted revenue growth was not also organic revenue growth. Management has stated in its FY21 results announcement that it is currently working on several additional acquisitions and we expect a steady stream of these announcements during FY22. However, with $51.7m in cash as of FY21, we are not concerned about serious dilution in the near future to fund these acquisitions.

FY21 was just the beginning

The market is rather bullish on Trajan's future, expecting EBITDA to rise from $10m in FY21 to $13.1m in FY22 and to $16.5m in FY23, i.e. about 30% EBITDA growth each year. Based on these consensus forecasts, Trajan is currently trading on FY22 and FY23 EV/EBITDA multiples of 29.6x and 23.5x. Normally, we would say that these valuations warrant a three-star rating.

However, with acquisitions in the pipeline, all of which management has stated will be EBITDA accretive and should generate between $1m and $25m in annual revenue, we believe these earnings expectations may prove to be way too conservative. We believe Trajan is a great company run by a strong management team that more than deserves a four-star rating, even at its current valuation.

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Share price chart

Source: Tradingview

Investing made easy

Raiz Invest has brought a rather well-known investment product in the United States to Australia, round-up micro investing. Applications like Acron have been doing this for years now, but Australia has been slow to adopt this valuable investing tool due to its higher trading costs. The idea is rather straight forward, investors download Raiz Invest's application, which allows them to pick from six portfolios based on their risk tolerance. Once they have chosen the portfolio they want to invest in, they can pick a mixture of three deposit options.

The first two are rather standard, recurring and lump sum deposits. The third option is what sets Raiz Invest apart from other Australian offerings, i.e. the ability to automatically round-up all debit card purchases and investing the difference. In practice this can be as low as $0.05 from your morning coffee, or as high as $0.95 from that weirdly priced snack pack you bought at 2am on your way home from the pub. This might not seem like a lot of money, but when you consider just how many small purchases we make, even $0.05 can add up rather quickly. The program is designed in a way that does not break the bank, but forces you to stash and invest a small amount of money during each purchase that you won't miss from that month's pay check.

The goal is in sight

Raiz saw strong results in FY21, with revenues growing 37% year-over-year to $13.4m as the number of Global Active Customers (GAC) grew 87% to 456,927. Raiz is not yet profitable, but with an adjusted loss of $258,000 during FY21, we would call that only barely, especially when we factor in the number of new products Raiz launched during the year. In the course of FY21, Raiz launched its mobile application in Malaysia, introduced custom portfolios and Self-Managed Superannuation Funds (SMSFs) in Australia, launched Raiz Home Ownership for first-time buyers and expanded its Indonesian platform. If this was not enough, the company recently acquired Superestate. This acquisition is rather strategic, as it expands Raiz's Superannuation offerings by allowing the company to offer residential property as an asset class.

On 6 September 2021, management released Raiz's August 2021 'Key Metrics' update. As of 31 August 2021, total Funds Under Management (FUM) had grown 94.2% year-over-year and 6.9% compared to July 2021, to $967.4m. Raiz's goal is to reach $1bn FUM by 31 December 2021, but it seems the company will achieve this goal by the end of September or October.

Importantly, it's also clear to us that this growth is not due to a few large client wins, but rather due to a steady stream of new client and account sign-ups across all areas of operation. As of 31 August 2021, Malaysia's total active customers grew 5.6% to 77,066 compared to July 2021 and Indonesia's increased 11.3% to 144,269. The Australian division saw considerably lower growth, but we find this unsurprising as the market is more competitive here. Australian active customers grew 1.5% to 286,789 compared to July 2021. Over the last three months, Indonesia, Malaysia and Australia have experienced 34.6%, 29.1%, and 6% active customer growth, respectively.

Profitability ho!

As we mentioned before, Raiz's FY21 loss is small, especially for a company going through such significant expansion. The market seems to agree with us as it is forecasting EBITDA profitability of $3.9m for FY22. This is expected to grow 66.7% year-over-year during FY23 to $6.5m. Based on FY21 and August's numbers, we see no reason to think the market is overestimating Raiz's potential growth. In fact, with an EV/EBITDA ratio of only 33.3x and 20x for FY22 and FY23 respectively, we believe the market may be underestimating the profits this company can raiz—four stars from us at Stocks Down Under.

SELFWEALTH

The people at CommSec are scared

Stocks Down Under rating: ★ ★ ★ ★

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Share price chart

Source: Tradingview

There's not been a lot to like about the Coronavirus Crisis of 2020-21. However, one of the upsides has been the way in which so many people in Australia have started taking charge of their own investment portfolios. In mid-2019 about 740,000 individuals could be described as actively trading stocks in Australia. Two years later it's more than 1.4 million. That's a heck of a lot of financially adventurous people who need to subscribe to Stocks Down Under to help guide their investment decisions…but we digress.

Double the active traders from a year ago

SelfWealth, with its close-to-market-leading $9.50 flat-fee brokerage, has been a key beneficiary of this boom that's showing no sign of slowing down. The platform may have only launched in 2016, but at the end of June 2020 there were about 46,000 active users on it. By June 2021 that active user count had reached 95,000 and the 100,000 mark was reached on 10 August. With 130 new active traders signing up every day, SelfWealth is far from a slow-growth company. And that's not counting the growing number of financial advisors who are also using the platform in increasing numbers.

All those extra customers have carried SelfWealth to the point where there's almost no red ink on the books anymore. In FY21 revenue amounted to $18.4m, up 135% year-on-year, and the EBITDA loss was only $0.5m, as against a $2.9m loss in FY20. FY22 won't be SelfWealth's first breakeven year because the company is still investing in its growth. That said, it should still be a good year. Many of the active traders that signed up since January will only start making a contribution in FY22.

In addition, a much-vaunted US trading service was only launched in December 2020 and six months later only around a third of SelfWealth's client base had added US functionality to their accounts. The thing about SelfWealth's business is that it is highly scalable. We note there was a large leap in gross margins in FY21, from 33% to 41%, although it helped that suppliers were giving volume discounts.

CommSec is so 2007

SelfWealth reckons the growth of its platform isn't likely to stop in FY22, because even if the addressable market stops growing, people now know there's a new kid on the share trading block. Back in the day, if you traded online in Australia you likely did it through the Commonwealth Bank's CommSec unit, through ANZ (which bought E*Trade Australia in 2007) or through NAB. The clients of those three platforms are now leaving in droves for lower cost offerings and SelfWealth's market research shows that its platform is the first port of call. FY21 actually saw SelfWealth overtake NAB. SelfWealth reckons it is getting a lot of 'word of mouth' referrals, the best kind of advertising there is.

The secret to SelfWealth's success is that it doesn't just provide a platform on which people can trade. It adds a lot of value to those clients while they are trading or evaluating trading opportunities. In last year's article we described the 'crowd-driven' research tools SelfWealth makes available, where subscribers who pay $20 a month in addition to their brokerage fees can receive unique, actionable insight from real investor portfolios owned by members of the community. SelfWealth isn't stopping with this service. It's investing heavily in other features that improve the user experience, such as custom notifications, advanced charting capabilities and better news feeds.

And it's not stopping with just offering US stocks in addition to ASX stocks – other markets are in the works. SelfWealth is well-funded to continue growing its platform. In July it raised $12m in a placement and Share Purchase Plan, the placement at $0.39 per share and the SPP at $0.35. That raised the cash balance from $7.5m to around $19.5m.

New leadership and a much better valuation

SelfWealth has the leadership smarts to take it further up the curve in terms of creating the Wow Factor that dinosaurs like CommSec just don't have. Cath Whitaker was named the new CEO back in late March. Her last gig was 'Managing Director, Global Digital Transformation Leader' at Marsh, the gigantic American insurance broker. Working there doubtless taught her a thing or two about what works for financial platforms, digitally speaking. Mandy Drake joined as the new CFO in June, making SelfWealth one of the few ASX-listed companies where both the CEO and CFO are women.

In June 2020 we were negative on SelfWealth because the stock looked expensive on Price/Book and EV/Revenue multiples, and where we had to be backward looking because there were no consensus forecasts available. There are still no consensus numbers, but the ratios are different this time around. As at June 2021 the NTA was $0.0278 per share, so the Price/Book ratio is only 15x as against 73.3x before. And the EV/revenue multiple is now a much more reasonable 4.5x as against 25.9x last year. With new leadership, plenty of new customers and plenty of innovation around the platform, we think that's a reasonable price to pay. Four stars.

Pitt Street Research Pty Ltd

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