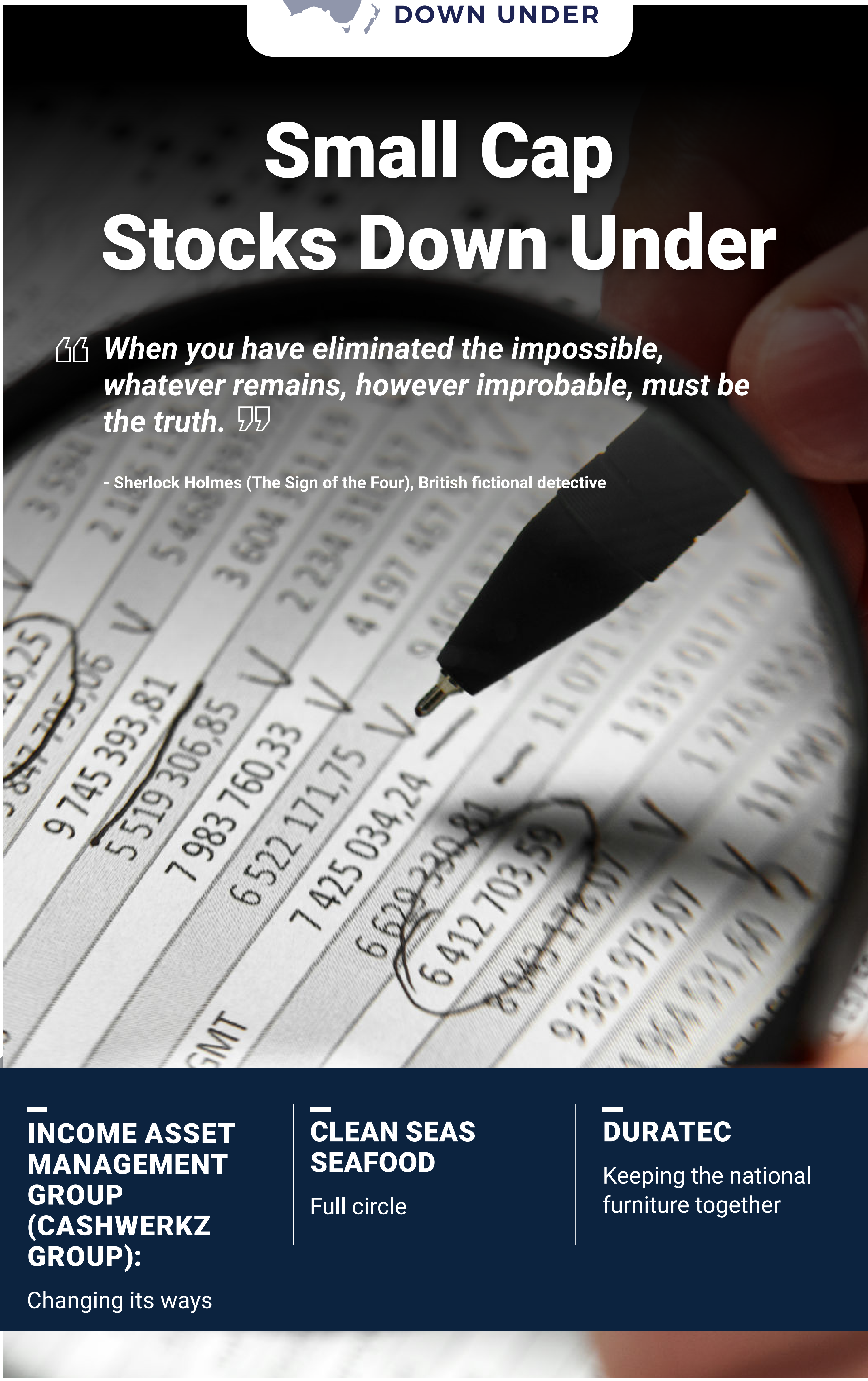
STOCKS DOWN UNDER

8 OCTOBER 2021



Small Cap Stocks Down Under

"When you have eliminated the impossible, whatever remains, however improbable, must be the truth."

- Sherlock Holmes (The Sign of the Four), British fictional detective

INCOME ASSET MANAGEMENT GROUP (CASHWERKZ GROUP):

Changing its ways

CLEAN SEAS SEAFOOD

Full circle

DURATEC

Keeping the national furniture together

INCOME ASSET MANAGEMENT GROUP (CASHWERKZ GROUP):

Changing its ways

Stocks Down Under rating: ★★★

ASX: INY (CWZ)
Market cap: A$91.4M

52-week range: A$0.125 / A$0.40
Share price: A$0.34

Based in Brisbane, the Income Asset Management Group (previously known as Cashwerkz Group) provides cash management services online. These services range from fixed-interest brokerage to advisory for fund managers and investors. While the name may seem like that of a new-age start-up, the IAM Group does something that has existed in the financial sector for decades. That said, the company's relatively new platform allows consumers to earn a higher interest rate on their cash by comparing various options online.

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Stocks Down Under rating: ★★★★

ASX: CSS
Market cap: A$90.9M

52-week range: A$0.50 / A$0.92
Share price: A$0.55

Clean Seas Seafood is an Adelaide-based seafood company. It engages in the sustainable production of seafood, beginning at the propagation stage and going all the way to selling the produce to wholesalers and distributors. The company's chief product is the Spencer Gulf Hiramasa Yellowtail Kingfish. The company is also involved in selling other seafood products, such as tuna and fingerlings. COVID-19 was particularly devastating for the company, but we believe that it can bounce back from the setback.

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Market cap: A$89M

52-week range: A$0.35 / A$0.95
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Perth-based Duratec has built a $200+m business, keeping valuable infrastructure, including Defence infrastructure, from falling apart. With infrastructure spending set to increase in Australia over the next decade or so, Duratec is well placed to increase its already sizeable order book. We believe the market is too focused on past results and has yet to appreciate the strong earnings growth to come from that book.

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Share price chart

Source: Tradingview

The fixed income specialists

The Income Asset Management Group listed on the ASX in 1987, when its main line of business was responsible entity, trustee and custodial services to fund managers. Simply put, the company was a regulated and authorised entity that could hold securities for safekeeping to minimise risk to investors. The company also managed trusts for third parties and help set up and manage investment schemes.

Until May 2019, the company was known as Trustees Australia Limited. It changed its name to Cashwerkz to coincide with its new primary business. And as of 23 August 2021, the company has changed its name again to the Income Asset Management Group following its refocus on its fixed income solution divisions. Trustees Australia still exists as a subsidiary of the IAM Group under the new name IAM Income Asset Management. It continues the same business that it has built its reputation on. Trustees Australia also provides advisory services to clients, ranging from rate research and analysis to reporting and compliance.

The company's second subsidiary IAM Capital Markets, previously known as Bond Income, provides access to global financial markets, linking investors in Australia to corporate bonds at a fair price. IAM Capital Markets is also responsible for researching and advising clients on the right investments and ensuring that new issues are available as quickly as possible.

Lastly, the third subsidiary IAM Income Asset Management, previously known as Cashwerkz Technologies, is a platform that tries to link banks with wholesale investors and financial managers looking to invest their cash. The platform is designed for defensive investments, meaning securities and bonds that are considered low risk but with high liquidity. Investors have the option of browsing the markets for cash deposits, term deposits and fixed/floating rate notes. Those looking for bespoke solutions can also access the company's trading desk that essentially functions as a middleman between bond issuers and purchasers.

From boring and rigid to interesting and flexible

In May 2019, the company decided to rebrand itself completely. Its legacy businesses were failing to generate a substantial profit and the company decided to focus on the Cashwerkz platform.

With the name change, the company decided to leverage its expertise in the fixed income space by solving a huge problem in the market. While finding information on stocks and other popular assets was easy, there was not a lot of easily accessible information on defensive assets such as term deposits. Sure, some services could help you compare the different interest rates between banks. Still, no one-stop solution provided research, KYC/AML and a platform to directly invest in term deposits.

The company fixed this with Cashwerkz Technologies. It signed agreements with 49 banks and began offering the platform to institutions and wholesale investors looking to park their cash in a secure, but somewhat profitable manner.

In June 2019, the company partnered with Agility Connect, the Australian referral platform, to enable greater transparency and empower its clients with more choices, mainly through access to 175 financial services groups in Australia. In the same month, the company also partnered with Praemium, the Australian Integrated Managed Accounts Platform. All the while, IAM continued to increase the number of partnerships with banks and financial institutions.

A slow swim across the Pacific

The company's goal is clear: To make its products as complete and widely available as possible. Therefore, it was no surprise when IAM established a cash investing program with Mozo, the Australian personal finance platform, in March 2020.

It seems that the company's efforts are showing results. At the end of FY21, it had experienced a 272% increase in revenue ($3.4m) year-over-year and a 154% increase in other sources of revenue ($0.9m), including R&D grants. The company also raised $14m in June 2021 at $0.27 per share for expansion purposes and a 25% stake in Tactical Global Management Limited, a Brisbane-based asset management firm.

The next step for IAM is to take its business global. However, that is easier said than done. To expand to other jurisdictions, the company will have to form agreements with banks and financial institutions once again. Only then can the arduous process of building a customer base begin. The fact that IAM has already set up agreements with many of those banks (when offering their products to Australian investors) should help speed things up, albeit only slightly.

That said, the company is still burning cash at a rate much higher than its revenues. Total expenses for FY21 alone were $19.6m. Due to its slim profit margins, the company's business model relies on volumes, which could be a problem if IAM fails to grow at the current rate.

While the company is doing extremely well in Australia, it remains to be seen if that performance can be replicated abroad. As such, we think IAM is a three-star investment. It has a lot of potential, but there are also many questions that need to be answered before it can be considered a worthwhile investment. Three stars for now.

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Full circle

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Share price chart

Source: Tradingview

Swimming upstream

Clean Seas Seafood was founded in 2000 with a vision to provide seafood, including rare fish that are endangered or close to endangered, in a sustainable manner. The company's goals have largely stayed the same since then, but its ambitions have not.

The company engages in aquaculture, meaning that it cultivates aquatic organisms in a controlled manner. Initially, the company mainly produced the Southern Bluefin Tuna while setting up a Yellowtail Kingfish production line. However, Clean Seas has been changing its focus depending on prevailing market conditions and global demand.

The company experienced growing pains in the first ten years of its existence. In September 2010, 80 tonnes of Kingfish died due to human error, causing a pre-tax loss of $0.7m. Despite small setbacks, management's vision for the company was beginning to take effect.

In total, the company raised $54m at $0.25 in 2009 and 2010. The capital was used to expand the company's breeding capabilities. Before long, Clean Seas was able to set up a full cycle breeding process. It was at this time that the company began shifting from Bluefish Tuna to Yellowtail Kingfish production.

The company hatches the Yellowtail Kingfish at its Hatchery in Arno Bay, SA. At 75 days, the fish are transferred to the company's sea farm in Port Lincoln in the Spencer Gulf. After 16-24 months on the farm, they are harvested and processed at the Adelaide facility. The company uses its proprietary Sensory Fresh technology, using liquid nitrogen to freeze the fish in 22 minutes instead of the 240 minutes it normally takes, which preserves the flavour. Finally, the company uses its network of over 150 distributors to supply its fish all around the world.

Colliding with a dam

By early 2013, the Yellowtail Kingfish was the company's entire focus. While other operations, such as the cultivation and sale of tuna, continued, the company believed the Kingfish to be its primary growth driver.

FY14 was the first year in which Clean Seas generated a profit. Despite the fall in revenue relative to previous years ($15m in FY13 to $10.4m in FY14), the company was able to cut down on costs due to a streamlining of its operations. It had also written off many of its assets relating to its previous operations. It was, in a way, operating as a brand-new company.

Clean Seas spent the next two years trying to vigorously expand its distribution networks and production capacity. Revenue increased, surging to $18.4m in FY15 and $30m in FY16. In November 2016, the company raised $8.7m at $0.0335 per share to set up a processing facility and upgrade the equipment used in the company's full cycle breeding process.

The company was well on its way to continue its upward trajectory until 2HY20, when COVID-19 effectively ceased its operations. Not only was the company hampered by the shutdown in restaurants and dining facilities, but transporting its fish globally also became a huge problem. FY20 was the first year since FY14 where revenue fell, declining from $46m in FY19 to just over $40m.

FY20 ended with a loss of $14.5m, the company's first yearly loss since FY16. And while the company is gradually beginning to recover, there is still a long way to go before it will have fully bounced back from losses sustained during COVID-19.

Back to where we started

Regrettably, Clean Seas was one of the companies with huge exposure to global disasters, such as COVID-19. In FY21, the price per tonne decreased by approximately 7.9%, but revenue still increased 20% year-over-year to $48.5m on the back of a 31% increase in volumes. The fact that the company had to impair over $8m in assets due to unsold inventory and mortalities didn't help its balance sheet, though.

In May 2021, the company raised $25m at $0.57 per share through an institutional placement for working capital requirements and expansion of business post-COVID.

It seems that Clean Seas Seafood has come full circle. After finding its niche in the seafood market and growing rapidly from FY13 to FY19, FY20 eradicated all the company's gains, leaving it to start over once again during FY21. However, while Clean Seas is starting over, it isn't starting from scratch. It clearly leveraged its state-of-the-art production facilities and vast distributor network to rebuild during FY21 and we expect this to continue at a much faster pace than before.

Consensus estimates reflect this sentiment. Net sales are expected to increase to $54m in FY22 and $64m in FY23. The company is expected to generate a positive EBITDA once again in FY23. This implies an EV/EBITDA valuation of 13.8x. Barring any unforeseen pandemics, we expect the company to continue to grow in the same manner as we witnessed in the last decade, making Clean Seas a four-star investment in our opinion.

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Share price chart

Source: Tradingview

An infrastructure boom? You bet

In 2019, the nation's independent infrastructure advisor, Infrastructure Australia, released a landmark audit calling for $600bn in investment over the following 15 years. In particular, the advisor sounded a klaxon recognisable to anyone who's ever walked around a major Australian city: our ageing assets. But which ASX-listed companies are set to benefit from the possibility of a post-Covid infrastructure boom?

When people think of infrastructure spending, specifically post-recession infrastructure spending, they probably have new public works in mind. Think Baron Haussmann's redesign of Paris in the mid-nineteenth century or America's New Deal public works of the 1930s. But that's misleading. Maintenance of existing infrastructure, while more humdrum, is far more important. Just ask the Pilbara iron ore miners what they'd prefer: a new railway line to the port, or their existing lines fit for purpose? They'll say the latter every time.

Enter Duratec as a big beneficiary of the boom in infrastructure maintenance in the Western part of the country. Headquartered in Wangara in Perth's northern suburbs, Duratec does approximately 50% of its work in the Wildflower State. The company generated A$247m in revenue and $21m in earnings in FY20, providing recladding, refurbishment and remediation services. All of Duratec's work is aimed at protecting and extending the life of assets. Combatting corrosion and weathering, especially in a predominantly coastal nation like Australia, are the company's lifeblood and provide a lot of work. Let's take a closer look.

As a specialist contractor, Duratec primarily repairs all types of steel and concrete infrastructure. It operates on the sound basis that governments and companies have a fiduciary responsibility to make their infrastructure compliant and have an ethical responsibility to make it safe too. We also see Duratec benefiting from stricter building codes, which will likely require Duratec's technical expertise. When you think about the 2019 Mascot Towers fiasco in Sydney, when residents were evacuated after cracks appeared in the foundation, you get a sense of the opportunity. The repair bill at Mascot now tallies $53m.

Defence wins games

However, it's not apartments that are the big earners for Duratec – it's the Australian Department of Defence. If you've recently been on an Aussie defence base, there's a 50-50 shot you've seen a Duratec employee. Duratec currently has operations at 37 of Australia's 75 defence bases scattered across the country. In FY21 a whopping 41.9% of the company's revenue came from the defence industry. The company's current tenders and orderbook has defence playing a significant role in future earnings as well, at 32% and 47%, respectively. Duratec has shown that it is very capable at winning tenders and in Australia, as future tenders go to the incumbent 75-80% of the time.

A good example of the type of work Duratec excels at is the HMAS Stirling Low-Level Bridge Repairs Project. Constructed in 1972, the bridge provides access to the HMAS Stirling, which is the Royal Australian Navy's main base on the west coast, so it is crucial for Australia's defence capability. The bridge required remediation of its reinforced concrete, structural steel and vehicle guard rails. Upon completion, the asset is now considered structurally sound until 2055, which again points to the cost-effectiveness of repairing existing infrastructure.

A lagging share price

Duratec did its IPO on ASX in November 2020 at $0.50 a share. The old owners took some money off the table, including Ertech, the civil construction company that Jim Giumelli founded in 1981. But Duratec also raised $24m in new capital, which left the company debt-free. Ertech sold down to 19.9%, but a substantial shareholder notice from early July, which combines the Ertech holding with other Giumelli interests, showed that Jim had been a recent buyer of stock and that's encouraging. And no wonder Jim was buying. The stock had trended back to the mid-$0.30 level by June, but with business brisk, as reflected by that order book, it was reasonable to expect better days.

How reasonable? Well, consider that in the six months to December 2020 Duratec posted revenue of $124m, down 3.2%, but EBITDA amounted to $11.7m, up 4.4%. Net cash at the end of the half was $23m. The market hoped the only reason 1HY21 was so slow was because of Covid-19 as well as some tender delays and that this would be resolved during 2HY21. Unfortunately, FY21's results showed that this was not to be with full year revenue coming in at $235.7m (down 4.7% year-over-year) and normalised EBITDA at $18.8m (down 14.3%). The reason for this downturn in 2HY21 was the same, i.e. COVID-19 causing the Eastern Region to experience operating inefficiencies and delays leading to EBITDA margin declines from 8.9% to 8% in FY21 as a whole.

Given how time-intensive infrastructural repairs can be and FY21's disappointing results, it is no surprise that the Duratec share price is right at the bottom of its 52-week trading range. Investors probably won't feel a sharp uptick in price until late in FY22, when that $657.2m in tendered work as of 31 July 2021 starts to finally trickle in. If you're a patient investor, with the stock effectively at rock-bottom, we believe the current share price is a great way to shore up the foundations of your portfolio. Four stars.

Pitt Street Research Pty Ltd

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