STOCKS DOWN UNDER

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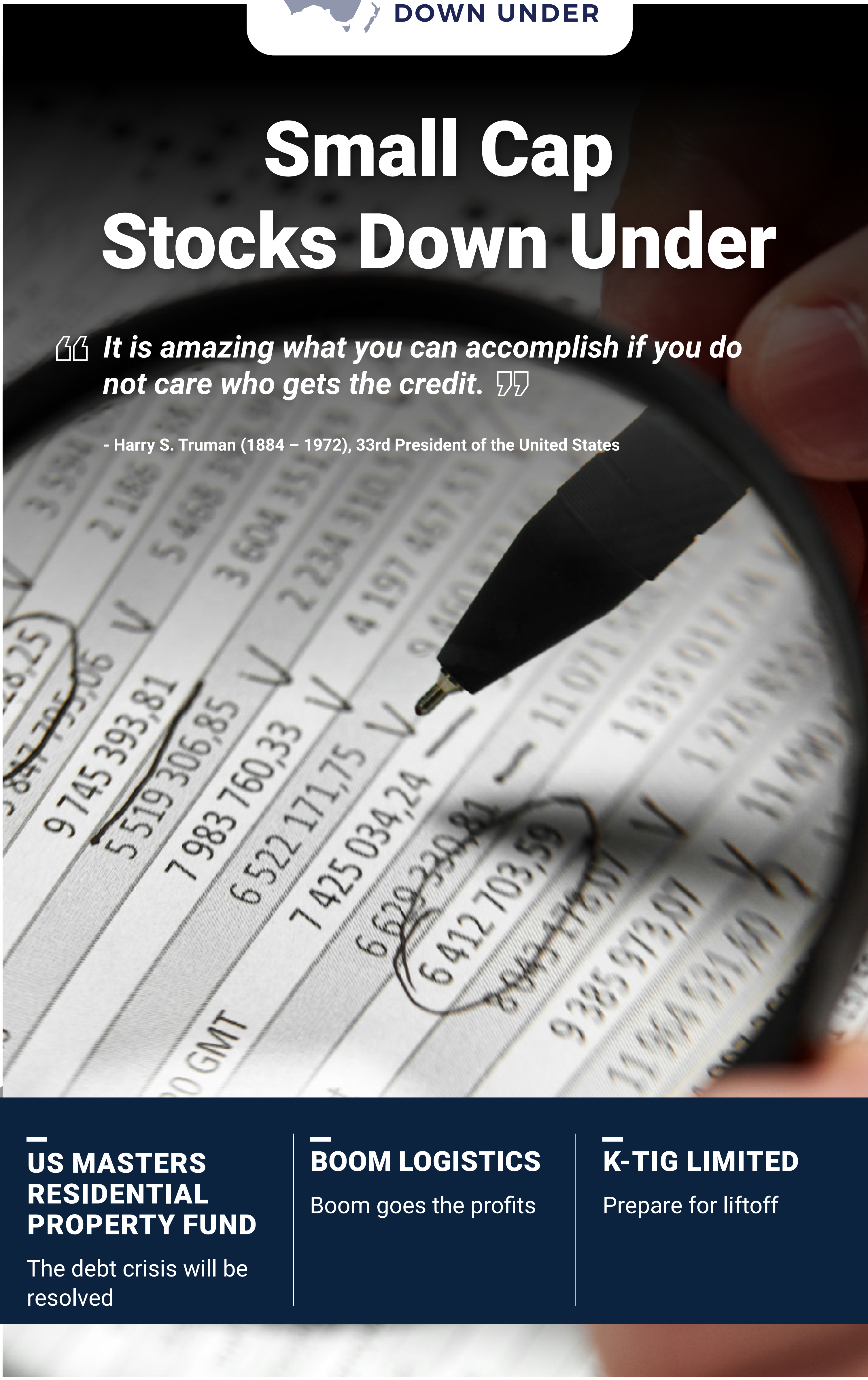
Small Cap Stocks Down Under



It is amazing what you can accomplish if you do not care who gets the credit.

- Harry S. Truman (1884 – 1972), 33rd President of the United States

US MASTERS RESIDENTIAL PROPERTY FUND

The debt crisis will be resolved

BOOM LOGISTICS

Boom goes the profits

K-TIG LIMITED

Prepare for liftoff

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Stocks Down Under rating: ★★★★

ASX: URF
Market cap: A$135M

52-week range: A$0.185 / A$0.39
Share price: A$0.345

With offices in Sydney, Australia and Jersey City, United States, the US Masters Residential Property Fund has one goal, to invest in United States residential property. The ASX has a large number of Australian-focused Real Estate Investment Trusts (REITs) of all sizes and focuses, but US Masters clearly stands out from the pack with its offering. What makes the REIT stand out even more is the weekly updates management provides on operations and the Net Asset Value per unit. And these updates have made one thing perfectly clear, the United States might still have COVID-19 problems, but US Masters certainly does not.

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ASX: BOL
Market cap: A$77M
Dividend yield: 8.3% (0% Franked)

52-week range: A$0.125 / A$0.20
Share price: A$0.18

Headquartered in the Melbourne suburb of Southbank, Boom Logistics offers lifting and labour services across the mining, energy, renewable and infrastructure industries. However, the story of Boom Logistics is more about lifting, than labour. By lifting, we mean cranes and while the pandemic was crushing for some companies, Boom Logistics is not only in the middle of a massive asset rejuvenation, but at the same time generated its first profit since 2012. The name Boom Logistics clearly indicates the massive splash the company is making.

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Market cap: A$57M

52-week range: A$0.245 / A$0.58
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K-TIG Limited has developed a new proprietary technology in what seems to be a fairly non-technological industry: welding. Like all processes, things and creations of industry and commerce, technological innovation is possible in all of these areas. While K-TIG's technology is unlikely to be as influential as the printing press or the cotton gin, we believe it is an revolutionary technology with significant potential.

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Share price chart

Source: Tradingview

A rather narrow focus

The US Masters Residential Property Fund is one of the most narrowly focused Real Estate Investment Trusts (REITs) we cover at Stocks Down Under, specialising in freestanding and multi-tenant properties in the New York City and New Jersey metropolitan areas. For those not familiar with the term freestanding, it means a building not attached to anything else. The fund was first established in 2011 and it is important to note it is only listed on the ASX. So while liquidity is not high (540,000 units traded daily on average over the last three months), investors don't have to worry about it being split with a United States secondary listing.

The fund has grown rapidly and as of 30 September 2021, either wholly or partly has an interest in 484 properties. These properties consist of one to four families per residential buildings split between what is considered New Jersey Workforce (Bayonne, Jersey City Heights, etc) with 300 properties, New Jersey Premium (Downtown and Weehawken) at 70 properties, New York premium (Cobble Hill, Williamsburg, etc) at 113 buildings (some of these properties are jointly held with Urban American) and Essex County with one building. However, it is important to note that during the month of October, the fund closed on the sale of one, unspecified property, bringing the total down to 483.

As of 30 September 2021, the total value of US Masters' portfolio was estimated to be US$635m, with 51% of the value coming from New York premium, 30% New Jersey workforce, 19% New Jersey premium and less than 1% from Essex County property.

COVID-19 is not a huge risk anymore

For those concerned about the repeated news flow around the United States' continuing struggles with COVID-19, don't be. As of the 31 October 2021 fund and Net Asset Value (NAV) update, rent collection was back up to 98% for the month. When we combine this with 3Q21's update, putting total unreserved for lease properties at only 2% (18) of total properties, we believe it is more than fair to say COVID-19 is not a concern when it comes to US Masters' operational results. In fact, 3Q21's same home trailing 12-month Net Operating Income (NOI) of US$19.6m was only 3.4% lower than the target set by management in 2019, before the pandemic hit

Discounted for a good reason

We do understand the questions that must be popping up in your head. If COVID-19 is not a risk and 3Q21's property value on 30 September 2021 was US$635m, why is US Masters' total market capitalisation only $134.6m? The answer here is actually rather simple and is due to two main factors that cause discounts across all industries: debt and earnings yield.

When it comes down to it, US Masters has far too much debt on its balance sheet and management knows it. As of 3Q21, total debt stood at US$350m, with indicative total interest costs at US$14m. Now, this is a sharp reduction compared to even 30 June 2021, with total debt down US$26m and indicative total interest costs down US$1.3m. However, the company still has a long way to go and this is why the trust sold US$16.4m in properties during 3Q21. The fund's goal is to bring its Funds From Operations (FFO) into the black, but that brings us to our second cause for the valuation discount: earnings yield.

The properties in US Master's portfolio have much lower yields than most of the other REITs we cover at Stocks Down Under. As of 3Q21, New York premium properties' net yield stood at 2.8%, New Jersey Workforce stood at 4.2% and New Jersey premium was 2.8%. Inflation is on everybody's mind and at Stocks Down Under we believe it is certainly not transitory with the era of low interest rates coming to an end. Even so, the fund's interest rate currently sits at a blended cost of 4%, higher than most of its property portfolio yields.

Despite the trouble with its debt, we remain optimistic that management has its hands around the situation and will have no trouble bringing Funds From Operations back into the black soon through continued property sales. Property prices in this region of the United States have been experiencing a sharp rally and while we believe a discount is in order from the stock's NAV per unit of $0.68 as of 17 November 2021, we think the current discount of 50% is far too much. We believe the the gap will largely be closed once the debt level has become more reasonable. But for those willing to wait (without a dividend), we believe US Masters offers a significant capital gains opportunity. Four stars.

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Share price chart

Source: Tradingview

Without cranes, our hopes go boom

If you live in a city, chances are you won't have to walk far to see one piece of equipment we take for granted in our modern life, but can't live without, cranes. Not only do cranes allow for skyscrapers to tower over our cities (and the construction of most other projects like bridges), but they also facilitate the operation of one of Australia's most important industries, mining. That's right, without cranes, mining operations would be unable to transport the raw materials ormove equipment and supplies. However, these cranes are highly expensive and specialised pieces of machinery, and are not one-size-fits-all. Therefore, it is often a lot easier to rent, lease, or hire the cranes and manpower from an outside company than maintain your own.

This is where Boom Logistics comes in, with its team of skilled engineers and slightly over 260 cranes (5-750 tonnes) and over 120 travel towers. The company also provides companies with low loads, boom lifts and scissor lifts. However, the majority (53.6%) of the company's $173.3m in FY21 revenue came from providing crane services to mining and industrial operations. And although this segment saw a slight decline in revenue of 2.8% compared to FY19, we would view that as a very strong result. COVID-19 caused shutdowns or delays across the mining and industrial industries during FY21, with most (if not all) operations resuming during

FY22. In fact, we expect these delays to cause a significant boost in revenue for this division during FY22 and FY23 as more contracts come up for bid. Boom Logistics already announced on 6 May 2021, that it had won a new contract at BHP Olympic Dam to support a major smelter shutdown project. The work started in August 2021 and is expected to provide $15m in revenue for FY22.

The next largest division is called Projects and focuses on bridge installations, wind farm and high voltage powerline construction as well as maintenance programs. During FY21, this division generated $37.5m in revenue, an increase of 6.8% compared to FY19, but a decrease of 1.3% on a year-over-year basis (vs FY20).

With the increasing focus on windfarm construction and the need for new basic infrastructure, such as bridges and rails, only set to increase over the next five to ten years, we remain highly optimistic about the prospects for this division. Boom Logistics has certainly established itself in the industry and we believe this foothold will help the company win contracts and expand the division in the near future.

The last two divisions are travel towers and Readi, generating $25.3m (1.6% increase compared to FY19) and $17.6m (35.1% decrease compared to FY19) in revenue, respectively. While the travel towers division does facilitate 5G, data network and power grid upgrades and construction, both these divisions are also involved in maintenance; travel towers through the use of its equipment, and Readi through the provision of specialised labour.

We believe that for both of these divisions the delays caused by COVID-19 during FY21 were likely felt especially strongly as maintenance was one of the main areas that company management decided to push. We believe now that the Australian construction industry is almost entirely back to work and with regular maintenance in catch-up mode, these two divisions (especially Readi) will benefit from the return to 'normal'.

Let the profit bell ring

Sure, FY21 was a bit of a mixed bag on the revenue side of the equation for Boom Logistics, but when it came to the company's profit performance, it was nothing but sunshine and rainbows as EBITDA grew 53% year-over-year to $36.3m. FY21's EBITDA performance is even more impressive when you compare it to FY19 and see that the company grew its EBITDA 25.2% during FY21 in the last two years. The main reason for this increase in EBITDA, despite the decline in revenue of 6.6% year-over-year, was a sharp decline in external labour hire and other equipment services and supplies expense. Unfortunately, it is unclear if Boom Logistics will be able to keep all of this margin expansion going forward, but due to the areas where expenses were cut, we find it highly unlikely that it will be able to maintain the majority of its margin gains.

However, don't mistake our expectation that EBITDA margins will decrease during FY22 to mean we expect EBITDA to decline year-over-year. If we did not make it clear above, we expect strong growth across the board at Boom Logistics during FY22.

Due to a lack of management guidance, we have used a trailing 12-months EV/EBITDA multiple to value Boom Logistics. At 3.4x, we think the share is not expensive at all, given the outlook. In our view, Boom Logistics is a company with strong management, an important industry niche, but lacks investor awareness. For investors willing to be patient, we believe FY22 will likely provide considerable upside, so four stars.

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Share price chart

Source: Tradingview

Innovate or die

Austrian-American management consultant Peter Drucker is often credited with coining the phrase innovate or die. The truth is, whoever was the first to utter the phrase could not have been more correct on both an individual company level, as well as on a national one. It is our job at Stocks Down Under to analyse companies to see how they might do in the future, but as any analyst should know, those who do not know history are doomed to make the mistakes of the past. And if there is one resounding message throughout history, it is that those who ignore innovation are doomed to be overcome by those who embrace innovation. A prime example of this is how the United States rose in prominence during the late 1800s and into the 1900s. It adopted of new steel production technology, something the United Kingdom heavily resisted at the time.

This brings us too the topic of welding. There are a number of different types of welding, using a number of different technologies, for a number of different purposes. But the most commonly used today remains arc welding. This process uses an electrical current to weld metals together. However, there is actually a number of different types of arc welding methods too, although they all use heat generated by an electrical current to melt and bond materials.

The two main methods of arc welding are TIG and MIG, each with its own uses, costs, time commitments and overall uses. MIG welding stands for Metal Inert Gas and is commonly used for large and thick materials, offering the golden combination of shorter welding times and lower costs. However, the largest drawback to this method is that the welds are not too precise, strong or clean.

TIG welding stands for Tungsten Inert Gas, a process that is considered to be the most versatile of arc welding, offering the ability to weld anything from thin, small or large material. However, to weld a thick piece of material using the TIG system, you will usually need to make multiple passes. And the process is much slower (hours versus under an hour), requires highly specialised training and generally costs more than MIG. Despite these drawbacks, TIG systems offer a stronger, neater and more versatile weld.

A new, patent-protected, way to weld

So, you now that you know the benefits of the TIG system, where does K-TIG come in? K-TIG is actually named after the innovative and patent protected new method of TIG welding it developed, called Keyhold TIG, or K-TIG. The K-TIG system fixes the main drawback of the TIG system, i.e. the amount of time it takes. According to the company, the K-TIG system produces the same quality weld at 50x to 100x the speed. In other words, using the K-TIG system saves power, gas and labour costs by up to 95% compared to a standard TIG system.

These claims are extremely impressive, but are they industry proven? According to K-TIG they most certainly are with some of the largest advanced manufacturing companies in the world using the K-TIG system. This includes GE, Doncasters, Bilfinger and the UK Nuclear advanced Manufacturing Research Centre, and many more. K-TIG generates revenue through direct sales of its system and through an international distribution network.

A value-add product without the valuation

Here is the part that you might find the most confusing. If K-TIG's system is so revolutionary and commercially proven by so many major companies and organisations, then why is its market capitalisation only $57m? Well for one, K-TIG is a new system, with the company only starting to generate revenue in 2Q20. However, revenue is growing fast and during 1Q22, K-TIG increased its revenues by 30.1% quarter-over-quarter, reaching $729,000. According to management, K-TIG has finally reached the point where global adoption is well under way and in the company's September 2021 update, management stated "this quarter-on-quarter growth is expected to continue into future quarters".

On a trailing 12-month basis, K-TIG is currently valued at an EV/Revenue multiple of 33.8x, which for most companies we would consider extremely high. But with K-TIG's powerful new product and strong revenue growth momentum, we believe the stock offers a compelling opportunity. If we take management's comments as guidance of 30% quarter-over-quarter growth for 2Q22 through 4Q22, the FY22 EV/Revenue multiple drops to 11.5x on 188.8% growth (to be clear, the comments made by management do not constitute official, exact growth guidance). If you need more convincing, consider the fact that we believe it is unlikely shareholders will experience dilution in the near future. As of 1Q22, net cash used in operating activities was $772,000 and the company ended the quarter with $4.2m in cash. Anyway you look at it, buying into the K-TIG system at a valuation of only $57m seems like a four star opportunity.

Pitt Street Research Pty Ltd

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