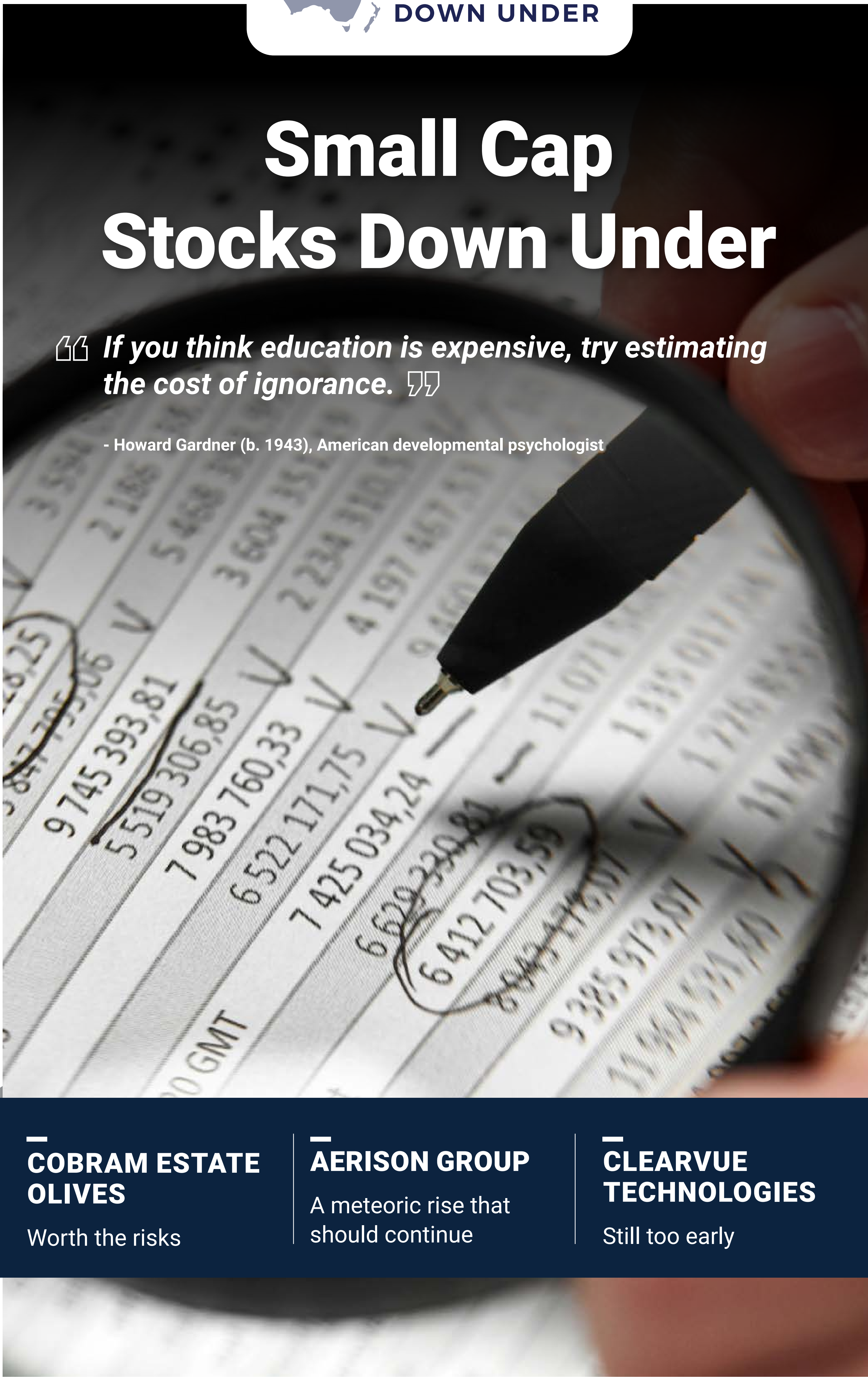
STOCKS DOWN UNDER

26 NOVEMBER 2021

Small Cap Stocks Down Under



If you think education is expensive, try estimating the cost of ignorance.

- Howard Gardner (b. 1943), American developmental psychologist

COBRAM ESTATE OLIVES

Worth the risks

AERISON GROUP

A meteoric rise that should continue

CLEARVUE TECHNOLOGIES

Still too early

COBRAM ESTATE OLIVES

Worth the risks

Stocks Down Under rating: ★★★★

ASX: CBO
Market cap: A$783M
Dividend yield: 1% (20% Franked)
52-week range: A$1.81 / A$2.21
Share price: A$2.02

You won't be shocked to find out that Cobram Estate Olives, based in Lara, Victoria, is involved in the farming and sale of olives and olive products. The name really does say it all. This stock is a rather recent edition to the ASX, listing on 11 August 2021 at an opening price of $1.87 per share. Initial shareholders have done well so far, but the company does have a significant amount of debt, raised no capital during the compliance listing and is in the middle of a tricky expansion into the United States. So, is it time to stock up on olives or is your investment likely to end up getting pressed?

READ MORE

AERISON GROUP

A meteoric rise that should continue

Stocks Down Under rating: ★★★★

ASX: AE1
Market cap: A$61.2M
52-week range: A$0.185 / A$0.29
Share price: A$0.20

Aerison Group is an engineering and construction company based in Perth. The company provides a wide variety of services to the engineering industry, ranging from design and construction to project management. The company also provides environmental products and services, such as water treatment systems. It mainly serves the government and power industries, although it has diversified its customer base in the last few years. Despite only recently IPOing, we believe Aerison is worth the market's attention.

READ MORE

CLEARVUE TECHNOLOGIES

Still too early

Stocks Down Under rating: ★★★

ASX: CPV
Market cap: A$47.6M
52-week range: A$0.215 / A$0.99
Share price: A$0.225

Headquartered in Perth, ClearVue Technologies is a company full of employees who see glass very differently than most people. The company has created see-through glass for buildings that generates solar energy. The company is in its early stages, but has ample cash on hand, despite significant losses. While we believe that ClearVue's technology is rather impressive, from an investment point of view we find ClearVue's to be just a little too early stage.

READ MORE

COBRAM ESTATE OLIVES

Worth the risks

Stocks Down Under rating: ★★★★

ASX: CBO
Market cap: A$783M
Dividend yield: 1% (20% Franked)

52-week range: A$1.81 / A$2.21
Share price: A$2.02

You won't be shocked to find out that Cobram Estate Olives, based in Lara, Victoria, is involved in the farming and sale of olives and olive products. The name really does say it all. This stock is a rather recent edition to the ASX, listing on 11 August 2021 at an opening price of $1.87 per share. Initial shareholders have done well so far, but the company does have a significant amount of debt, raised no capital during the compliance listing and is in the middle of a tricky expansion into the United States. So, is it time to stock up on olives or is your investment likely to end up getting pressed?

Share price chart

Source: Tradingview

An unusual IPO for a historical business

Cobram Estate Olives jumped onto the ASX on 11 August 2021 with an opening price of $1.87 per share. Cobram didn't raise any capital and, therefore, was not technically an IPO, but rather a compliance listing as the only new shareholders were employees granted ownership in the company. While not raising capital is certainly not unheard of, what makes Cobram's situation so unusual is that we think the company could really use the cash.

Cobram is not new business, founded in 1998 by Paul Riordan and Rob McGavin. It has grown to produce a staggering 71% of Australia's annual olive oil crop. To quote Chairman and Co-Founder Rob McGavin, Cobram produces "more olive oil this year than an entire country, so more than the entire production of France, more than Israel produced, more than the entire production of the United States".

The company is fully vertically integrated, growing the olives and producing, packaging and selling the olive oil, all in-house. The company sells its olive oil through five main brands: Cobram Estate, Red Island, Modern Olives, Wellgrove and Stone & Grove. Cobram Estate is its flagship retail brand, selling more Extra Virgin Olive Oil than any other brand in Australia by both units and dollars. To summarise, if you want to talk olive oil in Australia, there is only one name that should be on your mind and that's Cobram.

No capital raised with that debt load?

FY21 was a mixed bag for Cobram. The company saw total sales fall slightly to $140m from $141m during FY20. However, EBITDA rose sharply from a loss of $20m during FY20 to a profit of $70.3m during FY21. This is where things are getting interesting though. The discrepancy between EBITDA and sales is not because of a sharp decline in expenses, but rather due to the fact we looked at sales instead of total revenue. Since Cobram grows and owns the olives, it has to account for the net change in fair value of agricultural produce in its total revenue. Unfortunately, these swings are often rather significant and will skew the Australian division and total results. Since Cobram's end game is to sell olive oil, we believe it would be best to exclude this revenue line item from consideration and that's why we focused solely on sales.

When you look at the company's two divisions, the USA division saw sales grow 28.7% to $28.8m while the Australian division's sales declined 12.2% to $101.1m. Both divisions saw EBITDA growth during FY21, with the Australian division generating $75.1m in EBITDA during FY21 compared to a loss of $3m in FY20. The US division generated an EBITDA profit of $526,000 during FY21 compared to a loss of $8.1m during FY20.

Betting the farm on US expansion

Cobram has two main risks, in our view: it's US expansion and future water needs. As we briefly mentioned above, Cobram has a decent amount of debt, $178.2m to be exact. This puts the net debt/equity ratio at 92.9% as of 30 June 2021 and a total debt/EBITDA multiple of 2.6x. While this is not a catastrophic debt load by any means, especially with FY21's EBITDA/interest expense multiple at 24.1x, the issue from our point is the company's lack of cash holdings as of 30 June 2021 at $1.2m.

The reason this lack of cash concerns us is that Cobram is currently in the process of "replicat(ing) our Australian business in the USA". This has so far been a massive success as we discussed above, with the US operations only generated its first positive EBITDA during FY21. However, Cobram still has a ways to go and the largest issue for the company so far is not demand, but supply.

According to the company's estimates, USA consumer demand for olive oil has almost doubled since 2000 with total consumption during 2020 totalling 386,000 tonnes. The issue Cobram has is a lack of olives in the US. And this will remain a problem for a little while longer since olive trees take three years before you can harvest the first crop. Still, the company is expanding rapidly. During the Northern Hemisphere spring 2021, the company planted 53,000 new trees in California (110 hectares) and the company has secured an additional 182 hectares of land to plant additional trees. In our view, Cobram has clearly demonstrated that there is sufficient demand in the US market, but it is important to note the company will still need a lot of time to ramp up production locally.

The second potential issue we see for Cobramis the company's future water needs. Both Australia and California are considered water stressed areas and the price of water has been steadily going up. At Stocks Down Under, we don't believe this situation will change anytime soon. In fact, we believe the price of water is drastically undervalued globally. For more information on our view on water shortages in Australia and around the world please check out our 23 November 2021 report on Rubicon Water (ASX: RWL) and our 18 September 2020 report on Duxton Water (ASX: D2O). We see this water issue as a substantial potential risk to the company's future growth plans in Australia and the US.

Despite the risks facing Cobram, the market consensus puts EBITDA growth at 204% year-over-year in FY23. This follows an expected EBITDA decline of 59.3% year-over-year during FY22 to $28.1m. On 11 August 2021, management stated that FY22's crop yields will be lower than FY21's and we believe this is why EBITDA is slated to temporarily drop. We are confident in Cobram's US expansion, though, and believe that in the long run Cobram will be able to replicate its Australian business in the much larger US market.

Therefore, with an FY23 EV/EBITDA multiple of 11.2x, Cobram is a four-star stock for us, but be sure to keep a long-term view. We should anticipate volatility while we wait for the US olive trees to mature.

AERISON GROUP

A meteoric rise that should continue

Stocks Down Under rating: ★★★★

ASX: AE1
Market cap: A$61.2M

52-week range: A$0.185 / A$0.29
Share price: A$0.20

Aerison Group is an engineering and construction company based in Perth. The company provides a wide variety of services to the engineering industry, ranging from design and construction to project management. The company also provides environmental products and services, such as water treatment systems. It mainly serves the government and power industries, although it has diversified its customer base in the last few years. Despite only recently IPOing, we believe Aerison is worth the market's attention.

Share price chart

Source: Tradingview

Put your IPO where your mouth is

Aerison has been providing engineering acumen, construction and consultancy services since 1988. The four significant markets served by the company are infrastructure (both government and private), minerals and mining, oil and gas, and power generation. The company offers Engineering, Procurement and Design (EPC) services, but has focused on environmental engineering in the last decade.

Despite having been around for over three decades, the company only began to pick up momentum after FY17. Having achieved explosive growth between FY18 and FY20, Aerison debuted on the ASX through an IPO on 12 July 2021. The stock debuted at $0.20 per share, peaking at $0.28 on 15 July. However, the stock has fallen back to its IPO price of $0.20 since then.

The IPO was oversubscribed and the company managed to raise $13.5m. A total of 37,500,000 shares were issued, along with a sale and transfer of 30,000,000 million existing shares. The company aimed for a valuation of $61m, having raised $3m in the year prior in a pre-IPO raise.

Progression, nonstop!

As we said, the company had been struggling until 2017, when its fortunes changed by signing several major contracts. Revenue shot up from $30.2m in 2017 to $50.4m in FY18, an increase of over 65%. The company also turned a profit after tax of $1.2m, coming from a loss of $0.9m in 2017.

Aerison continued on its upward drive, increasing its revenue to $80m in 2019 and $100m in 2020. Net profits amounted to $4.1m and $5m in those two years. The company's nature has not changed and the core business is still the same as it was back in FY17. However, it managed to sign numerous contracts in the four markets that it serves and had an orderbook of $300m at the time of its IPO, $97m of which is slated for 2021.

For 2021, the company gave full-year revenue guidance of $130m, which it managed to "fully secure" on 9 August 2021. When we say "fully secured", that's a quote from management on 9 August 2021. While this might sound like impossible to say before 2021 is even finished, the company signed a number of new construction, manufacturing and maintenance contracts that ensured it will generate at least $130m in revenue during 2021. main contracts were relating to the Gudai-Darri iron ore mine and the extension of current agreements with Transurban Queensland.

Constructing a better future for itself

The company's strategy for the future is simple: Continue doing what it has done so far and increase the scope of its business by signing new contracts. Considering the revenues and profit increase we have seen in the last few years, it seems that this has been the right strategy.

The company has also diversified its industrial exposure by expanding to railway infrastructure development and has a contract to work on the Perth Metronet Project for the next five years.

Aerison has proven that it is a company currently going through a rapid growth phase. Revenues were only $100m in FY20, and the company is almost guaranteed to increase them by at least 30% in 2021 and has released 2022 revenue guidance of at least 15% growth to $180m. Based on the company's average net profit margin of 5.1%, this would mean a profit of roughly $9.2m in 2022, leading to an estimated forward P/E ratio of 6.7x for 2022. Coupling this with the fact that the company has hundreds of millions worth of contracts in the pipeline, we believe Aerison is a four-star investment that should grow consistently for the next few years. However, it is important to note that the company is virtually unknown by the market with only 140,000 shares on average traded daily over the last three months. So, while we believe the company's future growth should get the market's attention, there is a risk that it won't.

CLEARVUE TECHNOLOGIES

Still too early

Stocks Down Under rating: ★★★

ASX: CPV
Market cap: A$47.6M

52-week range: A$0.215 / A$0.99
Share price: A$0.225

Headquartered in Perth, ClearVue Technologies is a company full of employees who see glass very differently than most people. The company has created see-through glass for buildings that generates solar energy. The company is in its early stages, but has ample cash on hand, despite significant losses. While we believe that ClearVue's technology is rather impressive, from an investment point of view we find ClearVue's to be just a little too early stage.

Share price chart

Source: Tradingview

I looked in the mirror and I see what I saw

If you live in a major city, one thing you should specifically focus on next time you go outside is the amount of glass you see. Even if you don't live in the city, buildings usually have a significant amount of glass incorporated into them. And while this may not be great if there is ever a zombie apocalypse, when the current CEO and Chairman of ClearVue, Victor Rosenberg, looks at glass he does not see an indefensible position, but rather the next evolution in energy production.

When Victor first looked at glas this way the year was 1995 and the company was called Tropiglas Technologies. At the time, the company was producing low-e coating to save energy in buildings, not to produce energy itself. This was a failure in the end, but the core of the intellectual property turned out to be more valuable than it first appeared as it was reworked to become (through a partnership at Edith Cowan University) the underlying innovation behind ClearVue's current product: glass that produces solar power.

But just how much power can ClearVue windows produce? ClearVue's glass is currently rated to generate approximately 30 Watt Peak (WP). In order to determine this, ClearVie had its windows tested using 1.44 m2 of glass by one of the world's leading technical service organisations, TÜV SÜD in China, which is originally a German testing and certification organisation. The energy produced by windows depends on the installation location, system orientation, tilt angles, system design and implementation, seasons and weather, etc and ClearVue's window design is a patent protected technology.

ClearVue's tested its windows at its Warwick Grove (test) installation and the company recorded a daily average energy production of approximately 1.6 kWh. This was generated through 25m^2 of windows installed in four different sections of the test installation. According to management, when factoring in the effect of non-optimum angles and some strong shading, the average energy production figure is close to 70Wh per m2 per day.

Still slow and steady

Unfortunately for ClearVue, FY21 and 1Q22 saw yet another period go by without any real revenue asCOVID-19 had a significant impact on the company's operations. One of the main setbacks was the delay of solar PV glazing being installed at the Fujisan Winery in Mount Fuji, Japan, despite the order being received and product delivered during FY21. While you might be thinking, why does it matter when the glass gets installed, we remind you that ClearVue has yet to receive a significant order for its product and any chance for a commercialised proof-of-concept is valuable. Therefore, the delay in construction has also delayed additional proof that ClearVue's product works in a commercial setting.

During FY21, ClearVue received a total of three orders, all below $1m in value. However, neither of these orders were counted as revenue during FY21, because of the company's revenue recognition policies. Instead, this revenue will be recognised in FY22. So, it is unclear exactly how big each order was except from an order for 104sqm for a public park in Sydney that was announced as totalling $114,000 plus GST. While not an exact calculation, knowing that 104sqm sold for $114,000 plus GST, we were able to estimate that the other two orders for 500sqm and at the Japanese winery were not for over $1m.

Unfortunately, the situation did not drastically improve during 1Q22, with the company only receiving one order for 333sqm on 25 August 2021 from its Japanese distributor. ClearVue didn't recognise any operational revenue during FY21 and reported a loss of $6.9m after tax. During 1QY22, ClearVue used $1m in operating cash, but ended the period with $15m in cash. So, at the very least we don't have to be concerned about shareholder dilution for a while.

Still, despite the large amount of cash and a market capitalisation of only $47.6m, it's not clear when ClearVue may start to generate meaningful revenues. The company clearly has an impressive product and further Research and Development (R&D) is underway, but we believe it would be wise to wait until the company gets some more wind beneath its wings. On top of that, the shares have been in a down trend since the peak around $0.90 back in April this year. So, let's see where they find support first. Three stars for now.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and is founded on more than 40 years of combined experience researching companies in a range of different sectors.