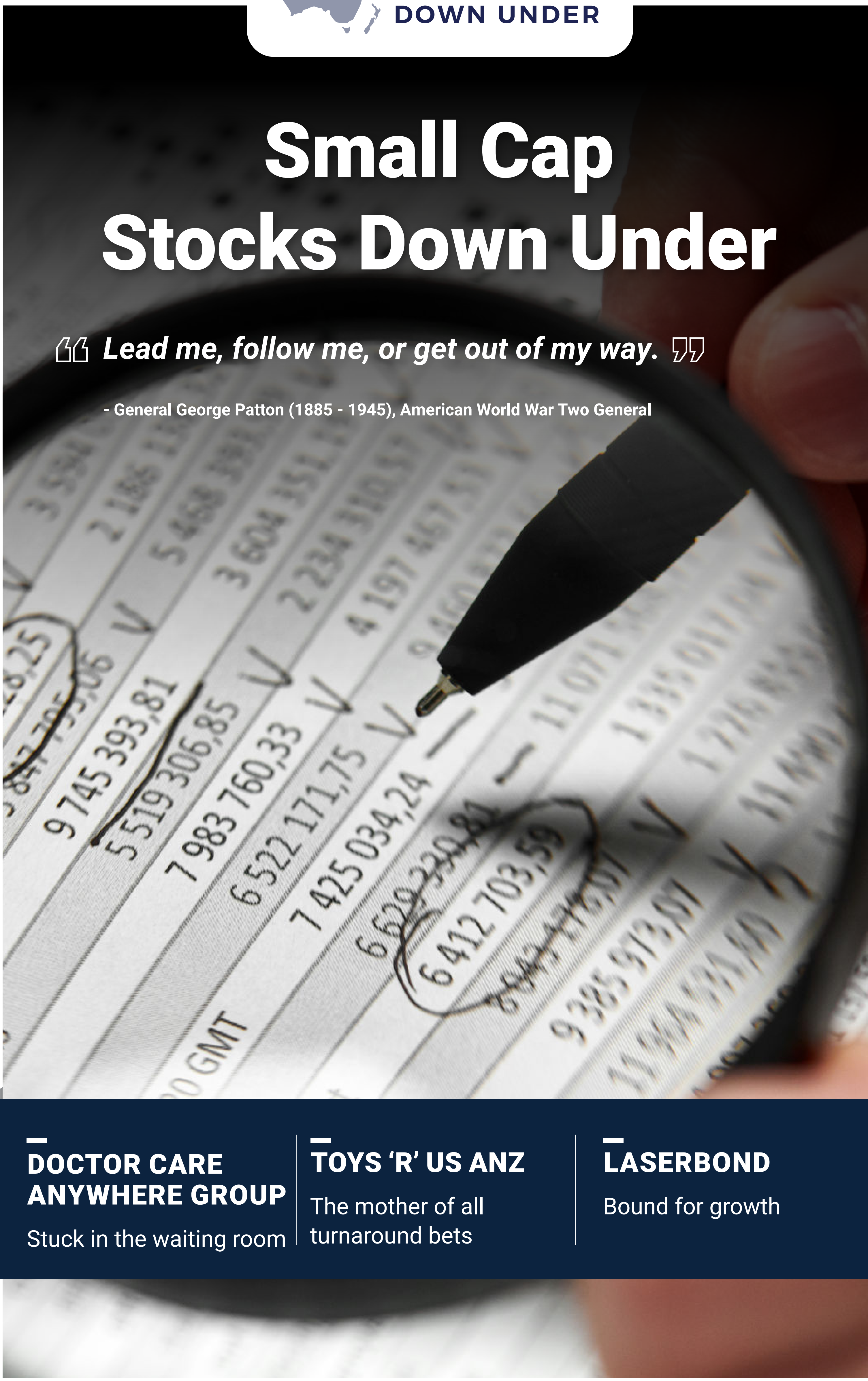
STOCKS DOWN UNDER

3 DECEMBER 2021

Small Cap Stocks Down Under



> ***Lead me, follow me, or get out of my way.***
>
> **- General George Patton (1885 - 1945), American World War Two General**

DOCTOR CARE ANYWHERE GROUP

Stuck in the waiting room

TOYS ‘R’ US ANZ

The mother of all turnaround bets

LASERBOND

Bound for growth

DOCTOR CARE ANYWHERE GROUP

Stuck in the waiting room

Stocks Down Under rating: ★★★

ASX: DOC
Market cap: A$172M

52-week range: A$0.48 / A$1.52
Share price: A$0.52

Headquartered in the United Kingdom, regular readers of Stocks Down Under are likely to be familiar with the Doctor Care Anywhere Group. We interviewed the CEO, Dr Bayju Thakar on 30 July 2021. This telemedicine platform has been a lifesaver for many during the pandemic, both in its home country of the United Kingdom and around the world. The market has been less than kind to shareholders since the company listed on 4 December 2020 and we think this means the market needs a check-up of its own.

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ASX: TOY
Market cap: A$148.5M

52-week range: A$0.075 / A$0.205
Share price: A$0.17

Toys 'R' Us ANZ is a company that needs no introduction. Although the actual company is based in the US, the Australian arm of the company is headquartered in Melbourne. The company is your average run-of-the-mill retailer, utilising online channels to sell toys, sporting and lifestyle products in Australia and New Zealand. It has a highly complex history, especially considering that the US company of the same name (from where the brand name comes) declared bankruptcy in September 2017. Let's dissect this one.

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LASERBOND

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ASX: LBL
Market cap: A$93.9M
Dividend yield: 1.2% (100% Franked)

52-week range: A$0.53 / A$1.07
Share price: A$0.98

Headquartered in Grange, New South Wales, LaserBond was founded to help industries with capital-intensive assets prolong the assets life, time between maintenance and performance. The last three years for shareholders could easily be described as an upward trending roller coaster with dividends. The stock has rallied a total of 177% since the beginning of 2019. FY21 was a mixed bag for LaserBond, so let's dive in and see how FY22 is shaping up.

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Share price chart

Source: Tradingview

Staying away from the doctor might save your life

Doctor Care Anywhere Group was one of the medical and video technology companies to take full advantage of the unique COVID-19 ASX IPO rush. The company listed on 4 December 2020 and raised $102m at $0.80 per CDI (headquartered in the United Kingdom remember). But as regular investors will know, the market got over its blindly buying anything to do with healthcare and video conferencing and that's clearly apparent by looking at DOC's stock price, which has declined to yesterday's close of $0.52 per share.

But now that we know how upset Doctor Care's original IPO investors must be, lets dive into what exactly the company does. Doctor Care was founded in 2013 with the goal of improving the efficiency of healthcare through the power of the cloud and other technology. In order to meet this goal, the company developed its own proprietary platform that allows General Practitioners (GPs) to securely offer patient consultations for both diagnostic and specialist referrals and reviews. The platform is underpinned by both a cloud-based patient system and the fact that Doctor Care made the decision to recruit its own clinicians. This is an unusual choice in the healthcare platform space and whether it will limit or provide that special niche is yet to be seen. But the company has experienced strong revenue and consultation growth, so there are early indications of success.

During 3Q21, Doctor Care only generated £5.8m, growth of 21.6% as consultations grew 30.6% to 116,800. However, the company's EBITDA loss expanded to £7.3 during 1HY21 (68.2% year-over-year) and while management does not report losses on a quarterly basis, we can see that out of the £10.7m cash used in operating activities during the first nine months of 2021, £5.5m was used during 3Q21. We therefore believe that 3Q21's EBITDA loss likely also expanded.

Profitability is too far off

The current market consensus has revenue growing rapidly over the next three years and that seems reasonable to us at Stocks Down Under. The market is currently predicting 2021 revenue will be £23.6m (103% year-over-year), 2022 will reach £36.3m (54.1%) and 2023 is expected to grow to £48.7m (34.1%). With 2021, 2022 and 2023 EV/Revenue multiples of 2.6x, 1.7x and 1.3x, respectively, we would normally rate the stock four stars when we compare our analysis of the company's track record, product and market consensus revenue growth. However, we believe the future is far too uncertain to take a gamble on Doctor Care at this time. While virtual doctor consults are likely here to stay, the question remains how prevalent they will be in the future and whether Doctor Care will be able to grow at its historical rate going forward.

This is a much larger concern when we account for the fact that the market is currently expecting EBITDA profitability during 2023, a significant turnaround from the current expectation of the company's EBITDA loss growing from £8.7m during 2020 to £16.3m during 2021.

As of 3Q21, Doctor Care only has $23.5m in cash, which means that the company will need to raise capital at least one more time before it is expected to become EBITDA profitable. Therefore, when we factor in further dilution and the uncertainty facing the company's industry demand as we look to 2023, we believe it would be best to put Doctor Care on the backburner for now and come back once the company has reported more progress. Three stars.

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Share price chart

Source: Tradingview

Toys Were Us

Toys 'R' Us has a lot of independent companies operating under one large brand (Toys 'R' Us Global). As the name suggests, the brand targets kids and people in their early teens with all sorts of toys and sporting equipment. A sub-brand, known as Babies 'R' Us, offers products targeting toddlers. Babies 'R' Us does not only focus on leisure, but also provides nappies, baby food and accessories.

The company had enjoyed success for decades, but began to suffer from increased competition in the new millennium. With added competition from stores such as Walmart and Amazon (along with other toy retailers), the company was beginning to struggle massively around 2010.

FY13 was the last time the US arm of the brand (the largest) delivered a profit and it only took four years after that for the company to declare bankruptcy.

The Australian arm of the brand was in a similar state. Having experienced declining sales for years on end, the company went into voluntary administration in May 2017. A month later, it was announced that all the Australian stores would be closed within a fortnight.

This should have been the end of the company in Australia, and it was for a few years. But in 2019 the parent company behind the brand, Tru Kids, entered into a licensing agreement with Hobby Warehouse, an Australian toy store, to re-enter the Australian market with an increased focus on online sales. From June 2019, both Toys 'R' Us and Babies 'R' Us products were available for purchase. Hobby Warehouse also offered the brand's products in New Zealand for the first time.

A new, more focused approach

If you think this is a complicated company, you haven't heard half of it. In October 2020, Funtastic, the Australian toys and sporting equipment retailer, announced its plans to acquire Hobby Warehouse and the rights to its associated brands.

Funtastic was founded in 1996 and has a story quite similar to Toys 'R' Us. The company had been struggling in the face of competition by the late 2010s. Revenues declined from $55m in FY17 to $30m in FY19. The only reason the company showed a profit in FY18 and FY19 was due to a massive amount of loan forgiveness that counted as income on the financial statements.

In 2020, the company initiated a strategic review. It announced in August that it planned to acquire businesses that align with the company's goals to target families with kids. In October, the company acquired Hobby Warehouse through a share-based transaction, issuing $32.6m in new shares at $0.112 per share. The company also raised capital through an institutional placement. A total of $29m was raised at a price of $0.112 per share. Lastly, the company converted $6m of its debt to equity at a similar price, using proceeds from the placement to pay off other long-term debt obligations.

The acquisition was complete by November and the initial results were very positive (indicating a brand affinity for Toys 'R' Us). Customer acquisition costs were down to $6.30 per customer (a historical low). The search impressions and revenues were also on an upward trajectory. In March 2021, the company announced its plans for accelerated growth. Part of these plans became clear on 27 October 2021 after management announced that it had signed an exclusive license for the United Kingdom rights to the Toys 'R' US and Babies 'R' US brands.

Accelerated growth, but to what end?

This year, the company has been streamlining its business model to focus almost exclusively on online sales. It has sold multiple businesses that did not align with its new vision (pocketing over $3m). It has decided to focus almost entirely on the Toys 'R' Us and Babies 'R' Us brands. To that end, Funtastic proposed changing its name to Toys 'R' Us ANZ Limited in April. The change was approved at an EGM. However, it is still early days, as illustrated by FY21's (ending July 2021) EBITDA, which declined to a loss of $4.4m from a loss of $1.8m the year before.

The bigger problem for the company is that it is still in the retail business, where it must deal with strong competition. Although the Toys 'R' Us brand definitely carries weight, large competitors can undercut the company and stifle its growth.

Consensus estimates show the company generating an EBITDA profit of $1.6m in FY23, increasing to $4m in FY24. The EV/EBITDA ratio, expected to be approximately 475x for FY22, is expected to decrease to 32.8x by FY24. While that may be considerably lower than for FY22, which is essentially a meaningless number because EBITDA is still expected to be very low this year ($0.3m), the valuation is still very high for a retailer in a highly competitive industry. And a lot can still go wrong with this turnaround story.

As such, we think Toys 'R' Us ANZ is a two-star investment. The company will likely achieve significant growth over the next few years from a very low base, but there are no guarantees with a turnaround of this scale. Combined with the very high valuation this means we are sitting on the sidelines until we can see more tangible results that the turnaround is working.

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Share price chart

Source: Tradingview

Harder, better, faster, stronger

The song Stronger by Kanye West goes "makes us harder, better, faster, stronger" and it seems this has been inspiring the company. LaserBond calls itself a specialist surface engineering company "that focuses on the development and application of materials, technologies and methodologies to increase operating performance and wear life of capital-intensive machinery components". But let's be honest, that's one complicated mouthful.

To break it down into plain English, LaserBond's three divisions, services, products and technology, all focus on using the company's research and experience to allow customers to use its equipment for longer periods of time without repair or replacement. When LaserBond says "capital-intensive machinery components", an example of that is steel mill rolls. The company has developed a proprietary composite carbide that is resistant to friction and pressure. LaserBond claims that this in turn can allow its steel mill rolls to last up to 20x longer. This is certainly quite the claim, but LaserBond does have the accreditations to back it up, including a testimonial from one of Australia's largest manufacturers and suppliers of structural and reinforcing steel, Liberty OneSteel (InfraBuild).

A truly mixed bag

LaserBond's FY21 results can be described simply as a mixed bag. While the services and technology divisions both saw a decrease in both revenue and EBITDA, the products division alone allowed the company to generate a 11.2% increase in revenue ($24.7m) and grow EBITDA by 3.2% year-over-year, to$6.4m. This is certainly an impressive result for the products division, especially with how reticent companies were to make large scale improvements during the majority of FY21. The technology division's performance, however, can only be described as disappointing.

Starting with the best performance and working our way down, the products division generated revenue of $13m (41.3% year-over-year) and EBITDA of $4.1m (37.8%). To put it simply, this division is responsible for the manufacture and sale of branded LaserBond products. These products generally fall into several categories, steel mill products (rolls and rotary feeders), drilling products (drill bits and the LaserBond Hammer, a Down-the-Hole (DTH) hammer).

FY21's growth is really only half the story for this division, because despite the travel restrictions, lockdowns and general COVID-19 hindrance, LaserBond finally managed to get its foot in the door of the United States steel mill industry. During FY21, LaserBond finished negotiations for a trial of its Rotary Feeder product. This is a massive step that was not included in FY21's results, because by the time FY21's annual report had been released (23 August 2021) the company had just shipped the product. A successful trial here would be a game changer for the company, as the United States iron and steel industry and ferrous foundries are massive, generating approximately US$91bn in revenues during 2020.

The services division generated $11.6m in revenue and $3m in EBITDA in FY21, a decline of 9.3% and 25.8%, respectively. Management states that this was "a direct result of COIVD and the restrictions" and we believe that is likely the whole story. Our willingness to trust management here is due to the division's consistent upward trajectory during FY19 and FY20 from a revenue and EBITDA perspective. In fact, 2HY21 was already seeing a sharp improvement, as management reports the division saw 35.6% revenue growth compared to 1HY21, generating $7.4m (63.8% of FY21 divisional revenue).

Across all asset-intensive industries, maintenance was one of the first things to be delayed due to COVID-19. But it can only be put off for so long and we expect this division to generate growth during FY22 not only compared to FY21, but compared to FY19's revenue of $12.8m and EBITDA of $4m as well.

The technology division's results were the most disappointing with revenue flat at $100,000. This division is responsible for the sale of licenses to LaserBond's technology and COVID-19 caused significant delays to a licensing agreement the company had in the works. Fortunately, on 28 May 2021, management announced that the deal had finally been signed, but it was too late to be accounted for during FY21, with $1.5m set to be recognised during FY22. This will drop down to at least $144,000 per annum in ongoing fees, and up to $670,000 per annum in consumable sales for the seven-year period of the deal.

The market needs to wake up

The is only one broker analyst covering LaserBond and that analyst is expecting FY22 EBITDA of $9m (40.6% growth year-over-year). Growth is expected to abate slightly over the next few years, with FY23 generated $10.3m in EBITDA and FY24 $12.3m. Still, FY22, FY23 and FY24 EV/EBITDA multiples are only 11.1x, 9.7x and 8.1x, respectively. Over the last three months, the average daily volume was only 70,000 shares and that is skewed by a few large trading days. So, the market doesn't seem to be paying much attention to LaserBond. However, given its growth momentum and its valuation, we believe this stock definitely deserves more investor attention. So, four stars from us.

Pitt Street Research Pty Ltd

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