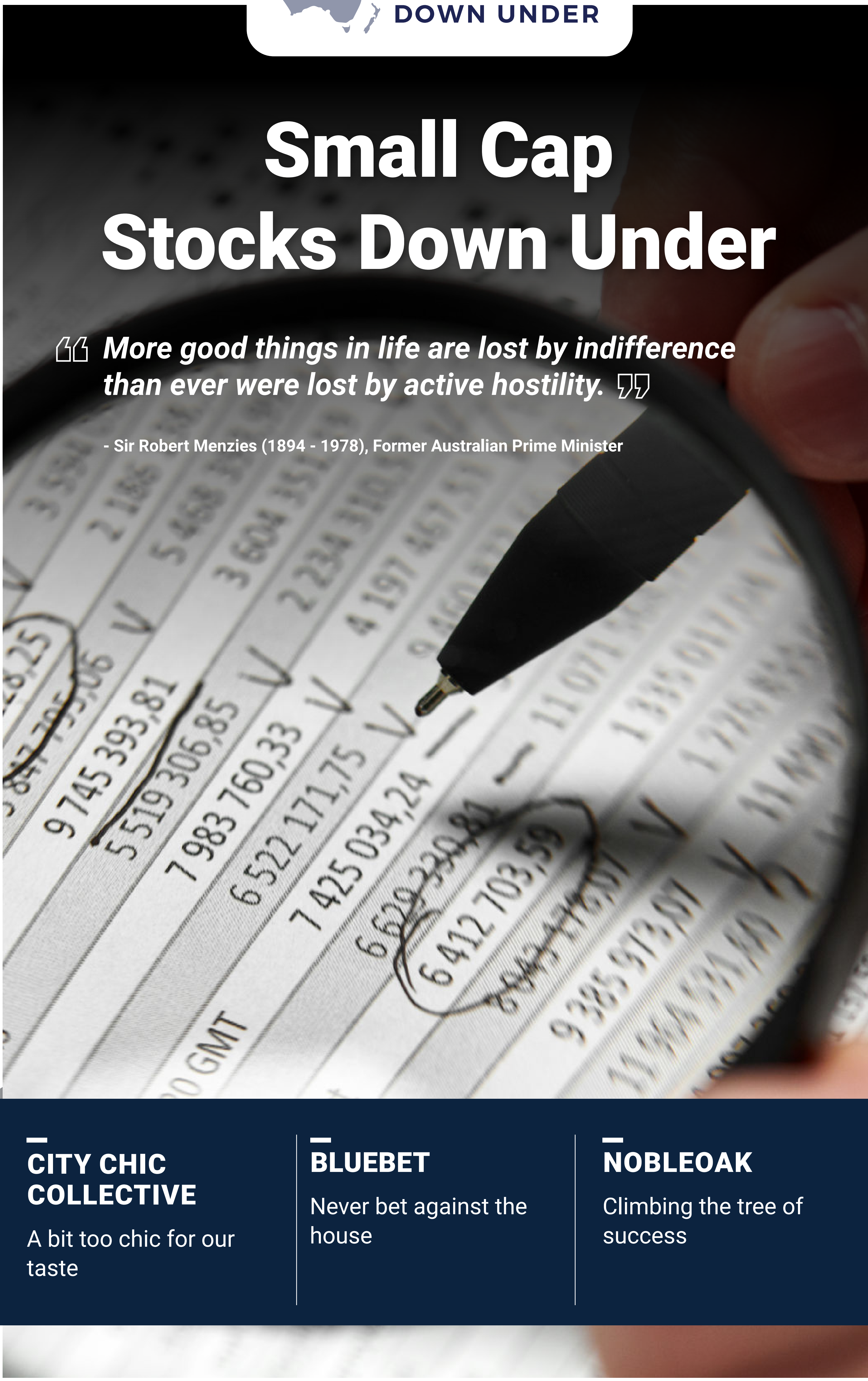
# Small Cap Stocks Down Under



> *More good things in life are lost by indifference than ever were lost by active hostility.*

**- Sir Robert Menzies (1894 - 1978), Former Australian Prime Minister**

## CITY CHIC COLLECTIVE

A bit too chic for our taste

## BLUEBET

Never bet against the house

## NOBLEOAK

Climbing the tree of success

# CITY CHIC COLLECTIVE

## A bit too chic for our taste

Stocks Down Under rating: ★★★

**ASX: CCX**
**Market cap: A$1.3BN**

**52-week range: A$3.51 / A$6.86**
**Share price: A$5.30**

City Chic Collective is a Sydney-based chain of retail stores specialising in selling apparel and accessories for plus-size women that we first reported on in our 18 February 2020 edition of Stocks Down Under. Numerous brands are owned by the company, including Avenue, City Chic, Evans and Hips & Curves Body. City Chic Collective has 89 retail stores across Australia, New Zealand, the Americas and Europe, as well as a wholesale operation and online presence. While the company caters to those who are plus-size, that doesn't mean the valuation has to be plus-size.

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Stocks Down Under rating: ★★★★

**ASX: BBT**
**Market cap: A$286M**

**52-week range: A$1.31 / A$3.03**
**Share price: A$1.43**

Sydney-based BlueBet is a provider of online wagering services in Australia, offering a comprehensive suite of products catering to sporting and racing events around the world. Apart from sports, it also tackles other gambling categories such as politics, live betting and promotions. At first glance it might be difficult to justify BlueBet as an attractive buy at its current price with exceptionally high multiples, but we are attempting to do just that.

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NobleOak is a life insurance company that's been around since 1861 but it is a relatively new addition to the ASX, having only completed an IPO on 22 July 2021. NobleOak sells life insurance products through its own systems and its partners. The recent IPO seems to have breathed new life into this established company, as we have seen some significant acquisitions since July. Even before these moves, the market consensus was suggesting some profitable years ahead, but with these new acquisitions, we need to answer the question: Is the market underestimating NobleOak's potential?

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### Share price chart


*Source: Tradingview*

### Filling up the demand

Whatever your notions about the right body size, one market segment that has been historically ignored is plus-sized women. With the advent of the body acceptance movement and the developed world's population continually getting heavier, stores began to spring up specialising in plus-sized clothing.

### The sales graph curves upward

After the company was founded as Miller's Retail in 1992, it changed its name to the Specialty Fashion Group in 2006. In the first half of the 2010s, the company had a lot of fashion brands operating under it, targeting various customer segments across both genders. However, after continuously underperforming for a few years, the company changed its name to the City Chic Collective in November 2018. As part of this restructuring, the company started afresh with a focus on one group: plus-sized women.

The City Chic Collective's decision to rebrand was made after taking an in-depth look at its individual brands as part of a larger restructuring of the company. This shift in focus was immediately profitable, going from a loss of $9.3m in FY18 to a profit of almost $16m in FY19.

By the time of the name change, City Chic was the only major brand under the company's umbrella. In October 2019, the company completed the acquisition of the e-commerce assets of Avenue Stores, the parent company behind the 'Avenue' brand, for US$16.5m.

COVID-19 was a massive problem for the City Chic Collective (as it was for all retail companies). There were supply-chain disruptions from China, and the company's stores experienced temporary closures in both Australia and New Zealand in March. The stores were re-opened in May. As a result, FY20's results were subdued, with net profit falling to $9.7m.

In July 2020, the City Chic Collective raised $80m at $3.05 per share through an institutional placement. The money was to be used to expand globally, and part of that was the purchase of United Kingdom-based Evans and a few other associated brands for $41m in December. The company further complemented this by acquiring Navabi, a German-based store specialising in selling third-party plus-size apparel, for $9.6m in July 2021.

If you were buying from the City Chic Collective today, it would be for two major brands: City Chic and Avenue. For potential future value, we'd watch out for two other brands, one called 'Evans' and other called 'Hips & Curves Body'. Evans stocks products coming from the City Chic Collective's other brands and a few others and has a name in the UK. Hips & Curves Body specialises in lingerie, underwear, and sleepwear, which could be a huge hit in the next few years.

## When everyone expects you to succeed

It seems that the City Chic Collective is back on track after the original COVID-19 setback in FY20. Revenues increased from $195m in FY20 to $259m in FY21, with the net profit shooting up to $21.6m. The company plans to make further acquisitions, with a particular focus on increasing its United States market share. In 2020 it tried to acquire Catherines, a United States-based plus-size brand with a conservative outlook that targets women between the ages of 40 and 60. That deal, however, went nowhere.

The market is currently estimating EBITDA growth of 25.4% in FY23 and 15.9% in FY24 for the City Chic Collective on the back of revenues rising to $476m in FY24, with an EBITDA profit of $88.7m. The EV/EBITDA multiple, currently at 16.4x for FY23, is at 14.2x for FY24's estimated growth and we think this is a little too expensive for a retailer.

It's also worthwhile noting that the last dividend from City Chic was $0.07 a share back in FY19. This was before the advent of COVID-19 and the announcement of the company's new growth strategy, so no dividend was offered in FY20 and FY21. Keeping this in mind, we think City Chic Collective is a three-star company. It should experience solid growth over the next few years, but the fact that everyone expects it to succeed has made the company to close to the top range of fair value for our taste.

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## Bet down under

Founded in 2015, BlueBet aims to be a betting platform for Australians by Australians. However, we know that is not enough to convince people to use the platform, especially when competing against international offerings such as bet365 and Unibet. BlueBet's primary focus is on smaller retail customers and providing a mobile-first interface that makes placing a wager intuitive and accessible. The minimum value for bets on the platform is lower than the industry average, and the platform includes features such as social betting. While the focus on smaller bets is unusual, BlueBet's competition all have mobile and social betting, so what else makes BlueBet stand out from the crowd?

For one, BlueBet has 'protest payout', a feature that pays out in athletic meets if a competitor wins but is demoted due to a protest. That's novel. For another, BlueBet's customer service is known for being some of the best in the business, and reviewers have lauded it for not discriminating against queries that are for smaller amounts.

As for the services offered, the company primarily focuses on racing and sports. Racing includes everything from horses to greyhounds. The sports branch is even more expansive and has American, European and Australian sports.

However, there are a few glaring omissions in the platform, such as users not having the ability to stream bets and no esports betting on offer. With the esports betting market forecasted to grow at a Compounding Annual Growth Rate (CAGR) of 13.1% and expected to reach US$13bn in total wagers in 2025 according to a Market Insight Report, this is a massive market segment where BlueBet is currently missing out.

## IPO off a hot streak

BlueBet listed on the ASX in July 2021 after a successful IPO of $80m at $1.14 per share. The price skyrocketed on the first day of trading, going as high as $2.10 at one point before closing at $1.775. Although the price has shot up a couple of times since, it has fallen to around the same levels as the first day of trading.

The company went public after a solid financial performance in FY19 and FY20. Revenues surged from $7.7m in FY18 to $9.5m in FY19 and $16.8m in FY20. FY20 was also the first year in which the company declared a Net Profit After Tax (NPAT). It wasn't much – only $4.4m – and it was helped by past losses BlueBet used to reduce its tax liability, but it was a profit nonetheless.

The company went from strength to strength in FY21, generating $32.3m in revenue and experiencing a 16.3% growth in active customers, to reach 32,400 by the end of the year. However, that didn't allow profit growth. NPAT came in slightly lower at $2.9m, mainly due to IPO costs, increased marketing expenses, and a higher effective tax rate.

## Entering the world up above

Using the cash from its IPO, BlueBet is now looking to expand into the United States. In July 2021, the company signed a 'skin' agreement to open an online sportsbook in the state of Iowa in partnership with the Dubuque Racing Association, a casino operator. In the gaming world, a 'skin' is where a betting company offers its service using someone else's license.

A month after the Iowa deal BlueBet partnered with BlueWater Resort and Casino and the Colorado River Indian Tribes to pursue an online sports betting license in Arizona. While the company met all the requirements for a license, it wasn't awarded the Arizona license due to only a limited number available. The partnership still stands if other licenses become available in the near future. Unfortunately, BlueBet was also forced to withdraw its application for a license in Virginia on the regulator's advice, as once again, only a limited number of licenses were available. So it's fair to say that the US market entry has been a difficult one, but the company remains confident given the rapid growth in demand in the US for new platforms. BlueBet's plans to enter the Iowa market remain on track and once it is up and running in that state Colorado, Tennessee and Maryland are next.

Consensus estimates point to a revenue of over $53.6m in FY22 and $71.2m in FY23. Despite this, it is estimated that the company will see its EBITDA drop to $750,000 in FY22 from $7.5m in FY21 due to increased marketing expenditures and the planned expansion into the United States. We are not certain the market is correct about FY22's potential after 1Q22 saw turnover increase 67.4% to $125.9m, generating $3.3m in operating cash flow. This was after BlueBet spent $3.3m in marketing, compared to $4.8m in all of FY21.

Even if FY22 turns to have EBITDA collapse to $750,000, we don't see this as a problem. BlueBet has over $57.8m in cash as of 1Q22, and a solid business model that is generating a healthy gross profit. Any success in terms of US expansion can make these numbers look conservative. As such, we think BlueBet's EV/Revenue multiple of 4.3x for FY22 and 3.3x for FY23 make the stock four-star with a strong balance sheet and numerous avenues for growth.

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### Share price chart


*Source: Tradingview*

### NobleOak is the name, and insurance is the game

NobleOak is involved in much more than just life insurance. The company also offers disability, trauma and two kinds of income protection insurance. The first kind caters to individuals, allowing the customer to receive benefits when they cannot work due to an injury or sickness. The second kind is for businesses, primarily small businesses operated by the owner. This insurance plan can help cover fixed costs if the proprietor cannot work due to sickness or injury.

NobleOak's primary advantage in the insurance market is its use of the direct-to-customer sales model for most of its business. Many insurance companies opt to use partners to sell the insurance products, but NobleOak's model mostly cuts out commission costs compared to its competitors. NobleOak claims the reduced commission costs allow the company to offer lower premiums and avoid hidden fees and tricks. While we cannot confirm the correlation, it is important to note the company scores above 85% in most online review aggregators. That's high for the insurance industry.

## A well-reputed firm goes public

We have already established that NobleOak has a long history, but what is more impressive is the company's strong standing within the Australian insurance industry. NobleOak regularly receives awards for its products and customer service. Indeed, it was the most awarded Australian direct life insurer in 2020. Some of these awards included the Platinum Trusted Service Award from Feefo and a five-star rating from Canstar. Feefo and Canstar are both highly reputed review services with a global presence.

NobleOak hit the ASX last year after consistent growth in both revenue and profits in the previous few years. Revenue (minus reinsurance expenses, which insurance companies use to reduce the risks associated with large payouts) increased from $21m in FY18 to $46.6m in FY21, leading profits to jump from $3.3m to $4.9m.

Active policies went up 66% in FY21 to a total of over 77,000. In-force premium growth (the increase in premiums from policies already in place) rose 66%, and premiums from new business increased by 42%. What's significant from the company's perspective is that all of this growth emanates from its core business.

This isn't NobleOak's first time on ASX, it having previously been privatised in mid-2004. After its re-debut at $1.95 per share (raising net proceeds of $31m), the stock opened at $2.05 before closing at its opening price of $1.95. The stock gradually recovered and has bounced between $2.25 and right below $2.40 since.

## Buy, buy, buy!

While NobleOak's core business is doing exceptionally well, the company has plans to grow by acquisition, albeit only in Australia where it knows the market well. For a good example of how NobleOak works, consider the August 2021 Ozicar deal. NobleOak bought the administration rights to this branded life insurance portfolio from Auto & General Services, a Brisbane-based insurance company. NobleOak only paid in scrip – the total consideration was $3.2m at $1.95 per share – and, importantly, Ozicar came with a distribution agreement with Auto & General and its million-plus customer base.

The same month as the Ozicar deal NobleOak also partnered with the Royal Automobile Club of Western Australia (RAC). Under that agreement, RAC members could acquire life insurance policies from NobleOak. With 1.2m members, the RAC presents another convenient way for NobleOak to add to its total policies.

Currently, NobleOak is trading at 20.7x FY22 consensus, where that consensus shows net profits increasing from $4.9m in FY21 to $12.4m in FY24. That means the company is trading at 12.4x its FY24 earnings. While that may seem a bit high for an insurance company, NobleOak is growing rapidly, and in our view, the current forward multiples don't match that growth. Our best estimate for NobleOak's current cash, bank bills and term deposits is $68.1m (including cash, bank bills and term deposits as of 30 June 2021, plus net IPO proceeds, minus IPO transaction costs and pre-IPO dividend payment). In our view, this is more than enough to fund future transactions and when we combine that with the company's strong organic growth prospects makes NobleOak looks even more attractive. Four stars.

**Pitt Street Research Pty Ltd**

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