STOCKS DOWN UNDER

5 AUG 2022

ASX Small Caps Stocks Down Under

In investing, it is never wrong to change your mind. It is only wrong to do nothing about it.

- Seth Klarman (b. 1957), author and hedge fund manager

HARMONEY

Its profitable again, so is it now a buy?

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Stocks Down Under rating: ★★

ASX: HMY
Market cap: A$75.8M

52-week range: A$0.67 / A$2.05
Share price: A$0.76

The bear market of 2022 has been tough for just about any company, but not least for companies that were already doing it tough in 2021. After listing at $3.50 in November 2020, personal lender Harmoney (ASX: HMY) has been in terminal decline. It struggled to standout in a crowded market of FinTech's and suffered a further sell off as central banks began hiking interest rates. But shares briefly rebounded last month when it announced that it had achieved profitability on a proforma cash NPAT basis. So, is it a buy now?

Share price chart

Source: Tradingview

Trying to stand out in a crowded market

Harmoney is a New Zealand based personal lender. It operates digitally without physical branches, but with a proprietary technology (called Libra) that makes credit decisions faster than major banks. This is not only ideal for the consumer, in getting credit sooner, but for the lenders' margins as well – by keeping costs low.

Obviously, with record low interest rates, demand surged in the first couple of years of the pandemic. And because the major banks have been withdrawing from direct personal lending, this has provided an opportunity for companies such as Harmoney, as well as MoneyMe (ASX: MME), Plenti (ASX: PLT) and Wisr (ASX: WZR). While the latter three stocks have other lending divisions, such as business lending and digital credit cards, Harmoney is just a personal lender.

Going for loan book growth

Lenders make money through interest charged to customers. While record low interest rates drive increased demand, it also means lenders have been making less money from each individual customer. New originations (new loans created) in Australia surged 260% in 2HY22 alone. The company's loan book, across both sides of the Tasman, reached NZ$501m. But Harmoney's full year revenue for FY21 actually fell from

NZ$86m to NZ$79.1m. And although it was profitable in FY20 – by NZ$2.8m - it swung into a NZ$400k loss in FY21. The catalyst was increased marketing spend as it tried to expand into the Australian market.

Harmoney's Net Interest Margin (NIM, the amount of money it is earning on its loans) was unchanged at 10.6%. Now of course this is higher than the big banks, which have NIM's under 2% because their loan book is skewed towards home loans that have lower interest rates, but longer durations. But this NIM is below MoneyMe's, arguably the most successful personal lender on the ASX, which achieved 20%. Although, as we noted above, MoneyMe has other products as well.

You see, with multiple personal lenders on the ASX you have to stand out to customers and investors somehow. We think although new FinTech lenders have done well to distinguish themselves from the big banks, there is little difference between individual personal lenders. For investors, it was all well and good to be on both sides of the Tasman, but judging by how Harmoney was sold off, even during 2021, unlike MoneyMe, it appears investors preferred diversity in product offerings rather than markets.

We also think Harmoney could have done more to show that it was lending to creditworthy customers. Of course, it has to make these assessments, but it did not go to as great the lengths as MoneyMe to promote the work it was doing in this respect. Harmoney did little more than promote performance related to its loan book, particularly the number of arrears, whereas MoneyMe would break down its typical customer profile in depth. We also observe that Harmoney's loans are typically unsecured, meaning if the customer defaults, there will not be liquid assets to sell in order to obtain the money left owing.

A pivot back to NPAT growth

Irrespective of investor interest, people kept taking up credit while interest rates were rock bottom. Twelve months on, interest rates have begun to rise and while Australia's Reserve Bank only began hiking rates in May, New Zealand's Reserve Bank began at the back end of 2021. Harmoney's loan book still grew 19% in 1HY22 and Cash NPAT was achieved. Australian new customer originations reached $71.4m, up 452% from 12 months earlier.

In 2HY22, Harmoney achieved cash NPAT for the full year – a feat that sparked a 24% share price rise on 19 July, the day of the announcement. It's pro forma loan book reached $685m, up 37%, and its Australian loan book reached $287m, up 113%. It also saw positive cash flow from operations. The group is aiming for NPAT profitability to be maintained in FY23 and despite passing on a 100bps weighted average interest rate increase, has reported no reduction in demand.

Judging by the market's re-action with the most recent interest rate rises, or perhaps perceptions that they may not have a lot further to run as inflation may have peaked, Harmoney and its peers are unlikely to continue to be sold off for that reason. But we doubt it can reach anywhere near its listing price because of the ultra-competitive nature of the personal lending space. And unlike its peers, Harmoney has no other segment to generate additional revenues. So, this one gets two stars from us.

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