ASX Small Caps Stocks Down Under

Investing isn't about beating others at the game, it's about controlling yourself at your own game.

- Arnold Van Den Berg (b. 1934), Century Management CEO

HUMM

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Stocks Down Under rating: ★★★★

ASX: HUM
Market cap: A$307.8M

52-week range: A$0.40 / A$0.92
Share price: A$0.605

There are hopefully not too many companies our readers will dismiss just by seeing the name, without even reading the article. Humm just might be one, however. Obviously, as a company that offers BNPL services, it has been battered by the Tech Wreck of 2022 – albeit not as badly as other companies, such as Zip (ASX:Z1P), given it has a profitable consumer finance business, not to mention a commercial asset finance division that is likewise profitable. But last April's attempt by Humm's management to sell the consumer business Latitude Group (ASX:LFS) did not help its cause. We think investors have taken the sell-off too far, to the point where it is trading at a ~30% discount to Humm's NTA. Particularly given that 9 months later, there has been a major board refresh and a rationalisation of the consumer business.

Share price chart

Source: Tradingview

A BNPL pioneer that is diversified today

Humm, which was known as FlexiGroup until mid-2020, was in the 'payments by instalments' space long before many of the other ASX plays. It was founded by Andrew Abercrombie in 1991, who remains with the business today. It started with consumer leasing, before branding out into interest-free cards, commercial finance and payment solutions.

Things were going well for the company until AfterPay came along. The company quickly lost market share to AfterPay and attempts to differentiate itself, both from a consumer and investor perspective, couldn't slay the giant. In June 2020, Humm's consumer business boasted 2.1 million customers and had added 380,000 during the preceding 12 months. This paled in comparison to AfterPay's customers, which numbered 3.2m in Australia alone. One reason was because Humm's small ticket offering had a focus on the travel sector, which went into hibernation during the pandemic. And there was little incentive to use Humm for big ticket items (such as home improvement) instead of personal loans because interest rates were low.

Humm also has a commercial asset finance division, Flexicommercial. It has consistently been the second largest non-bank provider of asset finance, is profitable and currently possesses a growing loan book worth

$1.5bn. Flexicommercial has been repositioned over the last five years and has a strategic position in the market, focused on sectors that commercial banks had stopped lending to, including agriculture and industrial sectors. Despite all of this, Flexicommercial was also disregarded by investors.

A deal that caused damage, without even going ahead

In CY22, Humm nearly sold its Consumer Finance division to Latitude (ASX:LFS). The deal appeared a win for both sides. Latitude would grow its Consumer Finance base, while Humm could focus on its Flexicommercial, with investor sentiment towards both companies theoretically improving as a consequence.

Flexicommercial was performing better than the Consumer Finance division, with the former recording 102% revenue growth in the 12 months to 30 June 2022 (FY22), while the latter only grew by 12%. And although both segments were profitable, the Flexicommercial arm recorded a $28.7m NPAT in FY22, while the Consumer Finance recorded $22.4m. We also observe that the Flexicommercial NPAT grew 28.7% in those 12 months. The Consumer Finance NPAT, however, halved from FY21's $46.1m.

Ultimately the deal did not go ahead and consequently led to the shares of both companies suffering and a major board overhaul. This included the departure of notable investment banker John Wylie who had been on Humm's board since early 2019 when he bought a 5% stake.

Forget the sector, look at the company

So, why are we looking at Humm now? Investors chasing the latest FOMO trend departed the BNPL space several months ago. And rising interest rates means a higher risk of existing clients enduring hardship and potentially fewer new clients.

We've already stated that both businesses are in good shape and we reiterate that view here. Flexicommercial is highly selective in which clients it lends to and it focuses on industries that tend to perform well irrespective of economic conditions. In many cases, Humm's clients have a critical need for the items they are seeking finance for. Humm also has software that is better able to assess would-be customers' creditworthiness. And this strategy is paying off - Flexicommercial had a default rate of just 0.7% in FY22.

Humm is also rationalising its consumer business, getting out of small ticket financing and consolidating its various products into one brand. It will specialise in big ticket items (items between $1,000 and $30,000 such as car repair, solar panels and dental work), where consumers will use Humm's products as a budgeting tool. We acknowledge that companies, such as OpenPay, have used this angle as a PR strategy before, but while these companies have never made a profit, Humm has a $21.3m cash NPAT in FY22 for big-ticket BNPL.
We also take confidence in the new board, led by former Bank of Queensland CEO Stuart Grimshaw, not to mention recent on-market buying from Chairman Andrew Abercrombie in the aftermath of the Humm deal. He bought ~$172k on market during 2Q23 and a further $1.6m as part of a dividend reinvestment plan.

The valuation is too low to resist

Consensus estimates for FY23 call for $499m in revenue (up 13%) and $48.5m in EBITDA (down 20%). FY24 is expected to be better with $530.5m in revenue (up 6%) and $66.5m in EBITDA (up 35%) called for by analysts covering the company. The median target price is 71c.

Given these estimates, Humm is trading at P/E of 19.3x for FY23, but at 12.6x for FY24. As noted above, it is trading at a ~30% discount to its NTA and it is also trading at just 0.5x P/B. But we think the most telling indication that the company is ridiculously cheap is that the current value of the Humm group (after removing unrestricted cash) is just $167.5m. This is just half of the price Latitude offered just for the Consumer business, which was $335m ($35m in cash and 150m Latitude shares at the February 2022 share price).

We acknowledge that some investors may not be interested in Humm simply because of the lower earnings forecast for FY23. But this is partially because Humm will be finishing the job of rationalising its consumer business. Apart from that, FY23 will be over in 5 months and we need to look forward.

We see strong potential for growth from FY24 onwards and the company could even return to paying dividends again. If it achieved EPS consensus estimates and paid out 66% of EPS as it did pre-pandemic, this would represent a yield of 4.5% for FY24. In the end, its four stars from us.

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