INDEPENDENT INVESTMENT RESEARCH

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Microcap Monthly Newsletter

Microcap Stocks to Watch

Mitula Group Limited (MUA: ASX) Well what a takeover premium offer by Japan's LIFULL who entered in to a scheme of arrangement with MUA at $0.85c which represented a 88.9% premium to the previous day's closing price based on the $0.85c scrip option. Japanese corporates certainly don't mess around with takeover bids! Just cast your mind back to Japan Post's takeover of Toll Holdings a few years back at a 49% premium. The average takeover premium is generally around 30%, but the Japanese seem to be doing what they can to bring this average up! MUA has traded around the $0.70c since the scheme announcement as the scheme is a scrip offer as opposed to an all cash offer. Investors need to work out if they are happy to take scrip in a Japanese listed company in lieu of their shares in MUA. Holding Japanese paper could be cumbersome or practically impossible for some investors both retail and institutional. The scrip nature of the offer has inject some uncertainty around the scheme being fully implemented and hence the share price is still trading below the offer price.

Given the gap between the current price and the scheme price I am sure there are plenty of hedge funds and savvy retail investors looking at this from a takeover arbitrage opportunity.

Some rough numbers
Share Price $0.70c 6 June 2018 Buy
Takeover/Scheme Price $0.85c 1 Oct 2018 Receive and Sell Scrip at $0.85c
$0.15 gain/21.4% Gain
Annualised Return circa 79%

Ok, there are transactions costs to think about, FX risk although there is a mechanism to limit FX Risk, the scheme potentially falling over and not going ahead, my end dates may be optimistic etc, but the above quick back of the envelope test suggest further research. Time will untimely tell, but it is certainly one of the more interesting takeover bids we have seen in microcaps for a while.

Frontier Digital Ventures (FDV: ASX) Came to market for a $14.4m capital raise at $0.65c in May which represented a 7.8% discount to the where the share had been trading prior to the raise. FDV has a portfolio of 15 auto and property online classified portals in frontier markets around the globe. Think places like Pakistan, Myanmar, Costa Rica etc. Shaun Di Gregorio the CEO has had previous successful stints at REA Group **(REA: ASX)** and iProperty. Patrick Grove & Luke Elliot of Catcha Group who were the main founders/backers of iProperty are also major shareholders in FDV. Readers might remember iProperty from its ASX listing at $0.25c in 2007 to its eventual takeout by REA in 2015 at $4.00. A 16x/bagger for IPO investors over an 8 year holding period. In microcaps it can be as much about backing the jockey, as the horse. Investors in FDV will be hoping that Shaun and the Catcha Group can prevail again with their current mount. Given previous form it looks like an interesting bet.

Smart Parking (SPZ: ASX) has had a roller-coaster 2018. Shares in the parking company went on a tear in 2018 rising from circa $0.20c at the start of the year to $0.55c more recently. Then came an announcement that their main parking management business in the UK has had some poor operational performance, due to bad weather. A similar weather related malaise (albeit in another hemisphere) caused a downgrade by Experience Co (EXP: ASX) this month as well. It's funny I can't ever recall a weather related upgrade to the earnings of company but it seems to cause a lot of downgrades! SPZ's other unprofitable technology division has always looked interesting to me and has been making steady (if slow and lumpy) progress over the last few years. However, the UK business is, and will be the mainstay for a few more years yet. Now that SPZ's share price has fallen back to nearly where it started 2018 it is on the watch list again for results season purely to check where their technology business is going as that is the interesting part of SPZ.

Goldman Sachs Research Small Cap Research

I recently read a great report by Matt Ross and the team at Goldman Sachs on the ASX Small Ordinaries Index. Some of the key takeaways I took from the report are as follows;

1. The actual number of analysts covering small caps is falling.
2. The breath of coverage is falling. Nearly half the stocks in the small ords index now have less than 5 analysts covering them.
3. The analysts that are covering small cap stocks are tending to cover the same names as the total number of earnings estimates/research in the market is also falling. In other words there is a clustering around the popular small cap stocks by the analysts, also contributing to the reduced breath in coverage from point 2.

4. Stocks with less analysts coverage have generally lower valuations (on a price to book basis) than those who had good analyst coverage. **A key point form the research.**

So, for microcap investors what does the above small cap research mean?
If analyst coverage is falling for small caps it must also QED be falling for microcaps. As microcaps are even less likely to be covered by sell side analysts than small caps. For a microcap investor this means less people looking at this end of the market. Thus, information asymmetry is increasing in microcap investors favour, in terms of discovering those hidden microcap gems. That's the positive side.

The flip side is, well there is no point finding these hidden gems if they don't get discovered by the broader market and picked up by the sell-side analysts and brokers. In other words once you find a hidden gem, in order to help increase the valuation/price of your hidden gem the rest of the market needs to catch on to the story. Or, it could remain cheap and undervalued and underappreciated for a long time with the share price no doing much.

Consequently, it is critical for microcap investors when they are researching and/or engaging with microcap companies via email or at the agm, to ask what is the board and management's investor relations (IR) strategy? What are doing to try and get research converge with sell-side analysts and brokers. Are, they looking at getting independent commissioned research out into the market if the sell-side analyst and brokers are not interested currently. Have management presented at any microcap conferences in the last 12 months etc. Have management presented at to various stockbroking firms either at the brokers morning meeting or to the brokers clients at another broker organised event.

IR for microcaps is a long and slow game, but its critical for unlocking value for microcaps shareholders. IR should be high up on microcap investors agenda in engagement with microcap company boards and executive management teams.

This month's microcap fund snapshot is of **The DMX Capital Partners Limited (DMXCP), which is an unlisted investment company**. I asked **Steven McCarthy** Portfolio Manager at DMX Asset Management what was one of the more interesting stocks from the current microcap portfolio and he highlighted **Easton Investment Limited (ASX: EAS)**

What does EAS do firstly?
EAS provides a range of accounting and wealth management services and solutions to more than 3,000 accounting firms and over 600 authorised representatives (that are licensed by EAS to provide financial advice).

Accounting support services (for small and medium accounting firms) include training, practice support, an online help desk, and document precedents. Wealth management solutions (for financial planning and accounting firms) include a full range of dealer services, including enabling accountants to provide financial advice. The 600 representatives licensed by EAS puts it in the top 10 of national dealer (financial planning) groups in Australia by adviser numbers, and makes it one of the largest non-aligned dealer groups.

Why does DMX like EAS?

Over the last 5 years, EAS has been focussed on establishing relationships with a large network of accountants and financial advisers. This provides EAS with a powerful distribution base as it grows its product offerings, and opens up a number of exciting organic growth initiatives. Accountants are likely to play an increasingly important role in the wealth management sector, and EAS is well placed to distribute further wealth solutions within the accounting sector as these two sectors look to converge. As a large, national, independent dealer group, EAS is also likely to be a beneficiary of financial advisers moving away from the institutions.

Other interesting growth initiatives include its recently launched interactive video-based online accounting training program for junior accountants up to partners (the first of its kind for small to medium accounting firms). EAS is aiming to deliver 65,000 training hours per annum to accountants by 2020.

Who is the management team behind EAS?

EAS is led by Greg Hayes, Greg is the founder and Chairman of Hayes Knight (NSW) – a long established accounting practice, and is well regarded within the accounting profession. Greg owns 5.7m EAS shares (16%). Grahame Evans, an experienced wealth management executive heads up the wealth management business. Grahame owns 1m shares. Directors have been active buyers of EAS stock on market over the past 6 months.

Does the valuation for EAS stack up in DMX's view?

DMX expect EAS to deliver underlying EBITDA of ~$4.25m for FY18, increasing to ~$6m in FY19 as it benefits from a full year contribution and synergies from its GPS dealer group acquisition. This puts EAS on a FY18 PE multiple of ~13x and on an undemanding FY19 PE multiple of ~9x. With all major acquisitions now completed and successfully integrated, and limited capital expenditure required, we would expect to see dividends commencing over the next 12 months. DMX consider the valuation to be attractive, given its unique business model, diversified customer base, high quality earnings and growth prospects.