under the radar report
SMALL CAPS

ISSUE 349
20 JUNE 2019

WHY GEOFF WILSON IS A BULL

We have been interviewing the founder of Wilson Asset Management for some years now and rarely have his listed investment companies had as low cash levels as they do now. This is a marked departure from when we spoke to Geoff Wilson at the start of the year, when he was fairly negative on the market.

In this issue Geoff delivers his thoughts on the markets, his investment philosophy and we drill down on his new WAM Microcap fund (WMI), which invests in ASX listed companies with market caps of less than $300m. I guarantee, you will never have heard of some of the stocks in this fund.

We go into detail on his group's stock selection criteria. To give you a hint, if the company achieves a score over 50, it's a Buy. We discuss how they get to that score. Then we look at the strategy behind his trading ideas. It's fascinating stuff.

This issue is a bumper one as far as stock coverage goes and we have made quite a number of ratings changes. We look at AfterpayTouch (APT) and its capital raising; the ship builder Austal (ASB), the reinvented fashion retailer City Chic (CCX), advertising and marketing services group Enero (EGG), aged communities provider Lifestyle Communities (LIC), motorbike retailer MotorCycle Holdings (MTO), rural services group Ruralco (RHL), digital services group RXP Services (RXP), niche financier Silver Chef (SIV) and the salmon harvester Tassal (TGR).

We also go through our Best Buys, which lie behind our average return of 40% on all the 240 different recommendations we have made since opening our doors close to eight years ago

Investing successfully is about generating growth and achieving diversification. Under the Radar Report is invaluable for achieving this. ■

Richard Hemming
Editor

the issue

Small Talk

"When people give us money it's because they trust us; when we buy shares in small companies we do so when we trust the management, given that we fully understand how the company makes money."

GEOFF WILSON

99% of all financial news relates to the 40 to 50 biggest companies. So what about the rest? They're Under the Radar.

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AFTERPAY TOUCH

Buy now pay later provider

The buy now pay later king has taken advantage of its high price to raise $317m in fresh capital via an institutional placement of 13.8m shares at $23.00, a 4.8% discount to the share price prior to the issue. This, along with management selling and increased regulatory scrutiny has seen the stock's price fall close to 25% in the past five weeks to below its institutional issue price. Is this a buying opportunity?

Retail shareholders might be luckier. They have an opportunity to participate through a share purchase plan, which will raise another $30m. Full details have yet to be announced but the price will be the lower of $23.00 per share or the 5-day VWAP up to the SPP closing date.

If Afterpay achieves its aggressive growth targets, it's a no brainer. But these are big targets. Management aims to exceed $20bn a year in underlying sales, known as gross merchant value (GMV), which is almost four times its current run-rate, while slightly diluting its margin on transactions from its current levels of 2.3% to closer to 2%.

Management pointed out that it's "not a forecast" yet the group has it put it's "aspirational target" out there for all to see.

The US is key and fortunately where Afterpay is kicking goals. Here the company is achieving $1.7bn in annualised GMV in 13 months of operations; the country now contributes 17% of group sales. However, we suspect the group is still making losses in this market as it spends big for growth. Afterpay is now also live in the UK and trades under the Clearpay brand.

Key managers have been selling into the heat. Three of the founders sold almost 2% of total shares outstanding to two US investors. Anthony Eisen and Nicholas Molnar remain Afterpay's biggest shareholders with each retaining stakes of 8.1%. They advised they would not sell any more shares "for at least another 120 days", which doesn't seem long at all.

Post the raising, Afterpay was served a notice by AUSTRAC, requiring an external audit with respect to its anti-money laundering and counter terrorism financing compliance.

Aside from increasing regulatory scrutiny, it's worth noting a couple of things: 1. Afterpay is not reporting profits (1H19 NPAT loss: -$22m) and not paying dividends. ***Unlike one of our Best Buys, Money3 (MNY), the not so sexy used car financier.*** 2. Afterpay is an unsecured lender that has not been tested through a full economic cycle. 3. Competition remains a threat. Afterpay's growing customer and retailer base is building a network effect between retailers and their customers. But new competitors such as Sezzle and Quadpay are putting pressure on margins. ■

RADAR RATING: The company has first mover advantage and is building a competitive advantage. If management successfully execute the offshore strategy this stock will likely run further. But there is significant price risk, trading on 22 times FY19 estimated revenue. Under the Radar first tipped Afterpay at $2.51 in May 2017. We have taken risk off the table and remain interested in keeping an exposure to this phenomenon. HOLD.

RADAR RATING **HOLD** ▲
(UPGRADE FROM TAKE $$$)

ASX CODE **APT**

CURRENT PRICE **$21.27**

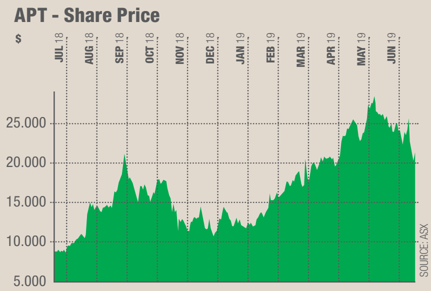
MARKET CAP **$5.4BN***

NET ASSETS **$341M**

DIVIDEND YIELD **0%****

TIP DATE **18 MAY 2019**

TIP PRICE **$2.51**



*Estimated post capital raising

**FY19 Forecast

RESEARCH TIP UPDATES

20 JUNE 2019

AUSTAL
Shipbuilding

Austal has been a great performer for subscribers almost since our newsletter started, and we have had multiple opportunities to buy stock at prices that have offered very good returns.

For instance, Under the Radar's Small Cap Portfolio has made three separate Buy transactions in ASB from 2017 to as recently as late 2018 and is showing 46% annualised return on these acquisitions. Including the trading profit we made through buying from Sept 2012, and selling in June 2015, our return for the entire transaction set is currently 35%.

Austal has settled into a manufacturing groove in the US, which is delivering substantial operating cash flow and returns. Being a cyclical business, these returns are likely to widely vary, however while the company is building vessels, operating cashflow should be strong.

Reflecting its success, this month it was announced that Austal will replace Navitas in the S&P/ASX200 index. This is one of a number of stocks we have covered that have been added to the biggest index in Australia. When a stock is added to a major index, the amount of buying by ETFs can be substantial and can give a nice boost to a stock. This is currently happening in Austal, and we suggest shareholders don't disembark.

RADAR RATING: If the ASB price rises continue, we might look to take profits on a small part of our core holding, but as the shares are hitting new highs daily, this is not a time to let go of all holdings. HOLD.

The Idle Speculator retains a holding in ASB in his SMSF.

RADAR RATING **HOLD**

ASX CODE **ASB**

CURRENT PRICE **$3.14**

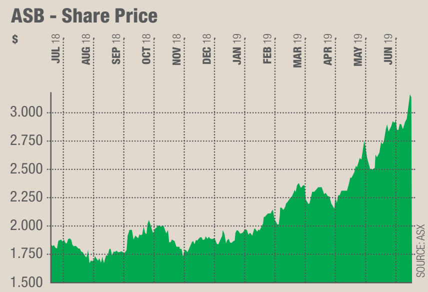
MARKET CAP **$1.1BN**

NET CASH **$54M**

DIVIDEND YIELD **1.9%***

TIP DATE **12 JULY 2012**

AVG TIP PRICE **$1.60**



*FY19 Forecast

CITY CHIC COLLECTIVE
Apparel retailer

Successfully targeting GenY sales could be known as the "Afterpay" effect, but the re-invention of City Chic from its Specialty Fashion origins is definitely up there with the best of the rest. To put it in context, AfterpayTouch (APT) has a market cap of close to $5.5bn, while City Chic's is just over $350m, but this is well above Specialty Fashion's valuation of closer to $100m this time last year. It is also the best performance by any domestic retailer, by far.

City Chic's shares are now up from sub-15 cents at the end of last year. The catalyst was the company's sale of most of its brands to NoniB (NBL) for $31m. The group now operates in a market that is underserved: plus-size (14+) young women's fashion.

A key reason for the recent move in its shares from $1 at the start of the year to current levels has been that its same store sales growth has been 10% plus; it has a plan to expand its 107 stores in Australia and New Zealand, as well to grow the floor size of existing ones. Probably more important is that it is able to increase its profit margins because of the lower cost of increasing online sales primarily in North America, plus growing its low cost sales though leading retailers in that market.

RADAR RATING **TAKE $$$**
(DOWNGRADE FROM HOLD)

ASX CODE **CCX**

CURRENT PRICE **$1.885**

MARKET CAP **$362M**

NET CASH **$15M**

DIVIDEND YIELD **2.7%***

TIP DATE **24 FEB 2016**

TIP PRICE **$0.60**

*FY19 Forecast

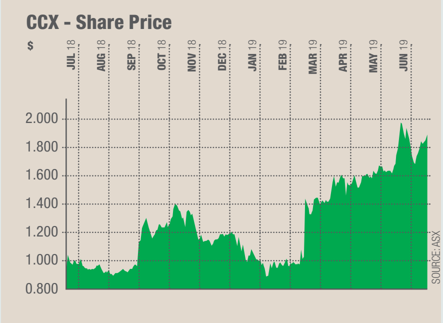
RESEARCH TIP UPDATES

20 JUNE 2019

The company is now valued as though it will grow EPS at 20% a year for the next three years, which is a third more than its retail competitors. If it successfully cracks the US market, this growth rate will be extended (and its share price will grow further).

The question is, how realistic are these expectations? How much competitive edge does City Chic have? We think that trading on an enterprise value/EBITDA multiple of about 11 times FY20 forecasts seem expensive for a retailer. However, City Chic is not a typical bricks and mortar retailer because it has a much higher portion of online sales (36% vs most retailers of 10%).

Another factor is consumer sentiment. The trade war between the US and China is heating up and goods will be more expensive in the US. Highly priced stocks like CCX will also suffer if there is general market weakness and signs of slowing economic growth. ■



RADAR RATING: If you are lucky enough to hold on to this stock, we think that it would be remiss not to take some profits because expectations are so high while consumer sentiment is declining. TAKE PROFITS.

ENERO
Marketing services

Enero has been another slow burning winner for Under the Radar Report subscribers, having turned into a substantial and fast-growing business. In its most recent interim result, net revenue rose 33% to $63.7m for the six months to 31 December 2018. For those looking back through our previous notes, this may look understated, but that's because it doesn't include agency revenue (due to new accounting standards). Adjusted operating EBITDA margins increased to almost 16% delivering operating EBITDA of $10m and EPS of 7.2 cents.

The organic revenue growth of 15% and operating EBITDA growth of 40% was very healthy, suggesting the acquisition of Orchard delivered around $2m EBITDA. EBIT was up 46% to $8.5m with NPAT up 94% at $6.1m from which an interim dividend of 2.5 cents was paid. The dividend is likely to continue to grow, boosted by cost reduction through the centralisation of the company's Australian operations into a Sydney hub.

The company originally attracted us because it had a lot of cash, some strong operating businesses, but its ability to use the cash was constrained by earnouts on acquisitions. Once these fell away, management has built a coherent group. Contingent consideration for acquisitions of $26m+ is still payable, but EBITDA converts to cash at a relatively high rate, with few large capital expenditure requirements otherwise. The group is on the lookout for further acquisitions.

Enero is grouped into four services: insight & strategy, creative & content, integrated communications & PR, and digital. Weakness in the UK and Europe due to Brexit questions are ongoing, but revenue there grew in 1H19, though EBITDA fell. The stand-out performer is the USA where earnings more than doubled in the last half, mainly from acquisitions. Half of revenue and earnings come from offshore, providing a useful hedge as the A$ weakens. ■

RADAR RATING **HOLD**

ASX CODE **EGG**

CURRENT PRICE **$1.475**

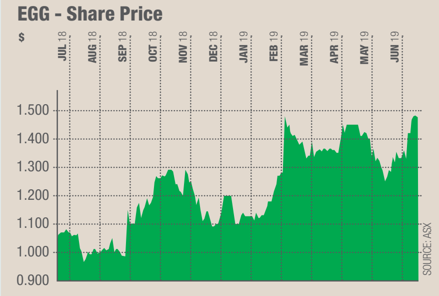
MARKET CAP **$126M**

NET CASH **$37M**

DIVIDEND YIELD **3.4%***

TIP DATE **12 JUL 2012**

TIP PRICE **$0.60**



*FY19 Forecast

RADAR RATING: Enero is an interesting and inexpensive play on Australian and international economic growth on a rating of only 14 times historic earnings with FY19 growth likely to bring the multiple into single digits. But marketing companies are vulnerable in economic downturns, since the marketing budget can be the first and easiest to cut when businesses encounter weakness in demand. HOLD.

LIFESTYLE COMMUNITIES

Aged communities

Lifestyle shares are up about 25% in the past six weeks on no new news. We suspect the market expects an upgrade to profit guidance. Current FY19 guidance for new home settlements is between 310-350 homes (FY18 321) and we expect a result at the top end of this range, given the strong start it had achieving a 24% lift in 1H19 settlements to 186 homes. A risk to our forecast is whether the uncertainty leading up to the May 2019 Federal election caused potential customers to sit on the sidelines.

This does not change the company's positive long-term prospects. We like the Lifestyle story, which hinges on positive demand demographic drivers of a growing an aging population.

Lifestyle does not run nursing homes or retirement villages like Aveo Group (AOG). It targets a different market, downsizers with a simpler land lease model where occupants own the homes they live in and lease the land from Lifestyle under a 90-year leasehold agreement. The home owners are charged a weekly site fee that covers use of the land, some rates, maintenance of common facilities and services. This provides an annuity income stream, contracted to grow at the higher of 3.5% or inflation, making it similar to an inflation linked bond.

The icing on the cake comes from deferred management fees. These are the fees homeowners pay when they sell their home, which is capped at 20% of the sale price. As they say death and taxes are the only two certainties in life so it is a question of when and not if the fee will be paid; either when a homeowner passes away or moves to a higher care facility. The proviso is that home prices appreciate. ■

RADAR RATING: This is a business with good growth prospects underpinned by a growing and aging population. We like its increasing inflation-hedged annuity revenue stream of rental income and the hidden value in deferred management fees. Key risks come from not being able to sell the property development pipeline and key man risk (the CEO is one of the founders). With the shares up over 30% since we initiated coverage in April 2018 and the sub 1% dividend we suggest taking some gains as this is the only way to generate some cash return from this stock. TAKE PROFITS.

RADAR RATING **TAKE $$$ ▾**
(DOWNGRADE FROM HOLD)

ASX CODE **LIC**

CURRENT PRICE **$6.47**

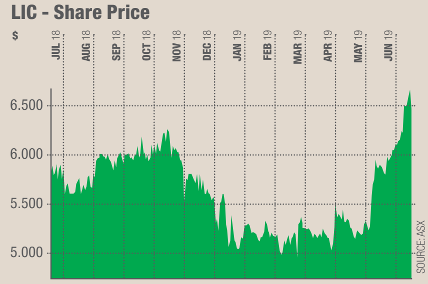
MARKET CAP **$677M**

NET DEBT **$62M**

DIVIDEND YIELD **0.8%***

TIP DATE **26 APRIL 2018**

TIP PRICE **$4.95**



*FY19 Forecast

MOTORCYCLE HOLDINGS

Motorcycle dealer

Australia's biggest motorcycle dealership is struggling, in May issuing its second downgrade this calendar year; and this is reflected in its share price. This company will always sail in precarious waters because motorcycles are almost the ultimate discretionary item, but importantly, we believe that this company will live to fight another day.

Cliches aside, its latest announcement was once again short on detail. Underlying EBITDA for FY19 was downgraded by close to 10% to $16.5m to $17.5m, which doesn't look too bad until you factor in the 1H19 result of $10.4m. 2H19 EBITDA forecasts were effectively downgraded between 18% and 30%. As if this wasn't bad enough, the company announced the immediate resignation of its CFO three weeks later.

The culprit once again was new motorcycle sales, according to the almost invisible CEO David Ahmet, who said that this market had contracted just shy of 15% during the first quarter. Although he add that MTO increased its market share from 9.9% last year to 10.6%.

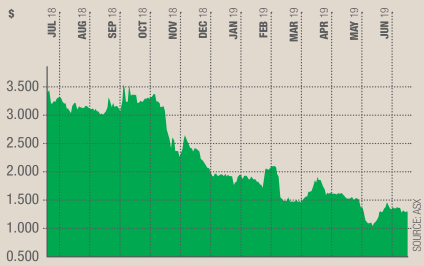
When downgrades happen, the first thing to look at is debt, of which the company has almost $50m relating to its October 2017 purchase of the accessories and parts group Cassons for $123m. At 31 Dec 2018, its net leverage ratio (net debt/ EBITDA), which excludes short-term (mainly bailment finance) for FY19 was 2.3 times, according to our numbers. The company trumpeted in its 1H19 presentation that the net leverage ratio covenant had increased to 2.95 "allowing plenty of headroom". After this downgrade on our estimates it sits at a precarious 2.6 times, underlining the importance of sales for the struggling group. Another profit downgrade will almost certainly entail a capital raising and dividends should not be expected in FY20.

What is there to look forward to? For one thing the election is out of the way and the easing of official interest rates may help (though probably not). Because of the Cassons acquisition, MTO is a much stronger group, having more earnings diversity. The cost cutting initiatives the company flagged at its last result were never going to benefit FY19 and will make a material difference for FY20. ■

RADAR RATING: This stock is only good value if earnings have bottomed in the current period. Debt is a definite concern, which creates unease as sales come under increasing pressure and key management leave. We are not selling because of MTO's strong market position and the huge operating leverage this group has can magnify gains when profitability improves and allow to dividends resume. HOLD.

RADAR RATING	**HOLD**
ASX CODE	**MTO**
CURRENT PRICE	**$1.285**
MARKET CAP	**$79M**
NET DEBT	**$74M**
DIVIDEND YIELD	**0%***
FIRST TIP DATE	**7 NOV 2018**
TIP PRICE	**$2.40**

MTO - Share Price



*FY19 Forecast

RESEARCH TIP UPDATES

20 JUNE 2019

RURALCO
Rural services

When we covered the proposed $4.40 a share takeover of RHL by the Canadian group Nutrien in March, we noted that although our recommendation was Hold for the potential franking tax credit from the dividend component (90 cents) component of the offer, there would be "an extensive regulatory review, and there may be competition or foreign investment issues, so those of a nervous disposition may want to bank some profits now."

Well, it now appears that those of a nervous disposition will inherit the earth, with the ACCC throwing a spanner in the works. Australia's competition authority announced it had a number of issues with the proposed takeover; in particular the reduction of competition in certain markets from the combination of two retail rural merchandisers (Landmark and Ruralco) coming under single ownership.

The market has agreed with management's view that the problems raised are potentially surmountable, with the share price only falling back to the low $4.10, rather than the $3 at which we made our final Speculative Buy call in February.

We had been positive towards RHL for a few years since we first covered the stock in the wake of our success with its competitor Elders (ELD) in 2013-2016. And we maintained Buy recommendations through 2017-2018 at prices above and below $3. RHL was on our Best Ideas list below $3 for many months, while the stock has paid more than a 5% yield. We therefore included the stock in three dividend portfolios over the period. Our interest for subscribers has turned out to be fully justified. ■

RADAR RATING: Even if this takeover were to be entirely abandoned, we don't think that the share price will fall back to the $3 level. The market will give more credit to the quality of the underlying businesses in RHL. The historic multiple is around 15 times at current prices, and the business has growth opportunities to offset cyclical vulnerabilities. The ACCC is expected to announce a decision by 15 August. HOLD.

RADAR RATING **HOLD**

ASX CODE **RHL**

CURRENT PRICE **$4.16**

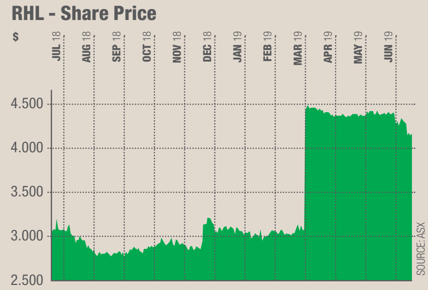
MARKET CAP **$437M**

NET DEBT **$117M**

DIVIDEND YIELD **3.6%***

FIRST TIP DATE **20 NOV 2014**

AVG TIP PRICE **$3.02**



*FY19 Forecast

RESEARCH TIP UPDATES

20 JUNE 2019

RXP SERVICES

Accounting and digital services

After three downgrades through FY18, RXP's recent earnings performance gives fresh hope for shareholders, including subscribers who had followed our recommendation to buy the stock at higher levels.

In the first half management did well to eke out 10% EBITDA growth from just over 1% revenue growth. However, the income the company receives continues to lack predictability or "stick-ability" as it continues to attempt to evolve from offering digital services to becoming a digital partner and then an "innovation partner" for its customers. These clients are some of the larger organisations in Australia. The group says it has over 100 clients, but the amount it charges each client varies.

The call that we made to Sell the stock last August at 55 cents was right, but as we upgraded after the first half results, we are now less negative than at the same time last year. The possibility exists for some upside surprise, even if the quality of the business is only slowly improving. ■

RADAR RATING: We suggest subscribers stick with it, despite the temptation to take a tax loss as we approach June 30. A single digit FY19 PE multiple does not seem demanding. As you can tell, our confidence remains low, so if you need the money do not be afraid to get out. HOLD.

RADAR RATING **HOLD**

ASX CODE **RXP**

CURRENT PRICE **$0.47**

MARKET CAP **$76M**

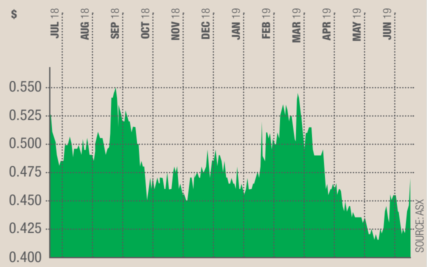
NET DEBT **$11M**

DIVIDEND YIELD **3.6%***

TIP DATE **10 AUG 2017**

TIP PRICE **$0.82**

RXP - Share Price



*FY19 Forecast

SILVER CHEF

Hospitality equipment finance

The prospects of Silver Chef being taken over by the Australian private equity firm Next Capital appear to be fading as the suitor's negotiations with its and Silver Chef's financiers have become protracted. Silver Chef has consequently extended Next's exclusivity period in relation to its indicative bid to 5:00 pm Wednesday 19 June 2019.

It is likely that Silver Chef would extend the exclusivity again if needed given its limited options, but critically it means that Next's indicative offer price may be reduced (from $1.00 per share plus deferred payments based on the run off of the GoGetta book) or result in no bid at all.

The kitchen financier has little bargaining power with its lenders. If no firm bid emerges then it would be a challenge for Silver Chef to rollover its debt without a highly dilutive equity raising. Silver Chef's waivers from its lenders expire on 30 June 2019.

This is a disappointing situation given the interim result showed that despite constraints due to the debt issues, Silver Chef's underlying hospitality business was actually doing okay. It made $92m of new loans, generated $80m operating cash flow and improved credit management practices. A trading update would have been welcomed, as the underlying fundamentals of the core business had been a reason to stay in the stock. Whether management can extract this value for shareholders in takeover or debt negotiations is more uncertain now. ■

RADAR RATING **SELL ▼**
(DOWNGRADE FROM HOLD)

ASX CODE **SIV**

CURRENT PRICE **$0.45**

MARKET CAP **$18M**

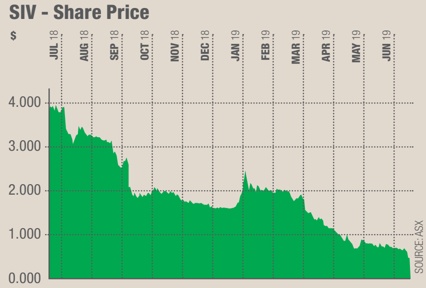
NET ASSETS **$86M**

DIVIDEND YIELD **0%***

TIP DATE **02 OCT 2011**

TIP PRICE **$2.69**

SIV - Share Price



*FY19 Forecast

RESEARCH TIP UPDATES

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RADAR RATING: Silver Chef's debt position is precarious and holding the stock now is a highly speculative bet that Next Capital will proceed with a bid in some form or the company can rollover its debt. Another bidder could emerge but we are only speculating. We think the company's financial risks are weighed to the downside. As a minority investor you are always in a very weak position when it comes to issues relating to debt. We accept that we have been wrong on our optimism regarding the company's financial position. SELL.

TASSAL

Salmon and seafood processing

The salmon harvester's shares have recently been trading over $5.00, up 15% over the past four months on the back of a bumper 1H19 result that was ahead of market estimates and delivered strong cash generation. The question is that in the volatile world of aquaculture, it is worth taking some risk off the table? We explore.

On the positive front, Tassal expects a record result in FY19, although this has been priced in to the current share price. It's worth noting that the second half will be below the first due to seasonal factors. Favourable market dynamics are expected to continue as demand outstrips supply, which bodes well for prices.

As we have written previously, Tassal is a not your typical food thematic stock as it is more a domestic than an export story. Domestic demand for a healthier protein alternative to meat is driving salmon consumption that has seen per capita consumption double over the past decade. Demand is expected to continue growing at 10% a year.

Exports into Asia remain important, however, and represented about a third of total volumes sold in 1H19. Tassal is targeting the higher end export market for larger fish.

Market expectations are for more balance in the supply demand equation in FY20 and we think Tassal will be more dependent on its prawn business to drive growth. This business was acquired in September last year and is expected to contribute to earnings from 2H19.

We are uncertain about the prawn business. While it brings diversification benefits for Tassal and strong growth potential it also brings high risk. Tassal paid $31.9m to buy it and plans to invest more than that ($34m) and hopes to increase production from 450 tonnes per annum to over 3,000 tonnes within three years and achieve annual EBITDA of $25m. This implies ambitious return of almost 38% on its total investment. ■

RADAR RATING: We remain positive about the business but accept that there are potential left field risks in aquaculture. The high growth opportunity in the prawn operations seems clear but also brings high risk. We have bought at prices between $3.58 and $4.90 over the past three years. With the shares now trading $5.00 plus we suggest investors use the opportunity to take some risk off the table. TAKE PROFITS.

RADAR RATING **TAKE $$$**
(DOWNGRADE FROM HOLD)

ASX CODE **TGR**

CURRENT PRICE **$5.00**

MARKET CAP **$893M**

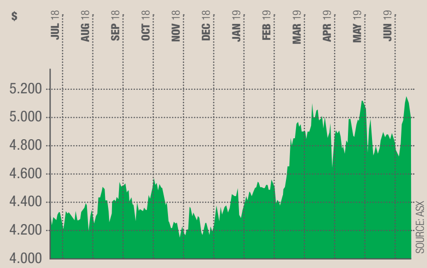
NET DEBT **$122M**

DIVIDEND YIELD **3.6%***

TIP DATE **31 MAY 2012**

TIP PRICE **$1.33**

TGR - Share Price



*FY19 Forecast

WILSON ASSET MANAGEMENT

Geoff Wilson AO,
Chairman and Chief Investment Officer

GEOFF WILSON AO,
Chairman and Chief Investment Officer

Maybe he's not everyone's idea of a celebrity, but you can't deny that the investment markets luminary has a loyal following. He has a long track record of success and is not afraid to put himself out on a limb. Geoff delivers his thoughts on the markets, his investment philosophy and we drill down on his new WAM Microcap fund (WMI), which invests in ASX listed companies with market caps of less than $300m.

WHY WILSON IS A BULL AGAIN

We have been interviewing the founder of Wilson Asset Management for some years now and rarely have his listed investment companies had as low cash levels as they do now. This is a marked departure from when we spoke to Geoff Wilson at the start of the year, when he was fairly negative on the market. As he says now:

"At the end of last year I was ultra bearish due to signs the US Federal Reserve would take liquidity out of the market and engage in quantitative tightening. I mean, when this happens, prices plunge. You have to remember what happened to Australian property during the financial crisis.

"The big difference is that the Fed did a complete 180 degree U-turn on quantitative tightening, indicating it might be over. This changed our views considerably."

Wilson adds that he is nervous about global growth and that Australia's economic picture is "not positive" as indicated by the recent official interest rate cut, but still, his cash levels are at historical lows.

WAAAX OFF

Although his funds have been buying in the past few months, there have been bouts of profit taking. Like his one time investment partner Matthew Kidman, Wilson is sceptical about the levels of the so-called technology related high growth "WAAAX" stocks that have had an unbelievable run – WiseTech Global (WTC), Appen (APX), Altium (ALU), AfterpayTouch (APT) and Xero (XRO). These are supposed to be the Australian equivalent of the FAANG (Facebook, Apple, Amazon, Netflix and Alphabet's Google).

"We have actively traded the WAAAX stocks during their surge, but collectively their valuations are now starting to look stretched. As a result, we have selectively reduced our exposure to the technology sector over the last two months."

> **"YOU CAN'T FALL IN LOVE WITH ANY OF YOUR INVESTMENTS. YOU'VE GOT TO UNDERSTAND THAT YOU HAVE AN OWNERSHIP BIAS; YOU HAVE A BIAS IN EVERYTHING YOU OWN."**

EXPOSURE TO THE OLD WORLD

One of the biggest contributors to many of his funds' performance in May was Channel 9 owner Nine Entertainment (NEC), which climbed almost 19%. They started buying early in the year following its merger with Fairfax Media. The company benefited from additional cost synergies of $30m a year projected for FY20 and the transformation of the streaming service Stan from loss to profit making. NEC is owned across WAM, WLE and WAX.

GROWTH STOCKS THAT ARE "ON SALE" WITH A CATALYST

Wilson repeats the mantra of his investment philosophy: "We are looking for under valued growth companies and we buy them if we see a catalyst to change the valuation. This can be a positive catalyst or a negative catalyst."

An example he gives is his group's high profile investment in the department store group Myer (MYR) where his funds have a substantial shareholding (over 5% of the shares on issue):

"We invested in Myer due to the track record of its incoming Chief Executive Officer John King, which we view as a catalyst. We see the potential for cost savings across Myer's stores and for his management team to improve sales."

King has proven to be a true impact player, if you look at the group's better than expected half year result in March.

RESEARCH VERSUS TRADING

But when you delve deeper, there is a clear distinction between the "research stocks" and the "trading stocks".

The new WAM Microcap fund (WMI) is a case in point. The fund owns some 75 different stocks. About 25 of these stocks are "research" while a little over 50 are "trading".

THE RESEARCH SCORING SYSTEM

The research stocks consist of those that have jumped through the group's selection hurdles, but boil down to stocks on low PEs that have strong growth prospects. In order to find these stocks management is first rated out of 20.

"When people give us money it's because they trust us; when we buy shares in small companies we do so when we trust the management, given that we fully understand how the company makes money. Let's say we like a company, when we give them 14 out of 20."

The team then calculate what their expectations for average earnings per share growth over two years will be. The example he gives is 18% (18 points).

They then look for a standardised number that compares a company's growth to how it is priced by the market (Wilson calls it "reverse GARP" where GARP stands for growth at a reasonable price). They take the growth rate, divide it by the forward PE, which for this example is 12 and then multiply that by 10, which gives 15.

Last, they score the company's industry position out of 10. This fictional company gets 6 points.

Adding these points up gives 53 (14+18+15+6), which means it's a buy because it's over 50.

HUNTING FOR A QUICK RETURN

Then there are the "trading" stocks, where there were two key contributors to the Microcap fund's May performance: the fixed wireless broadband provider Uniti Wireless (UWL) and digital media networking specialist Audinate Group (AD8). Says Wilson:

"For trading positions we look at a company's liquidity, so our positions are usually small and we can get out quickly. We are buying a stock and we try to have a 10% stop loss. We're simply looking for situations where we believe we can make money. It could be from placements, other capital raising vehicles or from buying blocks of stock."

These two stocks are a case in point, as is another stock he mentions, which has had a big share price run, the broadband services provider 5G Networks (5GN).

In May, UWL raised capital via a share placement, partly for making acquisitions to expand into wireless, fibre and speciality telecommunications services. This stock more than doubled in May. Meanwhile the group still own AD8 for its leading position in technology that improves the speed and range of audio connections.

THE BOTTOM LINE

When it comes to buying and selling, Wilson's words to Under the Radar when we first spoke to him many years ago always ring true:

"You can't fall in love with any of your investments. You've got to understand that you have an ownership bias; you have a bias in everything you own." ■

TOP 20 HOLDINGS @ 31.05.19
WILSON ASSET MANAGEMENT

1. 360 CAPITAL TOTAL RETURN FUND (TOT)
2. 5G NETWORKS (5GN)
3. CIRRUS NETWORKS HOLDINGS (CNW)
4. CITY CHIC COLLETIVE (CCX)
5. DATA#3 (DTL)
6. ENERO GROUP (EGG)
7. GENERATIONAL DEVELOPMENT GROUP (GDG)
8. INFOMEDIA (IFM)
9. JOHNS LYNG GROUP (JLG)
10. JUMBO INTERACTIV (JIN)
11. MYER HOLDINGS (MYR)
12. NONI B (NBL)
13. PROPEL FUNERAL PARTNERS (PFP)
14. PSC INSURANCE GROUP
15. QANTM INTELLECTUAL PROPERTY (QIP)
16. RHIPE (RHP)
17. SPICERS (SRS)
18. THINK CHILDCARE (TNK)
19. VILLAGE ROADSHOW (VRL)
20. VITA GROUP (VTG)

STOCKS WE LIKE NOW

These are the stocks we think offer value for money and the best risk/reward return.

This list is in alpha order. Please go online to check our full company research.

AUSWIDE BANK (ABA) — BUY

INDUSTRY	**FINANCIAL SERVICES**
MARKET CAP	**$219M**
DIVIDEND YIELD	**6.6%**
PRICE @ 18/6/19	**$5.18**

WHY WE LIKE IT Asset quality is key, so maintaining tight lending standards is critical, particularly given the concentrated exposure to Queensland. At current levels the stock is trading at a forecast PE around 12 times and paying a 6.6% yield.

GALE PACIFIC (GAP) — BUY

INDUSTRY	**MANUFACTURING**
MARKET CAP	**$92M**
DIVIDEND YIELD	**6.9%**
PRICE @ 18/6/19	**$0.325**

WHY WE LIKE IT Gale Pacific has restructured to improve unit profitability, and is now expected to capitalise on the US retail opportunity it has invested in. Positioned for revenue and earnings growth in H2 FY19, It is also paying a substantial yield.

MONEY3 (MNY) — BUY

INDUSTRY	**FINANCIAL SERVICES**
MARKET CAP	**$388M**
DIVIDEND YIELD	**4.7%**
PRICE @ 18/6/19	**$2.14**

WHY WE LIKE IT Money3 is a better business having successfully transitioned into a niche secured auto lender. It is on track to meet FY19 guidance and continues to look attractively priced trading at a forecast PE around 11 times and 4.7% yield.

MYSTATE (MYS) — BUY

INDUSTRY	**FINANCIAL SERVICES**
MARKET CAP	**$406M**
DIVIDEND YIELD	**6.4%**
PRICE @ 18/6/19	**$4.48**

WHY WE LIKE IT MyState provides ballast in the volatile small cap world, with modestly growing fully franked dividend. It is not a bargain trading at a forward PE just under 12 times but with a 6.4% dividend yield it represents good value.

under the radar report
SMALL CAPS

99% of all financial news relates to the 40 to 50 biggest companies. So what about the rest? They're Under the Radar.

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