under the radar report
SMALL CAPS

ISSUE 543
06 APRIL 2023

FREE SAMPLE REPORT: ANOTHER LITHIUM TAKEOVER CANDIDATE

This report was published on 6 April 2023.

We can never say it enough, investing is about being patient and being brave, which fortunately for many of our subscribers has been the theme this year. A combination of picking up stocks on the cheap and backing select companies in the energy sector has lifted our returns, maintaining our average return on over 300 recommendations over the past 11 years of 68%, which climbs to 73% for our Best Stocks To Buy Now.

Which stocks, you might ask? Last week one of the best buys on our list for a long time, **Liontown Resources (LTR)** received a takeover bid from US-based chemicals powerhouse Albemarle and is now up 75% on our last tip in January 2023 (see Issue 533) when the stock wasn't by any means on the nose, but lithium stocks in general were beaten down.

This week our mining analyst, Peter Chilton, discusses why the lithium price has been weak, which has caused stocks in the sector to fall. He forecasts a high probability for more takeover activity. The question is, which stock is next? Maybe **Argosy Minerals (AGY)**, which he covers in depth and has been hit hard from speculation of a capital raising. Peter looks in depth at the group's Rincon project in Argentina, which is poised to commence production.

As you'll see in the lithium chart, the price in China has been hit hard, heavily based on China-specific factors. But demand for lithium is skyrocketing around the world, in the giant North American and European markets as well as China, due to the rising demand for electric vehicles. This week, Argosy cited a lithium carbonate price of US$63k a tonne CIF (freight included in price); much stronger than the Chinese traded equivalent of CNY229.5k or US$34k a tonne.

We also upgrade to Spec Buy on two technology stocks. Hunting for cheap stocks now involves looking in this sector, where many have been hit hard by rising interest rates as investors look for instant profits. But some have levers to pivot to profitable short-term outcomes. I would put **Catapult (CAT)** in this category. Another stock worth having a look at is **Cyclopharm (CYC)**, which increased 35% in the past week on news that the FDA is closer to making a decision on the med-tech's nuclear medicine solution.

These are all stocks that have fantastic growth prospects and touch wood, don't need new capital. They're also very, very cheap. Get the message!

Richard Hemming
Head of Investments

the issue

FREE SAMPLE REPORT!

PLEASE NOTE: ALL RESEARCH, STOCK DATA, AND RECOMMENDATIONS WERE ACCURATE ON 6 APRIL 2023.
Before making any transactions, subscribe and login to our subscriber portal for accurate and timely information. Click here.

LITHIUM SPECIAL REPORT

The price of lithium in China is falling! We show you why the situation is a buying opportunity because of the rising demand for batteries around the world and the lack of availability of quality lithium supply.

ARGOSY MINERALS (AGY)	SPEC BUY

RESEARCH TIP UPDATES

A2B AUSTRALIA (A2B)	HOLD
AUSTAL (ASB)	HOLD
CATAPULT (CAT)	SPEC BUY
CYCLOPHARM (CYC)	SPEC BUY
QUICKSTEP (QHL)	HOLD
REGIS RESOURCES (RRL)	HOLD

BEST STOCKS TO BUY NOW

SMALL TALK: Albemarle's bid is a strong vote of confidence for lithium and hard rock spodumene.

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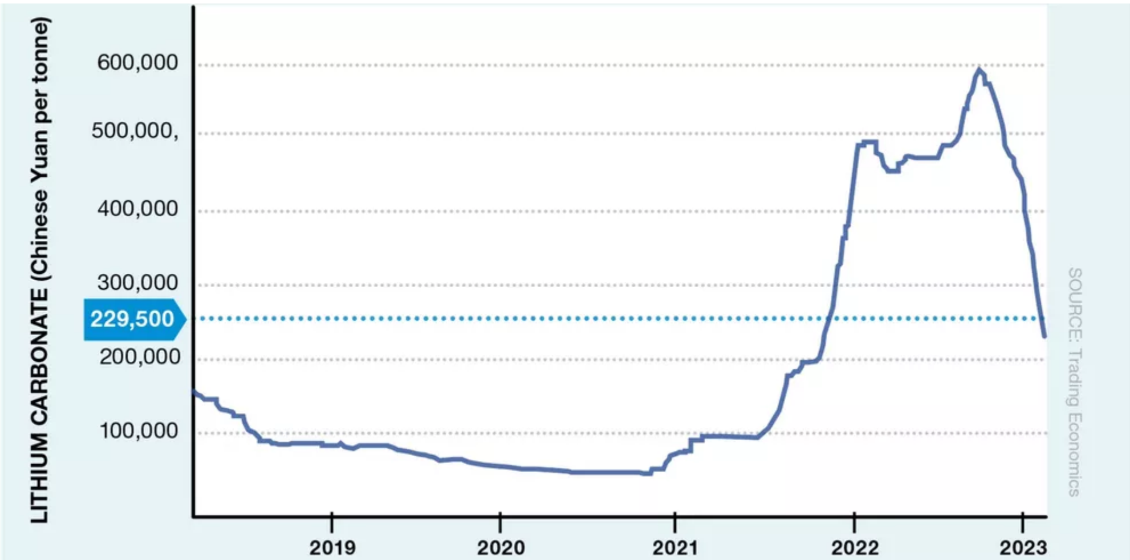
FREE REPORT: Lithium Analysis

Global Outlook Still Strong. Our mining analyst explores why the lithium price has been weak, which has caused stocks to fall. He also discusses why there's a high probability for more takeover activity, following Albemarle's bid for Under the Radar Report favourite, Liontown Resources (LTR), which has seen its stock spike 64%. The question is, which stock is next? We investigate Argosy Minerals (AGY) below.



The prices of battery grade chemicals such as lithium carbonate (pictured) and lithium hydroxide in China have been falling since November 2022. The demand side remains strong, when you account for the global market, most importantly, North America and Europe. On the supply side, high-cost low-grade Chinese production has been the factor that has surprised the market. Over time, as has occurred with iron ore, the market will differentiate between quality lithium and low-grade material due to ESG considerations.

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LITHIUM ANALYSIS CONT.

A NOTE ON LITHIUM PRICES

As you can see from the above graphic, the lithium price traded in China has fallen rapidly. Part of this fall is attributable to local factors. As we mention above, the demand for lithium exceeds the Chinese market, with big the markets of North America and Europe ramping up EV production. Only this week, one of the companies we cover, **Argosy Minerals (AGY)** cited a lithium carbonate price of US$63,000 a tonne CIF (Cost Insurance and Frieght), for lithium carbonate*. Much stronger than the Chinese traded equivalent of 229,500 CNY (yuan) or US$34,000 a tonne.

WHAT'S CAUSING THE LITHIUM PRICE WEAKNESS IN CHINA?

Demand for lithium from EV production was partly driven by a time limit late last year. China's government halted EV subsidies for buyers from 1 January. This sudden increase in demand caused higher prices spurring on new lithium production in China, via lepidolite ore. However, obtaining and converting lepidolite entails a much higher cost and carbon emitting process, compared to lithium brine production from South America and hard rock ores in West Australia.

As a result, stockpiles of lithium have built up, causing the price to fall. Over the longer term, the sustainability of the China lepidolite mining industry is questionable, both from a cost and sustainability perspective.

FALLING LITHIUM STOCKS LEADS TO OPPORTUNITIES

As we reported last week (Issue 542) US listed Albemarle (NYSE:ALB) made an opportunistic takeover bid for one of our favourites, **Liontown Resources (LTR)** at $2.50, a 64% premium to its share price. LTR is developing the Kathleen Valley hard rock lithium project, with first production in mid CY24.

Albemarle is a major US based chemicals producer. The bid is strong vote of confidence in the outlook for lithium and the hard rock spodumene which Kathleen Valley produces. This indicates the group's confidence extends to markets beyond China.

Perhaps the takeover offer is well timed because many expect prices to start recovering in coming months, the catalyst being year on year growth in volumes of lithium demand running at 20% plus a year. Below we discuss the lithium price outlook in further detail.

A FORECAST LITHIUM SUPPLY DEFICIT

Metals consultant Fastmarkets expects the lithium market to be mainly in deficit until 2026, due to strong demand for lithium-ion batteries in EVs and energy storage systems.

Demand from battery electric vehicles (EVs and hybrids) is forecast to increase by a compound annual growth rate of 20% to almost 2.3 million tonnes of lithium carbonate equivalent to 2033 from the last year's level of 321k tonnes. Currently, EVs account for a quarter of cars in China and there are close to 20 countries where the EV penetration has exceeded 5%. This is still low. There is a lot of catching up to do.

Whilst there might be oversupply in China, it is built from a low-grade, high-cost product. In the rest of the world, there is a deficit of supply. The US and Europe are doing everything they can to increase lithium production capacity, thereby reducing reliance on China.

*Benchmark Mineral Intelligence

Continued over page...

LITHIUM ANALYSIS CONT.

Although there are some 300 lithium projects outside of China in the pipeline, many will be at an early stage and producing lithium is a highly complex, not to mention, costly procedure. That's why Albemarle wants Liontown! As it's able to buy into a nearly completed production, instead of developing a new one on its own. Moreover, a higher lithium price is needed for many of these projects to advance.

SUMMARY: LITHIUM PRODUCERS IN THE BOX SEAT

The news has been all about the rising trend of battery gigafactories in Europe and the US, which is feeding the insatiable demand for EVs, driven by the imperative to reduce carbon emissions and avoid rising fuel prices. But these factories need lithium supply.

Given recent political instability and associated risks, countries are seeking to onshore the production of both upstream and downstream lithium products or establish supply chains with friendly countries with close, where possible, geographies. This is evident with moves by the US (the Inflation Reduction Act) and the EU, to locate lithium supply closer to where the demand is. The result will be a more a decentralised and less concentrated industry.

The key takeout for investors is that existing producers and those nearing production are in the box seat. Albemarle knows this and so do we.

The key takeout for investors is that existing producers and those nearing production are in the box seat. Albemarle knows this and so do we.

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A2B AUSTRALIA

SECTOR SERVICES **INDUSTRY** TAXI SERVICES

Australian Taxi Service

Downgrade to Hold

The market reacted positively when A2B announced the $78m sale of the largest of its property holdings in Alexandria, sending the stock up a further 25% to $1.50, It is now 35% above the price when we upgraded to a Spec Buy recommendation (Issue 517, 29 September 2022).

On top of the proceeds of the $19m sale of Bourke Road, A2B is left with $73m in net cash from which to pay a fully franked special dividend of 60 cents, according to our estimates. The transaction is not due to complete until the end of 2023, so there may be some time to wait.

We suggest that shareholders hold on. The remaining business is forecast to earn $17.5m in FY23 on revenue up around 10%. The rental cost incurred as a result of the sale costs is estimated at $4m in FY25, hence an adjusted base case for earnings is $14m. This suggests a cash flow multiple (enterprise value to EBITDA) of around seven times, reducing to 5 times including franking credits.

The remaining businesses, taxi fleets, payment processing and the Cabcharge network are still delivering substantial revenue, even if profit was dramatically impacted by Covid and competition from Uber. The corporate structure has been slimmed and simplified, staff have been cut, and loss-making activities eliminated. The market will expect the new CEO, Daniela Fontana, who started in March, previously CEO of the State Transit Authority, to focus on delivering incremental operational improvements.

RADAR RATING: New management selling properties and paying special dividends estimated at 60 cents. Company operates a profitable and cash flow positive taxi network. After the recent rise, we downgrade

RADAR RATING: **HOLD**

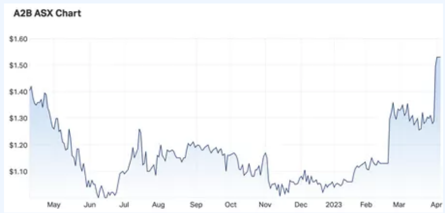
ASX CODE **A2B**

CURRENT PRICE **$1.57**

MARKET CAP $185M

DIVIDEND YIELD 0%*

NET DEBT ($M) -7.1



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ARGOSY MINERALS

SECTOR LITHIUM **INDUSTRY** LITHIUM DEVELOPER

Lithium Developer

Recent news articles suggest Argosy Minerals has been discussing an equity issue, which has been putting pressure on AGY's share price. This follows sector-wide pressure on lithium stocks due to a fall in lithium prices due primarily to high-cost Chinese production – see our full analysis in the issue.

One factor is the demand for lithium exceeds the Chinese market. But this week, AGY cited a lithium carbonate price of US$63,000 a tonne CIF (Cost, Insurance, and Freight) for lithium carbonate*, which is much stronger than the Chinese traded equivalent of 229,500 CNY (yuan) or US$34,000 a tonne.

Our analysis shows that AGY may not need an equity raising in the near term as it already has a strong cash balance and its initial production ambitions are limited and near-term. Furthermore, there is likely to be a recovery in lithium prices.

AGY also provided an update for its 2k tonne a year lithium carbonate Rincon project in Argentina (AGY 77.5% interest), which is on track for production in coming months, making it only the second ASX listed producer of battery quality lithium carbonate, after **Allkem (AKE)**.

The capacity is comparatively small and deliberately so, with the focus on quality. The next phase is an expansion to 12k tonnes a year, the key to which is funding and off-take agreements.

We estimate the capital cost to be US$200m on the basis of AKE's Sal de Vida and Olaroz stage 2, both in Argentina. Funding options include debt, potentially provided by off-takers, a selldown in equity in the project, or an equity issue. Most likely, the company will pursue a combination, which we have factored into our valuation.

RADAR RATING: Commissioning of Rincon lithium project in coming months, making AGY the second listed battery quality lithium carbonate produce on the ASX.

RADAR RATING: **SPEC BUY**

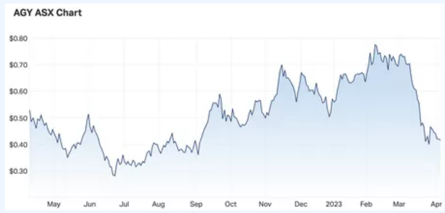
ASX CODE **AGY**

CURRENT PRICE **$0.405**

MARKET CAP $567M

DIVIDEND YIELD 0%*

NET CASH ($M) 36.6



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PRICE ($) 0.40

** Benchmark Mineral Intelligence*

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AUSTAL

SECTOR MANUFACTURING **INDUSTRY** SHIPBUILDING

Shipbuilder

Downgrade to Hold

After newspaper reports over the weekend, Austal announced that three executives, two former and one current, of Austal USA had been indicted (charged) by the US Department of Justice for making or enabling false and misleading statements in relation to the performance and financial condition of Austal USA between 2012 and 2016. Civil charges had also been filed by the SEC. The stock fell by a few percentage points, but has since stabilised. How serious is this?

Austal and its then CEO had previously been fined $650k in Australia arising out of the same general complaint, which involved failing in June 2016 to ensure that the market was informed that there was likely to be a write-down in one of its US Navy shipbuilding programs. The SEC alleges that for up to three years, revenue recognition and cost allocation policies were not being correctly applied and earnings were overstated as a result. The US regulator is concerned about damages suffered by US investors in ASB. The company itself has not been charged, but there have been suggestions that ASB might be barred from future contracts with USN, by far its biggest customer.

This action has been known for some time, yet the US Coast Guard still awarded a huge potential multi-billion contract to ASB in mid-2022. The company that lost that contract has been using all of its significant political clout to attempt to overturn this award, and this action serves those efforts.

Clearly there are questions that need to be answered in relation to future USN and USCG contracts. Until those answers are clear, we have to take a more cautious approach, and downgrade our recommendation which we had upgraded to Spec Buy only recently. We thought that most of the potential downside if the current large contract award was reversed had already occurred. What we had not counted on was the possibility ASB could lose all future USN business. This is a small possibility, however.

ASB's capability in service and sustainment, shipbuilding design and manufacturing, are simply irreplaceable in the medium term. If a change is required, one strategic solution would be for a major American defence contractor to buy ASB, which continues to generate profits. Other shipbuilding contracts are up for grabs, and the stock still looks cheap - subject to there being no existential resolution to the current controversy.

RADAR RATING: Charges relating to accounting misstatements against former Austal USA executives have muddied the waters. But there are a number of potential contract awards that could clear the picture.

RADAR RATING: **HOLD**

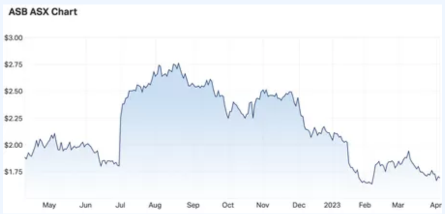
ASX CODE **ASB**

CURRENT PRICE **$1.67**

MARKET CAP $614M

DIVIDEND YIELD 4.7%*

NET CASH ($M) 58



DATA AS AT INITIAL COVERAGE:

DATE 12 JULY 2012

PRICE ($) 1.60

**Forecast 8 cents*
PORTFOLIO
The Under the Radar Report Portfolio has 5000 shares in ASB, c. 6% of the portfolio
The Idle Speculator retains a holding in ASB in his SMSF.

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CATAPULT

SECTOR SERVICES **INDUSTRY** SPORTS ANALYTICS TECHNOLOGY

Sports Analytics Technology

Upgrade from Hold

After disappointing on profitability in the first half for the six months to 30 September (Issue 525, 24 Nov 2022) we were right to downgrade to hold. Catapult's stock has more than halved since this time last year, but an update by the sports technology provider indicates that there is a light at the end of the tunnel.

We did well to take profits at $2.09 in November 2019 and acknowledge that we are underwater on our most recent buy recommendation, but the 10% boost on its update last week indicates improving profitability.

CAT is approaching an inflection point and says that it will not be raising capital, having lost US$25.8m ($38.7m) in the six months to 30 Sep 2022 and net cash halving over six months to $20m.

The positive news is driven by its acquisition for US$45m of sports software video solutions provider, SBG (Issue 453, 1 July 2021) which is boosting annualised contract value (ACV) towards its aim of US$100m (A$150m) in the current fiscal year (FY24) which began on 1 April. This is 30% above level of US$70m at 30 September 2022. At US$100m, the company makes a cash profit margin of around US30cents on every $1 of revenue. Moreover, the business now aims to be cash flow positive in the current fiscal year.

SBG's "MatchTracker" product has been successfully rolled out to F1 teams, which use it to make decisions in real time, based on the data it spits out. The product is being trialled in other sports where there is strong competition from incumbents, such as US based Hudl.

RADAR RATING: Now that we can see a line of sight to CAT being cash flow positive our confidence has been boosted. The group also looks very cheap, trading just over 1 times sales.

RADAR RATING: **SPEC BUY**

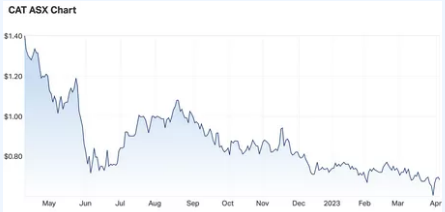
ASX CODE **CAT**

CURRENT PRICE **$0.68**

MARKET CAP $167M

DIVIDEND YIELD 0%*

NET CASH ($M) 20



DATA AS AT INITIAL COVERAGE:

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PRICE ($) 1.22

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CYCLOPHARM

SECTOR MEDICAL TECHNOLOGY **INDUSTRY** RADIOLOGY SERVICES

Medical Technology

Upgrade from Hold

Cyclopharm's stock has so far spiked almost 30% on news that the US medical regulator, the FDA, is closer to making a decision on the approval of Cyclopharm's nuclear medicine solution "Technegas" used for identifying Pulmonary Embolism (PE). Expectations are that Technegas will be sold in the US later this year. We were hoping for mid-2023, but the recent market reaction highlights the importance of the achievement no matter when it happens in 2023 or 2024.

CYC is washing its face financially speaking, so this announcement really does have the potential to supercharge earnings due to the US market's large size and because CYC's cost base is relatively fixed, giving the company a great deal of operating leverage.

The company has lodged a submission, initiating the FDA's six-month review process, the final major approval hurdle for Technegas in the US. The PE market alone is worth a US$180m a year, but CYC has ambitions for Technegas to be used in multiple indications, including chronic obstructive pulmonary disease, lung cancer, asthma and long Covid.

It has been a longer road than we had anticipated for CYC with the FDA throwing up a number of hurdles, but CYC's response has reinforced our faith in the reliability of the group's Technegas product, and its ability to scale up at the end of this year, when it counts. CYC is already in preparation mode in the US and currently sells Technegas to 64 countries. It is already being applied to 14 different indications, including Long Covid, demosntrating that "Beyond PE" is not simply wishful thinking on the part of management.

RADAR RATING: The spike looks impressive on a one-year chart of CYC, but remains at half its early 2021 levels. Cyclopharm still has a long way to go to fulfil its potential, but we believe that the fact it is trading on under 7 times sales is not reflected in its current valuation.

RADAR RATING: **SPEC BUY**

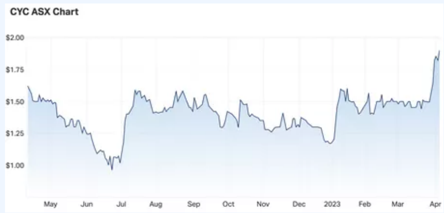
ASX CODE **CYC**

CURRENT PRICE **$1.89**

MARKET CAP $178M

DIVIDEND YIELD 0.5%*

NET CASH ($M) 20



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**Forecast 1 cent*

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QUICKSTEP

SECTOR MANUFACTURING

INDUSTRY MANUFACTURER OF CARBON COMPOSITE PARTS

RADAR RATING: **HOLD**

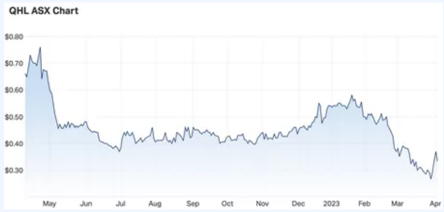
ASX CODE **QHL**

CURRENT PRICE **$0.36**

MARKET CAP $24M

DIVIDEND YIELD 0%*

NET DEBT ($M) -12.4



DATA AS AT INITIAL COVERAGE:

DATE 09 FEBRUARY 2016

PRICE ($) 1.40

Manufacturer of carbon composite parts

Quickstep is the largest independent producer of aerospace components in Australia, specialising in composites, or carbon fibre made products.

Profits have been under pressure due to industry wide supply chain disruption, skilled labour shortages, and equipment reliability issues in QHL's repair business for aftermarket and restructuring costs. The share price rebounded this week on news that QHL expects a smoother ride in the current calendar year.

In the interim result (1H23) revenue was slightly lower than the prior year at $45.4m, producing operating earnings (EBITDA) just above breakeven and a loss after tax of $2.0m. Revenue from the core Aerostructures business was $42m, delivering a gross profit of $7.0m. Aftermarkets and Applied Composites were loss making.

QHL restructured and reduced costs during the period and forecasts significantly stronger profits from Aerostructures (mainly military aircraft parts) in the current half as production deliveries return to historical levels. Although there is uncertainty in the timing of volumes reaching planned levels, major airlines remain very supportive of an on-shore MRO (Maintenance Repair and Overhaul) facility.

The Applied Composites business secured additional orders from Swoop Aero, Carbonix and Spright in 1H23. Production volumes continue to ramp up and further capacity was added in Geelong.

QHL has withdrawn its FY23 financial guidance.

RADAR RATING: Strong potential in its Applied Composites business but early stage. Aerostructures and Aftermarket expected to have a stronger second half.

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REGIS RESOURCES

SECTOR GOLD MINING **INDUSTRY** GOLD PRODUCER

Gold producer

Regis has finally received State approval for its McPhillamys Gold Project, near Blayney in the Central West region of New South Wales. The mine is one of Australia's largest undeveloped open pit resources, but the big question mark is on the cost and funding side. By the time it comes online in a few years' time, RRL's Duketon North mine will have closed. McPhillamys simply replaces Duketon's production, with a marginal overall increase. A capital raising is probable later in the year.

Regis acquired the project from joint venture partners Newmont Mining and Alkane Resources in August 2012 for a consideration of $150m, payable in Regis shares at a price of $4.20 per share. It has taken over 10 years to obtain approval for the development of the project.

RRL will need to incorporate the conditions of approval into a finalised feasibility study. This study is expected to lead to a higher revised capital cost for the project. This will require completion of a funding strategy. At this stage, the schedule for the development of the project and first production has not been finalised.

McPhillamys has an above average mineral reserve of 2.0m ounce with a 9 year mine life but until we know updated costs from the 2017 figure of $215m, it cannot be valued with much certainty. Estimates have been made at $500m.

RADAR RATING: McPhillamys approval a big plus, but feasibility study needs to be completed. A capital raising is probable.

RADAR RATING: **HOLD**

ASX CODE **RRL**

CURRENT PRICE **$2.155**

MARKET CAP $1.59BN

DIVIDEND YIELD 0.5%*

NET DEBT ($M) -190.4**

DATA AS AT INITIAL COVERAGE:

DATE 31 OCTOBER 2020

PRICE ($) 5.09

**FY23 forecast 1.0 cents*
***Debt at 31 December 2022*

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SAMPLE: Best Stocks to Buy

We cover 10 Stocks on our Best Stocks to Buy list. These are quality companies with the best risk/reward return. Our average return over the past 11 years is 77.7%.

Best Buy 1 (BB1) — SPEC BUY

INDUSTRY	**CONSTRUCTION SERVICES**
MARKET CAP	**$203M**
DIVIDEND YIELD	**4.5%**
12 MONTH HIGH	**$0.82**
PRICE @ 2023-04-05	**$0.80**

WHY WE LIKE IT

Firing on many cylinders. Organic growth across all divisions. Market shares gains and price increases. Higher margin business growth driven by engineering and design teams. It has upgraded its earnings 3 times this year. Attractively priced.

Best Buy 2 (BB2) — SPEC BUY

INDUSTRY	**MANUFACTURING, MEDICAL TECHNOLOGY**
MARKET CAP	**$201M**
DIVIDEND YIELD	**1.7%**
12 MONTH HIGH	**$1.47**
PRICE @ 2023-04-05	**$1.21**

WHY WE LIKE IT

Exposed to global secular growth trends assisted by regulatory tailwinds, with long term contracts supporting the business and allowing margins to expand. Investors will find this more attractive as other companies face cyclical downturns.

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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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