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Stocks Down Under

'The one thing you shouldn't do is try to tell a cab driver how to get somewhere'.

- Jimmy Fallon (1974), US TV host

A2B Australia: Cabcharge redux

Stocks Down Under rating ★★★★

ASX:A2B **Share price: A$ 1.45** **Market cap: A$ 176M**

It used to be a license to print money. Cabcharge Australia was the Sydney-based company that held a virtual monopoly over non-cash payments systems used by taxi networks in Sydney and Melbourne. Then along came Uber and, in disrupting the taxi industry, also overthrew Cabcharge. The company, however, refused to lay down and die. Now reinvented and growing profitably as A2B Australia, it's once again creating shareholder value.

Company Share Price Chart

Source: Tradingview

If there's one industry that has been creatively destroyed before our eyes in just one short decade, it's taxis. It used to be that in most countries around the world you were breaking the law if you offered taxi-like services that competed with licensed taxis. If there's one thing people hate, it's a lack of choice, which is why, when Uber came along from 2009, passengers started moving in increasing numbers to the law-breakers, until the regulators bowed to market forces and declared ride sharing 'legal'.

Cabcharge had been resistant to change

In Australia one company that was seriously taken down with the disruption of the taxi industry in Australia was Cabcharge. That company not only had a virtual (and hated) monopoly on inefficient payment systems used in taxis, it also owned several taxi networks itself. And it was somewhat resistant to change, as evidenced by the fact that in 2012, when Uber arrived in Australia, its CEO was still founder Reg Kermode, then aged around 85. From 2012 Cabcharge's business began to show cracks and by 2015 its share price was falling heavily.

Remarkably, under the new name of A2B Australia, which it adopted in November 2018, Cabcharge is still around, having reinvented itself in the wake of Uber. Heading the reinvention process was Andrew Skelton, who became CEO in June 2014 after Reg Kermode's stepped aside for cancer treatment (Kermode died soon afterwards). We believe Skelton was in his early 40s at the time.

Cabcharge has now reinvented itself

Basically, Skelton and his team took the view that taxis wouldn't die in Australia if the process of booking and paying for a ride became as easy as Uber had made it, and if the passenger experience was as favourable. The answer was a heavy investment in technology, marketing and fleet to make all that possible.

The result today is that you still see lots of A2B's cabs on the streets, mainly under the 13Cabs and Silver Service brands. In order to stay competitive A2B mandated that from January 2019 the vehicles be no older than six years. Like Uber, there's easy-to-use apps that allow the cabs to be booked and paid for. And the payment terminals for people who just hailed the cab work like payment terminals are supposed to work in the year 2020 – efficiently and with no hassles. The advantage for A2B is that its cabs don't come with surge pricing like Uber does.

Net cash on the balance sheet, and free cash generated

FY19 showed the fruits of A2B's five-year reinvention process. The market didn't like the FY19 result, marking the stock down from $1.77 on 21 August to $1.40 on 2 September because EBITDA only rose 5%, to $36m, on a 7% increase in revenue to $198m. That wasn't bad for a company that should have been in terminal decline by now, but what the naysayers really missed was the fact that A2B is now taking its MTI taxi dispatch systems to the world, and is also looking at acquisitions in the personal transport space including taxi networks. The New Cabcharge has been able to make the transition from the Old Cabcharge while keeping net cash on its balance sheet (it was $16.5m as at June 2019) and still throwing off free cash ($11m in FY19 and $15m in capex).

Currently A2B Australia is trading on a P/E of 12.6x FY20 earnings, dropping to 11x FY21. You can tell A2B is inexpensive, at least in the eyes of the CEO, because on 29 November Andrew Skelton bought 14,000 shares at an average price of $1.56. A small investment, but a signal that the man in charge of the turnaround is satisfied with how it is going.

Huon Aquaculture: Jellyfish survivor

Stocks Down Under rating

ASX:HUO **Share price: A$ 4.52** **Market cap: A$ 410M**

If you're looking for a 21st Century growth industry to work in and you like the outdoors, then aquaculture could be the one for you. With world seafood consumption rising at roughly twice the rate of population growth, there's plenty of demand out there for the product. That creates opportunity for companies like Huon Aquaculture, a fully-integrated producer of salmon and ocean trout from various marine farms around the state of Tasmania. We predict a solid FY20 for that company.

Company Share Price Chart

Source: Tradingview

Aquaculture is simply farming where the product being raised is fish or another kind of seafood. It's the way the world gets around half of all its fish these days, the other half being old-fashioned 'capture'. What's interesting about aquaculture is how fast the sector is growing. Between 2011 and 2016, according to the Food and Agriculture Organisation, capture fishing yielded a predictable 90-93 million tonnes of fish around the world. In 2011 aquaculture yielded 62 million tonnes but by 2016 the figure was 80 million tonnes. Basically, the only way fish supply is keeping up with demand is through marine farms like Huon's.

A fish producer from clean and green Tasmania

Huon Aquaculture is so called because its original marine farms lay in the estuary of the Huon River, offshore south-eastern Tasmania. The company's headquarters are in a tiny town called Dover, population 500 or so, around an hour's drive south of the Tasmanian capital, Hobart. Huon Aquaculture also has marine farms in Macquarie Harbour on Tasmania's West Coast and in Storm Bay off the southeast coast near that famous tourist attraction, Bruny Island. Huon Aquaculture is 'fully integrated' in that it doesn't just raise the fish, it also develops brood stock for egg production and operates processing facilities to prepare the harvested fish for the market. Brand wise Huon is well placed because Tasmania is one of those places in the world with a reputation for being 'clean and green', and Huon is able to leverage that in marketing its fish.

In aquaculture, anything that can go wrong, will go wrong

The thing to understand about aquaculture is that, like its cousin agriculture, the long-run outlook is favourable because more people on the planet want to eat well, but in the meantime anything that can go wrong, will at some stage go wrong. The year to June 2018 had been a great one for Huon, and the company had hauled in close to 23,000 tonnes of fish. However, the southern summer of 2017/18 had been too long and hot, and elevated water temperatures meant lower fish growth. Huon initially thought it would only get 20,000 tonnes. Then in November 2018 a jellyfish called the 'moon jellyfish' invaded the company's growing areas in the Huon River and the body of water near it (the D'Entrecasteaux Channel), killing and maiming Huon's fish as they went. That cut the tonnage expected to 19,000 tonnes in May 2019. In the end Huon's tonnage was 18% lower and while its revenue was only down 11% due to improved fish prices, EBITDA fell 34% to $47m, since Huon's fixed costs tend to be high and fish mortality also added extra costs.

There's good news too

That was the bad news. The good news for Huon coming out of a bad FY19 was that FY20 and FY21 were expected to see tonnage increases of 25,000 and 30,000 tonnes respectively, with good prices expected in FY20. So, while Huon stock has been mostly trending down since the moon jellyfish bloom of late 2018, we see potential for it to now turn around. Obviously, Mother Nature will have to agree but every now and then she is known to play along with Huon. The current year could be one of these times. Huon Aquaculture is currently trading on a P/E of 17.5x FY20 earnings, but that drops to a mere 11.6x in FY21. We think the proximity of FY21 will help Huon to re-rate.

Air New Zealand: Don't fly to Wuhan

Stocks Down Under rating

ASX:AIZ **Share price: A$ 2.78** **Market cap: A$ 3.23BN**

Now is not a good time to be in airline stocks, not even the stocks of well managed airlines like Air New Zealand. That's because epidemics coming out of China tend to be bad for the airline industry, as the SARS epidemic of 2002 and 2003 showed. The Wuhan Coronavirus epidemic, which has resulted in thousands of confirmed cases worldwide since its emergence last month, and more than 50 deaths, has the potential to be another SARS. Auckland may be a long way away from Wuhan but we believe Air New Zealand will not escape unaffected.

Company Share Price Chart

Source: Tradingview

Ordinarily Air New Zealand is a pretty great airline to be invested in, returning 15% p.a. on average in the decade to June 2019. And no wonder. The aviation research firm Skytrax placed Air New Zealand 16th on its list of the world's best airlines, as rated by passengers, in 2019. When the passengers like their airlines enough, they can generally grow top line revenues quite smartly. In FY19 Air New Zealand carried 4.5% more passengers and improved its passenger load factor by a percentage point, to a very high 83%. That helped operating revenue rise 5%. However, it didn't stop EBITDA from falling 31% as a result of higher fuel costs, but there have been years when virtually the reverse happened, such as 2016.

Across the cycle Air New Zealand is one of those airlines that can generally earn more than its cost of capital, which makes it a candidate for a re-rating when times are good. The trick is to buy the stock when there are a lot of headwinds and sell when there are tailwinds.

A big headwind has just blown out of Wuhan

Wuhan Coronavirus is likely to be one of those headwinds. During the 2003 SARS epidemic around 8,.000 people became sick and 774 died. Between late January 2003 and late April 2003 Air New Zealand stock dropped by quarter, and while some of that fall may be due to the Iraq War commencing on 20 March 2003, a lot of it was due to SARS, which came to the public's attention around 12 March 2003 via a World Health Organization global alert.

Indeed, on 23 April 2003 CNN reported '*Air New Zealand has made more cuts to capacity and downgraded its earnings outlook as the SARS outbreak continues to wreak havoc on Asia Pacific airlines. The New Zealand airline, which had to be rescued from potential bankruptcy in late 2001 by the New Zealand government, said Wednesday it expects its earnings in 2002-03 to fall to NZ$200 million because of the loss of passengers…This represents a decline of 13 percent from earlier estimates.*'. Don't be surprised if we see this sort of reporting again.

A slightly overvalued airline

The good news is that this virus will probably have burned itself out by the middle of the northern summer, as SARS did, through effective and co-ordinated public health awareness campaigns and the widespread use of facemasks. However, it will put a dent in the next couple of quarters for many airlines that fly to and from China, which includes Air New Zealand. China is the second biggest source of inbound tourism into NZ and Air New Zealand has flights to Beijing and Shanghai.

Air New Zealand is currently trading on an FY20 P/E of 11.1x forecast FY20 earnings and 9.8x FY21. The current P/E for airlines in the S&P500 is around 9x. That suggests the potential for weakness in Air New Zealand's share price in the near term. Should a passenger show up on an Air New Zealand flight with symptoms of the new virus, expect the market to get very panicky.

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