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# Stocks Down Under

***'A dollar won is twice as sweet as a dollar earned'.***

*- Edward 'Fast Eddie' Felson, played by Paul Newman, in* The Colour of Money, *1986*

## SkyCity: You gotta know when to fold 'em

**Stocks Down Under rating** ★★

**ASX:SKC Share price: A$ 3.62 Market cap: A$ 2.46BN**

Yesterday we sounded a note of caution with regard to Air New Zealand and the impact which the Wuhan Coronavirus epidemic will likely have on that airline's business over the next few months. Today we are going to put the spotlight on another company that might be impacted – SkyCity Entertainment Group, a New Zealand casino operator.

**Company Share Price Chart**


***Source: Tradingview***

Type in the word ‘Auckland’ to the images section of a Google search and the needle-like Sky Tower will jump out of the photograph – this iconic building is the tallest in New Zealand and the most noticeable element of the skyline in New Zealand’s largest city. Underneath Sky Tower is SkyCity Auckland Casino, flagship of SkyCity Entertainment Group with 2,100 or so EGMs (Electronic Gaming Machines, what they call ‘pokies’ in Australian and Kiwi vernacular) and 150 gaming tables. Okay, it’s not the Venetian in Macao or MGM Grand in Las Vegas, but in FY19 this casino and entertainment complex still raked in NZ$606m in the year to June 2019 and EBITDA of NZ$268m.

## SkyCity Auckland visitor numbers have to be dropping right now

SkyCity owns three integrated casino and entertainment complexes in New Zealand – in Hamilton and Queenstown as well as in Auckland – and another in the Australian city of Adelaide. A $330m expansion of the Adelaide Casino will be completed this year, however it’s still only SkyCity Auckland that really matters because that property generates roughly four-fifths of the company’s earnings and is likely to suffer if visitor numbers from China, and Asia generally, suddenly drop this year.

SkyCity grew its total revenue from continuing operations by 5% in the year to June 2019, to NZ$1,030m, but just about all that growth came from a 19% increase in IB or ‘international business’, which is the money that was taken in from overseas visitors to SkyCity’s casinos, mostly Auckland. In FY19 IB was close to 20% of revenue, so a downturn in international business of the kind that could result from the Wuhan Coronavirus is serious for SkyCity.

## Too many gaming machines at SkyCity Auckland?

The other problem that SkyCity Auckland right now is the fact that, for non-IB traffic, it has become more reliant on EGMs rather than tables, where the big money is. EGM revenue in Auckland grew 7.4% in FY19. We think that hints at a weakening of the property's value in recent times.

Next door to the Auckland casino, SkyCity is still dealing with the fallout from the October 2019 fire at the New Zealand International Convention Centre. This new property had been expected to be completed before the end of 2019. The fire might put off the date in which the centre can hold conferences for a couple of years.

Currently SkyCity is trading on a PE of around 17x, which is expensive given the low top-line growth. Balanced against that is the fact that gearing is low (net debt to EBITDA of only 1.5 as at June 2019), the comfortable dividend yield of 5.3%, and the safety net of a recent 5% share buyback. That said, we think that the Wuhan Coronavirus will ensure that SkyCity shareholders go on at least a short-run losing streak at the tables in the second half of FY20.

# Piedmont Lithium: Tar Heel upside

**Stocks Down Under rating** ★★★★

**ASX:PLL Share price: A$ 0.12 Market cap: A$ 101M**

As we've noted a number of times in recent days, the battery mineral lithium is set to make a strong comeback sometime in the next couple of years. 2019 was tough, and 2020 is probably the transition year in terms of pricing as marginal production comes off the market. But 2021, we argue, is when the good times *really* come back for the sector, for both hard rock and brine producers. Among the players whose stocks are recovering in advance of that is Piedmont Lithium, which is developing a lithium project in the US state of North Carolina.

**Company Share Price Chart**


***Source: Tradingview***

Piedmont Lithium sits on a number of spodumene properties not far from Charlotte, NC, a major urban centre in the southern part of the Tar Heel State that ranks as America's 16th largest city and, according to *US News and World Report*, one of the country's best places to live. Spodumene is the lithium-rich mineral which is the main source of hard rock lithium and this part of North Carolina has a long history of mining tin and lithium. They called the company 'Piedmont Lithium' because the Piedmont is the plateau running through North Carolina that separates the Atlantic coastal plain from the Appalachian Mountains. Confusing to non-Americans who think that the real Piedmont is the region of northwest Italy, capital Turin, but at least it sounded better than 'Tar Heel Spodumene'.

## A future lithium hydroxide producer

Piedmont Lithium's business plan is pretty simple – mine the spodumene in Gaston County, NC; convert it in next door Cleveland County into the high value lithium hydroxide that battery makers are going to want more of it the years ahead; and sell it to all the nearby Electric Vehicle makers who intend to produce in the United States in the years ahead.

Sounds crazy, right? Why would anyone want to do that in an expensive place like the United States? Well, for one thing, they still make a lot of cars in America – about 11 or 12 million units a year over the last few years – and a lot of that manufacturing happens in the more 'pro-business' parts of the country not far from North Carolina. And, as Tesla has shown, the economics of Electric Vehicles and their batteries is such that they, too, can be made in America. On top of all that, battery makers are now becoming concerned about where they source their lithium and would prefer it to be produced in an environmentally sustainable manner close to home. Throw in the fact that it's easy to get talented workers to move to the greater Charlotte area and Piedmont Lithium believe that that the economics of making battery-grade lithium hydroxide in North Carolina are more than sound.

## US$1.45 billion in net project value just waiting to be unlocked

An updated scoping study released in August 2019 suggested just how economic the Piedmont Lithium Project could be – spend US$168m to bring into production a mine yielding 160,000 tonnes a year of 6% spodumene concentrate, then use initial cash flows from that operation to build the lithium hydroxide plant producing 22,700 tonnes a year from year 3 through to year 25 of the project, and pretty soon you've got valuable battery-grade metal at an All-In Sustaining Cost of only US$3,600 a tonne. At reasonable medium-term lithium hydroxide pricing, the after-tax NPV from this integrated operation comes in at a cool US$1.45bn at an 8% discount rate, which is A$2.13bn at the current exchange rate. High cotton, as they say in the American South.

This new study has helped boost the stock off the 2019 low from 3 October at 9 cents. However Piedmont Lithium is currently trading at only 5% of that NPV. Obviously, there's DFS and financing required before the project comes to life, so the market is treading lightly in this story at the moment. However, we can see several reasons why the story can come to life sooner rather than later.

## A Definitive Feasibility Study late this year

The DFS is expected to be completed in late 2020 which could lead to financing in 2021. As we noted above, the proximity of Charlotte to car makers and domestic 'gigafactories' is a big plus for obtaining this financing. Another positive is the pro-business state of North Carolina, which has a corporate tax rate of just 2.5%, contributing to an effective tax rate for Piedmont Lithium of just 23%. In addition to all this, North Carolina has low costs on just about every input to the project, belying the notion that the US is an expensive place to do hard rock lithium.

At least one investor has backed this story at current prices. Director Jorge Beristain bought 851,000 shares on market at an average 13.3 cents a share on 10 January. We salute his foresightedness.

# Australian Dairy Nutritionals: Organic milk may one day be good for you

**Stocks Down Under rating**

**ASX:AHF    Share price: A$ 0.097    Market cap: A$ 36M**

Back on 27 May 2019 you could buy the stock of the Brisbane-based organic dairy company Australian Dairy Nutritionals at 19 cents a share. As of 14 January, it's under 10 cents, having broken a resistance level that was set in June 2017 and confirmed in March 2018. Recent on-market buying by Chairman Martin Bryant on 14 and 15 January at 10 cents hasn't turned the sentiment tide. What gives? Well, possibly investors have just got bored with the story for a while. Everything seems to remain on track for Australian Dairy Nutritionals in terms of its transition to 100% organic dairy company.

**Company Share Price Chart**


***Source: Tradingview***

Australian Dairy Nutritionals owns several dairy farms in southwestern Victoria near the town of Warrnambool producing around 17 million litres of raw milk. At the time of the company's 2014 listing the aim was simply to aggregate dairy properties to achieve economies of scale. In 2015 it acquired the Camperdown Dairy Company, a dairy processor located in the Victorian town of the same name, 190 km west of Melbourne. Then in July 2017 it unveiled a strategy that would take the dairies and the Camperdown processing operation down the path of organic dairy products where the company believed pricing and demand would be strong in the medium-to-long term. A name change from Australian

Dairy Farms Group to Australian Dairy Nutritionals Group went into effect in December 2018 to reflect this change.

## Organic growth

Definitions of 'organic' tend to vary but in broad terms 'organic' dairy products are those where the original milk came from cows that weren't fed antibiotics or hormones and eat pasture supplemented, if necessary, by feed that was grown without chemical fertilizers, pesticides or genetically modified seeds. Consumers in many countries will pay good money to buy organic dairy products, with retail premiums of up to 50%. Globally close to 1% of all milk produced is organic so the market definitely exists, albeit at present in niche form. Even in Australia it's probably 0.7%. Australian Dairy Nutritionals believes it is getting close to creating a profitable company out of this niche.

The road to organic has involved certifying the farms and converting Camperdown over to making organic milk and other products like yoghurt and butter. Camperdown started the switch during FY19, while the first farm certification happened in November 2019 when 'Yaringa', at Nirranda, 35 km southeast of Warrnambool, was certified. The other farms will follow by 2021. Camperdown will progressively widen its range or organic products over the next few years, with a move into organic infant formula business this year very important given the known strong global demand for organic in that category. Australian Dairy Nutritionals bought an infant formula plant in May 2019 – the reason for the share price peak at 19 cents - and is now commissioning it at Camperdown.

## Watch and wait

The trouble for Australian Dairy Nutritionals now is how to stand out from a range of smaller producers who are also pushing into the organic space. We liken organic dairy today to craft beer several years ago. We all knew there was growing demand for craft beer. It just wasn't clear which craft brewers could expand beyond the 'brewpub' stage and grow into 'real' businesses with strong brand recognition beyond a small local market, like what Gages Roads Brewing (ASX: GRB) has achieved in recent years.

Australian Dairy Nutritionals finds itself at a point not unlike Gage Roads Brewing around 2009. It's one reason why the stock has been dropping since May – the market is wondering if it can make the leap. We believe it can. If we see another reduction in the company's loss at the half year it will be evidence that the move to establish itself in organic is succeeding. We think this company has the smarts to make the transition. However, given the weakness in the share price for over six months now, it's wise to be a little cautious in the near term

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