15 January 2020

Stocks Down Under

'Formula for success: rise early, work hard, strike oil'

- J. Paul Getty (1892-1976) oil magnate

Revasum Inc - Playing the semiconductor cycle

Stocks Down Under rating ★★★★

ASX:RVS Share price: A$ 0.65 Market cap: A$ 50.6M

Semiconductor equipment maker Revasum has been taking a pounding since its listing on the ASX late last year and is now trading around A$0.65 per share. The recent revenue warning, which was driven by order delivery pushouts by customers, certainly didn't help in turning things around. We believe, however, that this stock should be seen for what it is, i.e. a highly cyclical semiconductor stock that is suffering from the current downturn in the industry. But if there's one thing we've learned in the last twenty years of following the semiconductor industry, it's that it ALWAYS bounces back … hard.

Company Share Price Chart

Source: Tradingview

The semiconductor industry is known for its extreme booms and busts, largely driven by overinvestment in capacity during the boom years. Once the cycle turns negative due to oversupply of computer chips and/or falling demand, Asia-based memory manufacturers in particular keep on churning out chips to cover the fixed costs of their extremely expensive factories, which drives chip prices down even further.

A full cycle, from boom to bust and back to boom, typically lasts between 3 and 4 years. The current downturn started in the second half of 2018 and has been exacerbated by the US-China trade war.

Smart semiconductor investors make their money before the industry actually hits the bottom or the top of the cycle, i.e. they get in or out when the turning point is approaching, usually 6 to 9 months ahead of that actual turning point.

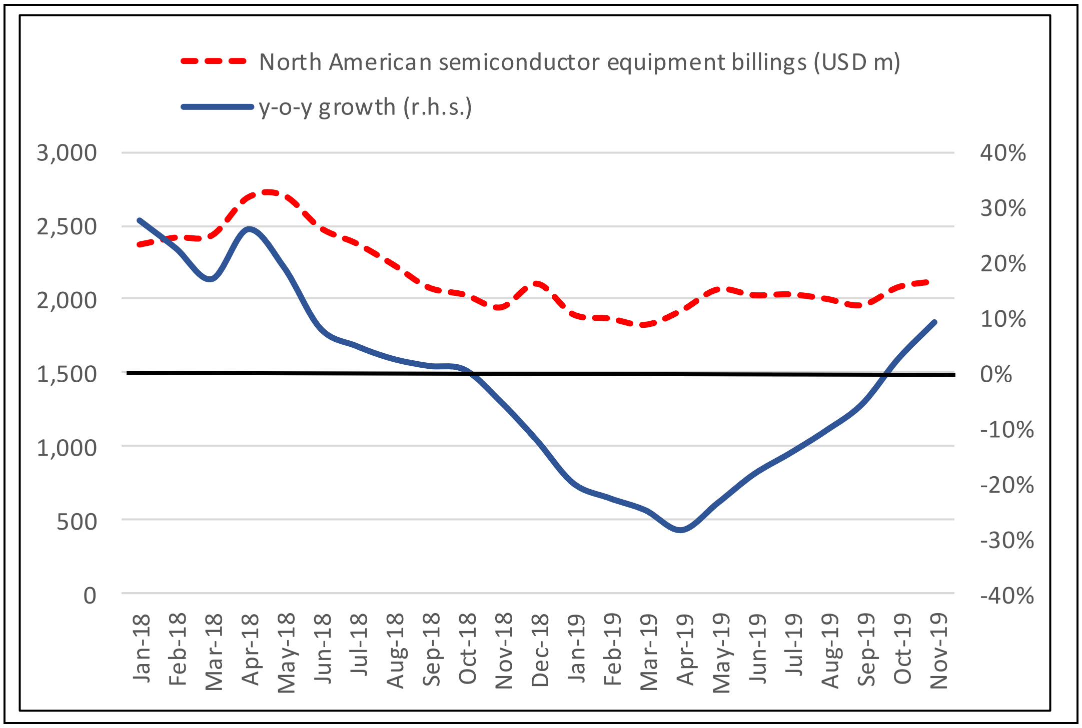
Indications that the cycle is turning

While monthly semiconductor equipment sales have been steady around USD2BN per month in 2019, the industry is about to turn positive again judging by the year-on-year growth rate of semiconductor equipment sales in the US (blue line in the chart below).

From peak negative y-o-y growth of -/- 28.5% in April 2019, North American semiconductor equipment sales look set to start growing again in the current quarter (if blue line >0%). This has traditionally been an early indicator of broader, industry-wide resumption of growth in the global semiconductor industry.

In other words, if anything, we believe now is the time to get into this sector, not out of it.

North American semiconductor equipment billings (USD m) and growth



Source: SEMI

RVS' revenue warning in October triggered a very sharp sell-off, which in itself may seem logical if you're only considering the news of the day. However, in light of recent industry developments, including the early indicator we discussed above, we believe RVS' revenue warning came just before the dawn of a new semiconductor upcycle.

RVS landed the biggest fish in SiC semiconductors, which was totally disregarded by the market

Furthermore, as we highlighted in our recent report on RVS, the company's new product range is geared towards so-called Silicon Carbide semiconductors (SiC) for power management, which are used a.o. in the high-growth electric vehicles market. RVS signed a multi-year deal with the largest player in this space, Cree from the United States, which recently announced a US$1BN Capex plan for the next several years. RVS will be delivering specialty equipment to Cree to manufacture SiC chips. This news was completely disregarded by the market!

In summary, Mr. Market doesn't like RVS right now, but at ~A$0.65 per share we believe investors should be all over this company and not only play the semiconductor upcycle, but also the long-term growth in SiC chips.

How come Mr. Market wants to give away Tap Oil virtually for free?

Stocks Down Under rating ★ ★

ASX:TAP **Share price: A$ 0.13** **Market cap: A$ 53.2M**

Yesterday the team here at Stocks Down Under put together a list of ASX-listed oil and gas companies, both established and emerging. We were curious as to what companies in this space were already undervalued even before the banking system put them on the hydrocarbon blacklist, of which more below. What we found was truly astounding in some cases. Take a look at the table below. There's a number of interesting companies in it where a considerable amount of the market capitalization is in cash, and some where the stocks are trading at less than two times book value.

Four companies jumped out at us on this screen: Tap Oil (ASX:TAP), Karoon Gas (ASX:KAR), Metgasco (ASX:MEL) and Cooper Energy (ASX:COE).

Company Share Price Chart

Source: Tradingview

Tap Oil in particular strikes us as compelling value right now

How compelling? At 13 cents per share on yesterday's close, the 425 million shares on issue capitalized this company at just A$55m. As at the end of September the cash on hand was around A$45m, and there's no debt. That means you get Tap's 30% of the Manora Oil Field in Thailand for a mere A$10m or so. Looking at industrial indicators, we should expect that the central banks keep up their relentless rate cutting diet and back this up with QE. Although one has to wonder with the decline in US capacity utilisation (chart below) that there is ample need to ramp up infrastructure spend.

30% of the Manora Oil Field is probably worth more than A$10m

Manora is an offshore oil field in the Gulf of Thailand, near the point on Thailand's western side where it narrows considerably as it heads down towards Malaysia. The field has been producing since 2014 and currently does around 5,000 barrels a day. Sell it for around US$65 a barrel after hedges and there's a nice margin at the current production costs of around US$30 a barrel.

The reason for the low notional value Mr. Market is putting on Manora is that the field is in decline and, on current reserves, only has around four years of production left. That four years is probably worth more than A$10m, however. Tap's share of 2P (Proved and Probable Reserves) is 2.1 million barrels, which even at a US$20m margin would be worth A$59m gross.

Manora's owners have plans to grow, and the stock is primed to respond

The reason that Tap Oil's current leadership under Executive Chairman Chris Newton has concentrated its efforts on Manora, and rationalized a portfolio of Australian assets, is its belief that Manora can be expanded considerably. In addition to recent workover programme, a number of development and exploration wells are planned.

Any exploration success would likely be well received by the equity market given that oil has had a reasonably good 2019 pricewise.

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