22 January 2020

Stocks Down Under

'I like my money right where I can see it…hanging in my closet.'

- Carrie Bradshaw, in the American television show Sex and the City

Mosaic Brands: Crisis equals opportunity

Stocks Down Under rating

ASX:MOZ Share price: A$ 1.68 Market cap: A$ 161M

It sure as heck wasn't a great way to start the year. The Sydney-based fashion retail group Mosaic Brands had already weathered a tough 2019, with its share price gradually trending down from a high of $3.30 on 8 March to a low of $2.23 on 27 December. Then last week, on Tuesday 14 January, disaster struck – the company announced that comparable store sales in the second half of November and early December were down 8% on the previous corresponding period. The market promptly punished Mosaic with a 17% one-day share price fall to $1.87. It's now down 26% since the end of 2019.

Company Share Price Chart

Source: Tradingview

8% is a significant sales drop off, but there's a good reason for it – a fifth of the company's stores have been directly affected by the bushfires that have recently ravaged the Australian countryside. Mosaic is by-and-large a bricks-and-mortar retailer and is therefore probably in long-run structural decline across most of its brands, but the foot traffic that has been elsewhere since November is likely to come back. Consequently, this crisis for Mosaic looks like opportunity for investors.

Do it for me, Noni B

Mosaic Brands is a retail company that, like all smart retailers today, is in the process of reinventing itself. You may know it by its old name, which was Noni B until November 2019. The company owns nine different chains mostly focused on ladies' fashion – the original Noni B chain, as well as other chains of long-standing that you'll see in any significant shopping centre in Australia such as Rockmans. What most of the nine chains have in common is a customer base of women over the age of 50 who like value for money.

We think that demographic is the reason that Mosaic can come back from the bushfire crisis of 2019/2020 - older women tend to be less mercurial in their spending habits, and a lot more loyal to the retail brands they know. And since Mosaic acquired the troubled Specialty Fashion Group for $31m in May 2018 – an acquisition that brought household names such as Millers, Katies and Rivers – the company now more or less owns this category of Australian retail. It took on the new corporate name last year in order to demonstrate this.

Mosaic is going online

Mosaic had a seemingly bad FY19 because same -store sales came down 4%, but that was expected as management were in the process of retooling the new chains that were being integrated. The company still eked out a U$5m EBITA on $882m in sales, and got its online sales, which rose 21%, to a significant 10% of total sales. There's plenty of growth where that came from because there's in excess of 4 million email addresses in the company's collective databases. Older women may not necessarily be on Instagram in 2020 but they are online, and they do buy there. As for the physical stores, they're not just good for click-and-collect, they've also been given a chance to 'jump the shark' (i.e. draw old fans back) with a noticeably new in-store experience. Interestingly, Mosaic reckons it can take its chains into new categories such as homewares, beauty products and luggage.

The risk of this stock is pretty low at this point, not just because there was $7m in net cash on the balance sheet as at June 2019. The P/E of this company on forecast FY20 number is just 5x. One should not try to catch a falling known, but we think it's fair to say that, as soon as the bushfires have been extinguished, there's a lot of women over 50 ready to wander back into the stores with open purses.

Stanmore Coal: Contrarians take note

Stocks Down Under rating ★★★

ASX:SMR Share price: A$ 1.02 Market cap: A$ 259M

Say 'coal' to Australian investors right now, and most want to run a mile. As if weaker pricing in 2019 wasn't bad enough, there's also been a lot of talk in the media about how bad coal is for the future of the planet, and, to top it all, you've had the world's largest fund manager, BlackRock, pledge recently to reduce its exposure to coal as part of a toughened stance on climate change. We think that will create bargains out of many coal producers, since the world continues to need both thermal and metallurgical coal into the foreseeable future to keep the lights on and provide the steel industrial countries always need. One of the coal mining bargains right now appears to be the Brisbane-based Stanmore Coal, which you can now buy for a P/E on FY20 numbers of only 4.6x.

Company Share Price Chart

Source: Tradingview

Want to buy a coal mine for $1?

Stanmore Coal is a producer of the metallurgical coal used in steel making. The company acquired the then-mothballed Isaac Plains mine near Moranbah in the Bowen Basin of central Queensland in late 2015 for a nominal $1. The vendors were the Japanese trading house Sumitomo and the Brazilian mining giant Vale, who had put the mine on 'care and maintenance' in September 2014 because of low coal prices. Stanmore brought the mine back online in 2016. In FY19, 2.4 million tonnes of coal were produced for shipment to customers via the coal terminal at Dalrymple Bay, 180 km away by rail.

Stanmore management has vision

Stanmore's vision proved brighter than Sumitomo's and Vale's over the four years post-restart. In FY19 the company's $403m worth of coal out of Isaac Plains generated $155m in underlying EBITDA. The 2.4 million tonnes of coal in FY19 was more than double FY18's and there's more growth where that came from. Next to Isaac Plains is a large deposit called Isaac Downs that Stanmore intends to bring into production once the relevant approvals, including Environmental Assessment, are received, potentially this year. Isaac Downs is expected to be able to bring unit costs down for the whole operation. Before too long Stanmore expects to go to 5 million tonnes annual production, or possibly 7 million tonnes. Stanmore is well placed to expand. As at June 2019 the company held $91m in net cash.

Metallurgical coal appears to be stabilising in early 2020

Sure, coal prices were weak in 2019, but at least half of Stanmore's sales are contracted to blue chip buyers in Japan and Korea, providing a buffer against spot movements. Also, many expect metallurgical coal to stabilise in 2020 and into 2021, particularly with the US-China Trade War now easing off. That will be great for quality producers like Stanmore.

Stanmore has looked weak, share-price wise, since the $1.54 high of July 2019, largely because of the weak prices for coal in 2019, which has taken the stock down by a third. That's the only note of caution we'd sound at the moment. Should metallurgical coal suddenly show signs of life again this year (and it seems stable at the moment), Stanmore is well placed. Beyond that, we think a victory for the opposition LNP in the October 2020 election would also be good for Stanmore given that party's generally pro-mining stance.

Stanmore Coal is one for the contrarians with a bit of patience. We predict they will be rewarded.

FSA Group: Too far, too fast

Stocks Down Under rating ★★

ASX:FSA **Share price: A$ 1.39** **Market cap: A$ 172M**

Last November and December life got interesting for the shareholders of FSA Group, the Sydney-based company which provides debt management solutions in Australia and also does car and home lending. For the previous twelve months the stock had traded in a very narrow band of $1.00-$1.10. Suddenly in late November it broke out of that band. By 18 December it had got to $1.30 on news that it had raised $200m via an issuer of residential mortgage-backed securities and by the start of this year it was touching $1.50, after which some well-deserved profit-taking kicked is. Which begs the question: is there more where that brief run came from?

Company Share Price Chart

Source: Tradingview

Well, times do seem to be a little bit better for providers of debt management in early 2020. For a while there after the Banking Royal Commission handed down its findings in February 2019 banks were reluctant to pursue debtors too vigorously lest they tar their reputations any more than the Royal Commission testimony already had. FSA has noticed a return to 'normal' since around November, which is good for their business of helping busted debtors consolidate their debts for easier repayment.

FSA is expanding its loan book

FSA is also doing well in terms of increasing its home and car lending book. This grew to $441m at the end of FY19, up 8% on FY18. Most of this expansion was in home loans, where 30-day arrears stayed steady at 1.42%. The arrears on the consumer loan book blew out to 3.4%, from 1.6% previously, but consumer loans are only 13% of the total book, so that's not really worrying. We think the residential mortgage-backed securities issue from last month was important because it provides the capital to expand.

So FSA is doing okay. However, we think that the current share price re-rating has been a little bit too far and too fast, causing the stock to bump into an all-time high previously reached in late 2017 but not break through. It's worth remembering that FSA isn't the only player in debt management solutions in Australia, and it potentially faces some serious competition from the likes of Credit Intelligence (ASX:CI1), a Hong Kong company that developed a strong position in that market in the early 2000s and now wants to expand in Australia and similar jurisdictions.

The failure to break the $1.50 resistance level suggests to us that the market wants to wait and see for a while. FSA isn't expensive but the current P/E of 11x suggests it isn't too cheap either. Probably best to be cautious.

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