25 JANUARY 2020

Stocks Down Under

"O Gold! I still prefer thee unto paper, which makes bank credit like a bark of vapour'"

- Lord Byron (1788-1824), Don Juan, Canto XII

OCEANAGOLD

Hey, where'd our mine go?

AUTOSPORTS

Positive earnings drivers

MONEY3 CORPORATION

Small loans, big earnings growth

OCEANAGOLD

Hey, where'd our mine go?

Stocks Down Under rating: ★★

ASX: OGC
Share price: A$ 2.66
Market cap: A$ 1.68BN

Now is generally a good time for a company to have the word 'gold' in its title. The yellow metal started 2019 at US$1,282 per ounce and ended it at US$1,523 per ounce. Currently it's US$1,558 an ounce and some commentators are seeing US$2,000 an ounce in the medium term. The Melbourne-based mid-tier gold miner OceanaGold, however, hasn't benefitted much from gold's recent good times, mainly because of a disastrous situation in a mine in the Philippines.

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AUTOSPORTS

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Stocks Down Under rating: ★★★★

ASX: ASG
Share price: A$ 1.70
Market cap: A$ 348M

Now, apparently, is not a good time to be an automotive retailer in Australia. In 2019 only 1.06 million new vehicles were sold across the country, 8% fewer than in 2018 thanks to a combination of lending reforms, low wage and house price growth, and drought. And yet, there's one retailer than we think is set to do reasonably well – the Sydney-based Autosports Group, which owns around 37 dealerships in Sydney, Brisbane and Melbourne. The company's distinguishing feature? – the fact that it only deals in luxury brands.

READ MORE

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Share price: A$ 12.01
Market cap: A$ 1.75BN

Next in Stocks Down Under we look at another company enjoying success in the automotive space – Money3, a Melbourne-based provider of small loans that operates in Australia and New Zealand and primarily focuses on car loans. Money3's shares have been running hot since the 5 November low of $1.97. And no wonder. This is a company that increased its gross loan book in FY19 by close to 50%.

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Share price chart

Source: Tradingview

How bad was 2019 for OceanaGold shareholders? The stock closed at $5.23 on 3 January 2019, but by Christmas Eve it was only $2.50. OceanaGold's leadership demonstrated some optimism regarding their company's prospects in November when several directors bought stock on market, including CEO Mick Wilkes. However, that hasn't prevented shorts recently showing up in the stock. Indeed, the short position increased suddenly on 17 January from 1.4% to 2.2% and one suspects there is more where that came from.

Oceana has lost the jewel in the crown

The issue for OceanaGold is Didipio, a copper-gold mine on the main Philippines island of Luzon which produced 115,000 ounces of gold in 2018, or just over a fifth of that year's total output for the company, as well as 15,000 tonnes of copper. Didipio used to be the jewel in the crown for OceanaGold in terms of its cost of production. Measured as All-in Sustaining Cost (AISC) – the direct cost of producing the gold plus the recurring capital expenditure at the mine site – Didipio produced in 2018 at just US$427 an ounce, as against the rest of the OceanaGold group where the AISC was US$863.

We say 'used to be' the jewel in the crown with regard to Didipio because in July 2019 this mine was more-or-less shut down by order of a man called Carlos Padilla, Governor of Nueva Vizcaya, the province in central Luzon where Didipio is located, around 300 km north of Manila. The governor, freshly re-elected in May 2019, regarded Oceana's mine as bad for the environment, and when a provincial court of appeal refused an injunction to stop him, there wasn't much OceanaGold could do. The company didn't even have an official license to operate from the national government because Philippines President Rodrigo Duterte had not pinned his all-important signature to a new 'Financial or Technical Assistance Agreement' (FTAA) that was due for renewal in June 2019. The mercurial Duterte, whose term of office doesn't expire until 2022, is on record as saying he wants to shut down the entire mining industry of the Philippines, so it's fair to say that OceanaGold's prospects of getting its jewel back are not very good.

Not all is lost at OceanaGold

Now, OceanaGold is not a complete disaster. The Haile Gold Mine in the US state of South Carolina plus a couple of gold mines in New Zealand – Waihi in the North Island and Macraes in the South Island – are all solid producers with profitable mine lives ahead of them and no danger of sovereign risk incidents. In 2019 they probably did around 400,000 ounces at an AISC of US$950 an ounce. The trouble is that costs were up at all these mines in 2019. Longer term, all three have major expansions in the works, but these projects will not likely deliver on costs in the near term.

Ordinarily we're bullish on gold miners with a decent medium-term outlook. Here, with Didipio offline for the foreseeable future and potentially a source of commentary for the mainstream media – who love a good Duterte story – we'd be cautious.

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Source: Tradingview

The thing about luxury brands the world over is that their sales tend to be more resilient, in a tough economy, than brands further down the scale. There is something of a flight to quality and the usual customer base tends to be less impacted income-wise during the downturn. We think that's what Autosports experienced in 2019.

Not all car brands are the same

That trend to luxury in a down market would explain why the Federal Chamber of Automotive Industries, which is now the primary tracker of new car sales in Australia after the ABS stopped collecting figures in 2017, noticed a rise in sales in 2019 of BMW (up 1%), Lexus (up 9%), Porsche (up 6%) and Volvo (up 16%) among others.

Now, don't get us wrong. FY19 was still a tough year for Autosports. It's like-for-like new car sales went down 4%, but since the company also sells used cars as well as parts and services, and made acquisitions, the total revenue of $1.7bn was flat. EBITDA was down 16%, to A$52m. However, the EBITDA decline was almost solely about extra costs that the company had taken on to improve dealerships it had acquired or build new ones from scratch. Gross margins actually improved. That would explain why Autosports Group saw its stock jump twice during 2019 – once after the half-yearly result in February when it rose from $1.13 to $1.30, and again after the full year result in August when the leap was from $1.25 to $1.77.

A new car sales recovery in FY20?

We think FY20 can be good for Autosports. The new car market can recover as house prices in Sydney, Melbourne and Brisbane stabilise, and for Autosports a few of the newer dealerships can improve their earnings contribution. Importantly, FY19 was a year when Autosports was dealing with 'WTLP' – the World-harmonised Light-vehicle Testing Procedure, which caused some supply delays in the first half of the year. FY20 is when Autoports believes its dealers can play catch-up.

The other thing to like about Autosports is the continued presence of the Pagents – father Ian and son Nick – who have built this company from two successful Audi dealerships greenfield sites in Sydney in 2006 (at Five Dock in the inner west and Sutherland in the south) to its current large spread of dealerships up and down the East Coast. Ian Pagent has been in the automotive trade for decades and knows the sector back-to-front. Together father and son own 52% of Autosports stock with no plans to move on.

Currently Autosports is trading on a P/E of just 13x forecast FY20 earnings dropping to 10x on FY22 numbers when it's reasonable to expect a recovery in luxury car sales. Seems inexpensive given the resilience of this business.

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Source: Tradingview

Money3 is one of four lenders in Australia that write about 70% of the country's small loans in any one year (the other three are Cash Converters, Nimble and Cash Stop). A 'small loan' is generally defined as one where the principal is $500 to $2,000 and the loan carries a slightly higher cost of finance than conventional loans.

Small loans are a growth market in Australia because the banks have traditionally been too bureaucratic to deal with, and a large segment of the population lacks access to ready cash resources without recourse to borrowing. The small loans industry tends to be frowned on by snooty commentators who see the operators as Scrooge-type usurpers taking advantage of low-income earners. That opens up opportunities for companies with ethical lending practices and trusted brands to grow. Money3 aims to be one of these companies. So far, so good.

Car loans is a large market opportunity

Money3 is actually a little up the quality curve compared to other players like Nimble. As a provider of car loans its average loan size is closer to $9,000. Every year around 2 million used cars get sold in Australia and the market for loans is probably $6bn in size. The car provides a collateral that limits Money3's downside, and there's perhaps 4-5 million Australians who are underbanked but still need a car for daily living. The other thing to keep in mind about Money3 is that the economy is still growing in Australia and unemployment is still low, so there remain plenty of customers to fill that loan book. Money3 took the model to New Zealand last year when it bought Go Car Finance for NZ$16m in March last year.

The naysayers on Money3 will argue that the company's loan book is bad quality because it deals with poor people with poor credit risk. Money3 disagrees, arguing that three-quarters of the loans have low risk of default and almost all of the rest are at only 'medium' risk of default for which the loan book is priced accordingly. In FY19 a mere 1.4% of loans were at high risk of default. Again, that default risk is priced in to the overall cost of finance.

Around 1 in 500 vehicles in Australia have a current Money3 loan

Money3 had a great FY19, growing EBITDA 17% to $48m, off $92m in revenue. What has everyone excited is the loan book. This expanded 48% in FY19, to $348m, to the point where one in every 500 vehicles on the road in Australia now have a Money3 loan attached. The company is talking about a 30% loan book expansion in FY20. That loan book provides a reasonably amount of future earnings visibility, yet the stock is still only on a P/E of 14.4x FY20 earnings, dropping to 11.6x for FY21. That looks to us like a stock investors can press the accelerator on even after the car has gone from 0 to 100 pretty quickly since November.

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