31 MARCH 2020

Stocks Down Under

"The only thing we have to fear is fear itself."

- Franklin D. Roosevelt (1882-1945), American politician and president

AVZ MINERALS

The world's largest hard rock lithium play

SEVEN WEST MEDIA

The Olympics are still on, just not this year

ECOFIBRE

Emerging hemp pioneer

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Stocks Down Under rating: ★★★★

ASX: AVZ
Share price: A$ 0.052
Market cap: A$ 115.5M

In January 2018 the stock of AVZ Minerals was riding high at 36.5 cents, having rallied from the 1.4 cents low the previous January. The Perth-based company was developing what could potentially become the world's largest hard rock lithium mine at a time when the outlook for lithium was bright. Now, in the middle of the Coronavirus Crisis of 2020, you can get AVZ for under 5 cents, but AVZ's Manono Lithium and Tin projects are much further advanced. The only potential downside, but that's manageable, is that the Manono Project is in the Democratic Republic of the Congo.

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ASX: SWM
Share price: A$ 0.073
Market cap: A$ 118.4M

How the mighty have fallen! Back in April 2011 when West Australian Newspapers merged with Seven Media Group to create Seven West Media, this Perth-based company, which owns the iconic Seven television network, saw its stock changing hands at north of $2.60. On 23 March 2020 the same stock closed under 7 cents. The problem is that Coronavirus is causing a reduction in advertising spend and a postponement of productions and has led to the postponement of the Tokyo Olympic Games, which were supposed to start in late July. It doesn't mean that this media play is finished or that it's not transitioning well into a New Media environment. At the right price this stock could be a steal.

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Share price: A$ 1.66
Market cap: A$ 206.7M

In the current Coronavirus Crisis the market is not in the mood to discriminate between companies with 21st Century business models or those hopelessly stuck in the 20th – the stocks of both have been thrown overboard. One 21st Century stock worth considered is EcoFibre, a Brisbane-based company now building a real business selling hemp-based products. EcoFibre's share price has dropped heavily since late November and it's now back close to the March 2019 IPO price.

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Share price chart

Source: Tradingview

Large JORC 2012 resource

As we've argued frequently in the pages of Stocks Down Under, lithium's medium-term future is bright. A decade from now there'll be a lot more Electric Vehicles on the road and the lithium-ion battery factories and other end-users of lithium will be consuming around five times more lithium than the world now produces. That's where AVZ Minerals thinks it has a bright future with Manono, of which it owns 65%

Manono is located in the south-eastern part of the Democratic Republic of Congo (DRC) in a province named Tanganyika because of the nearby lake. Lubumbashi, the second largest city in the DRC and the centre of the country's mining industry, is around 500 km due south. Manono is a truly huge hard rock lithium project that has its origins in an old tin mine developed when the Belgians were in charge.

Hard rock lithium is usually extracted from a mineral called spodumene, which in turn is to be found in a kind of igneous rock called a pegmatite. Manono covers six pegmatites spread over 188 square km, and in just one, called Roche Dure, there's a JORC 2012 resource of 400 million tonnes grading 1.65% lithium oxide.

A lot more where that came from

The upside for AVZ shareholders from Manono is twofold. Firstly, AVZ is currently completing a Definitive Feasibility Study on Manono based on Roche Dure, which it hopes to complete by the middle of 2020, and for which recent metallurgical test work has been encouraging. Secondly, AVZ regularly does drilling at Manono and the potential for further resource increases based on the other five pegmatites is strong. Drilling on one of them, called Carriere De L'Este, prompted the January 2018 share price high and led AVZ to suggest that this pegmatite could be bigger than Roche Dure. One potential issue for AVZ right now is that fact that the Coronavirus has recently shown up in the DRC and, indeed, prompted a lockdown in Lubumbashi.

The Roche Dure scoping study published in May 2019 suggested some strong economics for the Manono project. AVZ deliberately didn't include the potential for tin credits in its analysis, but still came up with a US$2.63bn NPV for the project at a 10% discount rate. The study envisaged a 5 million tonnes p.a. open pit operating over 20 years, which would only use up a quarter of the Roche Dure resource as it was then calculated. The thinking was that AVZ would use a conventional processing technology called Dense Media Separation to produce spodumene concentrate that would be shipped out to global markets via the Tanzanian port of Dar es Salaam.

Things still get done in DRC

The DRC does not tend to be rated highly by mining sector investors, in spite of its being rich in cobalt, tantalum, diamonds, copper and tin, among other minerals. The recent Annual Survey of Mining Companies from the Fraser Institute in Vancouver rated the DRC one of the least attractive mining investment destinations in the world at only 39.2 points versus 92.5 for the state of Western Australia. The issue is not so much the perception that since the fall of Mobutu in 1997 the DRC has been something of a Gangsta's Paradise, but rather the country's stringent and, at times, unpredictable regulations.

That said, foreign investors are still getting stuff done in the DRC, as evidenced, for example, by China's CNMC opening a new copper/cobalt mine earlier this year. AVZ argues that it has a team with a long history of operating in the DRC that knows how to ethically get things done in the country, as evidenced by a January 2020 announcement related to the rehabilitation of a local hydroelectric power station to supply electricity to Manono.

Th Coronavirus Crisis has taken AVZ stock back to a level of around 4 cents where there seems to be strong support. Obviously, the general equity market remains uncertain but the potential for progress at Manono could help AVZ stock buck the general trend. That's why we give AVZ Four Stars at current prices.

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Share price chart

Source: Tradingview

Let's face it, Seven West Media is still an 'Old Media' company against whom the gales of creative destruction continue to blow steadily. It owns the Seven free-to-air television operation that people are expected to watch less and less of in the future. The same goes for the various newspapers and magazines that SWM owns, which are equally in decline. The year to June 2019 certainly fitted this theme, with revenue down 4%, and underlying EBIT down 7.5%, to $212m. Likewise in the December 2019 half; revenue was 3.2% lower and EBIT fell 21%. Seven may have been the No. 1 free-to-air network in the country for the last 13 years with a current share of around 39%, but its revenue is falling faster than its cost base.

A change is gonna come

However, underneath the surface a New Media company is starting to emerge. The company put it like this in the December 2019 results announcement: 'Seven West Media's strategy to transform the group into an agile, content-led organisation continues at pace'. It used to be that just owning the broadcast medium was a license to print money. In the 1990s the Internet arrived, and we all realised that 'Content is King'. More recently Netflix has shown the importance of content by creating its own in addition to managing a platform where it can show everyone else's. It's taken a while, but Seven West Media is now figuring this out.

For proof of this, consider that Seven Digital, the Seven West's Broadcaster Video on Demand (BVOD) division, which brings you 7plus and related channels on your set top box, only did $40m in revenues in FY19. By contrast Seven Studios, its production house, did $90m. Both businesses put Seven West on the right side of history and they're growing fast but Seven West has realised its own content creation engine can create the most shareholder value for the group. And it can help keep Seven and Seven Digital fresh by giving the punters something worth watching. Seven West Media has the kind of conservative balance sheet that will allow the transition. As at December 2019 net debt was $541.5m, which was only 2.4 times EBITDA.

There's a lot to like about SWM at this valuation

During the current market rout Seven West Media has been knocked down to a P/E of just 1.4x FY21 forecast earnings. You read that right…. 1.4x next year's forecast earnings, starting in July. The current EV/EBITDA multiple for FY21 is 4.6x. It's hard to get profitable companies cheaper than that on ASX and the issue is that Seven is not giving guidance because, as we noted above, Coronavirus is playing havoc with all its businesses.

This valuation indicates that Seven West is a steal, in our view. We believe that the gradual transition to content-led company suggests a decent re-rating is possible once the general market rout is over. Furthermore, in past bear markets we have seen consolidation in the Media sector pick up, so there may be potential for some M&A activity involving SWM. And remember, Seven will still be bringing you the Tokyo Olympics, just not until 2021. Four Stars from us.

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Source: Tradingview

Peace-out

Two 'new age' products that you'll have heard about a lot over the last few years are cannabis and hemp. Cannabis is a catch-all for any number of drug products that come from a plant called Cannabis Indica traditionally used 'recreationally' and increasingly used these days as legally available medicines. Hemp is cannabis' botanical cousin, Cannabis Sativa, and this plant is useful for a range of applications including food, textiles and paper, and doesn't have much of the 'THC', the psychoactive property of cannabis.

EcoFibre wants to build a business out of hemp and to that end it went public on the ASX last year after raising $20m at $1 per share. At the time the market capitalisation was a cool $309m.

Canadians led the way

Cannabis companies have been achieving large market capitalisations in Canada for about six years now and it's no surprise as to why – there's significant market demand from patients globally for whom traditional medicine has failed and who want new cannabis-based treatments. Governments are generally making it easier for them to access such products. Canada has led the way in terms of the regulatory environment and other countries are following suit. EcoFibre has been one of the first ASX-listed companies in the space to get a Canadian-style market cap.

That market cap was partly a result of the backing of Chairman Barry Lambert, who sold the financial planning firm Count Financial to the Commonwealth Bank in 2011 for $373m. More recently he has become a strong advocate for medicinal cannabis because of his granddaughter's medical condition.

However, leaving the high-profile Chairman to one side, there's also an attractive and growing business behind EcoFibre, whose revenue for FY19 (ending June) was $35.6m and NPAT $6m. In 1H20 alone, revenue was $29m and NPAT $7.1m. Using the trade name 'Ananda', EcoFibre is selling hemp products into the food and nutraceutical space as well as in the textile market, the latter under the 'Hemp Black' brand. One important division, called Ananda Professional, markets CBD oils from hemp to the medical world, CBD being the 'cannabidiol' chemical compound that many doctors are exploring for the treatment of numerous medical conditions including epilepsy, cancer and Multiple Sclerosis.

Growth at a reasonable price

EcoFibre's outlook is bright because now that cannabis is on people's radar screens, hemp is also mainstreaming at a time when the company's brands are becoming established. It also helps that hemp is now legal everywhere in the US after President Trump signed the 2018 Farm Bill into law in December of that year. That event smoothed that path to EcoFibre's ASX listing three months later.

One aspect of the EcoFibre story that hasn't been bright since last November has been the share price. It has dropped by two-thirds, so that it is now not far from the issue price. However, with the underlying business continuing to grow, we see no reason why the stock can't come back into favour once the Coronavirus Crisis is over. It is currently on a P/E of 18.3x FY21 earnings, but that drops to 12.5x for FY22. In an environment where consumer interest in cannabis and hemp is rapidly increasing, we believe that's quite attractive. Four Stars from us.

Pitt Street Research Pty Ltd

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