STOCKS DOWN UNDER

6 MARCH 2020

Stocks Down Under

In the struggle against new diseases, it's our wits versus their genes.

- Joshua Lederberg (1925-2008), American molecular biologist

TERRAGEN

Time to harvest

SPLITIT PAYMENTS

David versus Goliath

NEW ZEALAND KING SALMON

The water is cold again

TERRAGEN

Time to harvest

Stocks Down Under rating: ★★★

ASX: TGH
Share price: A$ $0.15
Market cap: A$ 28M

With environmental sustainability at the forefront of political and economic transformation, Terragen, a developer of agricultural biotech solutions, uses micro-organisms and chemical-free fertilisers to reduce farmer's reliance on pesticides and antibiotics. Specializing in liquid biological soil conditioners, Terragen's patented technology enhances root development, which in turn, lowers production costs for conventional and organic farmers. But while the company's stock has lagged since its $20m IPO on 11 December 2019 – the IPO price was 25 cents – we believe Terragen's harvest could be right around the corner. We rate this stock 3 stars for now, but after the Coronavirus crisis ends it warrants four.

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SPLITIT PAYMENTS

David versus Goliath

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ASX: SPT
Share price: A$ 0.51
Market cap: A$ 153M

The monthly instalment payment solution provider Splitit Payments has seen its stock drop a long way since the spectacular January 2019 market debut. The stock had started life at 20 cents in the IPO and by 12 March they had made it to $1.62. They've since retraced most of that path and at the end of last month they were just 37 cents. However, a lot has changed for Splitit in the last twelve months. The stock could be worth a revisit.

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Share price chart

Source: Tradingview

Aligned within a growing industry

Certified in Australia and New Zealand – and also in compliance with the USDA National Organics Program (NOP) – Terragen serves a broad range of customers. From dairy farmers to banana, macadamia, avocado, vegetable growers and vineyards, the company is positioned to capitalize on an Australian agricultural sector in need of rapid improvement. Fuelled by record-breaking temperatures and months of severe drought, the September 2019 bushfires led to environmental devastation unseen in modern history. Farmers' crops were completely destroyed, while critical infrastructure also suffered unpresented damage. But because of this, agricultural biologics are needed now more than ever.

And as water availability continues to decline across Australia, the need for plant stimulants, including soil conditioners is going up. As farmer's ramp-up production to replenish the damaged crops, Terragen's technology can help streamline the recovery because it improves plant's ability to withstand periods of adverse climatic conditions.

The company continues to innovate

Currently, Terragen has two main commercialised products: Great Land, its liquid biological soil conditioner, and Mylo, its liquid, live microbial feed supplement for livestock. Certified for organic livestock production in Australia and New Zealand, Mylo is free of antibiotics and hormones. The product also contains genus bacteria – which allows calves to develop larger gastrointestinal organs and increases weight gain. A clinical study by the University of Queensland's School of Veterinary Science found that calves treated with Mylo were 8.4% heavier than those treated without. Researchers also found observed and accelerated development of gut structures.

Not skimping on R&D, Terragen is also in the process of developing Lactolin, a teat conditioner for maintaining and improving lactating production in animals, and Halo, an anti-inflammatory vaccine that assists dairy cattle and companion animals with mastitis and mobility impairments. Once both are approved and hit the market, the two veterinary medicines will add synergies to the business as the company expands distribution into Europe and also enters the scalable U.S. dairy and beef feedlot market. And as of H1 FY20, Terragen has already begun commercial trials for Lactolin in the United States.

Demand is increasing

With 16 retail agents already on board – including Elders Rural Services, a leading agribusiness based in Adelaide, and Murray Goulburn, a dairy processing co-operative based in Melbourne – Terragen has 73 retail outlets within its distribution network. The company also released its H1 FY20 results on 28 February 2020, which saw revenues from ordinary activities increase by 80.1% to $794k. Growth was headlined by the February 2019 launch of Terragen's B2B distribution strategy – with each accredited distributor put through the company's product training program.

And with Terragen currently in the early-expansion phase, we believe great things are ahead for the biotech firm. International distribution remains low, which demonstrates that Terragen hasn't even scratched the surface of its potential market. Furthermore, with Lactolin getting closer to commercialisation, the treatment will add even more momentum to the company's already soaring top line.

Adding to the optimism, management appointed additional sales representatives to Victoria and Tasmania to keep up with recurring demand. The company also continues to invest heavily in R&D, with initiatives planned across animal health, plant productivity and plant biocontrol. And further leveraging its expertise, Terragen is expanding its research into glasshouse nurseries, as they further analyse the effect of product efficacy under controlled conditions.

We're bullish on Terragen long-term. The stock is trading way below issue price, but management remains confident in their ability to increase future earnings. And as they do, we expect the stock price to follow suit. But wait for that wretched Coronavirus to get out of the way first.

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Share price chart

Source: Tradingview

The Splitit IPO was the kind of IPO investors wish they had more of. Splitit raised A$12m at 20 cents per share ahead of its listing on the ASX. The offer was heavily oversubscribed, and so by the end of its first day of trading on ASX on Tuesday 29 January, Splitit stock, trading under the code SPT, had made it to 38 cents. And no wonder. Investors had seen how the pioneering Buy Now Pay Pater (BNPL) company Afterpay (ASX: APT), which we profiled yesterday in Stocks Down Under, had taken the market by storm and they reckoned there was room for another player.

When BNPL meets credit cards

Splitit was the brainchild of the Israeli entrepreneurs Gil Don and Alon Feit. The original idea was Don's, who had tried to pay for a wedding by instalments using a credit card and wasn't allowed to. Don and Feit worked out a system where their company would obtain authorisation from a credit card company for the full purchase amount of a good or service, allowing the credit card company to then charge the customer the instalment.

The major factor differentiating Splitit from Afterpay is that customers must have a valid credit card, but only Mastercard or Visa with an appropriate limit, to make a purchase using the Splitit system. A second point of difference is that Splitit is targeting higher-end, higher-value purchases like jewellery, travel, homewares, sporting goods and high-fashion with an average value of around US$1,000. AfterPay charges a greater merchant fee of 4.17%, while Splitit charges only 1.5%. AfterPay also pays the merchant the total value upfront, taking on credit risk, while Splitit doesn't do this, leaving the risk with the card companies. Finally, depending on merchant requirements Splitit payments are charged to the credit card over the following 2 to 36 months, while Afterpay encourage short period payments of 6 weeks.

Goliath, meet David

That all sounds great. The trouble with Splitit from an investor perspective in early 2020 is that the business is still at the start-up phase. In calendar 2019 revenue was only US$1.65m and the company's loss for the year was US$9m. That said, Splitit is well funded to continue its growth trajectory – it held $16.3m in cash at the end of 2019 – and the company is actually growing very strongly, with US$88m in merchant sales volume up 52% on 2018. However, it will clearly be a while yet before Splitit is a contender against the mighty AfterPay, whose FY19 revenue was A$264m and EBITDA $35.5m and whose merchant sales volume was something like A$5.2bn in the year. This is David versus Goliath territory at the moment.

The reason we believe Splitit is a contender for leadership in this sector is the credit card factor. Its relationship with Visa bodes well given the strong willingness of that company to explore instalment payment solutions, and the fact that Visa has something like 3.3 billion cards out there in more than 200 jurisdictions around the world. And don't forget that e-commerce is a US$3 trillion industry so there's room for multiple competitors to AfterPay. Once e-commerce providers figure out that instalment payments via credit cards can lead to a 30% higher 'cart conversion' (which is Splitit's experience), a lot of new business is likely to come its way.

At the moment all sorts of stocks large and small are under pressure thanks to the Coronavirus crisis. Splitit has a long way to go before it delivers on the promise of its business plan but under new CEO Brad Paterson, appointed last October, it has made some progress. We see upside from here headed toward the full year result.

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Share price chart

Source: Tradingview

Ever gone out to dinner at a fancy restaurant and sampled the King salmon? Expensive, wasn't it? King salmon, also known as the Chinook salmon, scientific name Oncorhynchus tshawytscha, is valued the world over for its great taste and health benefits, both of which come from the high oil content. Demand for this particular salmon has been growing for years from upscale diners the world over. That's been great for New Zealand King Salmon a major supplier of this particular fish from eight sea farms in the neighbourhood of the Pelorus and Queen Charlotte Sounds, offshore from the Marlborough Region at the top end of New Zealand's South Island.

In hot water

In the year to June 2019 New Zealand King Salmon increased revenue 8%, to NZ$173m, but operating EBITDA was down 4%, to NZ$25m. The company would have done a whole lot better if the water in the Sounds had been cooler. As we saw when we looked at Huon Aquaculture (ASX: HUO) back on 29 January, if the water in which the fish are growing is the wrong temperature it impacts the speed at which the fish can grow, or kills the fish outright, leading to lower yields. For New Zealand King Salmon the warm 2018/19 season knocked the expected salmon harvest down from 8,700 tonnes down to 7,900 tonnes, while a profit warning of 1 May hammered the stock from a 30 April 2019 high of $2.85 down to the aforementioned $1.75 resistance level.

In FY20 things are better. In the six months to December 2019 New Zealand King Salmon held back sales so as to be better able to meet second half demand, but revenue and EBITDA were down only slightly on the previous corresponding period because fish selling prices were 7% better. About half of New Zealand King Salmon's output in the half was consumed in Australia and New Zealand, and another 35-40% went to North American tables, with relatively little eaten in Asia or Europe. Basically, this is not a company that relies on heavy Chinese consumption. However, the market didn't care that New Zealand King Salmon was doing okay because the Coronavirus crisis has been sweeping all sorts of stocks overboard. That said, 1HY20 bodes well for the company's long-term plans.

2022 is New Zealand King Salmon's year

In 2019, New Zealand King Salmon responded to the warm water issues it faced by introducing a new 'Single Year Class' production model for FY20. What that means was that all the fish in a farm area had to be harvested after twelve months and then the area left fallow before it could be restocked. This model means that production levels will be flat until FY22 when the benefits of the new model allow expansion. Throw in a new open ocean farm for which the relevant consents have been applied, and by FY22 production could be in a firm upswing.

Currently New Zealand King Salmon is trading on a P/E of 21.2x FY20 earnings but that drops to 12.5x FY22 earnings. The current multiple looks expensive but the FY22 looks very inexpensive. We rate the stock two stars for now with a bias for four stars should $1.75 prove a genuine support level again.

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Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and is founded on more than 40 years of combined experience researching companies in a range of different sectors.