2 APRIL 2020

Stocks Down Under

> *Two things are infinite: the universe and human stupidity; and I'm not sure about the universe.*
>
> **- Albert Einstein (1879-1955), German-born American physicist**

KINA SECURITIES

Prospering with PNG

GOLD ROAD RESOURCES

The big cheeses have been buying

WHITEHAVEN COAL

Can coal turn around in 2020?

KINA SECURITIES

Prospering with PNG

Stocks Down Under rating: ★★★★

ASX: KSL
Share price: A$ 0.90
Market cap: A$ 160.8M

Up until very recently Kina Securities had been riding high. This financial services company in Papua New Guinea owns Kina Bank, a major bank in that country. In 2019 Kina Bank had significantly expanded through the acquisition of the PNG retail banking business of Australia's ANZ Bank. The deal prompted a re-rating of Kina Securities from 86 cents, when the deal was unveiled in June 2018, all the away to $1. 53 in December 2019. The Coronavirus Crisis has now wiped away all those gains. What's not going away, however, are Kina Bank's growth plans.

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ASX: GOR
Share price: A$ 1.365
Market cap: A$ 1.2BN

It's been an amazing recovery. The share price of the Perth-based emerging gold miner Gold Road Resources more than halved between 24 February 2020, right after the general market peak, and 16 March 2020. The fall was from $1.77 to just 80.5 cents. Then, just as suddenly, Gold Road stock turned around and retraced a lot of that fall, so that by late March it had rallied towards $1.40. That's the power of gold in this current era of uncertainty. We think there's more rallying power for Gold Road where that came from.

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Share price chart

Source: Tradingview

Papua New Guinea is a small Pacific Island nation of 8.4 million people whose economy is in transition. PNG used to be almost solely an agricultural and mining nation. Thanks to ExxonMobil and Australia's Oil Search (ASX:OSH), among others, it has become a significant oil and gas producer and an emerging powerhouse in Liquified Natural Gas. While the country is still a low income one, with GDP per capita of only US$3,700 (Australia's is US$52,400), GDP growth over the last five years has been a creditable 5% p.a. and the economy has become resilient enough to cope with natural disasters, like the February 2018 earthquake that displaced over half a million people.

That there is more growth to come is evidenced by the fact that the incumbent government of Prime Minister James Marape has recently been in negotiations with ExxonMobil on fiscal terms for the P'nyang gas field that would potentially double the PNG LNG project (see our 7 February 2020 coverage on Oil Search for more).

As PNG goes, so goes Kina Bank

That rising prosperity in Australia's northern neighbour and former colony is a key reason why Kina Securities is worth paying attention to. As the PNG economy grows and continues to evolve, its banking sector will grow with it, alongside the rest of its relatively nascent financial services sector. Bank South Pacific is the largest bank in the country and Kina Bank was the fourth largest until the ANZ deal of last year made it the second largest.

That deal took a while to be completed. It was announced, as we noted above, in June 2018 but didn't receive the requisite approvals from PNG's central bank until February 2019 and from PNG's competition regulator until March 2019. And formal integration didn't happen until September 2019. However, at the end of that process, Kina Bank's deposit base had more than doubled and its customer base was fivefold bigger, at 125,000.

Strong organic growth

Even without ANZ, Kina Bank was in strong growth mode in calendar 2020, with organic loan book growth of 26% through the year. Also growing rapidly was Kina Bank's foreign exchange business, its deposit book business and its fund management business.

Kina Bank warned at the time of the earnings announcement that 2020 would be a slow year for PNG's economy because of the deferral of a P'nyang agreement as well as efforts by the PNG government to rein in its fiscal deficit. Also, PNG is unlikely to get away with no economic impact from the Coronavirus, with the first case of the virus having shown up in the country on 20 March. The oil price crash that started on 8 March is also likely to have an impact on PNG and Kina Securities in 2020 and 2021. That said, we still think the high recent level or organic growth by Kina Bank suggests that it can be almost immune to any slowdown.

Recently several members of Kina Securities' board seem to have agreed with that view and bought the stock on market. And no wonder. This stock has dropped to a P/E of only around 3.3x forecast calendar 2020 earnings. A good interim result in mid-2020 could significant re-rate this stock from that ultra-depressed level.

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Share price chart

Source: Tradingview

A mine named after a cheese

Gold Road Resources is a newly arrived gold miner on the ASX whose 'company maker' was the recently opened Gruyere Gold Mine, around 200 km east of the town of Laverton in Western Australia. Why they named a gold mine after that hard cheese that originated in Switzerland and is pronounced 'gree-yair', we don't know. What we do know is this mine represents some serious cheddar for the shareholders of Gold Road.

A large resource at a low AISC

Gold Road owns 50% of Gruyere, a 300,000 ounces p.a. mine that commenced production in June 2019, less than six years after discovery of the deposit. The other half belongs to the Johannesburg-based Gold Fields (JSE:GFI), one of the world's largest gold miners. Gruyere sits on a JORC 2012 resource of 6.6 million ounces, making it one of the largest virgin gold discoveries in Australia in a long while.

The current mine plan will see 300,000 ounces produced every year for at least the next 11 or 12 years at an average All-In Sustaining Cost (AISC) of US$745 an ounce. This is a very low cost of production given the current gold price of around US$1,630 an ounce, but no surprise given the fact that Gruyere is a simple open pit with a conventional and noncomplicated flowsheet.

Gold Fields liked this project so much that its entry price in November 2016 for just 50% was A$350m cash plus a 1.5% royalty on production over 2 million ounces. Gruyere is currently in ramp-up mode and Gold Road's guidance for calendar 2020 is 250,000-285,000 ounces at an AISC of A$1,100-1,200.

Underexplored greenstones can mean more of the green stuff

Beyond Gruyere, Gold Road's mission is to discover more gold mines in the Yamarna Greenstone Belt, within which the company-making mine is situated. In geology, 'greenstone belts' are large belt-like areas of volcanic rocks where those rocks are low in silica but where various minerals within the rock have a greenish hue because of the way they have metamorphosed.

Greenstone belts are great places to explore for gold as illustrated by Kalgoorlie's Golden Mile. This exists because it sits in the Norseman-Wiluna Greenstone Belt, while Canadian investors have done well over the years out of the Abitibi greenstone belt and gold camps such as Val D'Or.

Gold Road considers the Yamarna Greenstone Belt underexplored by the standards of Australian gold exploration and the company is spending a large exploration budget on the 4,500 square km of ground it holds in the belt looking for the next >1 million-ounce discovery. It may already have one with a 260,000-ounce resource to the south of Gruyere at a deposit called Gilmour. Given the success of Gold Road with Gruyere and Gold Road's longstanding commitment to the Yamarna, there's probably more where Gruyere came from.

Directors have been buying

Which brings us back to Gold Road's bounce back to life. Part of it was gold itself, which crashed suddenly between 6 March and 17 March before stabilizing as investors realized the economic stimulus to deal with Coronavirus meant lots of paper money out there. Part of Gold Road's bounce was also the recognition that low-cost producers are best placed to take advantage of the still-high gold prices we have at the moment. Most of all, though, we think investors recognised that the market wasn't paying much for the company's attributable reserve base, even before the crash. At December 2019 this stood at 1.9 million ounces.

That makes for a current EV/resource ounce of around A$600, which is low compared to recent valuations for other emerging miners such as Northern Star (ASX:NST) or Kirkland Lake (ASX:KLA). No wonder, then, that several directors of Gold Road - Chairman Tim Netscher, Executive Director Justin Osborne and Non-Executive Director Brian Levet - chose to take advantage of the market rout of March 2020 and buy some stock on market. Like those directors, we rate Gold Road as a Four-Star stock right now.

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Share price chart

Source: Tradingview

Whitehaven Coal is the company that the Gunnedah Basin built. That geological area of interest, whose major population centres are the farm towns of Gunnedah and Narrabri in the northwest of NSW, has emerged as a very competitive coal supplier in the last twenty years, serving mostly export markets in Asia. Traditionally, Australian coal miners went looking for their Next Big Thing in the Hunter Valley of NSW or in the Bowen Basin of central Queensland. Whitehaven recognised early on that coals from the Gunnedah Basin, with their low ash and low sulphur content, would increasingly be in demand in the future for both thermal and metallurgical coal as customers looked to increase the quality of their feedstock. Importantly, they saw that the premium pricing that Gunnedah Basin coals could potentially obtain would more than offset the extra cost of freighting the coal down to the Port of Newcastle for export.

The House that Gunnedah built

Starting with a single small mine in 2000 – the Canyon Coal Mine near Narrabri that closed in 2009 – Whitehaven has progressively leveraged that Gunnedah Basin pricing advantage to grow into a four-mine company, with more to come. Werris Creek, which commenced in 2005 and Tarrawonga in 2006, are now both rated at 2.5 million tonne of annual production. Whitehaven calls these two mines the 'Gunnedah open cuts'. In 2012 came the 11 million tonne p.a. Narrabri Underground Coal mine. Then in 2015 Whitehaven started up the gigantic Maules Creek open cut mine whose rated annual capacity is 13 million tonnes. Whitehaven's share of its coal output from these mines grew 3.6% in FY19, to 18.4 million tonnes.

Still to come are some more big mines - Vickery, near Gunnedah, slated for first coal in the second half of FY21, and Winchester South, a Bowen Basin project that represents Whitehaven's first venture outside the Gunnedah Basin and is expected to yield its first coal in FY24. Vickery will initially be a 10 million tonne p.a. mine and it's reasonable to expect that Vickery and Winchester South together can double Whitehaven's size over the next decade from a >20 million tonne overall producer now to more like 45 million tonnes.

The worse may be over for coal

The 2019 decline in coal prices hit Whitehaven badly, with EBITDA in the December 2019 half falling 68% to $177m. Thermal coal pricing fell from US$110 to US$70 a tonne and metallurgical from US$124 to US$94 a tonne. However, the company was also hit by drought, bushfires and labour shortages at the Maules Creek mine. All these issues were, in our view, temporary. The drought is now over and so are the bushfires, and coming soon, we believe, is the end of the Corornavirus Crisis.

We argue that coal prices can turn around from here now that Chinese factories are re-starting as China's rate of new Coronavirus infections has dropped markedly. The early signs coming out of China seem to indicate that the worst is now over, price-wise, for coal selling into China. Whitehaven doesn't sell into China but it's reasonable to expect coal pricing generally in Asia can follow suit.

That suggests Whitehaven may be good buying at the moment. Currently, Whitehaven is trading on a P/E for FY21 (starting in July) of 10.4x dropping to 9.4x for FY22 as Vickery kicks in. At the moment the Winchester South upside isn't in the share price at all. Sounds like plenty of upside for investors intrepid enough to come back to coal.

Pitt Street Research Pty Ltd

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