6 APRIL 2020

Stocks Down Under

> *Sometimes a loss is the best thing that can happen. It teaches you what you should have done next time.*
>
> \- Snoop Dogg (b. 1971), American rapper, songwriter, producer, entrepreneur and actor.

3P LEARNING
Its ducks in a row… just in time

MONASH IVF
Fertile fundamentals

LONGTABLE
Brand new recipe

3P LEARNING

Its ducks in a row...just in time

Stocks Down Under rating: ★★★★

ASX: 3PL
Share price: A$ 0.895
Market cap: A$ 118M

It hasn't been a fun ride for shareholders of 3P Learning, the Sydney-based online learning facilitator. After peaking at A$1.63 in February 2018, the shares are roughly back where they started in June 2016, around 84 cents. And that all-time low in 2016 was set following a slow, downward grind from the 2014 IPO price of A$2.50. Given the need for remote learning facilities and materials in the current COVID-19 era, one would expect shares in 3P Learning to do really well right now. But while we're now back at pre-COVID selloff levels above 80 cents, which in itself is a clear outperformance of the market, we believe anything to do with remote learning and working should be doing a whole lot better than that. What gives?

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MONASH IVF

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ASX: MVF
Share price: A$ 0.435
Market cap: A$ 106M

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Share price chart

Source: Tradingview

Online education for younger students

3P Learning (3PL) provides learning materials to schools and families, facilitating online education for around 5 million primary and high school students in 17,000 schools around the world. Key focus areas for 3PL are mathematics, English literacy, spelling, science and online safety. Mathematics materials account for about 75% of 3PL's revenues.

The company is active in Australia, Asia Pacific, Europe and the America's. Although Asia Pacific is by far the largest revenue generator for 3PL, at around 60% of revenues, the America's are an important growth area for 3PL.

Changing of the guard triggered selloff

When CEO Tim Power quite unexpectedly left 3PL in January 2016, after 10 years at the helm, the proverbial human waste hit the ventilator. The share price decline that had been going on for about 8 months, accelerated and the stock dropped from A$ 1.96 at the time of the announcement, to A$ 0.63 exactly six months later.

It turns out investors were right to abandon ship after their captain jumped off: The company's revenues peaked in the following financial year around A$ 55M but have been declining ever since. In the company's most recent announcement, for 1HY20 (ending December 2019), it said revenues declined almost 4% year-on-year, especially in Europe and Asia Pacific due to higher churn, Brexit and downward pressure on school funding across the EU. However, revenues in the America's were up 20%, to A$ 5M in the first half of the financial year.

The operating result, however, flipped from a positive A$ 2.4M in 1HY19 to an operating loss of A$ 1.9M in the first six months of FY20. Not very encouraging, to say the least.

Burn, baby, burn!

We believe the key reason why 3PL has been underperforming in the last three years is lack of scale. You see, in addition to direct costs related to new product development and software, the company capitalises a large chunk of its product development costs, around A$8M per year. This doesn't show up in the Profit & Loss account, but a cash flow statement is unforgiving. The company has been burning quite a bit of cash in the last few years, which is fine if you're building up and renewing your product portfolio. But it needs to go hand-in-hand with growing revenues, driven by more users. Simply put, 3PL's ambitions have been larger than its sales success until now and the company has been living beyond its means, in our view.

A lot of the cash burn in the last 18 months has been funded by the divestment of 3PL's 40% interest in Learnosity Holdings Limited in FY18, for which the company received A$24.9M. This was used to pay down debt that was built up in the prior years. But going forward, the company will have to fix the imbalance between product development costs and revenue growth (or lack thereof).

The moment of truth

In August 2019, 3PL presented a strategy update in which it explained the way forward. Following the build-up of a more global footprint as well as heavy investments in products, its online presence and the development of a better Software-as-a-Service (SaaS) business model in the last few years, the company has now arrived at the next phase of its strategy….actually selling more of its products and services.

We believe the next 12 to 18 months will be a defining period for 3PL; the company either strongly accelerates revenue growth and is able to build scale into the business and generates concomitant margins, or revenues continue to decline and the company will slowly be pulled under due to high development costs and write-offs of capitalised development.

Just-in-time management

Seen in that light, 3PL's timing seems impeccable. The company should experience a major tailwind from the current Coronavirus Crisis. Just when it's got all its ducks in a row, this crisis will be strongly driving global demand for 3PL's online learning offering. Investors who are willing to take the plunge right now can do so at an EV/EBITDA for 3PL of 6.2x for FY21 and 5.4x for FY22. The P/E multiples for both years are 21.1x and 14.1x respectively. We believe the jury is still out on whether 3PL can pull it off, which is probably why the share price hasn't done better than it has recently.

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Share price chart

Source: Tradingview

Balance sheet strength will help near-term challenges

Due to the impact of COVID-19, Monash followed many other Australian companies in withdrawing its FY20 earnings guidance on 20 March 2020. The risks associated with its Q4 FY20 financial performance are significant. On 25 March, the National Cabinet suspended all non-urgent elective surgeries in Australia, which will have a major effect on the company's fertility business. Monash announced on 1 April 2020 that it has deferred its FY20 interim dividend from 3 April to 2 October to preserve cash in the current environment.

Monash's strong balance sheet should help it endure the near-term challenges related to the coronavirus pandemic. It has a net debt position of $90m and access to $25m in cash from a $115m syndicated debt facility that doesn't mature until January 2022. This should support near-term operations including the continuation of treatments that were already in progress. It is also working with lenders to secure additional working capital and an update to this end is expected soon.

Looking beyond the current environment, Monash's business model is healthy due to strong Australian demand for in vitro fertilisation (IVF). In 2019 the number of Australian Stimulated Cycles grew 4.1% to 42,643. The supply of donor sperm is also improving nationally. The donor segment accounts for 15% of patient treatments in Australia. The company's fast-widening footprint was recently expanded by the acquisition of fertility clinic Fertility Solutions in Queensland. It also just increased its interest in Tasmanian fertility clinic Fertility Tasmania to a majority holding to further increase scale.

Diversifying through diagnostics and overseas opportunities

Monash is diversifying its revenue streams outside of IVF with a focus on diagnostics, genetics and pathology. The company differentiates itself through scientific advancements which are the value proposition to its patients. Its transition of the genetic screening business to non-invasive pre-implantation genetic screening technology (NIPGT) has increased screening penetration rates from 19% to 27% of Australian stimulated cycles. The ultrasound business has seen a rapid uptake of the world's first NIGPT technology across its clinical network. The Sydney Ultrasound segment reported 2.3% growth in total scans to 39,525 in the company's 1H FY20 report.

Growth outside of Australia has also been solid. Soft macroeconomic conditions in Malaysia along with the expectation of a tax relief for IVF treatments in CY20 has slowed stimulated cycle volume in the region, but this is expected to be a key long-term growth market due to strong Malaysian IVF demand. The Kuala Lumpur business returned to growth in Q2 and growth plans in the Asia Pacific region have seen progress. Management has noted that there are significant acquisition and partnership opportunities in the APAC region.

Technology is also a competitive advantage for Monash. Infrastructure upgrades including the development of a mobile patient platform are enabling the use of technology to improve patient and doctor communications. In addition to the NIPGT technology, a less invasive alternative for intracytoplasmic sperm injection (ICSI) is expected to be available at the MVF clinics by early FY21. Testing has thus far shown a significant increase in egg fertilisation rates and increased embryo availability per patient. Monash is also partnering with New South Wales bio-separations company Memphasys (ASX:MEM) to develop a Sperm Selection device which is expected to soon reach clinical trial.

Strong market share position with room for expansion

In the key markets of Victoria, New South Wales, Queensland, South Australia, and Northern Territory, Monash has a 19.6% market share of the stimulated cycles business and an overall Australian market share of 16.9%. It has a 20.2% key markets share and a 17.7% national market share in the frozen embryos industry.

We believe the fundamentals of the business make for a solid foundation of future growth at Monash. Strong demand for IVF in Australia combined with the company's growth investments in overseas expansion and technology are compelling, in our view. An annualised $2.5m cost reduction program also bodes well for future profitability.

At an EV/EBITDA of 5.7x and a P/E of 5.9x for FY21 (starting in July), and with multiple growth drivers ahead, Monash shares look poised for a rebirth, once the coronavirus pandemic subsides.

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Share price chart

Source: Tradingview

If there's one thing Australians are really into these days, it's food and drink. Or rather, 'cuisine', that is, premium food and drink. If you want proof of that, look no further than the fact that My Kitchen Rules, a cooking show you can see on the Seven Network, is now in its 11th season. Its rival on the Ten Network, Masterchef, will kick off its 12th season in a couple of weeks' time. At their peak millions tuned in around the country to both shows.

In Maggie's kitchen

One company that has sought to position itself as a beneficiary of Australia's enduring passion for all things gastronomic is Longtable, now headquartered in Tanunda, SA, in the heart of the Barossa Valley wine country around an hour's drive north of Adelaide. Longtable owns Paris Creek, a biodynamic dairy at a place called Meadows in the Adelaide Hills and it owns the St. David Dairy in the inner Melbourne suburb of Fitzroy. And, importantly, it owns Maggie Beer Foods, a range of gourmet food product created by Maggie Beer, a noted celebrity chef and Barossa Valley resident who is a Non-Executive Director of Longtable.

In late 2017 investors had high hopes for Longtable because the board had just named Laura McBain CEO. That lady had taken Bellamy's, a struggling dairy company based in the Tasmania city of Launceston, and grown it into a powerhouse of shareholder value creation off the back of booming Chinese demand prior to her 2016 departure from that company. With those customers still eager for more, investors thought Laura could do it again.

Eat more quark

Longtable, however, was markedly different from Bellamy's. Demand was mostly domestic and more oriented towards hipsters who are into things like dairy products produced biodynamically. Yeah…we confess we don't really understand it either, but it's kind of like organic food only with a little more wholistic thinking in terms of inputs and outputs on the farm.

And those hipsters weren't buying enough of things like Paris Creek quark (a sour milk cheese). In FY19 Ms. McBain had turned around a loss-making Maggie Beer business but was still losing money overall thanks to a badly underperforming Paris Creek and high corporate overheads. She resigned from Longtable in late November to be replaced by Chantale Millard, who had been running Maggie Beer Foods since 2015.

The six months to December 2019 showed Longtable in better shape, almost breaking even at the EBITDA line as costs were reduced. Maggie Beer Foods and St. David Dairy were profitable and the current leadership at Longtable reckoned that Paris Creek can be in the black as well by the end of FY20.

The brand is right

Going forward we see better days for Longtable investors. Unless you're into the esoteric work of Rudolf Steiner (1861-1925), who first thought up biodynamism as a way to grow food, you've probably never heard of Paris Creek. And if you don't live in Melbourne and frequent its cafes you probably won't know St. David Dairy. However, just about everyone in Australia knows Maggie Beer and many would-be chefs have one of her cookbooks in their kitchen. Longtable is currently pressing the accelerator on building this brand, with new products and new outlets slated for FY20 and FY21. And, let's face it, the Coronavirus Crisis is spoiling a lot of things at the moment, but cooking a decent meal at home using Maggie Beer vinaigrette or sugo isn't one of them.

Longtable is currently capitalised on ASX at a mere $16.6m market cap. This for a company that has no net debt, typically does A$40-50m revenue annually across its three businesses and can reasonably generate double-digit EBITDA margins if Maggie Beer's recent performance is any guide. Looks inexpensive to us. At least one director agrees with that view. Maggie Beer, the Wizard of the Barossa herself, was an on-market buyer of stock between 30 March and 1 April.

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