16 APRIL 2020

Stocks Down Under

> *The successful warrior is the average man, with laser-like focus.*
>
> **- Bruce Lee (1940 - 1973), Hong Kong American actor, director and martial artist**

VECTION TECHNOLOGIES

Welcome to Virtual Reality's day in the sun

DE GREY MINING

Exploration success but too much excitement right now

SUNCORP

Riding into the sunrise with a strong balance

VECTION TECHNOLOGIES

Welcome to Virtual Reality's day in the sun

Stocks Down Under rating: ★★★★

ASX: VR1
Share price: A$ 0.02
Market cap: A$ 13.2M

Early last month Vection Technologies made an important step-change in its path towards becoming a leading developer of real-time software, including Virtual and Augmented Reality. The ASX-listed multinational company with a strong presence in northern Italy, announced that it was acquiring Mindesk, the start-up which made it possible, for the first time, to build a Computer-Aided Design project from scratch in Virtual Reality. With Virtual Reality now coming into its own as an enterprise tool, that was huge news for a small company. Importantly, Mindesk brings a very influential new shareholder to Vection Technologies.

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DE GREY MINING

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Stocks Down Under rating: ★★

ASX: DEG
Share price: A$ 0.305
Market cap: A$ 311M

It's been one of the few stocks that managed to buck the generally bearish frame of mine on ASX. The Perth-based gold explorer De Grey Mining saw its stock change hands on 3 February 2020 at just 4.6 cents. By 25 March, with the rest of the market behaving like the world had come to an end, De Grey stock was 24 cents. That's the power of a strong gold exploration story in the Pilbara region of Western Australia. However, this one may have been welcomed a little too enthusiastically.

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SUNCORP

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ASX: SUN
Share price: A$ 9.21
Market cap: A$ 11.8BN

Brisbane-based Suncorp Group is an insurance, banking, superannuation and wealth management corporation that serves Australia and New Zealand. Thus far in 2020, the sun has set for the company's stock, which has reached its lowest level since 2012. As new CEO Steve Johnston approaches his one-year anniversary, the company has embraced a new digital strategy and aptly shifted away from the prior regime's quest to make Suncorp the "Amazon of financial services". A renewed focus on returning to its banking and insurance roots should lead to stronger financial results and make the stock a more appealing investment.

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Share price chart

Source: Tradingview

Doubtless you've heard a bit about Virtual Reality in recent years and the related field of Augmented Reality. Virtual Reality is where computers are able to simulate realistic images, sounds and other sensations to the user. Augmented Reality is where the real world is being presented to the user by the computer, but with other interactive digital elements overlaid on it. To some this will just sound like science fiction, akin to what we saw in The Matrix back in 1999.

Actually, these technologies are here, today, available at reasonable cost and on the cusp of revolutionising all sorts of industries. And Vection Technologies wants to be one of the revolutionaries.

Gaming is pioneering Virtual Reality, but that is for kids (and some adults)

The likely reason you would have taken note of Virtual Reality is the gradual increase in the number of video gamers preferring this medium. In VR gaming, users play the game wearing a headset that looks like a pair of oversized ski goggles and interact with their virtual environment using a couple of handheld controllers. If you've tried it, you'll agree that the user experience is stunning.

However, in 2020 VR gaming is still relatively expensive for most would-be gamers, requiring not just a costly gaming console with the requisite amount of computing power, but also the pricey headset and controllers. To set yourself up to play the new VR game that everyone's talking about – Half-Life: Alyx – might cost you a few thousand dollars. Consequently, many commentators are arguing that Facebook's US$2bn acquisition of Oculus VR, one of the first VR equipment developers, has not really panned out.

Vection Technologies would beg to differ. So would HTC Vive, a leading VR headset supplier well known to gamers which is about to become a Vection Technologies shareholder thanks to the Mindesk deal.

Vection Technologies has Virtual Reality for grown-ups

VR gaming, while fun, isn't where the real action is coming from in Virtual Reality. This technology's first serious billion-dollar application lies in its ability to allow people to collaborate virtually in their daily work using the computing power on their desktops or their devices. Imagine you're a furniture designer and you want to show your design to the people in the factory. How better than to have everyone don their VR headsets to look at the product like it was there in front of them?

Which is where Vection Technologies believes it can be a pioneer in this explosive new industry. When this company presented itself on ASX last year, its foundation product was FrameS, a VR collaboration platform that the company intended to make available via SaaS. Even prior to its formal October 2019 launch, FrameS had attracted important customers, such as its near-neighbour Lamborghini as well as Volvo and the Italian luxury fashion house Fendi.

The attraction for customers is the ease with which models created using tried-and-true 3D Computer-Aided Design (CAD) packages, like Rhinoceros, Solid Edge and SolidWorks, could be pulled into FrameS.

Mindesk backed by giant HTC

Vection Technologies' Mindesk deal expanded the company's product suite to the next level. What Mindesk had developed is a VR modelling system that users can interact with whether they are in Virtual Reality or in a CAD system. Consumer Electronics giant HTC from Taiwan backed Mindesk because, while its foundation business has been gaming, HTC shared the same vision of Virtual Reality's Next Big Thing being in enterprise collaboration.

Now, neither Vection Technologies nor Mindesk has hit the big time yet in terms of sales, which are only a few million US dollars. However, we believe the upside is immense because right now, with so many people working from home during the Coronavirus Crisis and looking for ways to interact virtually, industry watchers are now saying that Virtual Reality's time has come.

With Vection Technologies and Mindesk having multiple marquee customers to point to and with the products available at low cost via a SaaS model, the path to growth is clearer than ever before. We believe the Italian company's time may have come as well.

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Source: Tradingview

On 30 March in Stocks Down Under we wrote about how the town of Kirkland Lake, Ontario, had given a Canadian gold miner of the same name (ASX:KLA) the chance to get started and which has proved the springboard to create a major gold mining house. De Grey Mining wonders if the same kind of geology that created Kirkland Lake, as well as the gold-rich Ashanti region of southern Ghana, and the gold mines around Kalgoorlie in Western Australia, are at work in its part of the Pilbara.

Which is to say, the Pilbara also has very old rocks, from the Archaean era, of the greenstone variety known to be gold friendly. And it has long geological structures called 'shear zones' and 'intrusions' that under the right conditions have deposited scores of millions of ounces of gold in those other places we mentioned. Like, say, the 70 million ounces at Kirkland Lake or the 80 million ounces in the Kalgoorlie neighbourhood.

De Grey probably has its ‘company-maker’

As of 2 April, De Grey hasn’t found the next Kirkland Lake, but it has found 2.2 million ounces in a JORC 2012 resource. With its Mallina Gold Project it has staked out around 1,500 square km in the Pilbara, around 80 km south of Port Hedland. The geologists reckon they can get to 3 million ounces, after which there’s potentially a company-making mine in the works.

The Pilbara is a dry and thinly populated part of Western Australia that covers around half a million square kilometres. When Australian resource investors think of the Pilbara, they think of iron ore, which ships out to Asia via Port Hedland and with which the region is loaded. Those same resource investors don’t generally think gold, because even though there were gold rushes in the Pilbara in the 1880s, and the region has played host to a few modern gold mines such as Telfer (Newcrest, ASX:NCM) and Paulsen’s (Northern Star, ASX:NST), gold has shown up relatively thinly in this region.

However, some true believers like Andy Beckwith, a geologist who is De Grey’s Executive Technical Director, have been convinced over the years that more gold mines were coming in the Pilbara once relevant structural controls were better understood.

Thank you Dr. Drill

Recent drilling seems to be proving Beckwith right. By late 2019 De Grey had established 1.7 million ounces over five deposits within the Mallina Project area – Mallina itself, Toweranna, Withnell, Berghaus and Wingina. The drill results were generally encouraging and the story they generally told was ‘there’s more where that came from’. Then came 6 February 2020, when De Grey announced some results of drilling at a prospect called Hemi where the intersections were long and high grade. Together with subsequent drill reports, this allowed for a resource increase to the current 2.2 million ounces. The market responded enthusiastically to these reports and markedly re-rated the stock.

This re-rating has made De Grey a $311m market cap company as at the close on 15 April. That’s gratifying for investors who bought before 6 February, but it may be a little too enthusiastic, in our view. A market cap of $311m would represent an EV per resource ounce of around A$125.

For an explorer like De Grey that’s probably a little too high given the company’s current stage of development. Indeed, we know of companies near or past the DFS stage at much lower valuations. There’s probably a mine at Mallina. But that’s not coming for a few years yet. For now, we believe it’s best to be cautious with DEG.

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Share price chart

Source: Tradingview

Embracing regulatory change, reinsurance needs

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services industry concluded that Australian financial institutions engaged in money laundering, ignored terrorist financing and reporting duties, and conducted improper foreign exchange trading. In the aftermath of the Banking Royal Commission, Suncorp has made embracing regulatory change a priority. It has become focused on improving customer outcomes, corporate governance and its culture to meet the requirements of the Royal Commission. It is also enhancing its Risk Insight Program to satisfy the recommendations regarding risk management. While these steps will undoubtedly lead to higher near-term costs, they will improve the regulatory position of the firm and the perception of the entire banking industry.

Suncorp has experienced 10 natural hazard events across Australia and New Zealand since the beginning of 1HY20. It has seen more than 45k personal and commercial insurance claims lodged many of which were related to the bushfires. Natural hazards impacted the 1HY20 NPAT of $642m by $519m. Although this amount was above the company's allowance, it was lower than the $580 recorded in 1HY19, because the events fell within reinsurance deductible limits.

Suncorp strengthened its reinsurance program heading into FY20 by purchasing additional cover. This should continue to help reduce natural hazard costs and earnings volatility. It still has $170m of capacity remaining under its natural hazard aggregate protection (NHAP) and $200m of capacity remaining under the aggregate stop loss (ASL) program.

Wealth business under review amid focus on insurance

The Australian insurance business has been challenged by the bushfires and slipping yields. The long-lasting fires have resulted in industry-wide claims of more than $700m, which are still pouring in. Although a bolstered reinsurance program has helped mitigate losses, expenses related to claims processing have soared. Furthermore, there is mounting industry-wide concern that the bushfires and other recent natural hazards will send the price of insurance premiums skyrocketing. This would appear to be a positive for insurance companies, but perhaps not so if premiums rise so high that they can't be afforded by most of the market.

Insurance unit and premium growth were positive, the prior year reserve released was subdued and unemployment insurance tax report (UITR) decreased in Suncorp's 1HY20 report. However, the underlying yield on insurance funds of only 1.5% was down significantly and barely above the risk-free rate. Part of its plan to reinvigorate the insurance business is to invest in its digital platform. Digital sales in the Australian insurance business were up 13% in 1HY20. AAMI home insurance digital sales jumped 33% and 60% of new at-call deposit accounts originated online.

The main area of strategic focus for Suncorp right now is the improvement of its core insurance business. There is a good chance that this will lead to an exit from the wealth management business. Earlier this year management began a strategic review of its wealth business, which has become a less important part of its growth plans. The move may be welcomed by investors because it would allow the company to focus on the key insurance opportunity.

Strong capital position

Suncorp ended 1HY20 with a strong capital position. It has a very healthy balance sheet that gives it substantial capital flexibility for growth projects and shareholder returns. Investors are particularly interested in what the company will do with the proceeds from its divesture of smash repair business Capital SMART. While some would like to see these funds returned to shareholders immediately, management will be evaluating its investment needs at its annual planning process in May. A key priority heading into FY21 will be to retain maximum capital flexibility for reinsurance renewal negotiations.

Suncorp is one of the more interesting stories in Australian financial services, in our view. In the near-term, the mid-sized bank is likely to be significantly impacted by the current Coronavirus Crisis. A slowdown in economic activity in Australia and New Zealand will probably hit commercial loan volume most as many businesses put capital projects on hold. But we believe that has been discounted in the current share price to a large extent. As the economy rebounds and Suncorp shows progress in streamlining its business to focus on insurance and banking, we expect investors are likely to deposit some funds in the shares. At a current P/E of 12x for FY21, which starts in July, we believe Suncorp shares look pretty good right now.

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