17 APRIL 2020

Stocks Down Under

“I’m not going to lie. I am a psycho. Luckily, I get most of it out on stage.”

- Bill Burr (b. 1968), American stand-up comedian

BYRON ENERGY

A great Gulf between price and value?

MACA

Valuation very compelling

TYRO PAYMENTS

COVID-19 a drag on near term results

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Stocks Down Under rating: ★★★★

ASX: BYE
Share price: A$ 0.135
Market cap: A$ 122M

The market has not been kind to the Melbourne-based oil producer Byron Energy since all the Corona trouble started. Between 17 February and 1 April, it plummeted 69%, hammered by the oil price crash that happened at the same time as the Coronavirus Crisis was getting started. However, if investors can stay the course on this offshore Gulf of Mexico operator, we believe they might end up with a bargain.

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ASX: MLD
Share price: A$ 0.77
Market cap: A$ 214M

Perth-based Mining and Civil Australia (MACA) Limited is a mining services contractor that operates in Australia. It has specialties in mining, crushing, civil construction, infrastructure and mineral processing equipment. The shares are trading near an all-time low, but the company has some favourable momentum heading into the second half of FY20. Work in hand continues to grow nicely and the company is securing new contract wins at a good pace. The current economic environment has put near-term growth on pause, but it has a solid pipeline of projects in domestic civil infrastructure and expansion opportunities outside of Australia.

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TYRO PAYMENTS

COVID-19 a drag on near term results

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ASX: TYR
Share price: A$ 2.75
Market cap: A$ 1.4BN

Sydney-based Tyro Payments is a financial technology, or “fintech, company that specializes in merchant debit, credit and electronic funds transfer at point of sales (EFTPOS) services. Formerly MoneySwitch, the business has become one of Australia’s leading “nextgen banking” institutions as it aims to compete with major banks. The stock has only traded on the public exchange since December but has fared relatively well given the current economic environment. In the near-term, Coronavirus pandemic pressures are likely to weigh on results, but the long-term growth potential is good given the changing landscape of payment processing in Australia.

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Share price chart

Source: Tradingview

In early 2020 all sorts of sectors of the market got thrown overboard, but the one that got hit the worst was oil and gas, because just as global demand for energy was declining due to Coronavirus, Russia and Saudi Arabia decided to have a price war. The result was that oil, which had been at US$60 a barrel at the end of last year, was close to US$20 a barrel by late March. This price weakness, however, looks temporary to us. Once the mutually destructive squabbling between the two oil superpowers stops, a whole bunch of producers can re-rate, including, we believe, Byron Energy.

This company knows how to find oil

Byron Energy holds a portfolio of 50-100% interests in various leases in part of the Gulf of Mexico's Outer Continental Shelf next to Louisiana. It's done pretty well since its 2013 back-door listing on ASX, when its 3P reserves (Proved, Probable and Possible) were 7.8 mmbbl (million barrels) of oil and 164.7 bcf (billion cubic feet) of gas. Today the comparable figures are 25.1 million mmbbl of oil and 199.2 bcf of gas.

So, it's fair to say that Byron has a management team that knows how to find hydrocarbons. Consider SM71, which is the jewel in Byron's Gulf of Mexico crown. The SM is short for 'South Marsh' and SM71 refers to a 12 sq km oil lease to the south of Marsh Island, Louisiana. This lease had been an oil producer between 1995 and 2010 and Byron bought this lease when the Bureau of Ocean Energy Management, a US Federal agency which manages the Outer Continental Shelf, offered it for sale in 2012. The Byron #1 well found oil in April 2016 and after a production platform was installed production at SM71 started in March 2018 at a pretty strong rate. Byron got its capital costs back after just nine months and, having spent just US$14 a barrel to find a strong 2P (proved and probable) reserve, that reserve had an independent calculated NPV of US$160m at a 10% discount rate, which is about A$265m at the current exchange rate. Those valuations, by the way, are a standard part of the way the oil industry works, not some way to spruik oil company stocks.

It's good to be the operator

Byron has responded to the current crisis by cutting production from SM71 so as not to give away its valuable oil too cheaply. You can do that if you're the operator, which is Byron's modus operandi, and where you are carrying virtually no net debt. The company may also cut back on capital expenditure related to SM58 where the discovery well was made late last year and where the intention had been to start production this year. The 2P NPV at SM58 is a cool is US$332m (A$549m).

We think the market has over-reacted when it comes to Byron Energy. Indeed, the stock is now trading at a P/E of just 2.3x forecast FY22 earnings. FY22 is a while away, but between now and then there is a chance that Byron can benefit from a recovery in oil price and start to unlock some of that 2P NPV.

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Source: Tradingview

New contract wins reflect demand for comprehensive services

MACA's half year results showed 12% revenue upside to $364m, a 97% increase in EBITDA to $54.4m and 48% growth in NPAT to $12m. More than two-thirds of revenue came from the core Mining Australia division and the key gold mining sector accounted for 57% of revenue by commodity. The robust 1HY20 margin improvement was driven by improving labour costs and an absence of equipment delays that weighed on FY18 performance. The company is forecasting FY20 revenue of $770m and EBITDA from operations of $104m to $110m.

MACA has had a series of impressive new contract wins. In November 2019 it secured a five-year, $480m contract from West Perth nickel miner FQM Australia Nickel that will diversify its client base and commodity exposure. On 16 March it was awarded a contract with Atlas Iron to support the public road upgrade and access road works at the Corunna Downs Iron Ore Project in the Pilbara. The contract is expected to produce $38m in revenue over the eight-month life of the project. MACA also announced that it received a 12-month extension to its contract with mining company BHP for its Eastern Ridge Mobile Crushing project.

The company has experienced solid growth in its work-in-hand. Work-in-hand (WIH) refers to the portion of a contractor's order book that has yet to be completed. In FY19 WIH increased 62% to $2.1bn and has continued to climb in FY20 with overall WIH at $2.4bn as of 23 February. The tenure of the WIH contracts range from one to nine years extending out to 2028. Some 90% of the WIH is in the mining segment with the remainder in Crushing, Civil & Infrastructure and the company's 60%-owned Interquip Construction division. Within the Mining and Crushing divisions, we believe the WIH commodity exposure is well diversified among gold, coal, nickel, iron ore and lithium projects.

Brazil out, Cambodia in

The company's WIH position took an $8m hit as a result of its January 2020 exit from the Brazilian market. MACA enacted the early termination of its contract with Brazilian exploration company AVB Mineracao that was set to expire later this year. The decision stemmed from the company's bill payment tardiness, which impacted the financial performance of the agreement. The end to the five-year relationship caused MACA to record a $2m non-cash impairment charge related to the Brazilian departure. It also expects to incur approximately $5m in foreign exchange losses.

The Mining International division accounted for just 3% of 1HY20 revenue but is an important part of its growth strategy. Despite the recent exit from Brazil, MACA is moving forward with other international expansion efforts. On 12 March, it announced the signing of a US$230m mining contract with Emerald Resources to supply earthmoving equipment and conduct contract mining services for the Okvau Gold Project in eastern Cambodia over the next seven years. Progress is being made at Okvau with the first gold production targeted for Q2 2020 and MACA expects to start mobilisation activities at the site in August 2020.

Mining services market resumes growth

After experiencing negative growth from 2014-2019 due to the end of the mining boom the outlook for the contract mining services market in Australia is looking up according to research firm IBISWorld. The $10bn market is expected to return to growth in 2020 due to an increase in capital expenditures on mining. Much of this potential growth has been put on hold by slowing economic activity as a result of the Coronavirus pandemic. However, a recovery in commodity prices would spark the forecasted spending increase. Mining firms are investing in new expansion projects and looking to outsource much of the operations to services companies like MACA.

MACA has a strong pipeline of civil construction projects in Victoria where it is also seeking road and maintenance opportunities with state and local governments. The pipeline is also strong in the West Australian iron ore sector due to demand for bulk earthworks services. A commodity price recovery would allow MACA and the mining services market to realize some of this upside potential, in our view.

At an EV/EBITDA of 2.6x and a P/E 7.1x, both for FY21 that starts in July, we believe MACA is not expensive at all, especially considering the company's current backlog of work and future growth opportunities. Which is why we rate MACA 4 stars.

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Share price chart

Source: Tradingview

Early market entry, low transaction cost are advantages

Tyro's payments platform takes a software-led approach to payments. It is based on a proprietary technology that seamlessly integrates with many point-of-sale (POS) systems. Tens of thousands of Australian businesses rely on Tyro's payment terminals and other solutions. The company's focus on its core markets of health, hospitality and retail have earned it a reputation as the expert in these industries and secured new customer relationships. These merchants combined are a segment that has historically been underserviced by the major banks. The group accounts for 85% of Tyro's merchants and 91% of company transaction value.

The platform has several competitive advantages. Tyro enjoys a first mover's advantage having been the first entrant into the Australian EFTPOS business in 1996. The company has broad and direct access to the Australian financial system through its various licenses and memberships and is an active voice in industry regulatory discussions. It offers low cost routing with some of the lowest transaction fee rates in the business. Tyro's Tap & Save was Australia's first least-cost routing solution and enables merchants to process contactless debit card transactions at up to 6% lower fees.

Aside from transaction services, the platform doubles as a merchant bank offering deposit accounts and business loans. Tyro has been scaling its banking products to its full merchant base to increase revenue opportunities. All 32,450 of its merchants can check their business loan eligibility through the Tyro app whereas less than one-fourth could do so previously. It also recently doubled its maximum eligible loan amount from $50k to $100k. These steps led to a substantial increase in loan originations and active bank accounts increasing from 1,734 to 3,127 between 1HY19 and 1HY20.

Coronavirus Crisis slows momentum

The Coronavirus Crisis is likely to have a material effect on merchant transactions with many Australians staying home and avoiding discretionary spending. Just how much this will slow Tyro's growth in unknown as the economic environment remains very tepid. The company's recent entry into the e-commerce market, however, should help alleviate some of the near-term volume pressures. It launched its e-commerce channel in March 2019 and generated $3.1m in transaction value in 1HY20 from a base of zero. We believe E-commerce represents a significant growth opportunity going forward.

Tyro had a strong financial position going into the COVID-19 crisis. The December 2019 IPO increased contributed equity by $120.1m to $264.6m and bolstered its cash balance by $108.4m to $140.3m. It also helped increase its total capital ratio to 145%. The balance sheet should continue to support continued growth, in our view. Capex is expected to be $15.2m in FY20.

The company had solid momentum in the business prior to the Coronavirus Crisis. Operating leverage was increasing as strong cost controls led to its first positive EBITDA contribution since it obtained its banking license in 1HY16. In the payments business, transaction value was up 29% year-to-date through 20 February. Revenue was up 28% and gross profit was up 23%. In the banking business, loan originations jumped 75% and deposit balances nearly doubled YTD with overall banking revenue up 67% through 20 February.

Large market opportunity

The way Australians make payments is changing. A growing youth population and an overall consumer base willing to adopt a variety of e-commerce techniques, including social media shopping, has changed the transaction landscape. It has created a need for merchants to provide a simple, fast payment experience. With just 3.2% of its total addressable market Tyro is striving to capture share in the growing $651bn Australian card payments market.

An area of focus will continue to be the health, hospitality and retail subset of this market which is a $171bn market (of which Tyro has a 10.2% share). Once the Coronavirus Crisis subsides and shoppers return, the payment solutions provider should be able to strengthen its leadership position in its core verticals. It will also have expansion opportunities in new industries within the rapidly evolving Australian payments market.

However, near term we want to see how the current lockdown affects Tyro's bottom line. Hence, our 2-star rating at this point.

Pitt Street Research Pty Ltd

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