28 APRIL 2020

Stocks Down Under

“The greatest teacher, failure is”

- Yoda (896 BBY - 4 ABY), Jedi Master

NINE ENTERTAINMENT
Don’t watch the Jurassic Park reruns

NRW HOLDINGS
Attractively priced mining contractor

PANTORO
Now working on its ‘company maker’ at Norseman

NINE ENTERTAINMENT

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Stocks Down Under rating: ★★

ASX: NEC
Share price: A$ 1.21
Market cap: A$ 2BN

The market has not been kind to Nine Entertainment in the two years since the Old Media dinosaurs Nine and Fairfax got together. Back in July 2018, when that merger was announced, Nine stock peaked at $2.56 on the assumption that it could achieve good things with the Fairfax assets. By the beginning of 2019 the market wasn't so sure this hook-up could work, and by February 2020 it was reasonably certain that Nine remained a dinosaur. Covid-19 has made things even worse. Make sure you stay out of Jurassic Park.

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NRW HOLDINGS

Attractively priced mining contractor

Stocks Down Under rating: ★★★★

ASX: NWH
Share price: A$ 1.755
Market cap: A$ 683M

Perth-based NRW Holdings is a one of Australia's largest civil and mining contractors. Since its founding in 1994, the company has been able to grow and diversify its sales both organically and through strategic acquisitions. A favourable outlook for Australia's mining services industry should provide a supportive backdrop for continued growth over the next several years. The company's stock has bounced off its recent low following a strong 1HY20 performance. There appears to be room for additional upside as the global economy seeks to dig itself out of the Coronavirus Crisis.

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Share price: A$ 0.145
Market cap: A$ 170.5M

The emerging Perth emerging gold producer Pantoro has made a spectacular comeback from the 23 March low of just 6.9 cents. Last Thursday the stock made it to 14.5 cents. And no wonder. This company, which owns the Nicolsons Gold Mine near Halls Creek in the eastern part of the Kimberley Region of Western Australia, is not only debt free and holding $27m in cash and gold as at March 2020, it is also unhedged on future output from Halls Creek. And, more importantly, it holds 50% of the very promising Norseman Gold Project at the other end of WA. With gold running as hard as it has lately, that's an ideal position to be in.

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Share price chart

Source: Tradingview

Once upon a time the Nine Network was one of only three free-to-air television networks in Australia. Because it rated the best out of the three it was a license to print money for the legendary billionaire Kerry Packer (1937-2005) when he got it back from Alan Bond for just $250m in 1990. And if Covid-19 had actually been Covid-91 Kerry would have made back that money pretty quickly because all those temporarily locked down people would have been at home watching Channel 9 when they weren't reading the Fairfax dailies to get their news.

There's no sport to watch

But that was a long time ago. Today those locked down workers are watching Netflix instead and getting their news from Facebook. Nine and Fairfax have both basically lived off their accumulated cultural capital since the glory days came to an end about 2002. The transition to digital has been made but not definitively, so the businesses remain in long-term structural decline. And right now, the Coronavirus Crisis is giving the viewers and readers a reason to try out new entertainment and information options, especially since there's no sport to watch, like the Rugby League.

The trouble with structural decline is that it is steady, but slow, so you can sometimes be fooled into thinking things are turning around. Somewhere between 10 million and 15 million people tune in digitally to the company's various products in the course of a typical month, be it the Australian Financial Review, or 9now or Domain. However, in the December 2019 half Nine's revenue still fell 2% across the combined Nine/Fairfax businesses and EBITDA fell 8%.

Is Nine really digital?

CEO Hugh Marks and his colleagues can talk about digital being 40% of total EBITDA in the half, but there's 'digital' and there's real 'digital'. If it's just the tired Old Media format streaming over BVOD (broadcast video on demand), that doesn't really pull in any new eyeballs – or, more importantly, advertisers. And, interestingly, Stan, which is an Australian version of Netflix, including the development of original content, may have more than 1.8 million subscriptions these days, but that venture is still being left in the dust by Netflix, which has three times as many.

Nine's most successful response to its structural decline over the last few years has been to cut costs aggressively. This is now being stepped up in order to deal with Covid-19. Something like $266m is now being taken out of the business including broadcast programming and capital expenditure. We fear those kinds of cuts will impact competitiveness still further, because if there's one company that's not cutting back expenditure it's Netflix.

A modest debt burden

We believe Nine won't be going the way of the Virgin, or dodo, any time soon because its debt burden is modest – only $278m as at December 2019 for the non-Domain part of the Group. However, we don't think Nine is headed higher any time soon either because this current Coronavirus Crisis is throwing advertising markets into chaos as businesses cut all but non-essential spending.

Some people are talking about a 30% decline. More important than the number, however, is where it's going. It's not clear where the ad spend will be once all those eyeballs have moved to more interesting media properties. Two stars from us.

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Share price chart

Source: Tradingview

Strong industry outlook supports growth prospects

NRW produced some strong 1HY20 financial results. Revenue increased 55% to $808.7m primarily driven by increased activity in the civil business and higher mining volumes as additional fleets were deployed. EBITDA rose 27% to $94.6m and net profit after taxes (NPAT) was up 28% to $41.2m. The company's return on capital employed (ROCE) improved substantially from 12.5% in FY19 to 25.1% in 1HY20.

A look down the road suggests this type of growth can continue once COVID-19 issues subside. The Australian contract mining services industry has a strong long-term outlook. Over the next five years, with commodity prices forecast to increase gradually, mining companies are expected to increase capital expenditures to expand their mines and develop new exploration projects. This should give NRW lucrative opportunities to provide mine development works for some major Australian iron ore and other commodity projects. NRW has already seen some promising activity in gold mining stemming from its involvement with Perth-based gold exploration company Gascoyne Resources (ASX: GCY), which has seen increasing gold production in recent months.

Acquisitions bolster revenue diversification

NRW has significantly enhanced its capabilities over the years by making strategic acquisitions. The buyout of Golding Group and RCR Mining Technologies were highly successful and have been instrumental in NRW's development. Moreover, the acquisition of DIAB Engineering has further improved its capabilities across plant construction, product support and shutdown maintenance activities. A combination of aging assets and increasing demand for maintenance services in Western Australia and Queensland should support significant growth in these areas. NRW's M&A strategy has not only added complementary businesses to its portfolio, but has also given it much improved scale and revenue diversification.

NRW's civil business unit is one of Australia's leading contractors in the resources and infrastructure sectors. The recently completed $270.1m takeover of BGC Contracting has improved the company's growth opportunities in this division. It added a fleet of more than 200 pieces of mobile mining equipment along with its DIAB Engineering subsidiary, which generates maintenance annuity style revenue and has attractive growth characteristics. BGC was recently awarded a $155m rail formation contract at Eliwana by Perth miner Fortescue Metals Group spanning 65km of railway. The integration of the newly named NRW Contracting has begun and more than half of the projected $15m in annual cost savings have been achieved.

Very solid backlog of work

Much optimism can be taken from the NRW's sizeable order book, which has reached $3.8bn. It has focused on building its sustainable revenue base by adding more annuity style revenue to the order book. In addition to enhancing NRW's revenue and earnings base, the BGC acquisition included the company's robust $1.5bn order book of which $0.8bn is scheduled for delivery in FY20.

Most of this work in hand is in the mining business which contributed $493m to FY19 revenue. In February 2020, the company was awarded a $70m Iron Bridge package for Perth-based iron ore company FMG and Vietnamese steel company Formosa Steel and secured a new client contract from Sydney-based Origin Energy for around $15m. The company is looking to add to this order book by getting involved in the large infrastructure projects targeted to start in West Angelas next year.

Increasing cash balance and dividend

NRW has a strong balance sheet marked by a highly effective cash conversion of 91% of EBITDA. Its cash holdings increased to $122.5m as of 31 December 2019 supporting the company's recent 25% interim dividend hike to 2.5 cents per share. Debt increased in the most recent period because it assumed BGC's asset finance debt and took on $30m in debt for new equipment, but remains at a healthy level. Gearing was 38% after the BGC buyout, but is forecast to return below the 30% level by the end of the current fiscal year. The shares now offer a 3.8% dividend yield and are trading around 6.2x FY21 earnings (starting in July), which we believe is pretty attractive.

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Share price chart

Source: Tradingview

If you want proof that this Coronavirus Crisis has been doing crazy things to all sorts of share prices, Pantoro is a great example. At the 6.9 cent low, we were back at the same level as February 2014 when Pantoro, a mere junior explorer, acquired the project that became Nicolsons. At that time there was a JORC resource of 294,000 ounces, but no mine, and gold was only about US$1,270 an ounce, which translated to A$1,420 an ounce in Down Under money.

Halls Creek: Small but unhedged

In April 2020 there's around 35,000-40,000 ounces of gold coming annually from two mines near Halls Creek – Nicolsons and Wagtail North – and a 394,000-ounce resource. That operation isn't huge, and it isn't the lowest cost mine out there, with an All-In Sustaining Cost (AISC) right now of somewhere between A$1,550 and A$1,700 an ounce. However, as of the end of this month that production is all unhedged and with the Australian dollar gold price now north of A$2,700, Halls Creek makes good money for Pantoro.

Halls Creek, however, isn't the only thing to have gone right for this company in the years since 2014. Last year the company used its Kimberley-generated cash flow to buy into, what looks like, a genuine company-maker at Norseman, around 200 km south of Kalgoorlie in WA's Eastern Goldfields.

The old timers here found gold in a big way in 1894 and the Central Norseman Gold Mine was one important reason why Western Mining Corp. came to become an important mining company globally. WMC brought Central Norseman into production around 1935 and the mine was so rich it produced almost continuously until its closure in 2014. Pantoro is now working to bring this golden war horse with all its associated infrastructure and its 4.4-million-ounce resource back from the dead. That's right, 4.4 million ounces, half of which is now Pantoro's, split roughly 50/50 between surface and underground mineralisation.

Pantoro bought into a whole field

If you recall a London-based company called Norseman Gold plc, which was ASX-listed (code NGX) from 2009 to 2015, you'll know part of the recent history of the Central Norseman mine. It ran into production and cash flow difficulties and was placed in voluntary administration in 2012, from where it ended up in the control of the Sydney-based entrepreneur Kevin Maloney through his Tulla Group. In May 2019 Pantoro agreed with Tulla to acquire 50% of Central Norseman for $55 million in cash and shares, to be paid over time.

Pantoro and Tulla now control a vast block of exploration ground in the Norseman province, which historically has yielded around 6 million ounces. They are currently looking to prove up the existing Norseman resource and pick the first deposits to work once the mine re-opens. One likely candidate is the very high grade 'OK' underground workings where the average head grade was more than 9 g/t back in the day. Further afield, Pantoro is also getting started on the first systematic exploration work for the greater Norseman area since the mid-1990s.

Managing the 'nugget effect'

The challenge Pantoro faces at Norseman is that high grade mines tend to have too many 'nuggets'. If the geologists and the mining engineers aren't careful that can mean a serious over- or underestimation of the size of the resource and the grade of ore being processed. The nugget effect was the reason WMC sold to Croesus in 2002. Their loss is Pantoro's ultimate gain, since a high gold price makes the nugget effect much easier to deal with.

Norseman probably won't be getting started until 2021, however the increased resource combined with the higher gold price is likely to serve the company well for the foreseeable future. If you ever circumnavigate Australia using the network of highways called Highway 1 you'll pass through Norseman, population 574, as you drive between Esperance and the South Australian border. One suspects that by 2022 the population will be lot bigger than 574 and Pantoro's shareholders will be richer if management plays its Norseman hand adroitly. Wayne Zekulich, Pantoro's Chairman, likely thinks so – he was a recent on market buyer of Pantoro stock.

Pitt Street Research Pty Ltd

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