12 MAY 2020

Stocks Down Under

No one has ever become poor from giving.

- Anne Frank (1929-1945), German-Dutch diarist of Jewish origin

PUSHPAY

You gotta have faith, faith, faith

ENVIROSUITE

Airports not looking to spend money right now

WEST AFRICAN RESOURCES

A low-cost gold mine not quite in the Badlands

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Stocks Down Under rating: ★★★★

ASX: PPH
Share price: A$ 6.20
Market cap: A$ 1.7BN

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Share price: A$ 0.125
Market cap: A$ 118M

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Share price chart

Source: Tradingview

A lot of successful tech start-ups have an interesting history, but Pushpay's is one of the more unusual. A churchgoer in Auckland named Eliot Crowther was sitting in a worship service one Sunday around 2011 and asked himself whether it was possible to make contributing to the collection plate as easy as buying a song on iTunes. His fellow churchgoer Chris Heaslip agreed that app-based technology could bring that dream to life, and after NZ$40,000 seed money from each co-founder, the result was Pushpay.

A born-again business plan

The first customer for Pushpay's donor management system was Auckland's Life Church and pretty soon most of the big churches in New Zealand had followed suit but New Zealand isn't exactly bursting at the seams with churches. Indeed, people who hate the All Blacks might agree that the country is controlled by the Devil. Be that as it may, the big money for what Pushpay had to offer was in the US, where the churches are so large and plentiful that some have suggested their collective membership was able to swing a Presidential election in 2016. For Pushpay that market was, to borrow a Biblical analogy, the Promised Land and the first large US customer, a 7,000 member church in San Diego, signed on as early as April 2013.

Now fast forward in time and the milk and honey is flowing in for Pushpay. In the year to 31 March 2020, revenue was US$127m, up 32%, and EBITDAF (the 'F' stands for 'foreign currency gains/losses') was US$25m, as against just US$1.3m the previous year. There are now close to 11,000 customers across 19 countries processing in excess of 26 million transactions annually via Pushpay. The company makes its money partly from monthly subscription fees and partly from taking a cut of the credit card fees it collects. The subscriptions in the March 2020 year were only 28% of total revenue, so the company is not very reliant on selling to new customers. Which explains why the gross margin of this Kiwi technology wonder is now 65%, as against 55-58% for the prior few years.

300,000 American churches just waiting to be saved

We argue there is a heck of a lot more growth where that came from. America alone has more than 300,000 churches with an average of more than 500 members. That means even before the current crisis Pushpay was still only scratching the surface of its main market opportunity. Then came the Virus from Hell and suddenly bricks and mortar churches were shut and the pastors had to find other ways to keep their communities together.

Christians who take their religion seriously are not known for their embrace of technology, with their ancient belief sets and old-fashioned values – not to mention their average age, which is often higher than the general population. Which is why you find so few of them leading start-ups in Silicon Valley. However, because of the Coronavirus Crisis they all went online with alacrity. And went looking for new ways to stay on budget. Pushpay's season of blessing had come, which is why on 18 March the company was able to say that Covid-19 had not impacted it in the slightest. The re-rating of Pushpay we noted above followed hard after that announcement.

Re-rating to continue

We believe that re-rating can continue for a while yet. Consider that Pushpay is currently trading at 32x forecast earnings for the year to March 2021. Not exactly a single digit multiple, but low given the multiples being afforded to payments companies and other companies involved in the Cloud. On an EV/EBITDA basis, the valuation looks very compelling, though, given the massive growth opportunity Pushpay is addressing, with a multiple of 21.7x for FY21 and a projected 107% jump in EBITDA this year.

Buy on faith right now, or if you're a sceptic, wait until the next result that confirms the massive growth is real.

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Share price chart

Source: Tradingview

Envirosuite has developed software that uses analytics, both historical and predictive, to help companies such as miners, wastewater companies, port operators and refineries to monitor and model their environmental impact. For instance, using hyper-localised weather forecasts, customers' operating data and its own algorithms, Envirosuite can predict how odours from wastewater treatment plants, dust from loading cargo ships in ports and exhausts from industrial chimneys will travel and impact the facilities' surrounding areas. The software can provide predictions of up to 72 hours to help companies limit their environmental impact.

Envirosuite sells it software in a SaaS model (Software-as-a-Service) and is active in Australia, New Zealand, South America, Spain, China, Canada as well as a few countries in the Middle East. It recently announced several multi-million dollar deals in China in the area of wastewater management. In FY19 the company generated $7.7m in total revenues and recorded an EBITDA loss of $4.9m.

Disappointing performance to date

Envirosuite has been around for quite a while. The company was founded in 2004 and listed on the ASX in 2008 as Pacific Environment Ltd and was renamed Envirosuite in 2011. Since its listing, the share price peaked at 52 cents in 2008 and saw a low of about 2 cents in 2012. It's fair to say investors haven't really benefitted much from their Envirosuite holdings.

We believe lack of traction with prospects is mostly to blame for that. In 1HY20 revenues amounted to $3.7m, which is down from $4.8m the prior year, largely due to lower one-off hardware sales. Stripping out lumpy hardware sales, and only looking at recurring revenues from software, revenues grew by 11.5% year-on-year. That's not much for a SaaS company. After many years of disappointing revenue growth, management must have realised bolder steps were needed to make a difference in the world of environmental management technology. Enter EMS.

EMS acquisition is transformational

In January 2020, Envirosuite announced the acquisition of EMS Bruel & Kjaer Holdings (EMS), headquartered in Melbourne, for $70m in cash, 80m new Envirosuite shares and 95m options. EMS specialises in noise and vibration monitoring at airports. With 400 customers in 40 countries in its client portfolio the company is one of the largest global players in this space. It generated $47.5m in revenues in calendar 2019, of which $35m was recurring in nature. This is up from $43.7m the year before. Given the $7.7m revenues that Envirosuite generated in FY19, maybe the company should be renamed EMS Bruel & Kjaer.

Given that EMS is predominantly active in the US and Europe, the geographical synergy with Envirosuite is remarkable. The only significant overlap between the two companies can be found in Australia and New Zealand. Additionally, the addressable markets are highly complementary, so we believe there is likely to be a lot of cross-sell opportunity between the two companies.

EBITDA breakeven is a few years away

Envirosuite is only covered by one analyst, so blindly following "consensus" estimates is very tricky. This one analyst projects revenues to grow from $7.7m in FY19 to $26m in FY20, which would include the revenue contribution from EMS in the second half of the financial year. For FY21 and FY22, revenues are projected to grow to $63.6m and $76.5m respectively, strong revenue growth indeed. However, Envirosuite is not expected to become full year EBITDA positive until FY22 with an estimated EBITDA of $5.7m, or a 7.5% EBITDA margin.

With an approximate EBITDA breakeven level of $70m for the combined Envirosuite/EMS entity, investors wanting to see the scalability of the company's revenue model kick in, will need to be patient. But we believe that is factored into the share price given that Envirosuite is valued at an EV/sales of just 1.6x, which is very modest.

Even though the stock is not expensive in our view, airports around the world will not be jumping at the opportunity to spend money, given that COVID-19 is keeping 90% of the world's airplanes grounded right now. Additionally, a lot can go wrong between now and Envirosuite reaching EBITDA breakeven in FY22. So, we are neutral on Envirosuite for now.

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Share price chart

Source: Tradingview

When it comes to low cost production for a new gold mine, it doesn't come much cheaper than it does for Sanbrado, 90% owned by West African Resources, which has a 3.1-million-ounce JORC 2012 resource. This mine's average annual output for the next five years will be 217,000 ounces, at an All-In Sustaining Cost (AISC) of only US$563 an ounce.

Costs under US$700 an ounce!

Indeed, it gets even better. Thanks to high grades, Sanbrado will yield 301,000 ounces at an AISC of US$497 an ounce in the first year. For the whole ten years of Sanbrado the average annual output drops to 153,000 ounces, but this mine's average AISC will still be US$633 an ounce. Not bad when gold is currently changing hands at over US$1,700 an ounce.

Why so low? Basically, because Sanbrado has high grades and the metallurgy allows a very conventional flowsheet of SABC (SAG, ball mill and pebble crusher) followed by CIL (carbon-in-leach) recovery.

It’s also worth noting that ten years might not be the end of Sanbrado because exploration may yield further resources. Indeed, on 29 April West African Resources announced that it had just acquired a 1.1-million-ounce resource called Toega, only 14 km from Sanbrado, for US$45m in progressive payments.

Sovereign risk

There is a potential downside to all this, and it’s called sovereign risk – but not the usual kind where the government steals the mine or part thereof. Burkina Faso is small landlocked country just to the north of Ghana. It’s about the size of the US state of Colorado but with a population 2.6 times larger, at around 21 million. If you remember the maps of Africa on the wall at school, Burkina Faso is the old ‘Upper Volta’, with a new name that means ‘Land of Incorruptible People’. Mmm …

Like Ghana, Burkina Faso is a major gold producer. Many resource sector investors rate Burkina Faso higher than Ghana due to the fact that, with its mining code updated from 2015 and the tax burden reasonable, explorers can now go after big discoveries like Sanbrado in a region where the geology is favourable but the ground is relatively underexplored. The disadvantage of Burkina Faso is that it has a major problem right now with terrorism from Islamic militants, which an apparently weak government hasn’t been able to control. This has been on the rise since 2016 and it got really bad in November 2019, with an attack related to a gold mine in the east of the country. This impacted the Australian mining contractor Perenti Global (ASX: PRN – see our article on that company in the 21 April edition of Stocks Down Under).

Away from the Badlands

Sanbrado is only 90 km from Burkina Faso’s centrally located capital of Ouagadougou (pronounced ‘Waga doo goo’), and therefore notionally a long way away from the Badlands closer to the border with Mali where the trouble originated from. But with terrorism gradually showing up in more places within the country, the mine may not be immune.

That’s the bad news for would-be investors. The good news is that there’s potentially more upside to the company’s share price, which is why West African Resources has run very hard since the end of the Corona Crash. The 2019 DFS, using a gold price of just US$1,500 an ounce, suggests the mine’s after-tax NPV at a 5% discount rate is US$599m, which translates to A$929m at the current exchange rate. For investors willing to accept the sovereign risk we described above, this one looks attractive.

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