26 MAY 2020

Stocks Down Under

> *'I'm very proud of my gold pocket watch. My grandfather, on his deathbed, sold me this watch.*
>
> **- Woody Allen (b. 1935), American director, actor and comedian**

NEWCREST
Long life gold play

LIVETILES
Intranets 2.0

BOSS RESOURCES
The Honeymoon continues

NEWCREST

Long life gold play

Stocks Down Under rating: ★★★★

ASX: NCM
Share price: A$ 31.61
Market cap: A$ 25.4BN

When companies are raising capital these days it's almost inevitably to shore up the balance sheet and make sure that the company can get through the current Coronavirus Crisis in one piece. Not Newcrest, which just raised about $1bn at $27.54 per share. That capital is purely to fund growth in mines around the world and take advantage of the great times for gold we're seeing right now.

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LIVETILES

Intranets 2.0

Stocks Down Under rating: ★★★★

ASX: LVT
Share price: A$ 0.23
Market cap: A$ 207.5M

From its head office in New York, LiveTiles offers intelligent workplace software for corporates, government agencies and schools. What is intelligent workplace software you ask? It's software that helps a company's employees work and communicate more efficiently, which is particularly important with so many people working from home at the moment. LiveTiles signed its first paying customer in February 2015 and listed on the ASX in September of that year. Five years later, the company's annualised recurring revenues amount to more than $55m, generated by more than 1,000 customers.

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Share price chart

Source: Tradingview

When you look at the list of the world's largest publicly traded gold miners it starts with the perennial Big Three – Newmont (6.3 million ounces in 2019), Barrick (5.5 million) and AngloGold Ashanti (3.3 million), after which comes three relative newcomers – the Russian miner Polyus (2.8 million), the Canadian company Kinross (2.5 million), and, at No. 6, Australia's Newcrest (2.4 million ounces).

The reason all these companies are in this list is largely because of leadership decisions back in the 1990s to stick with gold when that commodity was not priced all that attractively, and because that commitment to gold subsequently yielded some significant and low-cost mines.

The House that Cadia Built

For Newcrest the mine that made it a world-beater was Cadia, developed out of a gigantic porphyry copper-gold system about 25 km south of the regional city of Orange (population 40,000) in central NSW. The original discovery at Cadia Hill was made by Newcrest geologists in late 1992 who followed it with Cadia East in 1994. Observers of the gold space were unsurprised by the Cadia discovery because it was so close to the Ophir gold strike that created the Australian gold industry in 1851.

What surprised everyone was the size of the resource, which by 1995 had reached a massive 6.8 million ounces of gold and half a million tonnes of copper. That size meant that, even if the mine came into production in the middle of the late 1990s bear market for gold (which went from over US$400 an ounce in early 1996 to under US$300 by mid-1999), the shareholders of Newcrest would ultimately do very well indeed.

The gift that keeps on giving

How well did those patient shareholders do with Cadia? Fast forward a couple of decades to FY19, and the operation contributed just over a third of Newcrest's gold output for that year, yielding 913,000 ounces of gold and 91 tonnes of copper. The All-In Sustaining Cost (AISC), once you kicked in the copper credits, was a mere US$132 an ounce. Not bad during a year when gold averaged more than US$1,200 an ounce. Indeed, Cadia is the gift that keeps on giving for Newcrest. Currently there's 37 million ounces of gold and 8.2 million tonnes of copper in the resource, so it'll likely to be producing strongly well into the 2050s. Let the Newcrest bears run a Discounted Cash Flow model on that!

Cadia, however, isn't the only monster asset in Newcrest's portfolio with decades to run. One with a potentially even longer mine life is Lihir, on the island of the same name that belongs to Papua New Guinea. Lihir, in operation since 1997, came into the Newcrest family in 2010 when the company spent A$9.5bn acquiring the listed Rio Tinto associate which owned it. This was the transaction that made Newcrest one of the world's biggest gold miners. The timing was lousy in that, no sooner had Newcrest spent $1.3bn to upgrade the mine to around the million ounce a year mark, the gold price fell in a heap. But, as with Cadia, Newcrest's vision has since been vindicated – in FY19 it produced 933,000 ounces at a still very low US$887 an ounce AISC. And there's more where that came from. Lihir sits atop a truly massive resource of 49 million ounces.

Moving into the Western Hemisphere

What we really like about Newcrest right now is that the same spirit which drove the Lihir deal is still at work today. The $1bn raised last month is going partly to increase Newcrest's exposure (via debt and gold offtake contracts) to the Fruta Del Norte mine in south eastern Ecuador, which just started up and is expected to produce at only around US$621 an ounce AISC over the next 14 years. The mine is owned by Canada's Lundin Gold (TSX:LUG), but Newcrest holds 32% of Lundin's stock.

The new Newcrest capital will also partly go to what could be the 'next Cadia', a copper-gold mine in the Canadian province of British Columbia called Red Chris. Newcrest bought 70% of Red Chris in March 2019 for US$806.5m. That mine is in the middle of nowhere, which is to say, a dreary 1,700 km north of Vancouver on the same latitude as the Alaskan capital of Juneau. What's not in the middle of nowhere is the resource, which currently covers 20 million ounces of gold and 5.9 million tonnes of copper. In the years ahead we expect to see big increases in the profile of Red Chris, which only produced about 36,500 ounces of gold in calendar 2019.

One for the big-time asset managers who like gold

Newcrest has re-rated nicely to more than $31 since the Coronavirus-related sell-off in February and March when it bottomed at just under $22 a share. However, we still think there's more upside from here. Newcrest is currently on a P/E of 20x FY21 earnings, which is low for a stock with the potential to grow EPS 25% in that year alone.

More importantly, gold continues to run hard and we think it won't have to try too hard to reach US$2,000 an ounce in the year term, carrying all the major gold players with it. The same institutions who would ordinarily buy Newmont to get exposure to gold now have to think about Newcrest given this company's global ambitions and exceedingly long-life assets.

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Share price chart

Source: Tradingview

Fast setup and deployment of Intranets

While you could be fooled into thinking that LiveTiles is a Microsoft subsidiary when you look at the company's website, LiveTiles is actually a provider of Intranet solutions. Its proprietary software revolves around fast and easy setup of customized Intranets for a range of different organisations. The idea is that a company's Intranet is the home page for its employees, which should therefore be highly engaging and provide highly relevant content.

LiveTiles' software, which is being sold as a service, i.e. in monthly recurring subscriptions, enables organisations to combine many different third-party applications, such as Canva, Zendesk, Workday and Drive, together in one place. Given that LiveTiles integrates with a number of different workflow platforms, including Salesforce, Slack, SharePoint and Outlook, the Intranet is no longer a standalone application that employees have to start up on their computers. Instead, it's present throughout employees' workspaces, including their mobiles.

High dependency on Microsoft products

One of LiveTiles' strategic pillars is the company's relationship with Microsoft. A lot of the services LiveTiles provides relate to Microsoft products in one way or another. For instance, Microsoft Teams is a unified communications platform that brings video conferencing, chat and file storage together in one place. Think of it as Skype, Zoom, WhatsApp, Drive, Dropbox, Messenger etc. all bundled into one application that integrates with Microsoft's Office 365. LiveTiles helps companies and government organisations set up and manage Microsoft Teams. Similarly, LiveTiles helps companies integrate Microsoft SharePoint with Teams.

The main reason for this strong relationship with Microsoft is Microsoft's presence in the Enterprise and SMB market where Office365 is widely used. LiveTiles estimates there are around 300,000 companies worldwide that use Office 365. So, focussing on integration with Microsoft products makes strategic sense.

Strong growth in the last 5 years

Annualised Recurring Revenues (ARR) is a term often used by SaaS companies to indicate what their annual revenues would be if we extrapolate the revenue from the last quarter. In other words, ARR is basically last quarter's revenue times 4. LiveTiles' ARR reached $55.2m in the third fiscal quarter that ended in March. That's up an impressive 60% from last year. ARR is not the same as actual revenues booked in the last 12 months, but it does provide a very good indication as to where actual revenues are headed in the next twelve months.

LiveTiles isn't yet EBITDA positive, although the company recently pulled forward its target to become EBITDA positive. It now expects to achieve this in the current calendar year. From the next financial year onward EBITDA is still expected to be modest. Consequently, EV/EBITDA as a valuation metric isn't very useful right now. Instead, we have looked at LiveTiles' EV/ Sales multiples to get a sense of the company's current valuation. For FY21, starting in July, the shares are trading at an EV/Sales multiple of 2.65x, while this multiple is 2.1x for FY22.

That is not expensive at all, in our view, for a company that is growing its revenue base so strongly. Add to that the fact that LiveTiles has a strong cash position of $33m and does not need to raise additional capital going forward, according to its own statements, and you end up with quite an attractive investment proposition, in our view. Four stars in our book.

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Share price chart

Source: Tradingview

It has been a long time between drinks for that clean, green energy source of the future, uranium. Back in mid-2007 uranium was changing hands at US$136 a pound. Then a long bear market set in, one that looked like it had ended in 2010 at around US$40 a pound, and allowed a re-rating to US$70 a pound, before the Fukushima Daiichi nuclear disaster of March 2011. That unfortunate event slowed the rate of new nuclear power plant development for a while and basically kept the uranium bear market going until early 2017. Since then uranium has been 'base building' at between US$20 and US$30 a pound. Suddenly, in the last few weeks, it's gone above US$30, with the Coronavirus Crisis having caused the shuttering of mines in Kazakhstan and Canada, most notably the Cigar Lake mine in Saskatchewan, which is the world's largest.

An overnight success story 40 years in the making

The timing of the uranium upswing timing was perfect for Boss Resources, which has been working on Honeymoon since it bought it from Uranium One, a uranium mining subsidiary of the Russian nuclear energy company Rosatom, in 2015.

A heck of a lot of work had already gone into Honeymoon, which is near the SA-NSW border only 75 km northwest of the famous lead-zinc-silver mining town of Broken Hill, NSW. The Honeymoon deposit was actually discovered way back in 1972. Why they named it Honeymoon given the hot, dry and generally incommodious location is beyond us, but mining is like that – there's also a nickel project owned by Russia's Norilsk in Western Australia called Honeymoon Well.

$170m in plant and equipment for just $9m

The South Australian Honeymoon was promising, but it didn't get a chance to get developed for a long while because of the controversial 'Three Mine' policy of the Australia Federal government, which limited Australia, one of the most uranium-rich countries on the planet, to just three mines from 1984. Thankfully that policy was abandoned in 1996.

Boss Resources actually got a more or less completed uranium mine in 2015. Uranium One had commissioned Honeymoon in 2011 but then put it on care and maintenance two years later because the falling uranium price had made the usual teething problems you get with a new mine not worth the bother. For just $2.6m down, and a promise to pay $7 over the next four years, Boss got a fully permitted mine, an 880,000 lb per annum solvent extraction plant and a very high grade uranium resource of 5.3 million tonnes at 0.14% U3O8 (that's triuranium octoxide, the principal ore of uranium, but U3O8 sounds sexier) containing 16.6 million pounds U3O8, in a politically stable jurisdiction. The plant's replacement cost is currently estimated at about $170m.

A low cost mine

The Feasibility Study that Boss completed back in January on a potential Honeymoon restart showed what a big kick the 2015 deal had given its shareholders. This mine now has a Resource of 71.6 million pounds of U3O8 - and Boss believes there's more uranium to be found in a project area that hasn't been explored much in recent years. More importantly, Boss has a license to export 3.3 million pounds a year of U3O8 equivalent, and you aren't allowed to start uranium mines in Australia without an export license. Boss's latest thinking on Honeymoon is an operation that taps about half the current Resource over a 12 year mine life to produce 2.0 million pounds a year of U3O8 equivalent for most of that.

The All-In Sustaining Cost estimate is just over US$27 per pound, making it one of the world's lower-cost uranium projects. And all it takes to get this up and running is about US$63m in capex. At an 8% discount rate that gives a post-tax NPV of US$113m, which is A$174m at the current exchange rate. Not bad when the current market capitalisation of Boss is only A$107m. And that could be just the beginning – Boss has aspirations to go above 3 million pounds per annum once conditions are favourable.

Now comes the big caveat – the Feasibility Study was done with US$50 a pound U3O8 in mind. Many will be asking whether the current upsurge in uranium is sustainable post Covid-19. We think it is, given the long base building period for the commodity, the continued demand for new nuclear reactors in Asia and the apparent willingness on the part of established producers to not flood the market again. If one is prepared to take the commodity risk, Boss is well placed to enjoy the upside. At least one director seems comfortable with that risk – Chairman Peter O'Connor was a recent on-market buyer of stock.

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