



4 JUNE 2020

# Stocks Down Under

🗨️ *'I don't believe in hope. Hope is a beggar. Hope walks through the fire. Faith leaps over it.'* 🗨️

- Jim Carrey (born 1962), Canadian-American actor and comedian

## IOOF HOLDINGS

Acquisition to drive scale and cost savings

## ATRUM COAL

Living next door to Gina

## FIELD SOLUTIONS HOLDINGS

COVID-19, and federal funding drive regional build out

# IOOF HOLDINGS

Acquisition to drive scale and cost savings

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Stocks Down Under rating: ★★★★★

**ASX: IFL**

**Share price: A\$ 4.92**

**Market cap: A\$ 1.7B**

Based in Melbourne, IOOF Holdings is a diversified financial services company that offers financial advice, portfolio management and administration, and investment management products to advisors and their clients. The group's roots date back to 1846 when the Independent Order of Odd Fellows (IOOF) was formed as a friendly society that provided security to those not supported by the Government. Today, it is a growing collection of businesses and brands that includes Bridges, Consultum, Lonsdale, Shadforth and IOOF. Cost synergies and a broadened reach gained from the recent P&I acquisition combined with the reliability of the Portfolio and Estate Administration business should be supportive of long-term earnings growth.

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# ATRUM COAL

Living next door to Gina

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Stocks Down Under rating: ★★★★★

**ASX: ATU**

**Share price: A\$ 0.245**

**Market cap: A\$ 133.5M**

You've got to hand it to Atrum Coal, the company which has owned the Elan Coking Coal project in Canada since 2017. Only a month after its share price was slashed by 70% thanks to weak coal prices followed by the Corona Crash, it managed to raise \$22m at 23 cents per share to move Elan into a Pre-Feasibility Study. With coal now coming back to life price-wise and a favourable Scoping Study now completed, there could be some upside in this one.

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# FIELD SOLUTIONS HOLDINGS

COVID-19, and federal funding drive regional build out

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**ASX: FSG**

**Share price: A\$ 0.03**

**Market cap: A\$ 12.6M**

Based in Sydney, Field Solutions Group is a provider of remote telecommunications solutions. The company specialises in developing voice over IP (VoIP) products and services for customers in rural, regional and remote locations across Australia. The COVID-19 outbreak and resulting lockdown conditions put a spotlight on the telecommunications problems that have historically plagued regional Australia and the need for reliable and scalable connectivity solutions. As the 'new normal' unfolds, businesses and schools will continue to develop work and study from home solutions and demand telecommunication services from micro-cap company Field Solutions.

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## Share price chart



Source: Tradingview

## IOOF becomes fifth largest platform after ANZ P&I buyout

IOOF has completed many mergers and acquisitions over the years creating a diverse financial institution that serves over 500,000 customers and has \$196bn in funds under management, administration and advice (FUMA). The group's 34% FUMA jump from 31 December 2019 to 31 March 2020 was primarily the result of its January 2020 purchase of Melbourne-based Australia and New Zealand Banking Group (ANZ)'s OnePath pensions and investments (P&I) business for \$825m. The acquisition brought in \$77bn in FUMA and has the potential to add meaningful value to the firm.

The P&I addition is expected to provide the scale and geographic reach to take the business to the next level. With the purchase, IOOF instantly became the fifth largest financial platform provider based on funds under administration. It should see a major synergistic benefit through a reduction in its long-term cost base and generate significant earnings accretion. Management upwardly revised its expected cost synergies to \$68m per annum beginning fully on 1 July 2023.



## **Portfolio platforms are popular with advisers**

In the wake of the 2018 Financial Services Royal Commission, IOOF announced a damaging \$223m provision for remediation costs. Yet, despite the shockwaves that rattled the financial industry following the Royal Commission, IOOF has been able to regain its footing. Advice inflows were strong in the most recent quarter supported by the onboarding of 11 new practices. This suggested that the group can grow the wealth management side of the business.

Meanwhile the Portfolio and Estate Administration business has remained a dependable part of the company. The segment had a strong second quarter posting \$360m in net inflows and followed it with net inflows of \$180m in the third quarter. Despite the challenges surrounding the COVID-19 crisis, this result was roughly on par with the 3Q19 performance. The Coronavirus Crisis has, however, impacted the market value of the group's assets. Yet returns have fared relatively well versus the S&P/ASX 200 benchmark. Net inflows in the second quarter were the highest they had been since the June 2018 quarter. And while total net outflows were \$704m in the third quarter, excluding the newly acquired P&I business, they were a mere 0.04% of the beginning of period FUMA.

IOOF's proprietary platforms, including IOOF Essential, eXpand and Shadforth Portfolio Services, had net inflows of \$180m in the recent quarter. There were not any major outflows in the financial advice business save for one client departure. IOOF's modern portfolio platforms are increasingly popular with advisers. It recently released a managed account solution, which has been well received by clients. Despite the current cautious market environment, the strength of these platforms should continue to support fund inflows in the investment management business.

## **Shine class action a temporary distraction**

IOOF shares are still reeling from the news that the group received a class action lawsuit filed by Shine Corporate Limited. The proceeding was filed in Federal Court on behalf of investors who bought IOOF shares from 1 March 2014 to 7 July 2015. It alleges non-disclosures and deceptive conduct regarding the alleged corporate misconduct that was first disclosed in the June 2015 Fairfax Media articles. The alleged misconduct involved potential insider trading, front running, staff cheating on exams and breaches of trustee duties between 1995 and 2005. IOOF has dismissed the claim saying it lacks merit and plans to defend itself in the matter. Although, the company is hoping the Court will rule in its favour, the issues around the Shine class action will be a near-term headache for the group.

IOOF's balance sheet is in good shape with a cash position of \$68.8m that gives it the ability to meet regulatory net asset requirements. It has ample liquidity to meet member redemption obligations. After a strong fiscal 2019 performance, the company appears to be righting the ship and we would be willing to come on board at the current price level. The stock is trading near an 11-year low and comes with a 6.4% dividend yield.

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Source: *Tradingview*

It was the great American writer Mark Twain (1835-1910) who supposedly once said 'The rumours of my death have been greatly exaggerated'. The same could be said for coking coal. If you look at the latest price forecasts from KPMG, the view is that Hard Coking Coal (HCC) stays at US\$140 or US\$150 a tonne until at least 2024. Sure, global steel production in April 2020 was down 13% on the previous year, but with China's economy open again and others to follow suit as the Coronavirus pandemic fades, we expect that the demand for HCC can reboot along with steel. That could potentially be very good for Atrum Coal.

## A Calgary stampede into coal

If you've ever travelled on the Canadian Pacific Railway across the Rocky Mountains you would have come close to where Atrum's latest potential 'company maker' is located, in the Crowsnest Pass region that straddles the border between Alberta and British Columbia (BC). The nearest town is Blairmore, about 30 km to the north, while the nearest big city is Calgary, another 170 km or so further north. Crowsnest Pass has a long history of coal mining dating back to the early 20th century. While all the mines from that time eventually shut due to fluctuating prices and strikes, Atrum Coal wants to be part of a revival of coal here.

People who have followed the career of the legendary Perth mining entrepreneur Gina Rinehart will have already encountered the Crowsnest Pass's coal potential. Last year Gina's Hancock Prospecting bought the 80%, or so, it didn't own in an unlisted public company called Riversdale Mining. Its total investment, from the initial 20% in 2018 and then the rest in 2019, was A\$744m. Riversdale's company-maker is a coking coal project called Grassy Mountain, featuring 195 million tonnes of the stuff with the potential to be producing from 2021 for a 25 year mine life. And right next door to Grassy Mountain is Atrum's Elan property.

## **Working with Elan**

Before Elan, Atrum's main asset was an anthracite coal project called Groundhog. Yeah, that's right, Groundhog, named not because of *Marmota monax* nor because of a certain 1993 American comedy film, but because over a century ago a man called 'Groundhog' Jackson discovered a still undeveloped coalfield of the same name in northwestern BC. It's still undeveloped because it is more or less in the middle of nowhere. Indeed, the nearest town is Stewart, BC, down on the coast, which at a population of 500 is not exactly a bustling metropolis. Anthracite is a high-carbon and low-impurity coal prized by steel mills. Atrum's foundation project had over 1 billion tonnes of it and a 2014 Preliminary Feasibility Study (PFS) valued it at A\$2.1bn. But as far as we can tell, Groundhog was more or less stalled by a combination of the coal market downturn of 2011 to 2016, the centre-left nature of British Columbia's recent provincial governments and deficiencies in infrastructure. Atrum still holds Groundhog but reckons Elan is a much more realistic alternative for future shareholder value creation.

For a start, Elan is in established coal mining country, not only in Crowsnest Pass but across the border in the famous Elk Valley of south-eastern BC, where the Vancouver-based mining major Teck currently operates four coal mines (and where the ASX-listed Jameson Resources (ASX: JAL) wants to develop another). Which means you have nearby railways to easily ship the coal out to Canada's Pacific Coast and on to export markets via either Vancouver or the port of Prince Rupert near the Alaskan panhandle. Indeed, coal from here can often get to northern Asia faster than it can from the Bowen Basin in central Queensland. Then there's the nature of the Elan resource – 454 million tonnes of tier 1 hard coking coal in thick, shallow seams that would make for a lower strip ratio than Gina's mine is expected to enjoy.

## **A billion dollar coal mine?**

Atrum's scoping study for Elan hit the streets in mid April. In the study Atrum modelled a base case operation where 4.5 million tonnes of HCC would be produced at an estimated total cash operating costs FOB of only US\$84 a tonne, as against the US\$140 or so we noted above as the market outlook. So far so good. Throw in the fact that in April 2019 the good people of Alberta elected a Conservative and mining-friendly government under Premier Jason Kenney and you've got the makings of a great project so long as demand for coal out of Asia is favourable, which we believe it eventually will. The operation would take US\$587m to get up and running but a 15 year mine life would yield a post-tax Net Present Value of US\$790m at a 9% discount rate. That's A\$1.2bn at the current exchange rate. For a base case...

Now, a lot of stuff has to happen before Elan gets close to shipping its first coal, namely, a PFS, followed by a BFS, then the financing. Not to mention a recovery in global steel production. Which is why we're only giving this one three stars at the moment. However, the PFS is now funded thanks to the recent capital raising.

With coal prices on a modest recovery since last month and with the market only valuing the company at about a sixth of the conservatively estimated upside, we believe this one is worth putting on your radar screen. It is certainly on the radar screen of Tim Roberts, of the famous Perth Multiplex Roberts, who in the recent capital raising took his Warburton Group family office stake up to 19.9%.

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## Share price chart



Source: Tradingview

## COVID-19 demand accelerates regional connectivity

Field Solutions is both a telecommunications carrier and a technology company that provides connectivity and business solutions for individuals and entire communities. It builds the towers and other equipment necessary to connect regional Australia to the internet. It also supports cloud computing, the development of cloud software and apps, as well as wholesale telecommunication. The group's customers have included universities, such as The University of Sydney and municipal organizations, like Coffs Harbour City Council. Field Solutions partners with a variety of other telecommunication carriers to broaden its reach across regional Australia.

Regional Australia has historically faced challenges in having a reliable telecommunications network. For starters, there simply have not been enough companies devoted to connecting these parts of the country. Up until recently government financial support has also lacked. Past attempts at creating new network connectivity have led to blackspots, equipment failure and other technical shortcomings often leaving this part of the nation in the dark.

The COVID-19 crisis has highlighted the need for better telecommunication solutions in regional Australia. Telecommunications were appropriately deemed an essential service and this is especially the case in the remote parts of the country. People in these areas need better communication networks to communicate with family and friends, receive emergency information, read news and shop online. As the new normal unfolds, schools and businesses will continue to implement systems that allow students and employees to study and work remotely and therefore continue to turn to companies like Field Solutions.

### **Adding assets amid surge in demand**

Field Solutions has taken several steps to respond to the high demand. The capacity of its core network and transit are being increased. It is also deploying additional backhaul regional capacity and services to enable remote connectivity. Customer service capabilities are being enhanced to ensure smooth order processing and sufficient support. While the broad economy remains sluggish, Field Solutions is seeing orders arrive at a rapid pace. As of 30 March, the group had a contracted order backlog of more than \$3.5 million scheduled to be delivered over the next 12 to 18 months. This figure is likely much higher today. The backlog gives the company solid revenue visibility and a favourable intermediate term outlook. Management's focus on core activities and expense control also bode well for its upcoming results.

In addition to the opportunities that have come from the COVID-19 crisis, management has an eye for potential acquisitions. This may indeed be a good time to bring a complementary business into the fold to add to capacity and expand the group's offerings. The company made a pair of recent asset acquisitions to enhance its scale and services portfolio. On 1 October 2019 it agreed to acquire the assets of Ordnance Networks, the owner of a network-as-a-service platform that simplifies the provisioning and management of large telecommunication networks. The platform is expected to power Field Solutions' core national rural network and enable it to deliver new operational efficiencies and cost savings. Also on 1 October 2019, Field Solutions entered into an agreement to purchase the assets of IP Transit, a pioneer in wholesale on-demand internet connectivity for telecommunication carriers and content providers. This purchase will allow the group to sell IP Transit's products as a flexible, cost-effective national service and to expand internationally.

### **Mobile Blackspots funding supports expansion**

On 21 April Field Solutions announced that it received \$650k in funding as part of round five of the Federal Government's Mobile Blackspot programme. The group's partnership with a tier one Australian telecommunications carrier helped it secure the funding which will be used to build-out its broadband infrastructure across Narromine, Warren and Bogan Shires in New South Wales. The project is expected to be revenue accretive starting in Q3 of FY20/21. The group plans to apply for a piece of the \$80m round six funding which is expected to be released over the next 12 months.

Field Solutions has a strong balance sheet with a cash balance of \$440,000, total assets of \$10.2m and an absence of long-term debt as of 31 December. At the most recent quarter end, it had loan facilities of \$1.88m comprised of a \$1.25m convertible note from Kestrel Growth Companies, a 24-month Moula loan facility and a director's loan.

The company has a strong position in a niche, high demand market and is one we would connect to our investment portfolio. We are aware, though, that this is a nano cap company, which typically carry higher risks than larger companies.





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