Stocks Down Under

“It’s health that is real wealth, not pieces of gold and silver.”

- Mahatma Gandhi (1869-1948), Indian lawyer and anti-colonial nationalist

SARACEN MINERAL HOLDINGS

Super pit, super excited

ALE PROPERTY GROUP

Cheers to long term leases and rent increases

CATAPULT GROUP

One of the cheapest Tech stocks on ASX

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Stocks Down Under rating: ★★★★

ASX: SAR
Market cap: A$ 6.6BN

52-week range: $6.23 / $2.18
Share price: A$ 6.11

You've got to hand it to the gold miners on ASX – it's as if the Corona Crash never happened. The stock of Saracen, which as of last year owns half of the famous Kalgoorlie Super Pit, came down 35% between 24 February and 16 March, while the S&P/ASX200 came down 28%. But since then Saracen has about doubled and the general market is only up about 20%. And with gold headed to US$2,000 an ounce, we believe the party is probably not over just yet.

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ASX: LEP
Market cap: A$ 957M

52-week range: $5.77 / $3.32
Share price: A$ 4.85

Sydney-based ALE Property Group is a real estate investment trust (REIT) that was established in 2003 when Fosters divested its hotel business. It owns Australia's largest portfolio of freehold pub properties. The COVID-19 crisis has had a significant impact on the pubs business putting pressure on ALE's tenants. It is not, however, expected to have a material impact on ALE's rental income, and as the economy reopens, the group's tenants stand to benefit from pent-up demand for socialization at pubs. This should support the continued outperformance of the REIT, which has delivered a 20.2% per annum return since inception. We believe ALE Property's long-term leases, well-capitalised tenant base and opportunities for rental increases in a pub industry that is here to stay make it a good choice for the conservative income investor. The dividend yield is a reasonable 4.1%.

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Share price: A$ 1.17

Catapult Group listed on the ASX late in 2014 and was a market darling almost immediately. Based in Melbourne, Catapult provides monitoring equipment and software for athletes, both professionals and avid amateurs, also known as Prosumers. The company's share price rose to a high of more than $4 by mid-2016 on the promise of a highly scalable, recurring revenue model. Since then, it's fallen back to $1.16 today, which has brought the valuation down to the point where we believe Catapult is one of the cheapest of the EBITDA-profitable Tech stocks on ASX. We see upside to at least $1.85 per share in the next 12 months.

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Share price chart

Source: Tradingview

Over on the south-eastern edge of the Western Australian gold mining town of Kalgoorlie there's a giant mine whose real name is the Fimiston Open Pit but which everyone in the industry calls the Super Pit. It's world famous because it represents the consolidation of a number of old underground gold mines into one large open pit. Miners had long dreamed of doing it, because it would radically lower the cost of production. It was almost achieved by the legendary Perth entrepreneur Alan Bond, but his cheque book ran out before the task was completed, leaving it to Homestake and Normandy to start reaping the upside in 1989. Today, the Super Pit is one of the largest gold mines in the world.

How Saracen conquered the Super Pit

For a long time the Super Pit was owned by overseas mining companies, but in 2019 an extraordinary thing happened – Barrick Gold , which got its share from Homestake, sold that share to Saracen for US$750m while Newmont, which inherited the Normandy share, sold that to Northern Star (ASX:NST) for US$800m. So, a major mine in Australia, the world's largest producer of gold, was back in local hands. Both companies got to buy cheaply because of rock falls in May 2018, which have hampered production ever since. However, we think the new owners will make out well in the long term because the mine is expected to recover within the next three years or so. The Super Pit produced a massive 730,000 ounces of gold in the 2017-18 financial year. And no one knows what resources lie beneath the Super Pit because the mineralisation remains open at depth. That is, the geologists are convinced that if they drill deeper they'll find yet more gold.

We think the Super Pit deal is one reason why Saracen stock has done so well in the post-Corona Cash market. Obviously, the rampaging gold price, which recently went over US$1,800 an ounce again, is another, making the 15 million ounces in resources very attractive. And then there's the fact that Saracen's balance sheet is virtually debt free so it can keep expanding by acquisition if it finds the right deals.

350,000 ounces per year headed to 600,000 ounces

Before the Super Pit deal, Saracen was an emerging producer with 355,000 ounces in production in the year to June 2019 from two other Western Australian mines - Carosue Dam, 120 km northeast of Kalgoorlie (200,000 ounces) and Thunderbox, 45 km south of Leinster (155,000 ounces). The company operated at a very creditable All-In Sustaining Cost of A$1,030 when it was selling at A$1,722. And the resources and reserves were building up because the exploration potential of the neighbourhood is strong, particularly Carosue Dam where the Karari and Dervish deposits had proved to be the gift that kept on giving in recent years.

The Super Pit meant that the company did more than 500,000 ounces in the financial year just passed and will do over 600,000 ounces in FY21. Saracen's costs will go up, but that's mostly because of wall remediation issues to get the Super Pit back to full strength. Currently, you can get Saracen for an EV/EBITDA multiple of just 7.7x FY21. Not bad when EBITDA is expected to grow more than 50% compared to FY20.

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Share price chart

Source: Tradingview

Leases have built-in rent increases and extension options

Otherwise known as Australian Leisure & Entertainment, ALE's investment portfolio includes 86 pubs located in capital or major cities in all five mainland states. As at 31 December its properties were valued at $1.17bn. All the properties are leased to Australia's leading pub operator Australian Leisure and Hospitality (ALH) Group. ALH Group's pubs are comprised of sports bars, bistros, restaurants, cafes and electronic gaming. ALE Property receives rental income from the profits made by ALH, which is owned by a joint venture that is 75% controlled by Australia's leading retailer Woolworth's and 25% by leading hotelier the Bruce Mathieson Group (BMG).

As per ALE's agreement with ALH, rent must rise at least in line with the consumer price index (CPI) prior to the next formal rent review in 2028. At that time rent may be increased by as much as 10%. The leases are for an initial term of 25 years, which is attractive from an investment standpoint because it locks in long-term income from a reliable tenant. ALE's average remaining lease term is 8.8 years and ALH has the option to extend the property leases. ALE's pub locations have been operating as pubs for an average of over 60 years, which speaks to the longevity of its properties. Moreover, since property repairs and improvements are the financial responsibility of ALH, ALE does not have any operational or development risks.

Strong pub property demand and limited supply

In FY19 the group's property revenue was up 3.7% to $60.2m. It earned distributable profit of $28.3m and net profit after tax of $26.6m. The total property value increased 2.4% and based on rental income generated the properties had an average yield of 5.09%. The group achieved 10% rent increases on 36 properties in FY19 as demand for pub property investments was strong.

Property revenue growth was 3.4% in 1HY20 to $30.7m amid ongoing favourable market conditions. ALE Property has benefitted from not only strong pub property demand but also from a limited supply of the leisure properties across Australia. It posted 1HY20 distributable profit of $15.6m and a net profit after tax of $20.5m. Its occupancy rate was 100% and the weighted average property yield stayed at 5.09%. Moreover, the company's balance sheet strengthened as gearing fell to a historic low of 41.1%.

The directors' valuations of ALE's properties increased 0.76% to $1.17bn as at 31 December 2019. Passing rent increased 0.77% to $59.62m driven by CPI rent reviews involving 40 properties, which led to an average rent increase of 1.73%. The group also has 43 properties which are expected to have rent determined in current half year.

Debt restructuring improves capital strength

In April 2020 ALE Property entered a new $250m debt facility with a term of up to 2 years to refinance all its FY21 debt maturities. The facility has a low opening credit margin of 1.75% and incremental increases of 0.75% every six months. The group stated its intention to refinance the new debt facility as soon as favourable terms are available for an extended tenor in the public or private debt markets. To further capitalise on lower interest rates, ALE also elected to exercise its early redemption option on its $225m 5% August 2020 Australian Medium-term notes.

Although ALE Property has not purchased a pub property since 2007, as the economy improves it may find a compelling investment opportunity that fits its strategy. More than likely, however, it will continue to strengthen its portfolio by working with ALH to explore opportunities to enhance pub profitability through development projects or better site utilisation.

While not huge, the dividend yield is reasonable at 4.1%.

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Share price chart

Source: Tradingview

Measuring is knowing

Having an athlete injured is a nightmare for professional sports teams. Not only can an injured player not contribute to the team's competitive performance, but the market value of players deteriorates if they suffer injuries repeatedly. So if there's a solution that enables these teams to accurately measure, track and manage their athletes' workloads during training in order to optimise performance during games and prevent injuries, it is almost a no-brainer for these teams to use it. Catapult has developed such a solution and currently has nearly 3,000 professional sports teams around the world on its books in a range of sports, including rugby, football, basketball, AFL, ice hockey and American football (which is not really football, let's face it).

Athletes wear Catapult's tracking sensors, called Vectors, in the vests they wear during training in both indoor and outdoor settings. These sensors include a heart rate monitor, an accelerometer, a gyroscope and a magnetometer, all used to measure an athlete's performance during training. The data is transmitted to a server in real-time and, using Catapult's proprietary algorithms, can be analysed straight away to get insights into the so-called PlayerLoad during that particular training session. This PlayerLoad essentially tells you how hard the training session was and what level of exertion was reached.

As a database for each player builds up, the team's staff will be able to closely monitor and even predict each player's fitness. If needed, training intensity can be scaled back, or increased, depending on what the data says. This way, each player is individually monitored and an optimal performance can be achieved on game day. At the same time, the risk of injuries can be minimised.

Catapult also provides video analysis and athlete management software that integrate with its wearable technology.

Focus on increasing recurring revenues

Catapult increasingly sells its products and services in a subscription model that generates recurring revenues. In 1HY20, that ended in December, the company generated $50.7m in revenues (up 18% year-on-year) and $5.7m in EBITDA, up from negative $1.4m y-o-y. Of the $50.7m in revenues, 76% was recurring in nature and Catapult is actively trying to drive that number higher. Operating cashflow amounted to $13.6m in 1HY20, up from negative $1.6m the year before.

About 94% of the company's revenues are generated in the professional athlete market. However, Catapult is also looking to tap into the Prosumer market, i.e. the sports enthusiasts who don't mind paying for rich data around their athletic performance, or their team's. We believe the amateur sports market is a very large potential market, albeit at different price points compared to the professional market. But Catapult basically has all the technology and Intellectual Property it needs to successfully penetrate these markets, so we believe from a margin point of view, the Prosumer market may even be more lucrative once scaled properly. However, getting to sufficient scale will take time and is not the company's highest priority, given that sales were still very small at around $3m in 1HY20. Catapult has scaled back investments in the last 12 months to bring the Prosumer segment to breakeven.

The land of opportunity

When it comes to future growth, the Americas is where the action is, especially North America. While the Americas account for 45% of the number of teams that use Catapult's technology, this region accounts for about 70% of revenues. In other words, on average they're paying more money per team compared to other regions. So, expanding the number of teams in the Americas and increasing the upsell to existing customers rightly is the company's focus at the moment.

Plenty of upside in the shares

COVID-19 will likely have depressed revenue growth from new customers in the last six months, while some customers may have even asked Catapult to defer payments. However, we believe this will mostly be a short-term effect, which doesn't take away from the long-term opportunity that Catapult is capitalising on. This becomes even more apparent when we look at the company's valuation.

At EV/EBITDA multiples of 10.7x for FY21, 6.7x for FY22 and 4.2x for FY23, we believe Catapult is one of the cheapest, EBITDA-profitable Tech stocks listed on the ASX. You see, EBITDA growth for these three years is expected to be around 78%, 60% and 58% respectively, which implies highly attractive EV/EBITDA-to-EBITDA growth ratios, our favourite valuation methodology.

Applying the EV/EBITDA multiple for the current financial year to FY22 generates an indicative valuation for Catapult of approximately $1.85 per share, which we believe provides attractive upside in the next 12 months. Four stars from us.

Pitt Street Research Pty Ltd

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Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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