STOCKS DOWN UNDER

3 AUGUST 2020

Stocks Down Under

> *Most of what I learned as an entrepreneur was by trial and error.*
>
> **- Gordon Moore (b. 1929), American businessman, founder of Intel and author of Moore's law**

GPT GROUP

Undervalued property play with nice yield

KAROON ENERGY

The Art of the Deal

WEEBIT NANO

ReRAM to the rescue

GPT GROUP

Undervalued property play with nice yield

Stocks Down Under rating: ★★★★

ASX: GPT
Market cap: A$ 7.7BN
Dividend yield: 5.7%

52-week range: A$2.82 / A$6.46
Share price: A$ 3.88

Sydney-based GPT Group is a major property company. Since becoming the first ASX-listed property trust in 1971, GPT Group (formerly General Property Trust) has become one of Australia's largest diversified property groups. It owns a diversified portfolio of retail, office and logistics assets valued at $25.3bn and has a growing investor base of 32,000 shareholders. A $12.6bn funds management platform focused on 25 office and retail properties rounds out the business. The shares are down over 36% year-to-date, offer a 5.7% distribution yield and look undervalued to us.

READ MORE

KAROON ENERGY

The Art of the Deal

Stocks Down Under rating: ★★★★

ASX: KAR
Market cap: A$ 404M

52-week range: A$0.34 / A$1.44
Share price: A$ 0.715

Time was when Karoon Energy was a tiny $8m gas exploration play just about no one had heard of. Today it's on the verge of becoming a mid-tier oil producer and a player in one of the world's more lucrative oil frontiers, the Santos Basin offshore Brazil. The recent re-pricing of an acquisition in the Santos bodes well for future shareholder value creation at Karoon.

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Weebit Nano is an Israeli developer of semiconductor technology, based in Tel Aviv. In a nutshell, the company is developing a new memory technology that has a number of major benefits compared to computer memory in use today. Weebit's so-called ReRAM technology uses a lot less energy than other technologies and is also much faster than other types of solid state memory, for instance the type used in mobile phones and microcontrollers. The company's Board comprises of several semiconductor rockstars and we believe its stock is incredibly undervalued, mainly because most local investors don't understand what Weebit Nano is all about. Let us enlighten you.

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Share price chart

Source: Tradingview

High quality commercial property portfolio

GPT owns and manages a $25.3bn diversified real estate portfolio. It consists of office, logistics and retail properties, which are mostly located along the eastern seaboard in the key growth markets of Sydney and Melbourne. There are presently 12 retail, 22 office and 35 logistics properties in the portfolio. Some of the largest properties are Melbourne Central and Highpoint in Victoria, and Australia Square and Westfield Penrith in New South Wales. Portfolio occupancy was a healthy 96.5% as at 31 December 2019.

The COVID-19 pandemic has had a major impact on the real estate sector and GPT has not been spared. Lower demand and high market uncertainty caused the downward revaluation of the property portfolio particularly within retail. This was based on expectations of increased vacancy and abatement allowances as well as lower market rental growth rates. Approximately 43% of the portfolio is in the retail sector. In its 9 June 2020 distribution and valuation update, the company did however note an increase in activity at its retail properties with 90% of stores reopened and foot traffic at 85% of last year's levels.

Targeting a $5bn development pipeline

The balance sheet is strong with decreasing and modest gearing of 22.1%. The weighted average cost of debt has come down to 3.6% while the weighted average term to maturity has increased to 7.7 years, which we consider a nice combination. It has $1.4bn in liquidity, including undrawn bank facilities, that was recently cushioned by a US$400 private debt placement in the US market at an average term of 12.9 years. The S&P (A) and Moody's (A2) credit ratings are investment grade.

GPT is aiming to increase its development pipeline to an expected end value of approximately $5bn. The current development pipeline includes 4 Murray Rose Avenue in Sydney Olympic Park. It is a fully owned, A Grade office building that has a 60% pre-commitment to Government Property NSW for the NSW Rural Fire Service. The 15,700 sqm property builds off GPT's history of successful developments in Sydney Olympic Park. The office pipeline also includes 32 Smith Street in Parramatta, Cockle Bay Park in Sydney and the upscale Frame at 300 Lonsdale Street in Melbourne.

Meanwhile, the logistics development pipeline totals more than 550,000 sqm of capacity with an expected end value of over $1bn. It includes seven land parcels in the growth corridors of Melbourne and Sydney. The retail pipeline assets are a $70m development at Melbourne Central, Australia's most productive shopping centre, and the $200m Rouse Hill Town Centre development.

Focus on logistics and office assets

GPT's capital allocation strategy is designed to shift its exposure toward the office and logistics sectors to capitalise on greater growth opportunities. It has target allocations of 40% and 20% respectively for office and logistics assets. The office strategy is focused on delivering strong income growth through favourable leasing outcomes and higher rents. The acquisition of high-quality commercial asset and making prudent divestments also increase portfolio value. Logistics growth is largely being driven by development completions and acquisitions.

The 2019 annual result was highlighted by 2.6% funds from operation (FFO) growth per security and 4.0% distribution growth per security. The group achieved 3.5% like for like income growth and $342.2 of revaluation gains. Net tangible assets (NTA) per security increased 3.9% to $5.80.

With the shares trading well below NTA, a dividend yield of 5.7% and solid growth prospects as its core Sydney and Melbourne real estate markets recover, we find the shares to be a good value. Low interest rates and higher infrastructure spending should also be supportive of market growth and drive improvements in GPT's performance. So, its 4 stars from us.

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Share price chart

Source: Tradingview

For observers of the oil and gas space globally, one of the biggest surprises of the last 15 years has come from Brazil. Latin America's largest economy liberalised its oil industry and opened it to foreign investment in the 1990s, so that by 2005 the country was producing about 2.5 million barrels a day. The big surprise came in 2006 when Petrobras, Brazil's state-owned oil company and a major factor in growing Brazil's oil potential since the 1950s, discovered the Lula offshore oil field in the Santos Basin. The field was in deep water, about 250 km off the coast from Rio de Janeiro. And it lay in a zone called the 'pre-salt', meaning that to get to it you had to go through 2,000 metres of water followed by 2,000 metres of salt.

The surprise was the size of the Lula discovery. Petrobras's new field held something like 6.5 billion barrels of oil. However, it wasn't the only major field in the neighbourhood. After Lula, discovery after discovery was made in the pre-salt, with names like Sapinhoa, Libra and Buzios, all of which provided confirmatory evidence that there is something like 50 billion barrels of oil sitting in those Cretaceous formations deep beneath the Atlantic.

An early player on the oil frontier

The thing we really like about Karoon is how readily it moved to go after this bonanza. Karoon realised that Lula had changed the oil world's perception of the Santos and there would be opportunities across the basin and not just in pre-salt plays. So, as early as November 2007 the company was bidding in one of the auctions of exploration acreage regularly held by Brazil's National Petroleum Agency and it won five blocks in the offshore Santos. The blocks were a long way from Lula and closer to Petrobras's Caravela discovery from the early 1990s. And they were prospective in the pre-salt, but the bold move still paid off with the discovery of two oil fields in these blocks, one in January 2013 and the other in April 2015. Karoon being an Australian company, it called its discoveries Kangaroo and Echidna respectively, before deciding on names that Brazilians would like better. Kangaroo became Neon and Echidna became Goiá.

By 2015 Karoon had the resources to go pretty hard on the Santos Basin opportunity because in 2009 it had made a gas discovery in the Browse Basin offshore Western Australia, called Poseidon, and in 2014 was able to sell this to Origin Energy (ASX: ORG) for US$600m. Karoon spent the next few years working on how to build a bigger stake in the Santos, which wasn't easy given the difficult years for oil from 2014. However, in mid-2019 it made a breakthrough.

A transformative deal

Karoon's transformative deal will see it buy a field called Bauna from Petrobras. Bauna is in the southern part of the Santos Basin, about 200 km from the town of Itajaí in the state of Santa Catarina. The field had been discovered by Petrobras in 2008 and brought into production in 2013. By the time the sale to Karoon was announced Bauna was doing 20,000 barrels a day and the plan was to take that to 33,000 barrels a day by 2022.

There were reserves and contingent resources at Bauna of 68 million barrels with potential to grow that. In July 2019 Karoon agreed to pay US$665m, or about US$13 a barrel for the 52.5 million in 2P reserves (proven and probable). It expected that over the life of the field it could produce at an inexpensive US$18.50 a barrel. Karoon raised A$284m in new equity at 93 cents as part of the funding package to get the deal done.

The Art of the Deal, Australian-style

So far, so good, but then came the Great Crash 2020 when the Russia-Saudi price war combined with Covid-19 to move Brent Crude significantly lower. That made it difficult for Karoon to raise the debt to complete the Bauna transaction. What makes Karoon so interesting right now, though, is that the company was actually able to go back to Petrobras and negotiate a better price for the field. The new numbers, announced on 27 July, are US$380m 'firm' and US$285m 'contingent'.

Sure, that still adds up to US$665, but the difference is that the latter figure only kicks in if Brent consistently goes above US$50 a barrel again between 2022 and 2026. And as for the US$380m firm, Karoon only pays US$150m upfront followed by US$130m after 18 months. It was a triumph of negotiation worthy of Donald Trump back when he was just a property developer, and says a lot for the business smarts of Karoon's leadership team.

Currently, Karoon is pretty inexpensive for a would-be emerging mid-tier producer. The company is holding A$389m in cash and no debt as a result of last year's capital raising, so the notional equity from Bauna is now only A$15m. That's right. Plus you get Neon and Goiá and a few other projects in Peru and elsewhere for free.

The Bauna project debt still needs to be raised, but the more advantageous terms of the deal, the fact that Brent is now about US$43 a barrel and the location in a basin still attractive to project financiers suggests that there's not too much downside. Four stars from us.

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Share price chart

Source: Tradingview

Storage technology is running into the limits of physics

Today's computer memory landscape is made up of roughly two types of memory; volatile memory and non-volatile memory. The difference is that volatile memory will lose all the data that is stored as soon as you turn off your computer. Non-volatile memory will retain all data when you turn of the device, say your mobile phone. Your selfies will still be there when you turn it on the next morning.

By far the most important type of volatile memory is Dynamic Random Access Memory, or DRAM, which is used in huge amounts in computers, laptops and such. DRAM temporarily stores data that the computer's Central Processing Unit (CPU) is working with. The main benefit of DRAM is that reading and writing information to it can be done extremely fast. The downside is that it is expensive and it consumes a lot of energy. You see, the electric charge in a DRAM cell needs to be refreshed every 32 or 64 milliseconds, otherwise it will lose its electric charge, and therefore the value (the data) that is stored in the cell.

Non-volatile memory is different because it will retain the stored value even after you switch off the device.

This has to do with the way the transitor is constructed, but we won't go into that here. The best know type of non-volatile memory is Flash memory, used in mobile phones, computers, camera's etc. The problem with Flash memory is that it uses a lot of energy and it doesn't really scale down anymore. What we mean by that is that despite the advances in semiconductor technology, as described by Moore's law, Flash memory cells can't get any smaller because they will start to interfere with each other. That's why chip manufacturers have started to stack them, like skyscrapers, so they can still increase the storage capacity of Flash memory chips as a whole without having issues with the individual celles that make up the chip.

ReRAM to the rescue

The technology that Weebit Nano is developing addresses several problems at once. Resistive Random Access Memory, or ReRAM, can be considered a hybrid technology. It is non-volatile, like Flash memory, and nearly as fast as DRAM. Not only that, but ReRAM uses substantially less energy than Flash Memory, let alone DRAM. So hypothetically, if your mobile phone used ReRAM today, you'd most likely be able to go for days on end without having to charge it.

Another major benefit is that ReRAM technology can scale down to much smaller geometries than Flash memory. This is important because the exponential growth in data consumption, especially video, requires more and more storage capacity. And the only way to cram all that capacity into electronic devices is to make the memory cells smaller and smaller so more of them will fit in the same device.

Several addressable markets

Now, Weebit's technology is likely to initially find its way into so-called embedded memory applications. Unlike stand alone memory, such as DRAM and Flash memory in your phone or laptop, embedded memory is part of a System on a Chip (SoC). Like the name suggests, an SoC has all elements of a system on board, i.e. a CPU, controllers, input/output ports and memory. Weebit announced two collaborations so far, with SiEn in China and with an unnamed tier-2 company in South Korea.

Another product Weebit is working on is stand alone, or discrete memory. ReRAM can potentially replace certain Flash memory applications, like NOR Flash, a market worth around US$2bn right now. China-based XTX Technology has already verified the technical parameters of Weebit's technology and both companies are working to get Weebit's technology into XTX's products as soon as possible.

Lastly, Weebit has been looking into the possibility to use ReRAM cells to create a Spiking Neural Network (SNN), similar to what BrainChip (ASX:BRN) is working on. See Stocks Down Under from 1 June 2020 for more background on BrainChip and neural networks.

Semiconductor rockstars on the Board

As a company, having a great technology is one thing. Having a team that knows how to commercialise it is quite another. Weebit's Board consists of several semiconductor rockstars. To begin with, Chairman David Perlmutter is the former Number 2 at Intel. Yes, Intel, the world's second largest chip manufacturer after Samsung. When he was passed up for the top job he left the company, where he started in the early 80's to set up Intel Israel.

Another notable member of the Board is Dr. Yoav Nissan-Cohen, who's worked in the industry for 40 years, including as CEO of Tower Semiconductor. He also founded Saifun Semiconductor which was later sold to Spansion. Also on the Board is Atiq Raza, the former COO of AMD, Intel's challenger in the CPU space.

With this team backing the company, we believe it's only a matter of time before Weebit's technology can be successfully commercialised. We'd expect announcements to this effect within 6 to 9 months. At a market capitalisation of only $25m, the market completely misjudges Weebit Nano's potential, in our view, hence four stars from us.

Full disclosure: Your Stocks Down Under editors own stock in this gem.

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.