STOCKS DOWN UNDER

6 AUGUST 2020

Stocks Down Under

"Money, horse racing and women: three things boys just can't figure out."

- Will Rogers (1879-1935), American stage and film actor, and humorist

MEDIBANK PRIVATE

Healthy offering and reasonable valuation

MOUNT GIBSON IRON

Don't underestimate Koolan Island

BETMAKERS TECHNOLOGY GROUP

Willing to take a punt on this one

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Healthy offering and reasonable valuation

Stocks Down Under rating: ★ ★ ★ ★

ASX: MPL
Market cap: A$ 8BN
Dividend yield: 4.3%

52-week range: A$2.45 / A$3.66
Share price: A$ 2.83

Based in Melbourne, Medibank Private is a private health insurance company. It was founded in 1975 as an arm of the Government's Health Insurance Commission. As Australia's second largest health insurance provider it has over 3.7m members to which it offers not only private health insurance, but life, travel and pet insurance as well as workplace health management solutions. With the shares down more than 20% year-to-date and a strengthening value proposition we find Medibank to be well worth the premium.

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ASX: MGX
Market cap: A$ 853M

52-week range: A$0.54 / A$1.035
Share price: A$ 0.745

The stock of Mt Gibson Iron, the Perth-based iron ore miner, fell earlier than most stocks when the Coronavirus Crisis got started and the fall continued longer. The stock was $1.02 on 15 January and by 4 May it had fallen to 58.5 cents. The recovery since then has been tepid, but we reckon the stock looks inexpensive given the expected doubling of Koolan Island's output over the next couple of years, the current strength of iron ore prices and the existing resource. No wonder Mount Gibson's major shareholder, Hong Kong's Allied Group, has been a recent on-market buyer of stock.

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ASX: BET
Market cap: A$ 240M

52-week range: A$0.06 / A$0.525
Share price: A$ 0.44

Newcastle-based Betmakers Technology Group listed on the ASX in December 2015 as Topbetta and has gone several name changes since then. It's also gone through several business models since it listed. Today, the company is a B2B technology platform that offers a range of services to the wagering industry globally. Customers include online bookmakers and racing authorities. Covid-19 initially triggered a share price crash of more than 80%, but the shares have rebounded remarkably as the company started to experience a lot of interest from online bookmakers. At the current market cap of $240m, the shares seem to be taking a breather right now. Let's take a closer look.

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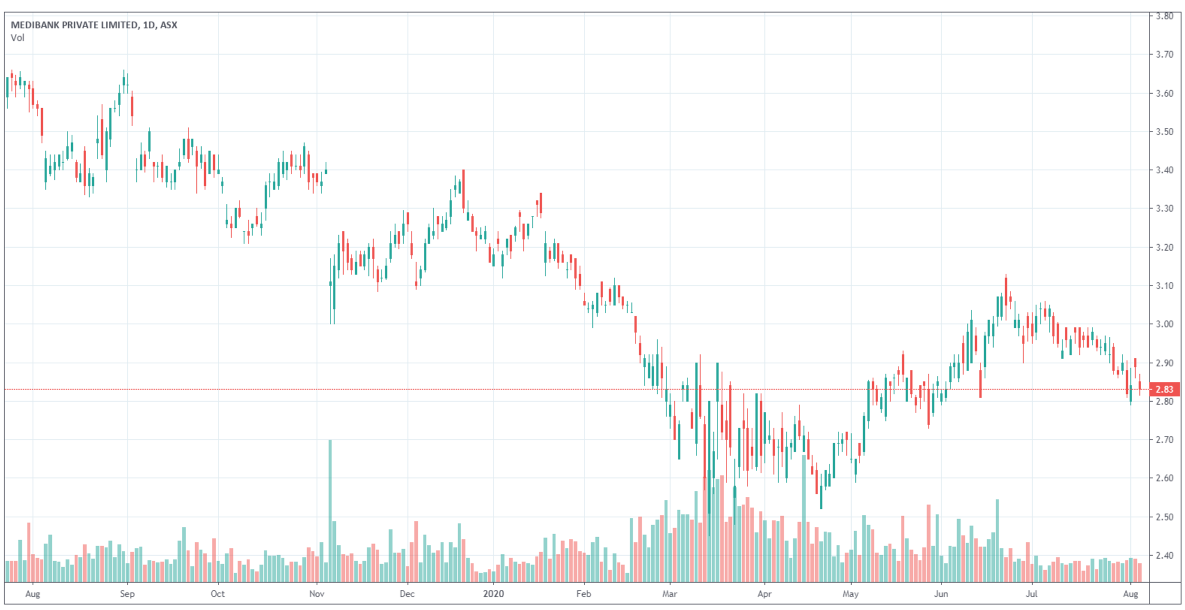
Share price chart



Source: Tradingview

Positioning as customer advocate drives sales

Medibank's health insurance products include standalone hospital cover, extras cover for services like dental, optical and physiotherapy, as well as packaged products. Its main Medibank brand is a premium, full-service offering that includes an online health hub and mobile health apps. The ahm brand provides cover for the things people need most aiming to maximise customer value and eliminate waste.

Australia's private health insurance industry is highly regulated by APRA and the Department of Health for the purpose of protecting consumers. There are not many players in the private insurance space, which combined with increased consumer demand for more comprehensive health services, provides a favourable backdrop for Medibank, in our view.

Medibank's strategy is based on a commitment to delivering "Better Health for Better Lives" by helping customers take control of their wellbeing. The company's competitive advantage lies in its portfolio of differentiated products and services for health insurance seekers. It plays a more active role in helping people stay well through illness and chronic disease prevention, offering more choices and providing 24/7 support where patients can chat with Medibank nurses.

Policyholder growth boosts profits

In FY19 group NPAT from continuing operations was up 3.2% to $437.7m. Medibank saw solid volume growth of 15.1k net resident policyholders and added 5 basis points of market share growth over the previous year. Net investment income advanced from $95.6m to $102.8m. The group paid an ordinary dividend of 7.4 cents per share as well as a 2.5 cent special dividend.

The half-year FY20 results showed a 9% decline in NPAT to $178.6m. In the core Health Insurance division, premium revenue was up 2.3% to $3.3bn. Net investment income jumped to $38.5m from $4.1m the year before and stayed in line with benchmark performance. Medibank has a strong balance sheet with $432m of cash and net assets of $1.84bn.

COVID-19 response strengthens value proposition

The COVID-19 crisis put pressure on private health insurers, such as Medibank, through increased claims risk. Regulatory authority APRA stepped in to apply a capital framework for all private health insurers. Medibank responded by putting a substantial claims liability in place and has maintained a strong capital position throughout the crisis. The group has an unallocated surplus above its target fund capital ratio of 13% of forecast premium, which is substantially higher than the minimum regulatory capital requirement. APRA's guidance is not expected to have an impact on Medibank's FY20 outlook including its prospects for dividend payments.

COVID-19 has certainly had an impact on Medibank's customers presenting financial challenges, increased anxiety and a heightened need for customer care. Medibank's flexible digital systems and processes have allowed it to respond quickly to customers during the pandemic. It offered financial hardship options and allowed customers to postpone premium increases. It also provided 24/7 webchat and launched a COVID-19 Customer Portal.

Reasonable valuation

Medibank has continued to broaden its services portfolio adding value added programs like Live Better at Home, COVID-19 Health Assist, 24/7 Medibank Nurse, 24/7 Mental Health Phone Support and even a Medibank Concierge service. It plans to continue to augment its personalised health and wellbeing offering to improve healthcare value for its customers. It had planned to drive reform in FY20 to target lower premium increases.

From 1 April 2020 it delivered its lowest average premium increase in 19 years (3.27%). Putting the customer first is causing health insurance shoppers to take notice. Recent customer-centric initiatives have strengthened Medibank's value proposition and we believe this is likely to lead to further membership gains and growth.

At a P/E of 19.4x and an EV/EBITDA of 11.1x, we believe Medibank is reasonable valued given the expected 11.5% growth in operating result in FY21. Add to that a 4.3% dividend yield and we think the shares are worth 4 stars.

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Share price chart

Source: Tradingview

It was a disaster that took Mount Gibson Iron four and a half years to recover from. The seawall that separates the company’s iron ore mine on Koolan Island, in Western Australia, from the Indian Ocean collapsed in October and November 2014, causing the mine to flood. No one was injured in the disaster, but until that seawall was back in place and the mine dewatered, its output would be zero, as against the 3.7 million tonnes of higher-grade iron ore that had shipped in FY14. The restart wasn’t completed until April 2019, but most of the $100m in costs was funded by an $86m insurance payout announced in mid-June 2016.

A mine that has bounced back before

The timing of the 2019 Koolan Island restart was perfect. Iron ore had steadily recovered from the US$40 nadir of late 2015 and by April 2019 it was close to US$100 a tonne. It’s remained about that level since then. Consequently the 2.3 million tonnes of iron ore shipped from Koolan Island in FY20 enjoyed pretty good pricing.

Koolan Island has bounced back from oblivion twice before. This tiny island, which is only about 12 km long and 3 km wide at its widest point, is one of several islands to be found in Yampi Sound, just off the coast of Western Australia's Kimberley Region. The nearest town to the island is Derby, 145 km to the south, while the famous holiday destination of Broome is 260 km to the southwest.

Followers of the Australian iron ore industry will doubtless know the name Yampi Sound because it's basically where the modern industry started. The Yampi Sound iron ore deposits had been discovered in the 1880s and a mine was actually proposed for Koolan Island in 1938, before the Australian government banned it in order to conserve Australia's iron ore resources for Australian industrial development. Admittedly it took a while for Koolan Island to bounce back from this first setback. BHP didn't start mining on neighbouring Cockatoo Island until 1951 and the first iron ore mine on Koolan Island didn't start up until 1965.

Location and quality

There are three main reasons to like Koolan Island today if you like iron ore. The first is the location. In places like the Pilbara further south, the iron ore is a long way from the port, so you've got to rail it hundreds of kilometres before it exports. At Koolan Island the pit is adjacent to the wharf, so your transport costs to port are virtually non-existent.

The second reason to like Koolan Island is the quality. The iron ore mined here is 'haematite', this being the iron mineral with high enough iron grades to make it 'direct shipping', where it can be fed directly into iron-making blast furnaces. Koolan Island, however, is not your garden variety 60% Fe haematite. This is a juicy 65% Fe product, which naturally attracts a premium. BHP used to average 67% with its ore.

The third reason to like Koolan Island is the potential to prolong the operation, which has been under-rated in the past. When BHP closed this mine in 1993, having operated it, as we noted above, since 1965, it figured Koolan Island had more or less exhausted its potential. So, the seawall was blasted away, allowing the mine to flood, and the relevant tenements were relinquished. A little over a decade later an adventurous and gutsy company called Aztec Resources staked Koolan Island and started again. By late 2006, when that company was acquired by Mount Gibson, it had outlined a reserve of 24.8 million tonnes at 65% Fe that was expected to be good for an eight year mine life after the first ore shipped in June 2007. Now fast forward to the 2019 restart. Mount Gibson has exported around 25 million tonnes from Koolan Island and there's still 20.3 million tonnes at 65% Fe in reserve.

Look for a longer life expectancy

Mount Gibson's recovery from the Corona Crash has been slow, we think in part because of concerns that Koolan Island's life expectancy is limited. Currently, the stock is trading at an EV/EBITDA multiple of only 1.4x FY22 forecast earnings. Sure, the current mine life is only six years, with a big step up in year 3, which is FY22, but we predict a lot longer life for this mine. Remember, the JORC 2012 resource is 51.2 million tonnes at 63.9% Fe.

It's also worth noting that iron ore has been doing well coming out of the Corona Crash, with supply constraints in Brazil combining with higher than expected demand from China as that country has sought to re-open its economy in a serious way, and we expect that dynamic will last for a while longer. Mount Gibson currently holds cash and liquid investments of A$423m, so currently one is acquiring Koolan Island and its expansion possibilities for just A$8 a tonne. That may be one reason why Mount Gibson's major shareholder, the Hong Kong-based Allied Group, has been a recent on-market buyer of stock.

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Share price chart

Source: Tradingview

Kicking goals

Betmakers Technology Group (BTG) is a technology platform that provides its services to a range of customers in the wagering industry, including bookmakers, rights holders and racing authorities. These services include white-labelled sportsbooks that enable corporate bookmakers to run everything, from user accounts, transactions, bets, promotions etc.

BTG also provides its Integrity Platform to racing authorities enabling them to monitor every aspect of racing. The platform provides a comprehensive view of live betting markets across multiple betting exchanges, allowing authorities to monitor quotes and historical fluctuations. It also includes race day updates, statistics on jockeys and trainers as well as live steward reports.

The white-labelled sportsbooks and the Integrity Platform are sold in a SaaS model that generates monthly recurring revenues for BTG. These recurring revenues accounted for 83% of revenues in FY19. But through its Global Racing Network, the company also has content distribution deals in place whereby it distributes race related content, e.g. from US Greyhounds and UK Greyhounds.

In FY19, BTH generated $6.2m in revenues. In 1HY20 it recorded a strong jump in revenues to $4m, from $2.8m in 1HY19 with EBITDA improving from $2m negative to $0.5m positive.

Signing deals left and right

BTG signed quite a few deals in the last six months, including a deal for fixed odds betting on horse racing in New Jersey, USA, with Pointsbet Holding (ASX:PBH, see Stocks Down Under from 2 July 2020). BTG will receive a monthly recurring fee from Pointsbet as well as a revenue share of each fixed odds bet placed by Pointsbet's customers on horse racing in New Jersey. The company also secured the rights to seven more racetracks in North America to manage and distribute their fixed odds betting in the US market, which in turn facilitate deals like the one BTG did with Pointsbet.

BTG also recently signed deals with on course bookmakers Rob Waterhouse and Mark Sampieri to enable them to take their individual betting operations online. Similar to most agreements BTG makes, these deals include a recurring revenue component as well as profit and revenue sharing components.

In terms of endorsement, the recent extension of BTG's deal with global wagering giant William Hill, originally entered into in 2018, is probably the most significant. William Hill decided to expand its agreement with BTG after 2 years of successful diversification of racing content.

BTG recently raised $35m at $0.37 per share. $4M of that was used to pay the final instalments relating to the dynamicOdds and Global Betting Services acquisitions in 2018 and 2019. But a substantial part of the proceeds will be used to fund the company's expansion in the US. At the end of June, the company was sitting on a cash balance of $31.6m. With that sort of growth capital, we'll likely see many more deals announced going forward.

Not cheap, but willing to take a punt

BTG hasn't announced its FY20 results yet, but for 4Q20 it indicated a 40% jump in its cash receipts, to $2.4m, compared to the third quarter. And the company was net cash positive during the quarter. To get a sense of BTG's valuation, let's use those cash receipts as a proxy for revenue and annualise it. That gives us close to $10m annual revenues right now. If we further assume the company can double its revenues two years in a row, that gives us about $38m in revenues by mid-2022.

At the company's current Enterprise Value of about $208m, we would be looking at an EV/Revenue multiple for FY22 of 5.4x (and 10.8x FY21), which isn't exactly cheap. On the other hand, BTG has plenty of growth opportunities, especially in the US and has got plenty of cash in the till to drive growth. And once the company exceeds certain costs levels, around $9m according to our estimates, revenues will largely fall straight to the bottom line, due to BTG's highly scalable business model.

In other words, despite the current valuation, we would be willing to take a punt on Betmakers Technology Group and give it 4 stars. Be mindful, though, that this one is speculative and volatile and will not suit everyone's risk appetite.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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