STOCKS DOWN UNDER

18 AUGUST 2020

Stocks Down Under

"This is a frightening statistic. More people vote in 'American Idol' than in any US election."

- Rush Limbaugh (b. 1951), American radio personality and political commentator

EVOLUTION MINING

Betting the farm on Canada

UNIBAIL-RODAMCO-WESTFIELD

Proof markets are not always efficient

STARPHARMA

Not a star attraction

EVOLUTION MINING

Betting the farm on Canada

Stocks Down Under rating: ★★★

ASX: EVN
Market cap: A$ 10.4BN
Dividend yield: 2.6%

52-week range: A$3.29 / A$6.59
Share price: A$ 6.09

With gold recently going through US$2,000 per ounce, one of the standout performers has been Evolution Mining. In FY20, through its Australian operations it produced over 740,000 ounces at an All In Sustaining Cost (AISC) of under A$1,000. If current prices were to remain, then it would have generated cashflows of over A$1.2bn. However, in 2019 it acquired the Red Lake project off Newmont Mining in Ontario province, Canada. The Red Lake project cost the company US$375m and was financed entirely by bank debt of A$600m. The Red Lake project is a significant project, but has the company taken on too much risk when it could have returned significant returns to shareholders.

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UNIBAIL-RODAMCO-WESTFIELD

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ASX: URW
Market cap: A$ 846M

52-week range: A$3.45 / A$11.74
Share price: A$ 3.65

Unibail-Rodamco-Westfield (Unibail) is a stapled security listed on three exchanges, Euronext Paris, Euronext Amsterdam and 20-1 CDI's listed on the ASX. Due to its primary listing in Europe, all its results are in Euros, which creates currency risk for Australian shareholders. Owning and operating properties across continental Europe, the UK and the United States, Unibail controls approximately €24.6bn in net tangible assets as of 30 June 2020. Despite significant risks facing Unibail, a 70% discount to EPRA net tangible assets indicates a risk of bankruptcy, a possibility not even on the horizon.

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Share price chart

Source: Tradingview

Evolution Mining was formed in 2011 out of two concurrent transactions that brought together four producing gold mines: The merger of Catalpa Resources and Conquest Mining, and, at the same time, the acquisition of two mines from Newcrest Mining. Other high quality, low cost operations were acquired and the company now has gold resources of 26 million ounces and reserves of 7 million ounces.

A leading Australian mid-cap producer

The Australian mines (Cowal, Mt Carlton, Mt Rawdon, Mungari, Marsden and Ernest-Henry, the latter a copper-gold mine) have resources of 15 million ounces and reserves of seven million ounces of gold. In FY20, the company produced 740,000 ounces of gold at an AISC of under A$1,000. That's the fruits of close to a decade of focusing on owning and operating high grade, low cost mines which provide substantial cashflows.

Currently the hedgebook is only 300,000 ounces from its Australian operations, which is delivered at A$1,872 per ounce and 120,000 ounces from its Red lake Mine in Canada at C$2,272 (A$2,385). 100,000 ounces was delivered in FY20 and the outstanding hedgebook in canada will be delivered quarterly over the next 3 years. The Australian deliveries represent only 15% of gold production and is considered low as opposed to its peers. The company has net debt of A$200m with bank debt of A$570m and cash of A$370m.

Golden upside at Red Lake

In 2019, the company acquired the Red Lake project from Newmont Gold. The project is in the Canadian province of Ontario and has a resource of 11 million ounces. Red Lake is one of North Americas largest gold mines with over 25 million ounces having been produced from it. It is high grade with some parts producing over 20 grams per tonne. There is an average grade of more than seven grammes per tonne. The acquisition cost was US$375m, which was funded through A$600m bank debt. In FY20, it produced 25,000 ounces of gold and is expecting to produce 130,000 ounces in FY21 with a view to producing 200,000 ounces by FY23.

At the time of acquisition, it was envisaged that Red Lake would provide the company with 13 years of production. However, with an upgrade to its resource and reserves, this may be closer to twenty years. The project covers 457 square kilometres and under the terms of the acquisition, the company has agreed to spend A$50m on further exploration so the mine life and resource may be significantly increased.

Significant capital expenditure ahead

The company will have significant capital and exploration expenditures over the next three years. It amounts to over A$1.1bn in total over the next three years. In FY21, there is up to A$290m in capital and A$100m in exploration, FY22 A$280m in capital expenditure and A$100m in capital expenditure and in FY23 A$260m in capital expenditure and A$100m. To put this into context of production of 800,000 ounces per year, that equates to A$450 - A$500 per ounce. Whilst with the current margin of A$1,800 per ounce this expense is justified, should the gold price fall to below US$1,500 per ounce, we believe this expenditure becomes harder to handle.

Is Evolution risking too much on Red Lake?

The Red Lake project will guarantee the company's production for at least 13 years if not more than 20 years with resource and mine upgrades. It is envisaged that it will produce 200,000 ounces of gold at an AISC of A$1,500 per ounce. This is more than A$500 per ounce more expensive than its Australian operations. Additionally, the cost of USD $375m plus US$150m in capital expenditure and exploration costs will see the cost close to A$1bn.

While Red Lake puts the company on the map as a world class producer, should the gold price not stay around the current level or in case of cost blowouts, the company has risked its Australian operations on becoming a bigger player on the world stage. One of the features that lead to Evolution's success was that it was able to become one of the world's lowest cost producers. Let's hope the company hasn't risked everything to compete with the big boys, when surplus cashflow of A$1bn could have been returned to shareholders over the next three years. So, three stars from us.

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COVID-19 a hit that's significant but not life threatening

Unless you live under a rock, you must be aware that COVID-19 has been stalking the world for the majority of 2020 with Europe and the United States still unable to get it under control. The damage from COVID-19 to Unibail is clearly evident in their 1HCY20 earnings with net rental income dropping 15.1% year-over-year, and -14.2% on a like-for-like basis.

Unibail's net rental income is derived from three separate income streams; shopping centres (94.6% 1HCY20), office and other (3.9% 1HCY20) and convention and exhibition (1.4% 1HCY20). Even pre-COVID-19, shopping centre net rental income was the focus, featuring approximately 90.7% of Unibail's 1HCY19 net rental income.

Almost all of Unibail's shopping centres have reopened having been closed for a weighted average period of 67 days. Foot traffic across Europe has rebounded with France, Austria and Denmark seeing footfall year-over-year numbers return to approximately 80-90% of their 1HCY19 heights. Central Europe and Spain have reached approximately between 60-70%, while the United Kingdom is lagging behind at approximately

45%. Despite the numbers coming from Central Europe, Spain and the United Kingdom, during 1HCY20, approximately 59% of Unibail's gross market value resided in France and the United States. While information for the United States is not as clear, Unibail's assets in France and across continental Europe have seen significant recoveries from its COVID-19 lows as of 30 June 2020.

No guidance but recovery ongoing

Despite some good news during the second half of Unibail's 1HCY20 reporting period, there are still significant risks in the near to medium term future and management has therefore decided to keep guidance suspended as well as the dividend for 2HCY20. While unfortunate for shareholders in the near term, this provides Unibail with significant capital reserves and will work out better for shareholder value in the long run, in our view.

Despite a year-over-year drop in leases signed during 1HCY20 of approximately 44%, total occupancy rates remain high at 92% as of 30 June 2020. Additionally, all rent relief during 1HCY20 was more than covered by cost cutting measures to administrative expenses, a situation we except to continue during 2HCY20.

From a solvency point of view Unibail is liquid and well capitalised to survive COVID-19. Including unused credit facilities, Unibail is currently sitting on approximately €12.7bn of liquidity. Additionally, Unibail has increased its asset disposal plan to a total of €8.8bn, meaning an additional €4bn worth of assets are going to be sold with the majority being retail. Factoring in Unibail's loan-to-value ratio of approximately 41.5% as of 30 June 2020, average debt maturity of 9.3-years and average coupon rate of approximately 2.3%, we believe the risk of significant dilution being forced upon investors in the foreseeable future is almost non-existent.

We also believe Unibail's financial position will allow them to potentially take advantage of any worthwhile deals that it comes across without adding significant liquidity risk.

COVID-19, currency risk and no dividend does not warrant a 70% discount

As of 30 June 2020, the total EPRA net tangible assets per stapled security had decreased 13.3% to €153.9 from €177.6 on 31 December 2019. The listing on the ASX is in the form of CDIs, which entitle the holder to 0.05 shares, or a ratio of 20-1. Therefore, using the closing price of the EUR/AUD currency pair on 14 August 2020, the value of one CDI is AU$12.70, a discount of approximately 70% the 14 August 2020 closing price.

It is important to remember that a security like Unibail contains an additional risk for Australian investors in the form of currency risk. Basically, this means that since Unibail's earnings, net asset value and dividends are in Euros, there is the risk that movements in the EUR/AUD currency pair could adversely affect investors' holdings, irrelevant of how Unibail performs. Additionally, COVID-19 is far from over with the United States still in the thralls of their first wave and Europe still yet to stifle new cases. According to the latest data, published on 10 August 2020, by the European Centre for Disease Prevention and Control, Europe is still seeing an increase of approximately 21.5 cases per 100,000 population over the 14-day reporting period. France, Unibail's largest European market, is seeing approximately 19.8 cases per 100,000 population over the 14-day reporting period.

There is still risk that this could get worse and cause renewed lockdowns across Europe and the United States. However, we believe Unibail trading at an approximate 70% discount to EPRA net tangible assets per CDI is far too significant a discount for the reality of the situation. With insignificant risk of large dilution for shareholders and a strong balance sheet as well as decent continuing earnings, we have to give Unibail a four-star rating.

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Share price chart

Source: Tradingview

If William Shakespeare were alive today and his 2020 version of A Midsummer Night's Dream featured executives of biotech companies as characters, he'd probably include this line: 'For aught that I could ever read, could ever hear by tale or history, the course of drug development never did run smooth'. That line would certainly describe the story of Starpharma over the last decade or so.

VivaGel doesn't strike out but doesn't hit a home run either

Back in April 2012, when Starpharma stock was trading above $1.80, this company's story was dominated by a product called VivaGel, for the treatment of Bacterial Vaginosis. As drug development plays goes, this one looked like a lay-down misere at the time. Bacterial Vaginosis, or BV for short, is inflammation in the vagina caused by a bacterial infection. Specifically, it's caused by a change in the 'microbial flora'of the area in question, meaning too much 'bad' bacteria and not enough 'good' bacteria of the Lactobacillus variety.

Over a decade ago Starpharma developed a gel-delivered dendrimer that would knock down the bad bacteria

and, it was believed, prevent the recurrence of this embarrassing and annoying female health conditon. Phase 2 for VivaGel looked good and by 2012 Phase 3 was ongoing. About 30% of women aged 14-49 get BV and in 2012 antibiotic treatment did a lousy job of treating it. So investors could almost smell the big money coming their way. However, as we noted above, the course of drug development never did run smooth.

Those initial Phase 3 trials yielded data in November 2012 and VivaGel actually gained European approval off the back of that data in September 2015. However, from the original Phase 3s Starpharma wasn't able to show that VivaGel could prevent BV recurrence. A second pair of Phase 3s actually got that evidence in August 2017. However, in December 2018 the FDA indicated that they were unhappy with the dataset they got. Consequently, VivaGel for BV has never gained FDA approval.

Now you know why Starpharma stock went close to 40 cents in mid-2015 and only made it to $1.65, or so, in the subsequent recovery before the latest bear market in the stock set in. Investors tend to have long memories when they get disappointed the way Starpharma has disappointed with VivaGel. And it's worth remembering that Starpharma's total revenue from product sales, royalty and drug development milestones in FY19 was only A$1.7m. This company burns about $900,000 a month. So to all intents and purposes this company is still 'pre-revenue' in our eyes.

A cool technology base

We think that VivaGel disappointment will hinder Starpharma stock for a while yet, by preventing investors from appreciating what the company is currently trying to do with its dendrimers. Before we talk about that, let us pause for a second and explain what a dendrimer actually is. Take a core molecule and add branches to the core and then branches to the branches and you've got a dendrimer. The shape of dendrimers is where the 'star' in Starpharma's name comes from. They've basically pioneered the science of dendrimers since the early 2000s and we think it's promising.

You see, the dendrimer itself is also a star in terms of what it can potentially do. The more arms on the dendrimer, the more properties you can build into your polymer. More than a decade ago Starpharma's scientists started to explore the potential of its dendrimers in drug delivery. They now have a lot of evidence that dendrimers can take other people's drugs and make them more soluble (and therefore easier to deliver), last longer, better targeted and less toxic. Among other exciting and desirable properties.

Trying to grow in drug delivery

Starpharma currently has three 'Dendrimer Enhanced Products' or DEPs in clinical development, all in the oncology space. They're basically better versions of the cancer drugs docetaxel, cabazitaxel and irinotecan, and the data to date suggests that they're pretty good drug candidates. They are, however, early. So far, none have been partnered and the most advanced – the docetaxel product – is only at Phase 2.

In addition to the internal programmes there is an important collaboration with AstraZeneca that was announced in 2015 as well as minor collaborations with other smaller pharmas. However, we don't believe Starpharma has taken the pharmaceutical world by storm with its DEPs, probably because there is so much competition around with other technologies that can do the kinds of thing DEPs can do. Also, pharma companies are probably worried about how much making a dendrimer is going to cost given the manufacturing processes are likely to be complicated and multi-step.

We think the current downward trend in Starpharma stock, which started in early 2018, is likely to continue for a while yet. Progress in getting VivaGel through US regulatory approval, or the progression of a DEP into Phase 3 may change that, but the likelihood of the first is fading as months potentially turn into years, while the second is still a while away. In the meantime Starpharma is a two star story in our eyes.

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