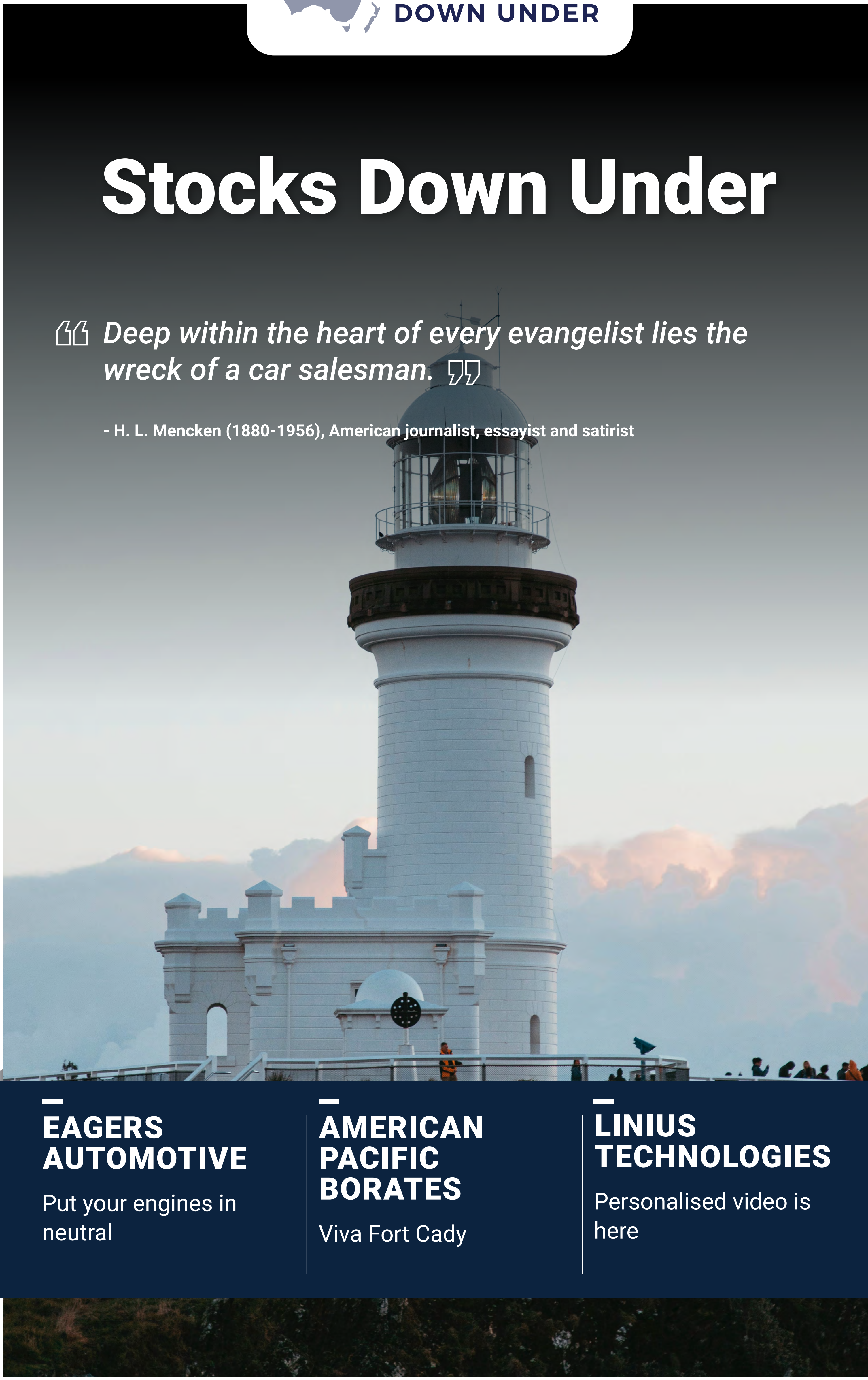
STOCKS DOWN UNDER

25 AUGUST 2020



Stocks Down Under

"Deep within the heart of every evangelist lies the wreck of a car salesman."

- H. L. Mencken (1880-1956), American journalist, essayist and satirist

EAGERS AUTOMOTIVE

Put your engines in neutral

AMERICAN PACIFIC BORATES

Viva Fort Cady

LINIUS TECHNOLOGIES

Personalised video is here

EAGERS AUTOMOTIVE

Put your engines in neutral

Stocks Down Under rating: ★★★

ASX: APE
Market cap: A$ 2.263BN
Dividend yield: 2.9%

52-week range: A$2.50 / A$14.49
Share price: A$ 9.10

Eagers Automotive is an automotive retail group with dealerships across Australia and a small presence in New Zealand. The company is headquartered in Newstead, Queensland, a suburb in the heart of Brisbane. Despite COVID-19, management has confirmed that their merger with Automotive Holdings Group has been completed without any complications. With 1HY20 earnings being released on 26 August 2020, we expect the company to outperform its peers due to large cost-cutting earlier in the year. However, we believe this has already been factored into the price and we don't see any significant potential to the upside.

READ MORE

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ASX: ABR
Market cap: A$ 245m

52-week range: A$0.15/ A$0.96
Share price: A$ 0.755

Recently, there has been a lot of investor focus on gold as investors flee to safety in uncertain times. However, when one looks at fertiliser companies one is often amazed at the upside available from long-life projects in relatively safe jurisdictions. American Pacific Borates is a great example with its Fort Cady Project in California. First cashflows here are only 18 months to two years away, so shareholders could really see some massive upside as Fort Cady progresses.

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Share price chart

Source: Tradingview

Eagers Automotive has not been idle

On 31 July 2020, due to the merger with Automotive Holdings Group, A.P. Eagers Limited changed its name to Eagers Automotive Limited. The ASX code remained unchanged, however. During the first half of 2020, Eagers Automotive was very busy. The company finalised a strategic sale of its refrigeration logistics division on 30 June 2020 for approximately $75m, allocating approximately $20m to an accounting loss and $60m to a reduction of net debt. The reduction in net debt was sorely needed as Eagers Automotive's total debt was becoming a significant concern at 82.8% of its total liabilities to total assets and 343.2% of its total debt to equity per 31 December 2019. Based on statements made during Eagers Automotive's 29 July annual general meeting, the company reduced its net debt to $7.6m from $315.8m on 31 December 2019. This was helped by the company's increase in liquidity to approximately $633.9m, including cash and unused credit and working capital facilities. Eagers Automotive's debt is a metric that we believe shareholders should continue to stay on top of over the next couple of years.

In order to achieve such significant positive liquidity changes during 1HY20, Eagers Automotive was forced to make some significant cuts. The company slashed its final dividend from its originally announced $0.225 to $0.1125, a 50% reduction. The board of non-executive directors also agreed to forgo its fees and the CEO agreed to cut his salary package in half. Additional measures included approximately 1,200 job cuts, saving around $6m a month, even though 165 people were hired back due to JobKeeper.

In total, the company's permanent cost cuts total approximately $78m in annual savings. This is a significant amount and should help the company's EBITDA margin rather considerably going into the future. However, we believe all this has already been factored into the price after being announced on 29 July 2020 with the stock rallying approximately 10.2% through 21 August 2020.

The Australian car market has been stuck in reverse

The Australian car market declined approximately 7.8% during 2019 and the first half of 2020 was significantly worse, seeing sales decline around 20.2% year-over-year according to careadvice.com.au. While June was considerably stronger than expected, it still marked the 27th consecutive monthly sales slowdown for Australia at a decline of 6.4%. Meanwhile, Eagers Automotive announced an expected underlying operating profit from continuing operations decline of 23.6% for 1HY20.

The company is better situated than most national car dealerships for dealing with the resurgence of COVID-19 as the company's lowest market penetration is in New South Wales and Victoria at pro forma market shares of 10% and 5.9% respectively at 31 December 2019. Despite this, however, Eagers Automotive's underlying operating profit from continuing operations still declined approximately 3.4% more than its sales decline for Australia, a reminder that continuing operations is more important this half-year as it excludes income from JobKeeper and the recently sold refrigeration logistics division. Industry experts attributed the less than expected decline in year-over-year sales in June to loosening COVID-19 restrictions and it seems that a lot of this was pent-up demand as Australia's new-car sales in July saw the largest year-over-year decline in 18 years at 12.8%.

However, as mentioned above, Eagers Automotive's Victoria market share is its lowest Australian state at 5.9% and Victoria reported the worst results with a 27.8% year-over-year decline in new-car sales for July, according to careadvice.com.au. The Australian car market is in a large and consecutive slump with no end in sight and we strongly believe this is a trend that shareholders need to keep a month-to-month eye on.

The value has been locked and loaded

Between 29 July 2020 and 21 August 2020 Eagers Automotive has seen an approximate 10.2% rise in its share price due to the results announced in its 29 July 2020 Chairman and CEO address. This has caused the company to trade at an EV/EBITDA ratio of 17.1x (31 December 2019 EBITDA) due to the market factoring in the good news the address contained.

We believe this will have taken out any potential significant move to the upside from Eagers Automotive's 1HY20 report, to be released on 26 August 2020. However, we do agree with the market that, despite the significant weakness in the Australian car market, the significant improvement to Eagers Automotive's balance sheet, liquidity position and operating expenses will be a large boon for investors going forward.

However, there is still a risk of poor guidance coming out from the company relating to the continuing weak Australian car market and therefore, we have to give Eagers Automotive a cautious 3-star rating.

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Source: Tradingview

American Pacific Borates, ASX listed since 2017, owns a rare and very large colemanite deposit in California's Mojave Desert, about equidistant from Los Angeles and Las Vegas. But what the heck is colemanite? Well, it's a natural source of boron, chemical symbol B, atomic number 5. American Pacific Borates is potentially going to be a big deal in the world market for boron because its Fort Cady Project covers the largest borate occurrence in the world not owned by Rio Tinto or Eti Maden, a Turkish company. In addition to this would-be company maker, American Pacific Borates also has a lithium project in Nevada, not unlike a large mine owned by the lithium major Albemarle elsewhere in the state.

Two fertilisers for the price of one

Boron has many applications, such as ceramics, fertiliser and electric cars, to name a few. It's important enough to have been classified as a strategic commodity in many countries, including the US. When we wrote about Ioneer (ASX: INR) on 28 February, the company whose Rhyolite Ridge Project in Nevada will produce boron as a by-product of lithium, we commented that boron's principal applications are in strengthened glass and permanent magnets. However, what American Pacific Borates wants to with its Fort Cady Project is become a substantial global producer of speciality fertilizer.

The thinking is quite elegant. Boron is the second-most consumed 'micro-nutrient' in farming in North America today, and about a fifth of the world's output of boric acid gets used in this way. Those same farmers who need boric acid also use a lot of Sulphate of Potash (SoP), the high value add form of potassium. What American Pacific Borates wants to do is make both at Fort Cady – buy in the lower-value Muriate of Potash, convert it using the Mannheim process to SoP, and use the hydrochloric acid created by that process to make boric acid from the borates that will be mined at Fort Cady. That way, the company ends up as the low-cost producer of boric acid and can work to edge out Rio Tinto and Eti Maden from their virtual duopoly.

A fast payback

Not only is it elegant, it's pretty lucrative too. The Definitive Feasibility Study, which was completed in December 2018 and updated in April 2020, valued Fort Cady at US$1.97bn, but that's once 'Phase 3' of Fort Cady is up and running. 'Phase 1a' only sets the developers back US$50m in capital costs to make 8,000 tonnes of boric acid and 33,000 tonnes of SoP annually, and yet the NPV (Net Present Value) at that Phase is a cool US$224m. Phase 1b requires another US$100m or so in capex, but that gets you up to 73,000 tonnes of boric acid for the same output of SoP, and suddenly your NPV has jumped to US$774m. Wow!

We like the modularity of this project very much because beyond Phase 1, both Phases 2 and 3 can be funded out of cash flows. EBITDA for year 1 for Phase 1a is USD$20m and phase 1b US$73m. That's so good, the whole thing pays for itself within three years.

American Pacific Borates has already done some construction work on site and expects to commence first production in the second half of 2021. The company expects to sell five key products from Fort Cady: Boric acid for industrial use, boric acid for agricultural use, SoP, 'enriched' SoP (i.e. SoP with boron) and, last but not least, that valuable building material called gypsum. The company has begun trials for the enriched SoP product. Most importantly, American Pacific Borates has sufficient cash to fund its Phase 1a capex. This really takes a lot of risk out of the project.

Better odds than Vegas

In addition to Fort Cady, American Pacific also has a lithium project with a borate story attached in Churchill County, Nevada, which is about 60 miles east of the Nevada capital of Reno. Surface samples have revealed up to 810 ppm and over one percent boron (equivalent to over five percent boric acid equivalent). The project lies in a similar self-draining basin to that of Albemarle's Silver Peak mine in Nevada, the only producing lithium mine in the whole United States. We would envisage that after American Pacific is in full production with the Fort Cady project, it may look to develop Churchill County, but currently the focus is on Fort Cady.

This company has exciting times ahead. Phase 1a capital expenditure for Fort Cady has been fully funded and then Phase 1b will be completed soon after. Cashflows from this will be significant, with EBITDA potentially in the order of US$100m ultimately on the cards. If the company only did Phase 1 and not Phase 2 or 3, it should demand 7 – 10x those earnings, which would equate to A$1bn market cap – and that is without Phase 2 and 3.

So, if you're driving from Los Angeles to Las Vegas any time soon, think about stopping at Newberry Springs, Ca., in San Bernardino County, not far from Fort Cady. We think the odds are a lot better than you'll get in Vegas. Four stars from us.

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Share price chart

Source: Tradingview

Scenes within a video file can be searched

Linius' technology enables people to search vast amounts of video content in a matter of (milli)seconds. For instance, you could search for all clips in which FC Barcelona's Lionel Messi scored against archrival Real Madrid and instantly see play out all those goals. Or if you're a LiveTiles user, you could search you're your company's Microsoft Team video meetings within LiveTiles using specific search words. Or if you're into horse racing, then through Racing.com you could find footage of your favourite horse in any race in Racing.com's archives.

Previously, you'd have to watch or fast forward through an entire video to find what you're looking for, because specific scenes in the video could never be tagged and catalogued, like a photo can be tagged. So there was no way to define the content of, say, a 10-second clip within a 1-hour long video. Linius has changed all that.

Video Virtualisation is the key

Linius enables video streams to be searched and spliced by opening up the video file, which is usually very large, and breaking it into many little pieces, or frames. It will then tag the so-called key frames in this video stream. Unlike normal frames, of which there are 24, 30 or 60 per second of video, depending on the video quality, keyframes indicate a significant change in the video stream, like a different shot, a new scene etc. So, in a video stream, there's typically only one keyframe every few seconds. Linius not only uses those keyframes to index, or tag, an entire video stream, but also to index specific scenes within the stream, like one of Messi's goal against Real Madrid.

When a user searches a large database of video content that has been indexed this way, Linius' so-called Video Virtualization Engine (VVE) actually searches the tags of the keyframes. Once the video content has been searched, the VVE splices the various, relevant, video fragments into a single video stream that is served up to the user.

Obviously, properly tagging the video content is crucial if you want to get good search results. Over the last few years, Linius has been optimising this process and can now also use Artificial Intelligence to index videos.

The use cases are endless

The reason we like Linius, so much in fact that we own stock (full disclosure), is that the number of use cases is endless, which is very helpful in commercialising the technology. It can be applied in a wide variety of situations. Take sports clubs, for instance. Using Linius' technology, sports clubs can enable their fans to create their own, custom news feeds from the clubs' online content. Or take news sites that have lots of video content. They can now let website visitors compile their own video feeds based on their specific interests. But the technology can also be used for surveillance purposes, e.g. for counter terrorism, creating highly specific video feeds on-the-fly.

Taking it one step further, broadcasters could potentially insert personalised advertising into the video stream of their viewers, based on their viewing preferences and online search history, similar to how Facebook and Google profile their users. Personalised advertising makes ad space substantially more valuable for advertisers. Research has shown that advertisers are willing to spend five to six times more money on an ad placement if that placement is personalised to the viewer. So broadcasters could generate substantially higher advertising revenues if they are able to personalise the experience.

Linius makes money every time its server gets an API call, which is when a customer's server, e.g. LiveTiles, asks Linius' server for data, like a personalised video stream or a search result. Linius will only receive a fraction of a cent for each API call, but the number of API calls can potentially be enormous if the company is successful in bringing on new customers in the next few years.

Still very early days

Linius has been able to sign commercial and trial agreements with a range of different customers, including LiveTiles (ASX:LVT), Sportshero (a security agency in Europe), Racing.com, Grafa (developer of a new stock charting app) and Sky Italia (Italy's largest pay TV broadcaster). Additionally, the company has business development agreements in place with Microsoft, IBM and Amazon, which should help it grow its customer base.

From a revenue point of view, however, Linius is still in the very early stages of its life cycle, with only $58,000 in cash receipts in the last twelve months through June 2020. Therefore, this investment is not for everyone. But if you don't mind taking a punt o, what can potentially be a revolution in how we watch video, and you have a bit of patience, we believe Linius could be an attractive addition to your portfolio from the emerging companies category on the ASX.

Pitt Street Research Pty Ltd

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