STOCKS DOWN UNDER

01 SEPTEMBER 2020

Stocks Down Under

"We will make electricity so cheap that only the rich will burn candles."

- - Thomas Edison (1847-1931), American inventor, speaking in 1879.

MERCURY NZ

A growth electricity producer? How shocking!

TELIX PHARMACEUTICALS

A cancer treatment revolutionary

CATALYST METALS

Central Victorian gold hopeful

MERCURY NZ

A growth electricity producer? How shocking!

Stocks Down Under rating: ★★

ASX: MCY
Market cap: A$ 6.480BN
Dividend yield: 2.9%

52-week range: A$3.29 / A$5.15
Share price: A$ 4.76

Mercury NZ produces, sells, trades and pipes natural gas and sells solar equipment in New Zealand, which is why the company is headquartered in Auckland. Mercury NZ produces the electricity through 14 power stations comprised of nine hydroelectricity plants and five geothermal plants. Mercury NZ has drastically increased its annual capital expenditures and is expanding its electricity generation portfolio to include 60 wind turbines slated to be completed during 2QY22. However, investors are always better off paying a fair price for a low growth company than a significantly overpriced valuation for a growth company.

READ MORE

TELIX PHARMACEUTICALS

A cancer treatment revolutionary

Stocks Down Under rating: ★★★★

ASX: TLX
Market cap: A$ 409M

52-week range: A$0.76 / A$1.95
Share price: A$ 1.65

The Melbourne-based Life Sciences company Telix Pharmaceuticals has rewarded its followers nicely since the late 2017 IPO at 65 cents per share. Investors have appreciated the late-stage nature of the Telix pipeline, as well as the therapeutic potential of Telix's 'molecularly targeted radiation' approach in cancer. We expect continued interest in this stock as the first commercial products launch in the near future.

READ MORE

CATALYST METALS

Central Victorian gold hopeful

Stocks Down Under rating: ★★★

ASX: CYL
Market cap: A$ 199M

52-week range: A$1.74 / A$3.40
Share price: A$ 2.44

After the Corona Crash in February-March, the stock of the Perth-based gold explorer Catalyst Metals reached new a new high of $3.19 in May, thanks in large part to a stronger gold price and reports of high-grade gold mineralisation at the Four Eagles and Tandarra Gold Projects near Bendigo in central Victoria. The challenge for Catalyst now is to make good on its various findings from the last five years. Keep this one on your watch list for a while.

READ MORE

MERCURY NZ

A growth electricity producer? How shocking!

Stocks Down Under rating: ★★

ASX: MCY
Market cap: A$ 6.480BN
Dividend yield: 2.9%

52-week range: A$3.29 / A$5.15
Share price: A$ 4.76

Mercury NZ produces, sells, trades and pipes natural gas and sells solar equipment in New Zealand, which is why the company is headquartered in Auckland. Mercury NZ produces the electricity through 14 power stations comprised of nine hydroelectricity plants and five geothermal plants. Mercury NZ has drastically increased its annual capital expenditures and is expanding its electricity generation portfolio to include 60 wind turbines slated to be completed during 2QY22. However, investors are always better off paying a fair price for a low growth company than a significantly overpriced valuation for a growth company.

Share price chart

Source: Tradingview

Heat and water equal electricity

Mercury NZ generates electricity through two types of renewable production, geothermal and hydroelectric. At the end of FY20, Mercury NZ produced electricity through 14 power stations, nine hydroelectric and five geothermal. The company also owns approximately 20% of Tilt Renewables (ASX and NZX: TLT). Tilt owns wind and solar facilities in New Zealand and Australia.

Mercury NZ has been branching out and currently manages a few subsidiaries that offer solar installations, subscription-based electric vehicles and a solar and battery research and development facility. Additionally, the company is building a wind farm set to become operational in two phases. The northern half is estimated to be operational during 4QY21 while the southern half is slated for 2QY22. The windfarm will operate 60 turbines.

Despite Mercury NZ's subsidiaries, electricity generation remains the overwhelming force behind the company's earnings. For FY20, approximately NZ$175m of the company's net profit after tax of NZ$207m came from electricity generation and approximately NZ$32m came from other revenue. It is important to note this 42% decline in net profit after tax was distorted due to the inclusion of the sale of smart meter company Metrix during FY19. Excluding the sale, net profit after tax was up approximately NZ$27m year-over-year.

Death and famine: If FY21 brings conquest and war, Mercury NZ is in trouble

Alright, so we admit Mercury NZ did not have to deal with famine during FY20, but a drought is in the same general area. Financial year 2020 was not kind as the company faced a combination of drought and COVID-19. The company still managed to produce a small like-for-like year-over-year increase in earnings before interest taxes depreciation amortisation and change in fair value of financial instruments (EBITDAF). Yes, it's a mouthful.

COVID-19's main impact against Mercury NZ was to force a delay in the construction of the company's windfarm project. Otherwise, the impacts were minimal since electricity generation is considered essential. The company managed to overcome social distancing requirements and had employees working from home. Therefore, while it is not correct to say Mercury NZ is a COVID-19 proof business, the company has certainly built up a strong resistance. The largest concern surrounding a resurgence of COVID-19 in New Zealand is further delays and cost increases surrounding the company's large renovation and expansion plans.

Drought was certainly the most punishing event Mercury NZ had to face during FY20. Since the majority of the company's power generation is based on the hydroelectric plants situated on the Waikato River, the drought starting in September 2019 in northern New Zealand had a notable impact on both the margins and revenue generated by these plants. The moves into geothermal and wind energy are strong, concrete steps that can reduce Mercury NZ's drought risk in the medium term.

Low interest rates offer a shocking boost

Mercury NZ is taking advantage of two major events in the global markets, rock bottom interest rates and the demand for 'green debt.' On 21 August 2020, the company announced the offering of NZ$150m in unsecured, fixed interest 7-year green bonds, with an option to accept up to NZ$50 in oversubscriptions. On 31 August 2020 the company announced the annual yield would be between 1.25% to 1.45% over the underlying swap rate. The actual yield will be announced following the completion of the book building process, however the bonds have been rated BBB+ by S&P Global Ratings. To quickly clarify, a green bond, also known as green debt, is a standard bond where the money is required to be used on projects that are of a benefit to the environment and are sustainable. As of 30 June 2020, Mercury NZ's total debt to equity ratio is 37.9% and EBITDA/interest expense is 8.5x.

After factoring in the other aspects of Mercury NZ's balance sheet and cash flows, we believe accepting up to NZ$200m of additional debt is well within the company's capacity at this time and with its focus on improving current assets and vertical expansion, we believe the funds will be a solid, low cost, boost.

The price is not right

Management clearly has its eye on the ball and the company is positioning itself to take advantage of strong investor and industry demand for renewable power generation. The windfarm will be a welcome diversification away from the drought risk. However, investors won't see the full realised benefits of the project until at least 2QY22, maybe later if there are additional delays. If we utilise a pure EV/EBITDA growth valuation with approximately 10% growth in EBITDAF from management guidance and an FY21 EV/EBITDAF of 16.8x Mercury NZ is highly overvalued. Due to the company's resilience and strong pipeline of capital expenditures, we believe Mercury NZ demands a slight premium. However, the premium currently demanded by Mercury NZ's share price is too high for us and, therefore, we are forced to place a Two Star rating.

TELIX PHARMACEUTICALS

A cancer treatment revolutionary

Stocks Down Under rating: ★★★★

ASX: TLX
Market cap: A$ 409M

52-week range: A$0.76 / A$1.95
Share price: A$ 1.65

The Melbourne-based Life Sciences company Telix Pharmaceuticals has rewarded its followers nicely since the late 2017 IPO at 65 cents per share. Investors have appreciated the late-stage nature of the Telix pipeline, as well as the therapeutic potential of Telix's 'molecularly targeted radiation' approach in cancer. We expect continued interest in this stock as the first commercial products launch in the near future.

Share price chart

Source: Tradingview

Back in the day it was difficult to tell which was worse when it came to cancer – the disease, or the way it was treated. There have always been three basic ways to deal with cancer – cut it out (surgery), poison it (chemotherapy) or irradiate it away (radiotherapy) – and historically these approaches tended to be applied indiscriminately. The surgeons would cut out not just the obviously cancerous tissue but a whole lot of healthy tissue around it that might or might not have had cancer. And the chemotherapy and radiotherapy drugs wouldn't just kill cancer cells, they would impact a whole lot of innocent bystander cells.

In the 1980s this bleak picture started to change as cancer researchers and the pharmaceutical industry gradually figured out that you could target drugs just to the cancer cell. The key breakthrough here was the development of the monoclonal antibody, which is basically a 'magic bullet' that hits a specific cellular target, and only that target. If you've ever seen the 2008 movie Living Proof, starring Harry Connick Jr, you will have learned a lot about monoclonal antibodies because it tells the true story of one of the first of those magic cancer bullets, a drug called Herceptin. It was the 1998 FDA approval of Herceptin, for breast cancer, that in our view ushered in the Cancer Treatment Revolution where most of the new treatments for cancer are targeted treatments.

A Phase 3 company that's doing something new

Telix Pharmaceuticals is a recent product of the Cancer Treatment Revolution. It's pioneering the field of 'molecularly targeted radiation' where the magic bullets, be they antibodies or another molecule with targeting capability, are used to deliver radioactive compounds called 'radiopharmaceuticals' direct to the cancer cell. The molecular targeting part has been with us for a while now, thanks to companies like Seattle Genetics (Nasdaq: SGEN) and their antibody-drug conjugates, where the antibody doesn't do the cell killing but just delivers a drug payload. However, before Telix no publicly traded Life Science company had gone after antibody-radiopharmaceutical conjugates as their 'company-making' technology. Seattle Genetics, by the way, is today a US$27bn company. That's right. Billion, not million.

Part of the investor excitement around Telix relates to how far down the development path this company has travelled. It has already shown that it can light up a tumour for imaging purposes better than the standard of care and it's now at the regulatory stage for a prostate cancer imaging product, while another imaging agent for renal cancer is in Phase 3. Behind the imaging products are therapeutic programmes in prostate cancer, renal cancer and a rare brain cancer called glioblastoma. The prostate cancer product, called TLX591, is advanced enough to be entering Phase 3 shortly, and that's where we think the first lick of big money will be coming from.

The early clinical evidence looks good

TLX591 is an antibody to PSMA, generally regarded as an important marker of prostate cancer, with that antibody conjugated to a radiopharmaceutical called Lutetium 177. Telix's product has a long development history that started at the famous Weill Cornell Medical Center in New York and progressed via a small French company before Telix picked it up in 2016. Prior to Telix, TLX591 had been tried out in about 200 patients in Phase I/II settings and one notable study, in metastatic castrate-resistant prostate cancer (mCRPC) patients where those patients were 'second line' – that is, they had failed the standard initial treatment for mCRPC – showed median survival at the highest dose of 42 months. Not bad for a group of patients with a life expectancy under 24 months. Telix is now preparing for a properly controlled Phase 3 study in this setting and to that end has had discussions with the FDA about trial design. An 'Investigational New Drug' application, allowing the trial to take place in the US, will likely be filed with the FDA before 2020 is out.

Telix stock has recovered smartly from the 80 cent Corona Crash low but we think it will continue to hold investor attention from here. There was $24m cash as at June 2020 so the company is funded into 2021. We expect regular news flow across the product portfolio, and of course the European approval for the prostate cancer diagnostic is coming sooner rather than later, the relevant filing having been made in April 2020. The market capitalisation of Telix is currently well above $350m, but we've seen other revolutionary Life Sciences companies with higher market capitalisations than that. This stock is Four Stars from us. The lifetime chance of men being diagnosed with prostate cancer is about 1 in 8, so we at Stocks Down Under are cheering this one on.

CATALYST METALS

Central Victorian gold hopeful

Stocks Down Under rating: ★★★

ASX: CYL
Market cap: A$ 199M

52-week range: A$1.74 / A$3.40
Share price: A$ 2.44

After the Corona Crash in February-March, the stock of the Perth-based gold explorer Catalyst Metals reached new a new high of $3.19 in May, thanks in large part to a stronger gold price and reports of high-grade gold mineralisation at the Four Eagles and Tandarra Gold Projects near Bendigo in central Victoria. The challenge for Catalyst now is to make good on its various findings from the last five years. Keep this one on your watch list for a while.

Share price chart

Source: Tradingview

Its heyday may have been the mid-to-late 1800s, but the area between Ballarat, Bendigo and Stawell in central Victoria every now and then attracts a new wave of exploration interest, and the latest gold rush is happening right now. Navarre Minerals (ASX: NML) is working the Stawell Corridor Gold Project looking for a revival of the historic Stawell and Ararat fields, while Kalamazoo Resources (ASX: KZR) is working on Castlemaine. Catalyst Metals's dream of the next big gold windfall in Victoria begins along the 75-kilometre Whitelaw Fault, which starts about 40 km north of Bendigo.

Not far from Fosterville

The area in which Catalyst is exploring includes the Four Eagles and Tandarra Gold Projects. The zones covered by these projects are important because the Whitelaw Fault is thought by geologists to be essential for the formation of a lot of the gold deposits in the Bendigo area, but the Fault has been underexplored due to a covering of sediment brought in by the Murray Basin. This was the view put forward by the Victorian Government's 'Gold Under Cover' initiative way back in 2006, the same year Catalyst went public. For

Catalyst's technical director, Bruce Kay, himself an experienced geologist and miner, Gold Under Cover was a reminder that Catalyst's project areas have been virtually untested by historic and modern gold explorers alike.

Not far from Bendigo, the Kirkland Lake-owned Fosterville Gold Mine produced over 619,000 ounces of gold in 2019, with guidance for 2020 of 570,000 – 610,000 ounces at a mere US$130 - US$150 per ounce. This is the same ground which earned worldwide fame and produced 22 million ounces of high-grade ore (15 g/t) during the Great Rush. Catalyst's belief in the familiar but untested region has been helped by some great drill intersections at Four Eagles, which sits directly on the Whitelaw corridor.

Four Eagles has helped Catalyst to fly

Though no significant resource has been reported as yet, Catalyst has gained confidence from RC drilling at Boyd's Dam in the Four Eagles project area, results of which were reported in May. It was these results which propelled the stock to the $3.19 level we noted above. In June drilling at the Macnaughtan Prospect in the Tandarra Project saw one particularly juicy intersection of 3 metres grading 94.9 g/t. Investors have cooled a bit on Catalyst since May but drilling campaigns planned for the next year or so have the potential to turn this around. Watch out for names like 'Golden Camel' and 'Sebastian North', among others. Joint ventures between Navarre at Tandarra and St Barbara (ASX: SBM) at Drummartin (near the Fosterville Mine) have helped Catalyst navigate the costs of exploration.

After five years of progress, Catalyst has held up well despite the recent market turbulence. That said, this is still one for the speculators – and bold speculators at that given the market capitalisation close to $200m. Remember, there's no JORC 2012 resource as yet. The locations available to Catalyst, along with investments from Navarre and St Barbara, have so far kept this company in play, and as at June 2020 there was $18m cash, but there are other gold players less expensive than Catalyst. We like what we see so far, but think this one is still a little early. For now, it's Three Stars.

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.

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document