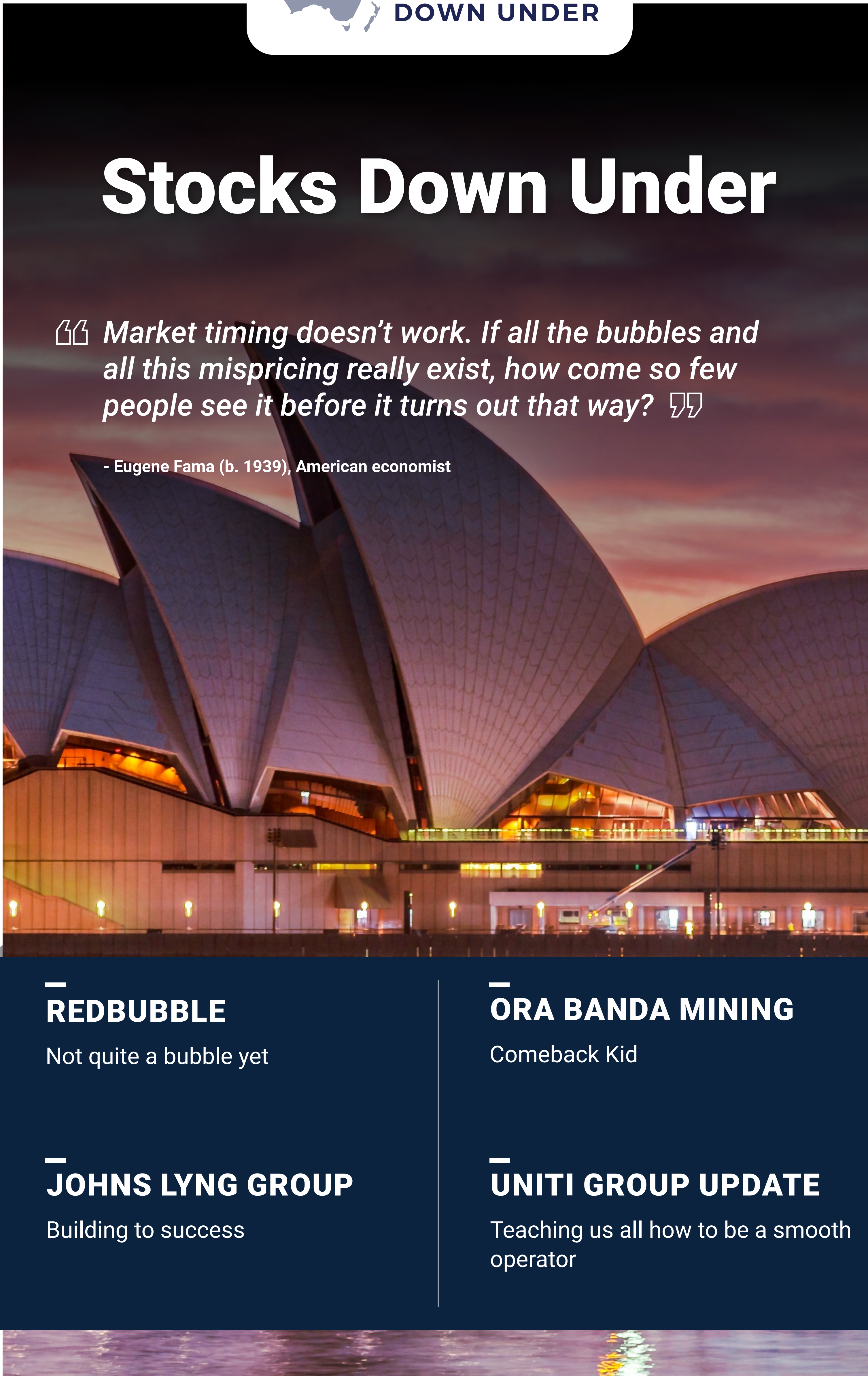
STOCKS DOWN UNDER

17 SEPTEMBER 2020

Stocks Down Under



"Market timing doesn't work. If all the bubbles and all this mispricing really exist, how come so few people see it before it turns out that way?"

- Eugene Fama (b. 1939), American economist

REDBUBBLE

Not quite a bubble yet

ORA BANDA MINING

Comeback Kid

JOHNS LYNG GROUP

Building to success

UNITI GROUP UPDATE

Teaching us all how to be a smooth operator

REDBUBBLE

Not quite a bubble yet

Stocks Down Under rating: ★★★★

ASX: RBL
Market cap: A$ 1.1BN

52-week range: : A$0.40 / A$4.52
Share price: A$ 4.38

Back in March you could get Redbubble, the Melbourne-based online marketplace for art, at 46 cents per share. Then about a month later, when the world realised that the Coronavirus Crisis was really good for online marketplaces, the stock took off. It has shown no signs of slowing down since, because there's a lot of 'Wow factor' built into this business.

READ MORE

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Building to success

Stocks Down Under rating: ★★★★

ASX: JLG
Market cap: A$ 572M
Dividend yield: 1.6%

52-week range: A$1.63 / A$2.98
Share price: A$ 2.64

Headquartered in the Melbourne suburb of Doncaster, Johns Lyng Group is a diversified building and construction conglomerate. Johns Lyng Group is broken into 17 different companies, each of which have its own speciality. These range from commercial building to emergency builders, and even the removal of hazardous materials from buildings and construction sites. Johns Lyng Group has all the hallmarks of a COVID-19 recovery play and we believe the company is well on its way to buildings itself to success.

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Share price: A$ 0.38

Ora Banda, postcode 6431, is a virtual ghost town about 70 km north of Kalgoorlie more famous for its currently-closed pub than for its gold mining heritage, which stretches back to the 1890s. Ora Banda Mining is, by contrast to the town and the pub, very much alive in 2020. Now that its Davyhurst gold plant is set to restart, Ora Banda Mining is looking to become one of the next emerging gold producers in WA's Eastern Goldfields from next year.

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Share price chart

Source: Tradingview

The line that tells you about Redbubble.com when you Google it tells you that at that site you can find 'Awesome products, created by independent artists'. How awesome? Well, we tried something that to most people would seem a little arcane – we plugged the name 'Wayne Shorter' into the search bar at the top of the page. Wayne Shorter is an American tenor saxophone player who doesn't have much appeal beyond jazz but is a living legend within that medium. Up came a whole bunch of pictures of T-shirts, cushions, posters, phone cases etc., some which had Shorter's picture on them and some of which were from related acts, but all were designed to appeal to a jazz fan knowledgeable about Shorter's work and the jazz scene from the late 1950s to the present time.

So, the claim was true – this site is genuinely 'deep-catalogue' awesome, to the point where we could even order face masks printed with Wayne Shorter album covers. The last time this Wayne Shorter fan was this excited about an eCommerce site was when Amazon was new, back in the late 1990s.

Like Wikipedia, but for art

Think of Redbubble as Wikipedia, but for print-on-demand fashion and art. At Wikipedia you have thousands upon thousands of independent contributors labouring every moment of the day to create new articles or update and edit existing ones, so that there's something on that site for everyone. At Redbubble you have more than 500,000 independent artists – indeed, it could now be closer to 800,000 – contributing to the marketplace, so nothing is too obscure, as our Wayne Shorter experiment showed.

The beautiful part about Redbubble's business is that it scales so easily. The cost to Redbubble to add extra products to the site is very low indeed, and this in turn makes Redbubble's customer acquisition costs very low. And it doesn't even have to deploy a whole bunch of warehouses and delivery vans because everything gets to the customers via third-party logistics, most of it localised so the customers aren't waiting forever.

Growing like topsy

Redbubble's business has been growing like topsy in recent years as network effects kick in. Revenue has tripled since the 2016 IPO. In the six months to December 2019 revenue rose 26% and operating EBITDA 46%, while in the year to June 2020 revenue at $257m was up 36%, allowing operating EBITDA to reach $15.3m, up a massive 141%.

Okay, not all of this was organic growth because in October 2018 Redbubble acquired TeePublic, which as its name suggests is an online marketplace for T-shirts. However, the trend in organic growth was strong in the second half of FY20 because that's when COVID-19 changed the e-commerce landscape in a serious way.

COVID-19 was a blessing for Redbubble because suddenly people were more inclined to buy things online rather than instore, and creative types who were locked down and/or temporarily unemployed were more disposed to create art for sale to a global audience on Redbubble. The customers, of whom there are now close to 7 million, have come to love both Redbubble and TeePublic, so that about 40% of Redbubble's business in revenue terms now comes from repeat customers. And there's more where that came from because Redbubble is still in the early stages of personalising the offering and building out the formats the artwork can come in. Word about Redbubble has largely travelled via digital marketing and if the company ever needs to step up the marketing spend it is well placed to do so – as at June 2020 its cash balance was $58m.

There's more where that came from

Redbubble may have started in Melbourne in 2006 but it is now global. That is not without its challenges in that 70% of current revenue comes from North America. Redbubble is going to have to work hard growing in Europe in order not to be overly reliant on consumer tastes in its core market. As for Asia, Redbubble hasn't even started there, but that's fair enough since the Redbubble app only made it into Android format last November.

We think there's still some life in Redbubble stock even after the massive run up this year. On consensus numbers Redbubble is expected to expand EBITDA 64% per year between FY20 and FY23, yet on forecast FY23 numbers the stock is on an EV/EBITDA multiple of only 13.1x. That looks very reasonable to us.

Now, Redbubble stock is not without its risks. Last December a trading update revealed that sales for the important Black Friday and pre-Christmas period were down on market expectations. The Redbubble share price tanked for a while and in the aftermath of that trading update Martin Hosking returned as interim CEO in February, replacing Barry Newstead. It's not unreasonable that this Christmas could disappoint as well if consensus expectations get out of hand. That said, we still think the general trend on growth will keep a lot of investors happy from here. This stock is four stars from us.

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Share price chart

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Cutting the portfolio into manageable portions for investors

The Johns Lyng Group is broken into three different main operating divisions. Insurance Building & Restoration Services is the main revenue driver and is comprised of ten different companies. The ten companies that make up the operating division Insurance Building & Restoration Services, each have a specific speciality in either repair and restoration from insurable events, hazardous waste removal, strata management and property and facilities management. While the vast majority of the company's subsidiaries are based in Australia, Steamatic, a subsidiary company part of the Insurance Building & Restoration Services division, is based in the United States.

Commercial Building Services is comprised of 6 different subsidiary companies that specialise in either residential and commercial flooring, emergency household repairs, shop-fitting, pre-sale property staging and commercial heating, and ventilation and air conditioning mechanical services.

The smallest division is Commercial Construction, which only includes one company, Johns Lying Commercial Builders, a large-loss insurance rebuild specialist in Victoria.

Insurance Building & Restoration Services: the meat of the business

Insurance Building and Restoration Services not only provides the largest percentage of revenue and EBITDA, but also the most significant organic growth. Excluding acquisitions, EBITDA grew 45.5% year-over-year, while margins grew from 8.9% during FY19 to 10.3% for FY20. Including acquisitions, EBITDA grew 76.4%. Insurance Building and Restoration Services is classified as essential services, which allowed this division to provide earnings durability during the worst of the lockdowns.

On a slightly scary but realistic perspective, experts agree that natural disasters and pandemics are likely to increase in regularity over the next decades. During COVID-19 the Johns Lyng Group has proven it can not only maintain its main source of revenue, but maintain strong growth and increase its margins.

Don't disregard the small portions, they are still important

The Commercial Building Services division and the Commercial Construction division produced 10.9% and 8.8% of Johns Lyng Group's total revenue respectively during FY20.

The former saw significant organic revenue growth during FY20 at approximately 20%. However, FY20 also saw a sharp decline in an already tight EBITDA margin from 6.4% to 5% excluding acquisitions. The deterioration in EBITDA margins has led to the implementation of an overhead reduction plan with results expected to materialise during 2HY21. However, we remain cautious about the success this division will have in reducing its overhead and will be paying close attention to 1HY21's organic EBITDA margin results.

The Commercial Construction division has an even tighter EBITDA margin at 2.3%, a decline from FY19's 2.7%. Despite the decline in EBITDA margin, the operating division saw significant growth in revenue and EBITDA of 29.2% and 10.9%, respectively. This was due to the significant pipeline of core-competency projects, which is expected to accelerate during 3Q21 as the company catches up with its delayed pipeline due to COVID-19. While the tight EBITDA margin remains a concern, we believe this division will continue to see accelerating growth, so long as Victoria continues to see its COVID-19 situation improve.

A group of businesses still being formed and off to an excellent start

We fully expect the Johns Lyng Group to continue its acquisitions during FY21. However, this should not be in anyway confused with a growth by acquisition strategy. As we discussed above, all of the operating divisions are experiencing autonomous growth, i.e. excluding acquisitions. While we have concerns surrounding the EBITDA margins of the two commercial operations, the opening up of the economy should help by reducing some macro pressure.

While it was not directly stated by management, our analysis of the industry shows that it is reasonable to believe that a portion of the EBITDA margin squeeze came from the precautions required due to COVID-19 and its reappearance in Victoria, the main revenue centre of these two operating divisions.

The Johns Lyng Group is currently valued at an FY21 EV/EBITDA ratio of 12.5x, slightly higher than the consensus EBITDA growth expectation of 10.8% in FY21. However, due to a combination of the strength of the Insurance Building & Restoration Services division throughout FY20 and Victoria getting a significant handle on its COVID-19 outbreak during these last few weeks, we believe the current consensus may be underestimating the Johns Lyng Group's potential performance for FY21. Therefore, we are rating the stock four out of five stars.

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Share price chart

Source: Tradingview

Ora Banda means 'Band of Gold' in Spanish and for Ora Banda Mining that could prove to be accurate, since the company's Davyhurst Project currently covers about 1,336 sq. km of ground in the neighbourhood of Ora Banda township, allowing for about 200 strike kilometres of continuous gold-prospective greenstone sequences. At the centre of this golden band is a 1.2 Mtpa conventional carbon-in-pulp processing facility near another ghost town called Davyhurst, about 40 km to the west of the iconic pub.

Ora Banda stock has been uplifted by the company's most recent Definitive Feasibility Study (DFS) for Davyhurst, which was published in June 2020 and which presented a solid financial basis for restarting the plant. Davyhurst is a revamp of a mining venture initiated under Ora Banda's previous incarnation; a company called Eastern Goldfields (ASX:EGS). That company fell into administration in 2019 due to under capitalisation. Unlike its predecessor, Ora Banda plans to actually meet its production targets using the six major deposits dotted around Davyhurst, including the Riverina, Waihi and Callion underground and open-pit mines.

Funded and ready to go

Part of the company's quick turnaround can be attributed to Managing Director Dave Quinlivan (formerly of Silver Lake Resources), who oversaw the DFS and the subsequent $55m capital raising. Eastern Goldfields spent considerable energy refurbishing infrastructure at the Davyhurst site, so the new company is looking at a lower-cost start of only $45m for pre-production costs. Should gold average A$2,100 per ounce in local currency terms, the DFS cash flow estimate for the project is $175m over five years.

The success of the DFS is in part due to the proximity of the various deposits from Davyhurst, none more than 50 km away. The project reserve is only 460,000 ounces, but the resource extends to 2.1 million ounces. The best grades have been returned from the southern area around the Riverina deposit (48 km from Davyhurst), which will become a key priority when open-pit mining begins in late 2020. Phase Two RC drilling campaigns have recently uncovered further mineralisation at Riverina South and nearby Golden Eagle, where a high-grade intersection of 6.4 g/t over 12 metres was announced on 10 August.

With a maiden resource estimate of 77,000 ounces at Callion (13 km from Davyhurst) announced in June, alongside an increase in the resource at Riverina to 322,000 ounces, Ora Banda has certainly not disappointed on the exploration front. Ora Banda's ability to bring many of the oldest mining prospects around Davyhurst back to life in such a short amount of time has been central to its 2020 investor appeal.

Shiny bars of gold in 2021

Having only come back to the ASX in June 2019, Ora Banda is well-placed to capitalise on what its predecessor company, Eastern Goldfields, started. With the first gold pour slated for early 2021 and an average annual gold production of 81,000 ounces expected for the first five years thereafter, the company's staged plan to optimise each pit should substantially improve its cash flow for the period. And although it's difficult to pinpoint success before its even started, Ora Banda's plan under David Quinlivan is about finding the best ore ahead of time, meaning the company has enough options in years six, seven and beyond for new exploration and drilling programs over the Davyhurst Project area.

On the DFS numbers, we believe Ora Banda can also look forward to some rapid shareholder value creation. Even with an Australian dollar gold price at the A$2,10- an-ounce figure we quoted above, the payback was only 14 months and that increased to 7 months at A$2,550 an ounce, at which point the post-tax NPV is about A$291m. Gold is now close to A$2,700 an ounce in local currency terms.

In a way, Ora Banda's necessary reinvention of itself has earned a newfound sense of trust from investors, and it's clear the company is keen to keep it. This stock is a four-star opportunity in our book.

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Share price: A$ 1.42

Uniti Group update on Stocks Down Under report published 21 August 2020.

Share price chart

Source: Tradingview

On 21 August 2020 we published our analysis and four star rating for the Uniti Group based in part due to its plan to acquire Opticomm for $5.20 a share with a mostly cash offer. We argued this was a bold move that was highly advantageous for Uniti Group's shareholders. Additionally, while we stated there was risk surrounding the acquisition being completed, overall, the company's stock price was low compared to the growth prospects, even without the acquisition.

Alright, so if you have not guessed by now, this is an update on the acquisition of Opticomm. A lot has happened in the last week; First State Super became one of the first superannuation companies to try and do what the industry has been discussing for a long-time, attempt a large scale, all-out, acquisition. First State Super issued an all-cash $5.85 per share offer two-days before the shareholders were set to vote on the proposal by the Uniti Group.

Despite OptiComm's board of directors backing the original offer by the Uniti Group, Uniti Group's share price dropped as short sellers pilled in. However, Uniti Group's management pulled a highly impressive, and completely unexcepted manoeuvre announced on 15 September 2020.

Through its contacts at Bank of America, Uniti Group has taken a direct 6% interest in OptiComm as well as exercisable call options allowing the purchase of an additional 13.5% interest in OptiComm over the next 6 months. This would give Uniti Group a 19.5% stake in the company and more than enough voting power to block any additional offer by First State Super.

Lastly, Uniti Group also increased its bid of cash and shares to match the offer made by First State Super. This led to a short squeeze in Uniti Group shares as the chances of the company's bid not going through are basically non-existent at this point in time. We continue to believe the company deserves a strong four out of five star rating.

To review our more in-depth analysis of the Uniti Group published on 21 August 2020, please view our previous publication here:

https://stocksdownunder.com/edition/ampol-uniti-group-4dmedical/

Pitt Street Research Pty Ltd

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