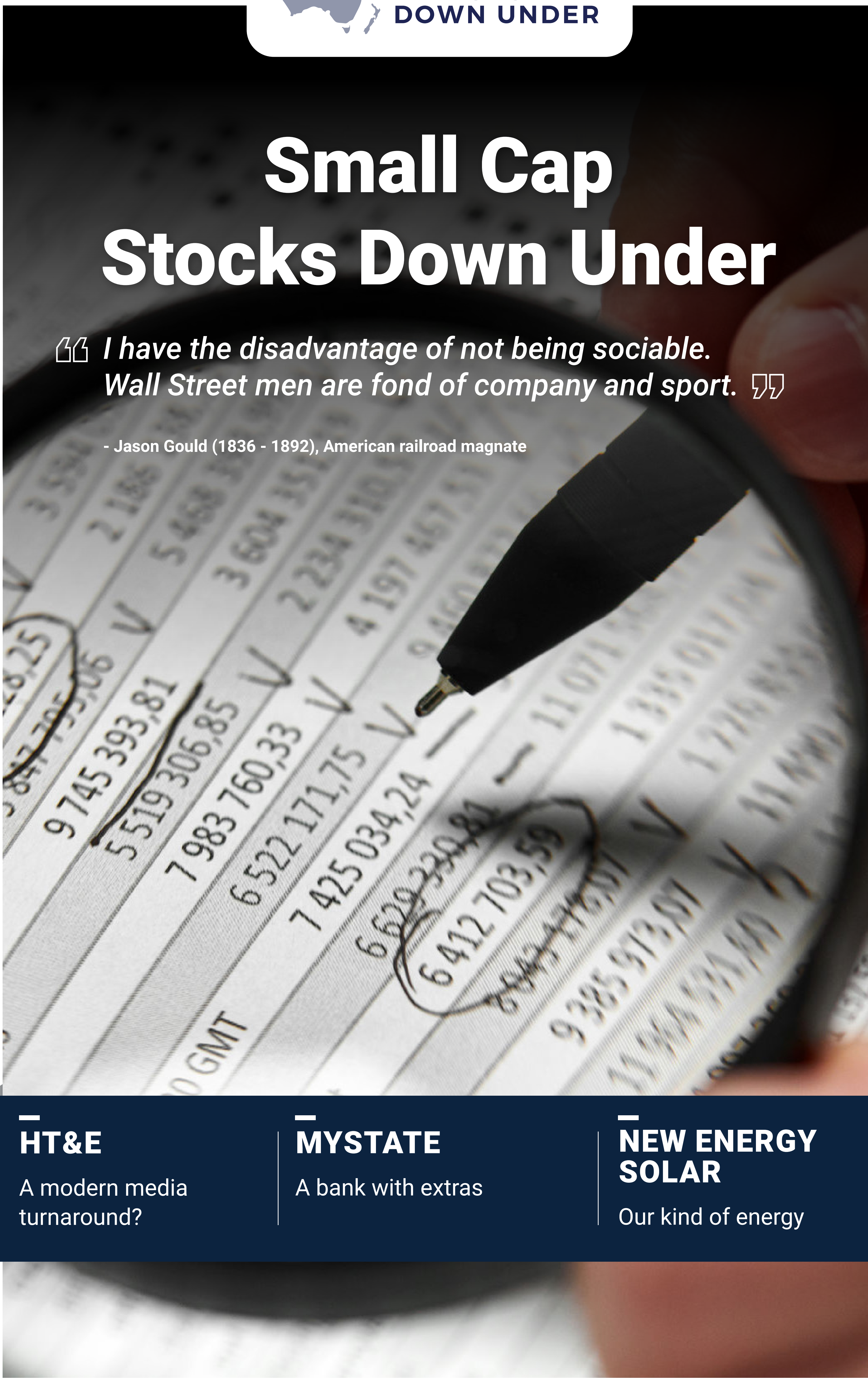
STOCKS DOWN UNDER

23 APRIL 2021



Small Cap Stocks Down Under

> *I have the disadvantage of not being sociable. Wall Street men are fond of company and sport.*

- Jason Gould (1836 - 1892), American railroad magnate

HT&E
A modern media turnaround?

MYSTATE
A bank with extras

NEW ENERGY SOLAR
Our kind of energy

HT&E

A modern media turnaround?

Stocks Down Under rating: ★★★

ASX: HT1
Market cap: A$ 527M
Dividend yield: 2.4% (100% Franked)

52-week range: A$1.00 / A$2.10
Share price: A$ 1.89

Headquartered in Macquarie Park, New South Wales, HT&E is a company that our Australian readers have likely heard of, literally. HT&E owns many of Australia's most popular audio brands, including radio and podcast brands. Like many companies in the media sector, HT&E is in strong decline, while attempting to turn things around. The question is, can the company swim against the current and achieve this turnaround?

READ MORE

MYSTATE

A bank with extras

Stocks Down Under rating: ★★★★

ASX: MYS
Market cap: A$ 415M
Dividend yield: 6.0% (100% Franked)

52-week range: A$3.55 / A$5.42
Share price: A$ 4.55

MyState is an Australian diversified financial services group. This Tasmania-based holding company supplies customers with banking services, trustee services and wealth management across Australia. Despite the recent increased popularity in high-yielding stocks, MyState has been on a sharp decline, dropping 10% between 22 February and 1 March 2021 alone. So, is MyState a failed state or should we seriously consider investing in it?

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How do you combine the modern economy and the shift in that economy towards renewables? Headquartered in North Sydney, New Energy Solar has decided to take up this challenge by investing in solar power stations around the world. The company's total FY20 power generation reached 1.4 Terawatt/hours. Despite this achievement, the company is currently in a strategic review of its Australian assets and is providing weekly Net Asset Value updates. So, where does that leave investors?

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Share price chart

Source: Tradingview

We know you have 'heard' HT&E

You may be thinking to yourself, I've never heard of HT&E. That's not surprising at all. You may not have heard the name HT&E, but you have likely 'heard' HT&E. The company is the Australian Radio Network parent, a subsidiary that owns 100% of The KIIS Network, The Pure Gold Network and The Edge. These three core radio brands broadcast to over 4.5m Australians each week. This subsidiary also owns a 50% share of Perth's Nova 93.7FM, Brisbane's 97.3FM and Canberra's 104.5FM and Mix106.3. While HT&E does not own iHeartRadio, it does have the exclusive rights to sell the brand in Australia.

The Australian Radio Network has continued to be a dominant force in Australia. It has managed to grow its estimated commercial metro radio audience cumulative reach each year since 2016 from slightly over 10m to 11.1m during 2020. The subsidiary has also managed to maintain its number one position in Australian commercial radio ratings for nine years straight. However, in today's ever-evolving media environment, that is no longer enough. This is why HT&E launched the iHeartRadio Podcast Network Australia in February 2020. The company has quickly become the number one podcast publisher in Australia.

As of December 2020, five of the top 10 podcast downloads in Australia was published through iHeartRadio Australia's podcast network. The new business has been widely successful, with podcast downloads increasing by 124% since its launch in February 2020, with revenue across 148 advertising campaigns generating $2.5m during 2020. Unfortunately, the number of downloads is not specified, just the growth rate.

HT&E has two other businesses that warrant mention, although the company does not own these companies outright. Soprano is a software vendor providing companies with the ability to manage secure interactions across SMS, MMS, email, voice, Rich Communication Services (RCS), WhatsApp and SecureIP. The company has operations in Europe, North and South America, Asia and Australia. Soprano is 25%-owned by HT&E providing the company with $3.3m in Net Profit After Tax during 2020, a 29% increase compared to 2019.

The second investment is Emotive, a creative design company controlled by HT&E through its 51% stake. Unfortunately, the specific details of Emotive's results are not broken out at this time. However, the Digital Investments division contains both the Emotive and Soprano investments. Remember, we know that the Soprano generated Net Profit After Tax attributable to HT&E of $3.3m during 2020. Therefore, since the division's net profit was $3.8m during 2020 we can estimate that Emotive generated approximately $483,000 in profit during 2020.

A period of suffering and poor results

HT&E has been dealing with a period of serious decline before COVID-19. During 2018, total revenue was $272m, which was followed by a decline to $252.7m in 2019. And during 2020, COVID-19 triggered a revenue collapse to $197.3m for the company as a whole.

Unfortunately, the company's profitability decline was even sharper. What started as $64m in EBITDA in 2018 quickly dropped to $38.3m in 2019 and $33.3m during 2020. These declines are basically due to a collapse in demand for advertising via more traditional radio means and, hence, the prices of these advertisements and sponsorships.

Unfortunately for HT&E, the same problems that are plaguing print media are very much alive in radio as well. This is why we believe the company's expansion into podcasts is investors' main hope for a return to growth.

One point of positivity towards a turnaround is the fact that, as of 31 December 2020, HT&E is sitting on $105.1m in cash, cash equivalents and short-term deposits. It is uncertain what the company will spend this large amount of cash on, but it has spent approximately $1.6m buying back 923,000 shares on market between 12 March 2021 and 23 March 2021. According to the company's latest filing, 20.7m shares may still be bought back at some point.

The market believes

HT&E is attempting to turn things around and the market currently expects that it will indeed be able to. The company's stock is followed by six different analysts currently and even the lowest EBITDA target for 2022 expects growth, albeit at a low rate of 5.5% compared to 2021's market consensus of $49.3m.

Unfortunately, we don't see what the market does. The company is branching out and has a number of potential avenues for a future turnaround, but we really don't see things as rosy as the market. However, we will not be issuing a two-star rating at this time for one main reason, the company's cash reserves. These reserves could be used for a major acquisition, dividend payment, share buybacks or any other potential enhancement of shareholder value.

Considering that the company's current market capitalisation is only $527m with over $105m in cash, we believe the only rating that makes sense is three stars at this time.

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Share price chart

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What's going on with interest rates?

Interest rate speculation really kicked it up a notch during 2021. Despite the Reserve Bank of Australia indicating that it will buy enough bonds to prevent interest rates rising on any Australian government debt offering until at least 2024, the three-year bond yield began to tick up towards the end of February 2021. This led to a slight ASX market correction as investors became concerned that interest rates would escape from the Reserve Bank's bond-buying cage.

Unfortunately for those hoping for a rise in interest rates anytime soon, we here at Stocks Down Under believe that the RBA is more than capable of keeping the rate cage locked in the foreseeable future. Despite the positive economic data coming out right now, we believe the government and the RBA are likely to want to play it extra safe, especially when the rest of the world is not looking so hot.

However, this means that Australia's banks will have to do with a significantly lower Net Interest Margin for the next couple of years. As of 3 March 2021, the RBA places Australia's major bank's Net Interest Margin at 2% on average during 2HY20. This is the lowest the major bank's net margins have been since at least 2000, when it was well over 3%.

For those not familiar with Net Interest Margin, it is a number you get by subtracting the financial institution's investment returns from its interest expenses and then dividing that by the company's average assets during the period in question. Basically, it concisely informs analysts and shareholders about the profitability of the financial institution in question.

A bank with extras

MyState calls itself a diversified financial services company. While that is technically true, from an income perspective the company is really a bank. Out of the $68.7m in total operating income generated by MyState during 1HY21, 90% was generated by the banking division and 90% of the banking revenue was generated through interest income. Its wealth management division generated the remainder of the company's operating income at $7m during 1HY21, a 15% decline year-over-year.

Despite the declining fortunes of MyState's wealth management division, the banking division had a fantastic 1HY21. The division increased its Net Interest Income 15% to $55.4m despite a decline in interest income of 13%. How did the bank manage this? Management has been focusing rather heavily on margins. The bank has suffered from a strongly underperforming Net Interest Margin with 1HY19's being as low as 1.81%. We mentioned earlier that Australia's major banks are at an all-time low of 2% right now, you can see how 1.81% during 1HY19 is a pretty poor reading for MyState.

Fortunately, management has successfully tackled the issue plaguing the majority of banks in MyState's position, fixing the bank's funding mix. Customer deposits are by far the cheapest way to fund loans for banks like MyState, so management had to find a way to increase its customer deposits. Between 1HY20 and 1HY21, the company managed to successfully increase customer deposits from 68.1% ($3.7bn) of its funding mix to 71.1% ($4.1bn).

In fact, that's not the only cost-saving measure MyState Bank has implemented. The bank has been going full steam ahead on integrating automation and AI into its operations to both increase efficiency and reduce overall costs. While these investments have increased costs in the short term, we are confident that shareholders will see a solid long-term return.

MyState's banking division has also managed to come out of COVID-19 rather unscathed. The company has solid loans with its current 30+ days and 90+ days loans in arrears below 1% and 0.4% as of 31 December 2020 respectively. This is well below the industry average of more than 1.5% and 0.8% respectively.

A solid dividend play

Investors looking for a solid bank play with a high dividend yield, we believe MyState is certainly one to look at. The company is currently trading at 1.5x its Price/Tangible Book Value with an FY22 and FY23 Price/Earnings ratio of 11.3x and 11.1x, respectively. The market expects growth to remain on the low side with only 2.5% expected earnings growth across FY22 and FY23. However, with the banking division's success in turning its operations around and the strength of the bank's loan book, we believe these forecasts may prove to be too low.

The one main risk we see to our thesis remains the wealth management division. We are not overly optimistic about its future after 2HY20 and 1HY21's capital flight. Management is attempting to turn the division around. However, as it only accounts for 10% of MyState's total operating income, we regard the risk as acceptable.

With its 6% indicative dividend yield and banking turnaround in full swing, for investors looking for an interesting dividend stock, it's four stars from us.

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Share price chart

Source: Tradingview

The rise of worldwide solar

During 2020, the world crossed a massive line in the generation of renewable energy. According to the International Energy Agency (IEA), the world authority on energy prices, certain parts of the world, such as China and India, can now generate electricity "at or below US$20 per MegaWatt/hour," less than half it's quoted price range for gas and coal. More significant is the fact that this makes solar the cheapest energy source in world history. This is due to several factors, but one of the main reasons has been the strong growth in solar installations around the world. Between 2010 and 2020 alone, solar experienced an average annual growth rate of 42% in the United States. This has resulted in 97 GigaWatts of solar capacity installed nationwide. To put this another way, this is enough to power around 18m homes, according to a report by the Solar Energy Industry Association. With prices so low, the question remains: How are the profits for a company involved in this trade?

New energy

As of 2020, New Energy Solar generated US$75.1m in revenue, an increase of 38% year-over-year. However, the company is not currently profitable. The company generates its revenues from the sale of electricity from its multiple solar power plants in Oregon (USA), North Carolina (USA), California (USA), Nevada (USA) and New South Wales (Australia). Notably, 97% of its revenue is secured for the next five years under long-term Power Purchase Agreements (PPA). In fact, 87% is still contractually protected through 2030. When it comes to revenue protection, these contracts offer significant protection and certainty for investors and management, especially when the power generation in question is 1.4 TerraWatt/hours (TWh) like it was during 2020. The current average Power Purchase Agreement price is $70/MegaWatt/hours (MWh), although this is based on an AUD/USD exchange rate of $0.77.

Portfolio review underway

New Energy Solar's management has decided to provide the market with weekly estimated (unaudited) Net Asset Value (NAV). The most recent was $1.22 per security. The main reason management has decided to provide the market with these statistics is the company's history of trading well below its Net Asset Value. The company's stock is currently trading at a discount of 36%, quite a steep discount, especially when you factor in its implied annual dividend yield of 10.4%. Unfortunately, it is unclear why the company has consistently been trading at such a significant discount, but value hunting investors need to be aware that this is nothing new.

To better unlock shareholder value, management has decided to undertake two main initiatives: selling its USF investment and taking bids for its Australian assets. Management has already sold its USF investment for $20.3m on 7 October 2020 so we won't discuss this further. The New South Wales assets are expected to be sold by mid-2021. The proceeds are slated to be used to fund unspecified capital management initiatives, which should bring up the company share price towards its Net Asset Value.

Where are we now?

New Energy Solar presents an interesting problem for investors. The company is clearly worth far more than its current valuation, with its Net Asset Value per security at $1.22 according to the 19 April 2021 value estimation by management. The issue for investors is two-fold. The first issue is liquidity; across the last three months, the daily average trading volume was only 310,000 or $214,800 per day at yesterday's closing price. The second is the market's refusal to buy the stock at anything less than a steep discount, although we believe this would change if the company became profitable.

There is certainly a lot of potential here for investors willing to take a chance. However, when we take the 36% discount and 10.4% implied dividend yield, we believe it's worth a punt. Four stars.

Pitt Street Research Pty Ltd

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