FINANCIAL REVIEW smartinvestor

SE portfolio

HD **Mine the market of the future**

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WC 2,312 words
PD 19 September 2014
SN Financial Review Smart Investor
SC FRSINV
ED First
PG 48
LA English

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HOEY'S TOP TEN

After the recent results season, analysts are seeing strong upside in shares with exposure to markets where underlying demand is untapped or set to grow, writes Trevor Hoey.

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1. PlatinaResources

MATERIALS

While graphite is the real buzz mineral at the moment, with any hint of news triggering sharp share price increases, scandium may be the next big thing. There are some similarities in end uses, but the common denominator is the substantial growth in industries using both metals.

The anticipated surge in electric vehicles is expected to drive demand for graphite. Similarly, new fuel cell technology, lights, lasers and applications in the aerospace industry are expected to result in a surge in demand for scandium, a mineral in very short supply.

Platina Resources provides investors with the best exposure to high-grade scandium. The resource is near surface with a maximum depth of 55 metres and its location near Parkes in NSW is in close proximity to essential services. Since August, two **Chinese** groups have negotiated supply agreements with Platina, totalling 20 tonnes of scandium oxide at 99.9 per cent purity. The first is Hunan Oriental Scandium, the largest **Chinese** manufacturer and processor of the mineral.

The signing of a heads of agreement in July between Platina and Honfine Zirconium Industry for 15 tonnes of scandium oxide resulted in the share price increased more than fourfold in the ensuing week. Management said negotiations with Honfine were an important breakthrough, and will not only allow the **company** to start early production, but incorporate a supply, technology, processing and marketing agreement.

Honfine's factory is located in inner Mongolia, and the two companies intend to collaborate on establishing the cheapest processing technology required to produce the desired products from the **ore** produced at its Owendale project.

This deposit is the world's highest grade laterite-hosted scandium deposit and offers a stable and potentially large tonnage production. Management highlighted the potential for Platina to export a moderately upgraded concentrate from Owendale for further processing in **China**, providing an opportunity to start production by 2016. While the tonnage numbers may not sound big, in the past four years the mid-range price for scandium was $US2650 a kilogram, valuing the agreements at $53 **million**.

Si view: The Owendale project has 519,000 ounces of platinum and 9100 tonnes of scandium, making it a possible long-life project. Management believes it could become Australia's sole platinum mine.

2. Oz Minerals

MATERIALS

While Oz Minerals had a strong second quarter for copper and gold production, resulting in management increasing copper production guidance for the 12 months to December 31, 2014, there was a mixed response from brokers.

Bell Potter noted June quarter production of 22.1 thousand tonnes of copper and 30.7 thousand ounces of gold was well ahead of its expectations of 16,000 tonnes of copper and 28,000 ounces of gold. Higher copper grades and recoveries contributed to the result, which also featured substantially lower cash costs.

The fall in cash from $US364 million as at December 31, 2013, to $US155 million at June 30, 2014, detracted from this. Bell Potter believes this was due to increases in working capital, which it expects will reverse in the following quarters. Deutsche Bank isn't so sure. It highlighted free cash flow is not expected to turn positive until 2016. It upgraded earnings forecasts for the 12 months to December 31, 2014, and increased the 12-month target from $3.30 to $3.40, but kept a sell recommendation.

Bell Potter has a different take on earnings expectations and cash flow projections. It has a buy recommendation and increased its 12-month price target from $4.50 to $4.70.

After revising currency estimates, the broker increased its 2014 forecasts from a loss of $7 million to a profit of $25 million.

While currency variations negatively affected revised medium-term estimates, Bell Potter is forecasting a net profit of $107 million in 2015, representing earnings per share of 35.2¢, up 330 per cent, compared with its 2014 projections.

Si view: Bell Potter sees potential upside from SA's Carrapateena copper-gold project. And exploration results from the copper-gold project at Bellas Gate, Jamaica, may be a share-price catalyst.

3. Starpharma Holdings

HEALTHCARE

Starpharma Holding's announcement that the United States Food and Drug Administration had granted an agreement regarding the design and analyses of Phase 3 clinical studies of its VivaGel bacterial vaginosis product appeared to go unnoticed by the market. But the Special Protocol Assessment is significant as a binding agreement that the Phase 3 clinical study design, endpoints, statistical analyses and other aspects of the studies address objectives in support of a US regulatory submission for approval of the product.

This eliminates regulatory risks associated with clinical development by specifying the FDA's trial design. The company has received a similar commitment from the European Medicines Agency.

Approval would be an important breakthrough. There are no approved products for prevention of recurrent bacterial vaginosis, which affects about one in three women.

Si view: While there was little share price response to the USFDA Phase 3 agreement, the receipt of Australian TGA certification for the VivaGel condom triggered a significant share price gain.

4. OTOC

INDUSTRIALS

Engineering and construction group OTOC has defied negative industry conditions, delivering earnings before interest, tax, depreciation and amortisation of $12.8 million in 2012-13. This was struck on revenues of $113 million, indicating the company has been able to maintain respectable margins in a competitive operating environment.

OTOC is also in a strong cash position with $15 million after June 30. The company did not provide details of its forward order book, but management is confident its infrastructure services operations will deliver solid earnings.

Though conceding the resources market is challenging, OTOC has secured new contracts, including the Roy Hill project. The Nauru processing centre provides infrastructure work with the likelihood of further expansion. OTOC is looking to grow its surveying, planning and aerial mapping services operations, particularly given the latter is highly fragmented.

Si view: OTOC considers itself ideally positioned to acquire complementary businesses and create a premium national surveying group. The August acquisition of Bosco Jonson is a good start.

5. MACA

INDUSTRIALS

Mining services group MACA began 2014-15 with a double dose of good news: the award of a sizeable contract and a net profit of $55.4 million, comfortably in excess of the previous year's $49.5 million. Management conceded conditions were challenging, but said the company had performed well across its mining and civil projects, laying the foundation for revenues in excess of $600 million in 2014-15.

This was an outstanding result given it implied year-on-year profit growth of about 12 per cent. The award of a $90 million contract to complete major works at the Karara iron ore project over a 17-month period will help to boost income out to 2015-16.

MACA has several major projects generating income until December 2017, with some extending to 2020. Argonaut has a buy recommendation with a 12-month price target of $2.70, well ahead of its recent trading range and just above its all-time high of $2.67.

Si view: MACA has been a very consistent performer, yet it trades on a conservative P/E multiple compared with its peers. The company should re-rate early if the mining services sector comes back into favour.

6. Panoramic Resources

MATERIALS

Despite the share price of nickel producer Panoramic Resources having increased fourfold between February and July, news that it had intersected a second zone of mineralisation at the Savannah North project provided further share-price momentum.

Massive sulphide mineralisation over a broad area was evident and, with the potential for more exploration success, there is optimism this could lead to a resource increase and the likelihood of a longer mine life for Savannah North.

Panoramic had an impressive year, with production from its two mines totalling 22,255 tonnes. The company finished strongly with June production of 5720 tonnes. Panoramic is also in good financial shape with cash of $65 million at June 30. This provides it with the scope to deliver on its active exploration plan. The company is guiding to production in a range between 20,000 tonnes and 21,000 tonnes in concentrate in fiscal 2015.

Si view: Analysts at Bell Potter rate Panoramic Resources highly, particularly medium to long term. However, after a strong share price run, further upside is likely to be exploration-driven.

7. Smartpay Holdings

CONSUMER DISCRETIONARY

Bell Potter is upbeat about the prospects of Smartpay Holdings, the holding company of the Smartpay Group, which designs, develops and implements payment solutions for customers in New Zealand and Australia. It rents eftpos terminals to merchant customers and provides specialised transaction and reporting services, using its own proprietary switching system.

Smartpay is the leading provider of rental eftpos terminals in NZ but is a relatively new entrant in the Australian market. Its shares are dual listed on the NZ and Australian stock exchanges. Bell Potter acknowledges the emergence of new mobile payment systems as a potential threat to the business, but said the company only needed to increase its Australian market share from about 1 per cent to about 2 to 3 per cent to meet its forecasts.

It estimates Smartpay will experience earnings per share growth of 84 per cent in 2015-16 with profit increasing from $NZ3 million ($2.69 million) to $NZ5.5 million, representing NZ3.2¢ a share.

Si view: Apart from the rollout of new terminals, there is the potential for smaller banks to outsource their eftpos operations. They currently account for 155,000 of the total 800,000 terminals in Australia, representing 19 per cent. However,such a transaction would be a bonus, and at this stage the company is reliant on demand-driven incremental expansion.

8. Gryphon Minerals

MATERIALS

After the August release of Gryphon Minerals' bankable feasibility study on the Banfora gold project in Burkina Faso, Hartleys modelling pointed to annualised production of 80,000 ounces over a nine-year mine life. The broker expects production to start in 2015-16 with about 18,000 ounces for Gryphon, ramping up to 71,600 ounces in 2016-17. Based on a gold price of $US1296, it expects this to generate $8.3 million profit, or earnings per share of 8.3¢.

Hartleys values the Banfora project at 34¢ per share and its 12-month price target is 35¢, implying a price-earnings multiple of 4.2 relative to 2016-17 forecasts. A game changer would be the addition of a 2 million tonnes a year carbon in leach plant which would have much higher recoveries of about 92 per cent. This could result in production of about 150,000 ounces a year.

Hartleys expects recent exploration success to result in an increase in the current reserve estimate of 850,000 ounces.

Si view: As well as Banfora, Gryphon is exploring tenements on the Hounde Belt, also in Burkina Faso and near Roxgold'shigh-grade Yaramoko deposit of 810,000 ounces at 15.8 grams per tonne.

9. Ardent Leisure Group

CONSUMER DISCRETIONARY

Ardent Leisure Group, owner and manager of a diversified portfolio of entertainment and leisure assets in Australia, New Zealand and the United States, has acquired eight Fitness First health clubs in Perth. They add to its six Goodlife clubs in Western Australia, making it the state's largest full-service health club chain.

Total consideration of $32.5 million was funded through an underwritten $50 million institutional placement. Additional funds will be used to accelerate expansion of its Main Event group, one of the fastest-growing family entertainment businesses in the US.

Before synergies are realised, management expects the acquisition to deliver pro forma earnings per share growth of between 3 per cent and 5 per cent in 2014-15, not allowing for EPS dilution as a result of the capital raising. Ardent announced it had achieved a statutory profit of $49 million for the year to June 30, representing impressive year-on-year growth of 37.6 per cent.

Si view: Ardent Leisure has the scope to expand its fitness club and Main Event businesses while benefiting from resilient earnings streams flowing from its Dreamworld and WhiteWater World theme park assets.

10. FlexiGroup

FINANCIALS

FlexiGroup delivered a 2013-14 cash net profit of $85 million, representing year-on-year growth of about 18 per cent. This was in line with consensus estimates of $85.2 million and should have restored confidence after the shares were sold down heavily in the first half of 2014.

The company delivered operating cash flow of $124.3 million, up 28.4 per cent on the previous corresponding period. The Certegy business performed strongly, with profit increasing 17 per cent to $32.3 million. The interest-free cards operation was also successful; with the acquisitions of Lombard and Once bedded down, it contributed $11 million. RentSmart, Think Office Technology and Equico NZ should make a significant contribution in 2014-15.

Management provided 2014-15 net profit guidance of between $90 million and $91 million, which was slightly below Bell Potter's pre-result forecast of $93 million. FlexiGroup is in a robust financial position with recourse debt to equity gearing of 20 per cent and an undrawn corporate facility of $55 million.

Si view: FlexiGroup has been one of the most consistent performers in the diversified financials sector over the past five years, delivering annual earnings growth in the order of 20 per cent. While earnings per share growth is likely to taper in 2014-15, the company is trading on a conservative multiple relative to consensus forecasts.

NS nran : Rankings | ncat : Content Types

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

PUB Fairfax Media Management Pty Limited

AN Document FRSINV0020140918ea9j00012

