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Stocks Down Under

'Whenever you save five shillings, you put a man out of work for a day'

- John Maynard Keynes (1883 -1946), British economist

Ramsay Healthcare could be running a fever soon

Stocks Down Under rating

ASX:RHC Share price: A$ 74.71 Market cap: A$ 15BN

If you bought the stock of the Sydney-based private hospital operator Ramsay Healthcare (ASX:RHC) on the last trading day of 2009, and held until the all-time high in September 2016, you would have made ~39% p.a. before dividends without having to worry too much from year to year. Since September 2016, the story has been mixed, share price wise – with Ramsay stock trended down by a third between September 2016 and October 2018.It has since regained most of that lost ground, to the point where it's now only 4.7% off the top. A stellar recovery, and it allowed the holding of the late founder Paul Ramsay to be sold

down to just 21% in September. However, we'd be cautious about this patient's prospects for further recovery right now.

Company Share Price Chart

Source: Tradingview

An unexpected gift from the voters

We argue that the main reason for Ramsay's return to favour was the unexpected re-election of the Morrison government in Australia on 18 May. It was Prime Minister Scott Morrison's Liberal Party who in the 1990s put in place the current system of funding for the Australian health care system, where our take on universal health care, called Medicare, took care of the basics of the system but people were also incentivised to hold private health insurance. It was a reasonable bet that under Labor this dual system would be either further weakened or dismantled altogether. With that bullet dodged, people felt that Ramsay was a good bet on continued growth in healthcare spending in Australia.

Alongside the steady rise in healthcare spending, Ramsay has rewarded its shareholders richly over the last decade or so because, it as the leading owner of private hospitals appears to have gained market share over time. Also, it has continued to enlarge the range of specialties that it offers, and the company continued to do brownfield expansions of its existing facilities. These fundamentals remain in place. What isn't so certain is whether the funding environment will remain healthy for Ramsay.

Private health insurance is in decline in Australia

The Liberals may be in charge in Australia until 2022, but they can't control is whether the relentless rise in private healthcare insurance premiums will cause more people to drop their private health insurance. This would leave less funding to go to Ramsay and its competitors. Or the private health insurers themselves could start to push back with more than usual vigour on what they're prepared

to pay. Either way, we think Ramsay stock looks vulnerable. Currently, around 44% of Australians have private health insurance. Back in 2013 it was closer to 47% and the numbers tend to tick down each quarter despite $6bn or so in government subsidies. This decline has been the main reason Ramsay's share price went into reverse until last October.

A recent two-part report from a Melbourne-based think tank called the Grattan Institute has suggested that private health insurance coverage will go under 40% by 2030 unless significant reforms are made. The main reform would be dropping the 'community rating' for people under 55. Community rating, which is compulsory, means that everyone's premium is the same regardless of their age, something which makes private health insurance unappealing to young people. Should the government be brave enough to take the axe to community rating, Ramsay's growth might be assured for another decade or so, but it will likely be a vote loser.

Ramsay is priced to perfection

The Federal government just signed off on the private health insurance premiums that will be allowed from April 2020, and it's not a pretty picture for Ramsay. The average rate increase is only 2.92%, which is the lowest increase in close to two decades. We predict that such low increases, combined with steady membership declines, will make it more difficult for Ramsay to get properly reimbursed in 2020 and beyond.

So watch out for the forthcoming fights over reimbursement, which may see private health fund members unable to go to a Ramsay hospital for their surgery or other medical care. These kinds of fights are not a risk a company should be exposed to when its stock is priced to perfection, trading on a P/E of 25 times FY20 consensus. Also, the dividend yield is only about 2% and the Paul Ramsay stake is still a legitimate overhang. Throw in the risk of more nurses strikes next year and we'd be very cautious with this one.

Shine Corporate – Ready to shine again

Stocks Down Under rating

ASX:SHJ   Share price: A$ 0.95   Market cap: A$ 163.7M

It's been a good six months for shareholders of Shine Corporate (ASX:SHJ), the Brisbane-based legal services company, market cap ~$150m. Shine operates mainly in insurance recovery and personal injury. Back on 21 June the stock was changing hands at 63 cents, but by 21 November it had made it to 97 cents. $1.00 seems to be an important resistance level and should Shine's stock find its way through that barrier, the next stop is about $1.30 and, after that, $1.70. So Shine is worth paying attention to right now.

The reason for Shine's recent recovery was the settlement, announced on 29 May, of a $250m class action against the company which had formally kicked off in September 2017. That, in turn, related to a 29 January 2016 earnings downgrade in which Shine stock had dropped $250m in market capitalization after a halving of its FY16 EBITDA forecast. Interestingly, the 2019 class action settlement, while confidential, had 'no impact to balance sheet or earnings'.

Company Share Price Chart

Source: Tradingview

The bad news is now ancient history

The January 2016 debacle may be ancient history but it's worth considering for a moment to understand why you can currently buy a national and well-branded law firm in Australia with solid growth prospects for only 6.9x FY20 consensus earnings. The downgrade related not to growth or decline in the business itself but to an accounting issue - Shine chose to revise downwards the value of work in progress on the balance sheet. That was understandable because a huge number of variables will impact claims for negligence under the law of tort, and these matters typically take a long time to settle. The market, however, chose not to be so understanding.

Back in 2016, Shine's competitor, Slater and Gordon (ASX: SGH), was in serious trouble over its UK expansion and an ASIC investigation. Investors chose to shoot

first and ask questions later. Before January was out Shine's stock was down a bone-jarring 73%. Investors have been wary of Shine ever since.

However, there's a lot to like about the post-2016 Shine. For one thing, the company continues to acquire practices as well as move into new areas such as family law and class actions (its own class actions, that is). For another, there's more technology at the back end to boost the efficiency of the lawyers, such as the Claimify platform designed to markedly speed up claim lodgment. Finally, earnings are improving. In FY19, $178m in billings, more-or-less flat on FY18, saw a 26% increase in EBITDAI (EBITDA pre-impairments) mainly because overhead costs were down markedly.

It all meshes together

Shine is one of those companies that tend to generate really good news for its shareholders every now and then, because at any one time there's more than 6,000 matters in the pipeline, of which a few will generate high profile headlines. Shine generally comes out from a settlement or a court judgement looking like the 'good guy' because of the 'little guys' that it tends to represent. The latest such matter was the 21 November court decision in the well-publicised Johnson & Johnson vaginal mesh class action in the Federal Court. Shine helped record a win for the plaintiffs and got big coverage on the evening news after the judgement was handed down. We think there'll be more of this kind of good news in FY20. Or simply a solid 1HFY20 result in which the company continues to grow earnings may see this stock continue its progressive return to favour.

Collection House – It isn't as bad as it looks

Stocks Down Under rating

ASX:CLH   Share price: A$ 1.10   Market cap: A$ 156M

When you think about it, it's a great tribute when an outgoing CEO quits and the share price tanks. Clearly the guy, or gal, must have been doing something right, and shareholders are worried that he's no longer around. Good for the

reputation of the former CEO, and, potentially, a great buying opportunity for investors if the company can handle the succession issues properly.

We wonder if the Brisbane-based receivable management company Collection House (ASX:CLH) has now presented one such buying opportunity. On Friday 22 November Collection House ended the week at $1.21. When it was announced the following Monday that CEO Anthony Rivas had resigned over the weekend the stock quickly dropped to $1.12 and it’s now $1.08. Rivas had been with the company around three years and he had had time to build a strong bench. Collection House was therefore able to name CFO Doug McAlpine as the new CEO, with immediate effect.

Company Share Price Chart

Source: Tradingview

Dividend yield greater than 7%

Doug McAlpine inherits a company that’s not really growing at the moment. Consensus revenue and EBITDA in FY20 is expected to come in at $171m and $54m respectively, the former up around 7%, the latter down around 4%. However, that relatively slow FY20 is already built into a share price trading at only 6.2x consensus FY20 earnings. The dividend yield is currently a handsome 7.6% fully franked. The question is what McAlpine and his team can do to grow from here.

The first thing they can do is purchase more ‘PDLs’. Collections House buys, for cents on the dollar, various ‘Purchase Debt Ledgers’ representing overdue personal loans, credit card debt and so on, and then starts to collect. During FY19 Collection House stepped up the pace on PDL acquisition to $132.6m, and that bodes well for better earnings over the next two years. In FY20 the company is targeting $80-100m, well above the historic average.

Kash is knocking on debtors' doors

The second think the team can do is continue their investment in technology. Collection House's interactive portal, featuring a fictional character named Kash, is already making it easy for debtors to work with the company and FY20 is likely to see it used more and more.

The third thing it can do is just wait. When Collection House isn't collecting on its own PDLs, it is collecting the debts of others, on a fee-per-service or success-fee basis. That side of Collection House didn't have a great FY19 largely because the Banking Royal Commission was causing banks to be less willing to refer a debt to Collection House, as well as causing the banks to review their policies over collection procedures. We believe once this review has completed there will be something of a return to normal for Collection House.

A bad economy could be good for business

A fourth thing Collection House can potentially do is make less use of bankruptcy laws. There's been various comments in the media about how Collection House subsidiary Lion Finance has been taking more debtors to court than its competitors do. It's within the company's rights to do so – and is better than the traditional method of baseball bats – but may tarnish its corporate reputation over time.

We expect it will take until the FY20 half yearly result in February for the market to decide if it likes the new leadership team at Collection House. However, we don't see anything to worry about at the moment. Indeed, if the Australian economy is slowing down, creating more bad debt ledgers to buy, this stock may be well placed moving in the New Year.

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