27 FEBRUARY 2020

Stocks Down Under

"That money talks, I'll not deny. I heard it once: It said, "Goodbye"

- Richard Armour (1906-1989), American poet

WISETECH GLOBAL

Diamond or Dog?

ANSELL

Good company, but bad timing

ELANOR RETAIL PROPERTY FUND

Slow to react to industry growth trends

WISETECH GLOBAL

Diamond or Dog?

Stocks Down Under rating: ★★★★

ASX: WTC
Share price: A$ 17.57
Market cap: A$ 5.6BN

The market's views on WiseTech, the Sydney-based logistics software company, can roughly be divided into two camps…the people who love it and the people who think there has never been a more over-priced stock on the ASX. The company has recently taken it on the chin twice; in October 2019, when two high-profile short seller reports came out; and last week when the company lowered its full year EBITDA guidance, blaming the evil Coronavirus.

ANSELL

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Stocks Down Under rating: ★★

ASX:ANN
Share price: A$ 27.97
Market cap: A$ 3.96BN

Ansell, the Melbourne-based maker of industrial and medical gloves, has had a dependable track record of growth for more than a decade now. This continues in the December 2019 half year when revenue grew 3.9% and EBIT 4.8%. However, the stock has been sold off since early February, on concerns that a China slowdown will be bad for sales of industrial gloves. We expect a near-term period of share price weakness, after which the company can resume its usual growth.

ELANOR RETAIL PROPERTY FUND

Slow to react to industry growth trends

Stocks Down Under rating: ★★★

ASX:ERF
Share price: A$ 1.23
Market cap: A$ 154.2M

The Elanor Retail Property Fund is a real estate investment fund focused on Australian retail properties and managed by Elanor Investors (ASX:ENN), the Sydney-based fund management group. Since being listed on ASX about three years ago, the Elanor Retail Property Fund has failed to make a splash and is trading below its $1.35 debut. This is a tough business to get excited about given all the challenges in the current retail environment. The specialty store-centric, high-risk nature of the fund's investment portfolio makes for an unfavourable risk-reward profile.

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Share price chart

Source: Tradingview

WiseTech's main product is CargoWise, a cloud-based end-to-end logistics execution platform that freight forwarders and other logistics companies can use to manage their logistics transactions. CargoWise is a modular product, meaning that customers can pick the modules they need and tie them together to work seamlessly within their organisations. These modules include functionality such as customs, warehousing, geo-compliance and eCommerce. And because CargoWise is cloud-based, there is very limited investment required on the part of customers.

Sceptical investors were right for the wrong reasons

WiseTech has been around since 1994 and has grown strongly, reaching $348m in revenues and $108m in EBITDA in the last financial year, which ended in June 2019. In the last 18 months or so, the company's highly scalable revenue model and strong growth profile had driven up the company's valuation to the point where investors were starting to question if WiseTech, and other ASX-listed Tech companies for that matter, could ever live up to investors' expectations around revenue and EBITDA growth. For good reason, as it turns out … or not?

Short seller ahoy…

In two separate reports published in October 2019, an investment firm called J Capital accused WiseTech of failing to properly integrate newly acquired companies, resulting in poor post-acquisition performance of these companies. It also said WiseTech was inflating its revenues through accounting tricks and tried to hide how much the company's revenues were growing organically, i.e. excluding acquisitions. The combined effect of these reports was a 25% decline in the share price, to around $26, within a week.

Full year guidance lowered substantially

Then on 19 February, in its 1HY20 earnings release, WiseTech lowered its FY20 revenue guidance from the original range of $440m-460m down to $420-450m, while EBITDA guidance was lowered to a range of $114m-$132m from $145m-$153m previously. So, quite a substantial downgrade.

The company mainly blamed the Coronavirus, specifically its stifling effect on global supply chains, for the downward revisions. Just as WiseTech's share price had recovered to around $29, this revised guidance has triggered a major selloff, to $17.57 at the close of the market yesterday.

As always with this sort of thing, when investors are presented with the opportunity to buy a long-term growth stock at a price that is well below recent trading ranges, the question is - should I buy now?

Look beyond Corona

Purely looking at WiseTech from a technical analysis angle, we believe the shares could fall towards the $14.50-$15 range, where a longer-term support level formed in 2018. However, from a fundamental perspective, we believe the valuation has already become attractive.

At some point the Coronavirus will burn itself out, like SARS did in mid-2003, and with global supply chains severely impacted currently, we expect to see a major catch-up effect later in the year. Following the recent analyst earnings downgrades, WiseTech is now trading at an EV/Sales multiple of 10.8x and an EV/EBITDA multiple of 33.8x for FY21 (starting in July). The projected EBITDA growth for next year is close to 41% on current, lowered, consensus estimates. In other words, quite an attractive EV/EBITDA-to-EBITDA growth ratio, in our view, i.e. lower than 1x.

Is there room for further earnings downgrades? There always is. They say bad news comes in threes. But at a potential entry point of around $15, based on the price chart, we believe WiseTech would present a very interesting long-term investment opportunity.

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Share price chart

Source: Tradingview

Many investors unfamiliar with the Ansell of today will think of this company as one of the world's leading maker of condoms, despite having divested this business back in 2017. The thing to remember about Ansell is that industrial and medical gloves, which is all it does today and where it is a world leader, can be a license to print money given the importance most companies place on hand protection so as to reduce insurance costs as well as the lost-time costs from injuries. No wonder Ansell stock has enjoyed a steady climb over the past decade.

A market leader with unique R&D capabilities

Ansell has been able to differentiate itself by offering a wide range of products, superior customer engagement, and having a presence in more than 100 countries. Sales grew by only 0.6% in FY19 (3.2% on a constant currency basis) due to the US-China trade war, Brexit and a contraction in global manufacturing. Adjusted EPS, however, grew by an impressive 9%.

Part of what drives Ansell's success is its dedication to research and development (R&D). It continually develops innovative solutions designed to improve human safety. One area where R&D may lead to sustainable growth is electric vehicles. Ansell makes the specific gloves that are required in the handling of car battery components. Its healthcare brands include Gammex and BioClean-D which posted 17% and 11% growth respectively in FY19. On the industrial side of the business, HyFlex, complete with built-in fingertip sensors, is the world's number one industrial glove approaching $300m in sales. Profitability on both sides of the business is robust with operating margins around 15%.

Fiscal 2020 is expected to be marked by better performance. Management is forecasting EPS in the $1.12 to $1.22 range. At the midpoint, this would represent a whopping 42% earnings growth over the $0.826 reported in FY19.

Coronavirus fears spurring demand

The current Coronavirus outbreak may create significant opportunity for Ansell. It is likely to lead to continued strong demand for gloves, protective suits, goggles, and face masks globally. Despite only having a handful of Coronavirus cases, surgical masks are sold out in the U.S. As a global supplier of these products (including in China), Ansell looks well-positioned to be a beneficiary of the soaring demand. Even if the Coronavirus epidemic subsides, the issue has put a spotlight on the need for protective equipment for future viruses and other needs.

Another avenue for growth is vertical integration. Ansell recently acquired a 50% stake in the Malaysian examination gloves supplier Careplus Group Bhd. Although the move will not be accretive to earnings in FY20, it will provide Ansell with valuable wholly owned manufacturing facilities.

The company stands to gain market share over the next few years through both organic growth and making more acquisitions. Longer term, Ansell is targeting 5% to 10% annual EPS growth on 3% to 5% of organic growth. The surgical gloves market alone is expected to grow at a 7% annual pace over the next five years.

Transformation plan well-timed

Upon completion of the divesture of the sexual wellness unit in 2017, Ansell set forth an aggressive strategic plan. It deployed $90m for transformative investments, $80m for acquisitions, $265m for share buybacks and $125m for dividends. These moves are geared towards igniting growth and taking a more shareholder friendly stance.

As a global leader in safety products, Ansell has a diverse customer base that is increasingly exposed to rapidly growing emerging market countries. Income-oriented investors will also be pleased to know that the company has increased its dividend for 16 straight years.

Why only two stars?

From a valuation standpoint, Ansell is coming back into the value range. The stock currently trades around 17.7x FY20 forecast earnings, dropping to 15.4x by FY22. However, we think there's further downside from here in the near term. The Coronavirus crisis in China, while good for medical gloves, is likely to impact the market for industrial gloves globally in the near term. Medium and long term, and at the right multiple (say, under 15x FY21, currently 16.5x), so down another 10% or so, this stock is likely to be attractive given the company's market leadership and its solid pipeline of R&D projects. Near-term, we'd be cautious though.

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Discretionary exposure threatens income stability

Elanor faced challenging conditions in the sub-regional shopping centre space last year. Despite public marketing campaigns, properties had a hard time finding buyers causing the market to be repriced. As a result, yields within the company's sub-regional segment have been compressed and may get even tighter as 2020 progresses. This has prompted Elanor to shift its focus from the sub-regional market to inner city retail assets.

Retail properties in the inner ring tend to generate more investor interest. These assets involve mixed-use development, which typically has greater upside potential -- things like residential, office, or build-to-rent properties. Over the next several years, the most successful retail centres are expected to be those with exposure to supermarkets, convenience stores and other nondiscretionary retailers.

Unfortunately for Elanor, the company is sitting on the wrong side the fence. More than half of its portfolio is dedicated to 'Other Specialties' tenants that are more discretionary in nature. Although Woolworths, Coles, and Big W comprise 13%, 12% and 8% of tenants respectively, this may not be enough for the company to outperform its peers. This is because specialty store tenants tend to garner more volatile income patterns compared to more reliable tenants, like Woolworth. As a result, Elanor's strategy is unlikely to the deliver stable income growth that is generally coveted by real estate fund investors.

Refocusing on value-added properties

In June 2019 Elanor had a $332m portfolio and a Net Asset Value of $1.53 per share. The comparable figures for December 2019 were $334.9m and $1.54. Gearing has increased over the period, from 38.2% in June 2018 to 39.3% in December 2019, while portfolio occupancy has weakened from 98.5% in June 2018 to 97.4% in December 2019.

Late last year Elanor recognized the need to reposition its non-discretionary value-added retail assets to produce better risk-adjusted returns. It separated its properties into value-added assets and income assets. Value-added assets comprised 61% of the overall portfolio and include Auburn Central and Tweed Mall. Income assets accounted for the remaining 39% and include Manning Mall and Northway Plaza.

Along with changing its retail mix and focusing on the development of current assets, it also mentioned the possibility of exploring property sales through M&A activity. To this end, Elanor recently parted ways with its Moranbah, Manning Mall, and Gladstone Square properties. The proceeds of the sales will be put towards value-added retail assets or be used to repurchase company stock.

More Big W departures a big concern

While the company's new strategic direction makes sense, the question from an investor's standpoint is will it be enough? And are they too late to the party?

In December, Elanor signed an agreement for lease (AFL) with Aldi Foods Pty Ltd. at Auburn Central for a new 1,755 square meter supermarket. It will, however, be a replacement tenant for Big W, which chose to vacate earlier this month. So, while the move to secure the relatively steady Aldi appeared to be a step in the right direction, the timing may not always be so fortunate. A similar Big W exit could result in a sizeable income loss if another tenant is not waiting in the wings.

Despite having a 7.75% dividend yield, the stock is thinly traded and lacks a desirable level of liquidity. Even though it has taken steps to improve its risk-adjusted returns, the risky composition of its current portfolio is reason to take a flyer on this stock. We think there are better investment opportunities in the real estate space and beyond.

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