28 FEBRUARY 2020

Stocks Down Under

"Pundits forecast not because they know, but because they are asked"

- John Kenneth Galbraith (1908-2006), American economist

IONEER

What happens at Rhyolite Ridge

GOODMAN GROUP

A logical bet on logistics growth

JANUS HENDERSON

Fund outperformance, retail gains key to 2020 growth

IONEER

What happens at Rhyolite Ridge

Stocks Down Under rating: ★★★★

ASX: INR
Share price: A$ 0.17
Market cap: A$ 286M

Recently, we've written a lot about lithium and how we think that the stocks of prospective lithium miners have reached and potentially passed 'peak despair', thanks to temporarily low pricing for the commodity. One lithium developer that, in our view, is now looking attractive is the Sydney-based Ioneer. That company's stock peaked at 52 cents in March 2018 but by June of last year was plumbing the depths at 13 cents. Ioneer will soon complete a Definitive Feasibility Study on a lithium project in the US state of Nevada called Rhyolite Ridge. It's attractive for two reasons: Firstly, its location, and secondly, its valuable boron co-product.

GOODMAN GROUP

A logical bet on logistics growth

Stocks Down Under rating: ★★★★

ASX: GMG
Share price: A$ 15.55
Market cap: A$ 28.1BN

Goodman Group is a Sydney-based real estate manager that develops both commercial and industrial properties. The company's share price took a nosedive during the Global Financial Crisis of 2008/09, falling below the $1 mark at the market bottom. In the decade since, the stock has managed to claw back as the commercial property industry has stabilized amid an improved global economy. After hitting a post-crisis high last week, we believe the high-performing REIT has the growth catalysts to keep the rally going.

JANUS HENDERSON

Fund outperformance, retail gains key to 2020 growth

Stocks Down Under rating: ★★★

ASX: JHG
Share price: A$ 34.37
Market cap: A$ 6.3BN

Janus Henderson, the global asset manager headquartered in London, offers the full spectrum of financial products to individual investors and institutions. It is the product of the 2017 merger of Janus Capital Group and Henderson Group. The company manages fixed income, equity, alternative and multi-asset mutual funds and ETFs. It counts industry legends Myron Scholes (Nobel Laureate) and Bill Gross (formerly of U.S. bond manager Pimco) among its notable leaders. Although Janus Henderson is one of many choices in the world of investment management, it has some interesting traits that make it worthy of investment consideration.

IONEER

What happens at Rhyolite Ridge

Stocks Down Under rating: ★★★★

ASX: INR
Share price: A$ 0.17
Market cap: A$ 286M

Recently, we've written a lot about lithium and how we think that the stocks of prospective lithium miners have reached and potentially passed 'peak despair', thanks to temporarily low pricing for the commodity. One lithium developer that, in our view, is now looking attractive is the Sydney-based Ioneer. That company's stock peaked at 52 cents in March 2018 but by June of last year was plumbing the depths at 13 cents. Ioneer will soon complete a Definitive Feasibility Study on a lithium project in the US state of Nevada called Rhyolite Ridge. It's attractive for two reasons: Firstly, its location, and secondly, its valuable boron co-product.

Share Price Chart

Source: Tradingview

If you've made a trip to Nevada in recent years you may have driven down US Route 95, which takes you most of the way between the two main population centres of Reno and Las Vegas. These days the route has another name – the Nevada Electric Highway – because of all the charging stations for electric vehicles (EVs) that you can find by the roadside. The Electric Highway initiative got started around the time Tesla opened its 'gigafactory' to make EV batteries in Reno in 2016.

What Ioneer spotted on the Electric Highway

The reason why the Electric Highway and Tesla are relevant to the Sydney-based Ioneer is that Rhyolite Ridge sits in Nevada's Esmeralda County not far from the Electric Highway and close to Silver Peak, an operating mine owned by the lithium major Albemarle (NYSE: ALB). As we noted when writing about Piedmont Lithium (ASX: PLL) on 30 January, lithium resources located close to gigafactories are set to succeed going forward due to the need of battery makers to shorten their supply chains and know that their lithium was produced in an environmentally sustainable manner.

With Nevada a leading proponent of the EV revolution, Ioneer has geography on its side with Rhyolite Ridge. It's also worth keeping in mind that the Fraser Institute, in its 2019 Survey of Mining Companies, rated this state as the world's third most attractive investment destination for miners, after Western Australia and Finland.

Why should the Turks have all the good boron?

Rhyolite Ridge also has geology on its side. It isn't the usual spodumene deposit where most of the world's hard rock lithium comes from. It's a combination of the lithium-bearing mineral sepiolite and the boron-bearing mineral searlesite. That means Rhyolite Ridge's cost of production for lithium is, potentially, at the bottom quartile globally because of the boron 'credits' and the fact that both lithium and boron could be extracted in the same simple but environmentally-sound acid-leach process.

Boron, element symbol B and atomic number 5 on your periodic table, is a valuable commodity used principally in strengthened glass and permanent magnets. The world's users of boron would likely welcome Ioneer's output because at the moment there's a virtual duopoly, divided between a Turkish company called Eti Maden (Turkey holds the vast majority of the world's boron reserves) and Rio Tinto, which owns a borates mine in southern California.

A five-decade resource base

Rhyolite Ridge covers a large resource in the order of 1.33 million tonnes of lithium carbonate and 12.42 million tonnes of boric acid. That's enough for a mine life in excess of five decades. An October 2018 Pre-feasibility Study gave the project an after-tax NPV of US$1.8bn (admittedly on a 7% real discount rate), which translates to a cool A$2.75bn. The only downside is that Rhyolite Ridge will need about US$599m in capital expenditure to get going. However, that number could reasonably be lower after the Definitive Feasibility Study hits the streets shortly, and the quality economics of the project combined with the business-friendly location could attract that sort of capital fairly easily given the boron opportunity. It's worth noting that Ioneer secured an offtake partner for the boron last December.

Ioneer stock made a nice recovery between the June 2019 low – when the current Rhyolite Ridge resource was announced - and last November before easing back slightly. We see potential for the stock to go again once the DFS is published. The market capitalisation of Ioneer isn't as low as some of the other lithium developers available on ASX, but the path to market in the pro-business and pro-mining state of Nevada could unlock some of the upside to the massive project NPV somewhat faster.

GOODMAN GROUP

A logical bet on logistics growth

Stocks Down Under rating: ★★★★

ASX: GMG
Share price: A$ 15.55
Market cap: A$ 28.1BN

Goodman Group is a Sydney-based real estate manager that develops both commercial and industrial properties. The company's share price took a nosedive during the Global Financial Crisis of 2008/09, falling below the $1 mark at the market bottom. In the decade since, the stock has managed to claw back as the commercial property industry has stabilized amid an improved global economy. After hitting a post-crisis high last week, we believe the high-performing REIT has the growth catalysts to keep the rally going.

Share Price Chart

Source: Tradingview

Strong first half performance and development pipeline

Goodman's portfolio includes warehouses, logistics facilities, and office parks located around the world. It has 394 properties under management globally and $49.2bn in assets under management. It also has 55 developments in progress in 15 countries the combined value of which is expected to top $5bn in FY20. While 39% of these developments are in Asia, management has said that it has not seen short-term effects from the coronavirus outbreak although it certainly remains a business risk.

The company's results for the half year ended 31 December 2019 pointed to strong double-digit growth. Operating profit grew 14% and operating EPS was up nearly 13% compared to 1H19. It was good to see that the growth was broad-based with investment, development and management earnings all rising by at least 10%. The consistency of the results relates to the company's avoidance of the higher volatility parts of the market like retail and residential properties.

Earlier this month, management upwardly revised its guidance for FY20 earnings growth. It is forecasting EPS growth of at least 11% to 57.3 cents. The full year distribution is expected to be 30 cents per share.

Surge in e-commerce driving facility demand

As impressive as the recent financial results, is the company's portfolio quality and occupancy rate. It has an industry-leading occupancy rate of 98%. Tenant demand is robust because Goodman's properties are in popular areas where businesses want to be and that also command strong rental returns. Moreover, these locations tend to lack high quality properties, and this makes Goodman stand out from the crowd. In Sydney, for example, land located near ports is scarce as large format retail and residential developments compete for space.

The booming e-commerce sector and the rise of the middle class in developing countries should be a prolonged tailwind for Goodman's industrial properties. Much of the recent success has been due to the company's focus on markets that are experiencing solid e-commerce growth and consumer confidence is strong. This is because these markets have a greater need to have more efficient supply chains and can turn to Goodman for its logistics property solutions.

Customer demand for automated facilities is rising. Goodman is well positioned to add to a top-notch client list that includes the likes of Amazon, DHL, Japan Post, and Wesfarmers. Businesses are looking to reduce costs and are seeking technology-driven properties that can meet their needs. Much of Goodman's active development portfolio is dedicated to meeting this demand especially in urban logistics locations where land is hard to come by.

Real estate fundamentals supportive of growth

The current fundamentals of the real estate industry are supportive of growth at Goodman. Demand is strong and supply is limited especially in some of the fastest growing regions of the world. High occupancy rates are also indicative of a healthy property environment that is poised to see upward revaluations in the next few years.

Goodman's growth has been strong because it has a keen ability to develop properties in fast-growing parts of the world that have an appetite for commerce and limited facility supply. It is building scale in its key markets and has a deep development workbook that should support future growth.

The balance sheet is conservatively managed at 10% gearing which affords it ample room for both investment and securing financing. Goodman's stock is trading at a P/E of around 27x and EV/EBITDA of 24x. The valuation continues to look attractive given the company's growth metrics and exposure to high demand markets, and the fact that the current low interest rate environment is set to continue into the foreseeable future.

JANUS HENDERSON

Fund outperformance, retail gains key to 2020 growth

Stocks Down Under rating: ★★★

ASX: JHG
Share price: A$ 34.37
Market cap: A$ 6.3BN

Janus Henderson, the global asset manager headquartered in London, offers the full spectrum of financial products to individual investors and institutions. It is the product of the 2017 merger of Janus Capital Group and Henderson Group. The company manages fixed income, equity, alternative and multi-asset mutual funds and ETFs. It counts industry legends Myron Scholes (Nobel Laureate) and Bill Gross (formerly of U.S. bond manager Pimco) among its notable leaders. Although Janus Henderson is one of many choices in the world of investment management, it has some interesting traits that make it worthy of investment consideration.

Share Price Chart

Source: Tradingview

Focus on active management

Janus Henderson is an active investment manager meaning its funds seek to outperform passively managed portfolios. Its value proposition centers around its ability to find undervalued securities around the world through its research capabilities and local presence.

The company's FY19 results were driven by a better second half performance that sparked a late-year rally for the stock in 2019. As better than expected corporate earnings reports and U.S.-China trade dispute relief propelled global equities to record highs in 4Q 2019, investment performance at Janus Henderson naturally strengthened.

Despite experiencing net outflows from its funds to the tune of US$27.4bn, assets under management (AUM) grew 14% in FY19. Investors primarily exited quantitative equity, emerging

market equity, European equity and core plus fixed income asset classes to lock-in profits or dump underperforming funds. The fixed income, alternative and multi-asset funds are Janus Henderson's bright spots due to their track record of strong relative performance. Quantitative equities are a black eye for the company as these funds have badly underperformed.

Where will the growth come from?

While the rise in outflows from the US$18.1bn witnessed in FY18 is cause for concern, the company does have reason to be optimistic. More than three-fourths of its AUM beat their respective benchmarks over the three- and five-year periods. Furthermore, for the same time periods, 82% and 76% respectively of its mutual fund AUM are in Morningstar's top two quartiles. This is a vote of confidence for active management and for Janus Henderson investment management.

Beyond the fund performance it is gaining market share in key retail markets by expanding relationships with intermediary advisors. An emphasis on building out its global institutional business is also driving new business wins. A recent shake up of its portfolio management teams was geared towards improving performance and mitigating outflows in 2020.

While net outflows have worsened, there are some silver linings. Flows within the intermediary advisor business turned positive in 2H 2019 across several regions and strategic fixed income products are growing nicely. As an asset manager with most of its assets in equity funds, a major part Janus Henderson's financial results this year and beyond will depend on the performance of the global stock market. Fund performance relative to benchmarks and peers will also be an important driver of earnings.

The active battle with passive ETFs

The merger and three years of strong global markets have grown Janus Henderson's AUM to US$375bn as of the end of 2019. The financial health of the company is solid marked by strong cash flow generation. The balance sheet has an increasing cash balance and a 6.6% debt-to-equity (D/E) ratio that is supportive of growth investments.

The company's AUM growth, however, will continue to be challenged by the increasing popularity of low-fee ETFs. Both individual and institutional investors are turning to index funds because they are losing patience with underperforming active funds or are seeking to lower their management fees. This will make fund performance even more critical at Janus Henderson as the active versus passive battle rages on.

Shares of Janus Henderson are inexpensive, at a P/E of only 10x and an EV/EBITDA of 7x. We believe continued fund outperformance, improved net flows and increasing penetration in the advisor retail channel have the potential to drive meaningful multiple expansion in 2020. However, until the fund flow moves decisively in their favour it's best to be cautious. Three stars for now but put this one on your watch list against the day when fund flows start going Janus Henderson's way.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and is founded on more than 40 years of combined experience researching companies in a range of different sectors.

You are receiving this email because you subscribed to our Stocks Down Under newsletter.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.