



19 MARCH 2020

# Stocks Down Under

🗨️ *Well, you know, I was a human being before I became a businessman.* 🗨️

- George Soros (b. 1930), Hungarian-American investor and philanthropist



—  
**CSL**

Core holding in any portfolio

—  
**SIMS LIMITED**

A metal of honor

—  
**BENDIGO AND  
ADELAIDE  
BANK**

A Fintech in disguise

# CSL

Core holding in any portfolio

---

Stocks Down Under rating: ★★★★★

**ASX: CSL**

**Share price: A\$ 271.40**

**Market cap: A\$ 134.8BN**

If there's a sector of the market you're looking for to position yourself in when there's a market panic, healthcare is always a good place to start. Healthcare demand rises from year to year without fail in most countries in the world as populations age and as more sophisticated treatments get developed. And healthcare is generally always the last part of the budget that gets cut. Which is why the Melbourne-based CSL, a world-leading supplier of blood products, is worth taking a look at right now. With the stock having dropped only 8% between 19 February and 13 March when the S&P/ASX200 was down 23%, this CSL is showing its defensive qualities.

[READ MORE](#)

# SIMS LIMITED

A metal of honor

---

Stocks Down Under rating: ★★★★★

**ASX: SGM**

**Share price: A\$ 7.03**

**Market cap: A\$ 1.5BN**

Embedded within its very soul, Sims Limited, a leading metal's recycler based in Sydney, has an operational philosophy that revolves around five principles: safety, health, environment, community and sustainability. And with over 250 facilities worldwide, Sims Limited is at the heart of the "circular economy" – where it recovers and recycles products to ensure maximum value and minimal waste. But while no good deed goes unpunished, investors have been scrapping Sims Limited's shares since their peak in 2018. But with metal's prices poised to rebound in 2020, we believe prospective investors will receive maximum value in the near future.

[READ MORE](#)

# BENDIGO AND ADELAIDE BANK

A Fintech in disguise

---

Stocks Down Under rating: ★★★

**ASX: BEN**

**Share price: A\$ 6.18**

**Market cap: A\$ 3.3BN**

Relevant. Valued. Connected. Tenets of Australia's fifth-largest bank. With more than \$71.4bn in AUM, Bendigo-based, Bendigo and Adelaide Bank is a top 100 ASX-listed company with more than 1.7 million customers. But plagued by low interest rates, increased regulatory pressure and low consumer and business confidence, Bendigo and Adelaide Bank has seen its share price fall by more than 42% since its 2019 high. But we believe panic presents opportunity. And with the coronavirus only adding to the selling pressure – we believe now is the time for investors to make their deposit.

[READ MORE](#)

# CSL

Core holding in any portfolio

Stocks Down Under rating: ★★★★★

ASX: CSL

Share price: A\$ 271.40

Market cap: A\$ 134.8BN

If there's a sector of the market you're looking for to position yourself in when there's a market panic, healthcare is always a good place to start. Healthcare demand rises from year to year without fail in most countries in the world as populations age and as more sophisticated treatments get developed. And healthcare is generally always the last part of the budget that gets cut. Which is why the Melbourne-based CSL, a world-leading supplier of blood products, is worth taking a look at right now. With the stock having dropped only 8% between 19 February and 13 March when the S&P/ASX200 was down 23%, this CSL is showing its defensive qualities.

## Share price chart



Source: Tradingview

## Continued strong growth

The six months to 31 December 2019 was another great growth period for CSL, as usual. Revenue was up 11% and so was NPAT. Across the board the stalwart immunoglobulin products, which CSL fractionates out of blood, were enjoying robust demand growth in most parts of the world and the company's Squiris influenza vaccine products business also had a good half, with double-digit demand growth for the seasonal vaccine.

CSL is one of those great companies where nothing much seems to go wrong from half to half. Doctors always seem to be finding new uses for intravenous immunoglobulin and albumin. And even for an Orphan indication like haemophilia, where you'd think every last patient had been tracked down and fully treated, there always seems to be demand growth out there somewhere for the latest CSL innovation. At the half-yearly result, CSL effectively narrowed its guidance for the FY20 full year. It was going for 8-16% NPAT growth. It now believes 10-13% is where it is heading.

## **Potential blockbuster in the making**

One of the things to like about CSL is the fact that the R&D spend is fairly mild compared to the growth opportunity. CSL generally needs to spend a lot less than the usual percentage of revenue than its Big Pharma competitors because the development cost for a new blood product is usually a lot lower than a conventional large molecule drug. That said, CSL has upped its game somewhat. In the December 2019 half the \$446m in R&D spend was 12% of revenue. It used to be more like 7%. That R&D spend is part of an ongoing effort to keep CSL competitive and position the company for some serious growth ahead.

CSL-112, the company's formulation of a naturally occurring protein called apolipoprotein A1, is a huge bet for the company. If it clears cholesterol out of the arteries as effectively as CSL's scientists think it can, this product is a blockbuster with maybe US\$5bn in sales a year. The product is in Phase 3 trials now.

## **Well-positioned for the China opportunity**

The other thing to like about CSL right now is the China opportunity. Coming out of the current Coronavirus crisis it's reasonable to expect a large increase in Chinese healthcare spending as the government looks to reassure the population that it cares about their health. Last year CSL started to sell directly in China so it's well placed to grow in what can easily become the world's largest drug market by far.

## **Part of a post-Corona portfolio**

Now, CSL isn't inexpensive right now, trading at a P/E of 44x FY20 earnings, but that drops to 33x by the time FY22 earnings are considered. The main reason to go for CSL right now is the company's name – investors have come to trust in the dependability of this company's growth profile and in the defensiveness of its businesses. That's why they'll be looking for CSL as part of a strategy to be part of a post-Coronavirus market rebound. Five stars for CSL, which we believe should be a core holding in any portfolio.



# SIMS LIMITED

A metal of honor

Stocks Down Under rating: ★★★★★

**ASX: SGM**

**Share price: A\$ 7.03**

**Market cap: A\$ 1.5BN**

Embedded within its very soul, Sims Limited, a leading metal's recycler based in Sydney, has an operational philosophy that revolves around five principles: safety, health, environment, community and sustainability. And with over 250 facilities worldwide, Sims Limited is at the heart of the "circular economy" – where it recovers and recycles products to ensure maximum value and minimal waste. But while no good deed goes unpunished, investors have been scrapping Sims Limited's shares since their peak in 2018. But with metal's prices poised to rebound in 2020, we believe prospective investors will receive maximum value in the near future.

## Share price chart



Source: Tradingview

## A sustainable strategy

More than just lip service, Sims Limited is an international leader in turning discarded consumer products into valuable secondary resources. In FY18, the company joined the World Business Council for Sustainable Development – a CEO-led organization of over 200 international companies based in Geneva, Switzerland – demonstrating its commitment to a greener future. And capitalizing on increased environmental awareness among businesses, Sims Limited expects to recycle 200,000 tonnes of cloud material by the end of FY25. Moreover, the company plans to double its non-ferrous metal's recycling business within the next six years, while also increasing its ferrous business by 40% in the United States. And leveraging its industry-leading cloud recycling capabilities, Sims Limited has secured new contracts with data centre providers to recycle various items within their warehouses.

The company also partnered with LMS Energy, a leading renewable and carbon abatement group based in Adelaide, to expand its footprint across untapped markets. And investing heavily in its metal output technology, Sims Limited has explored several landfill-gas-to-energy investments across the U.S. and the United Kingdom. And though none have met the company's disciplined return requirement, the area presents opportunities for future growth. Within the U.S. market, Sims Limited is also expanding its municipal recycling operations, partnering with Nespresso, a subsidiary of the Switzerland-based Nestlé Group, to recycle its aluminium coffee pods and compost its coffee grinds.

## **A recovery is on the horizon**

Streamlining its operations, Sims Limited sold its European compliance recycling scheme to TSR Recycling, a German reprocessor of steel scrap and non-ferrous metals, for EUR 83.5 million on 26 November 2019. Not only did the divestiture strengthen the company's balance sheet – insulating it from any near-term disruptions – but it also furthered Sims Limited's strategic pivot toward cloud recycling. In H1 FY20, the company's cloud volume reached 8,900 tonnes and is on-track to hit management's full-year target of 20,000 tonnes. Management has also undertaken diligent restructuring and cost reduction initiatives that target run-rate savings of \$30m.

And despite ferrous and non-ferrous metal prices coming under intense pressure, the scrap metal market may have bottomed – with a return to FY19 levels on the horizon. Management predicts that underlying EBIT will come in at \$40m to \$60m in H2 FY20, with figures adjusted for the sale of its European compliance scheme. In H1 FY20, profitability was hurt by a slowdown in automobile sales, declining global manufacturing and the brewing trade war between the U.S. and China. However, we believe the weakness can be resolved, as Chinese authorities will implement new metal standards on 1 July 2020 – reclassifying high quality zorba-related products as new metals rather than waste.

There is also evidence of a recovery in Turkey. And assuming no further market disruptions – with TSI Turkey scrap metal, and zorba prices remaining near their current levels – we believe Sims Limited could generate underlying EBIT of \$50m to \$70m in H2 FY20, potentially at the lower end given the impact COVID-19 may have on the business.

## **The numbers don't tell the real story**

Sims Limited released its H1 FY20 results on 8 February 2020. Sales fell 18.7% to \$2.71bn, while EBITDA fell by 82.4% to \$30.5m. However, the aforementioned weakness in zorba led the declines, while intense competition and product discounting also weighed on profitability.

But despite that, we believe the downturn will be short lived. Demand for ferrous and non-ferrous metals are rising, with the U.S., China and Turkey poised to stimulate future growth. And because scrap metal is more environmentally friendly than iron ore, Sims Limited is well-positioned to capitalize on this growing secular trend.

Furthermore, as investors price the stock below its fair-value, management's share buy-back program – commenced on 8 November 2019 – will provide some relief. Often done when executives believe their stock is undervalued, they agreed to repurchase up to 10% of Sims Limited's issued capital over the next 12 months. Additionally, because SGM is currently trading around the lows of 2016, we believe the shares are even more of a must-own.

# BENDIGO AND ADELAIDE BANK

A Fintech in disguise

Stocks Down Under rating: ★★ ★

**ASX: BEN**

**Share price: A\$ 6.18**

**Market cap: A\$ 3.3BN**

Relevant. Valued. Connected. Tenets of Australia's fifth-largest bank. With more than \$71.4bn in AUM, Bendigo-based, Bendigo and Adelaide Bank is a top 100 ASX-listed company with more than 1.7 million customers. But plagued by low interest rates, increased regulatory pressure and low consumer and business confidence, Bendigo and Adelaide Bank has seen its share price fall by more than 42% since its 2019 high. But we believe panic presents opportunity. And with the coronavirus only adding to the selling pressure – we believe now is the time for investors to make their deposit.

## Share price chart



Source: Tradingview

## Restructuring the business

In FY19, Bendigo and Adelaide Bank divested its underperforming self-managed superannuation fund business and its financial planning business. The bank also closed 11 branches and 16 agency outlets. Focusing on its competitive advantage, the bank is leveraging its large footprint in the rural and regional areas of Australia by offering unique products and services tailored to those communities.

On 17 February 2020, the bank raised \$250m through an underwritten placement and commenced a share purchase plan for retail shareholders to raise another \$50m. The capital will be used to expand the bank's residential mortgage division, strengthen its balance sheet and further develop its industry-leading technology. The cash-cushion also lifted the bank's CET1 capital ratio – which is a measure of bank solvency – to roughly 9.67% - 9.81%, in-line with The Australian Prudential

Regulation Authority's (APRA) requirement. And while the decision wasn't popular among shareholders, management cut the bank's H1 FY20 dividend from 35c per share to 31c per share. However, we believe the action was prudent as it provides Bendigo and Adelaide Bank with more capital to fund strategic growth.

### **Innovation at its best**

Avoiding the pitfalls of other legacy institutions, Bendigo and Adelaide Bank is betting big on technology. In 2018, the bank launched its "Up" mobile application – one of Australia's largest digital banks. Considered best-of-breed – alongside Sydney-based Macquarie and CommBank, as well as Netherlands-based ING – "Up" increased its customer base from 130,000 in October 2019 to 165,000 in February 2020. And leveraging its partnership with Tic:Toc – a Fintech firm based in Adelaide – the bank is set to become the first global lender to provide digital home loan applications and assessments under its own brand.

In H1 FY20, the bank also invested \$16.9m in digital services, open banking and automation. The strategic pivot toward technology will streamline customer's experience and optimize the bank's cost structure – where management expects to deliver a cost-to-income ratio of 50% in the medium term. Furthermore, increasing technology investments will allow the bank to attract more millennial customers and provide synergies with "Up" – where roughly half of the platform's customer base is between 16 and 24, with a median age of 20. Gaining traction with younger customers will allow the bank to accelerate its growth trajectory and generate economies of scale. And while the initiatives come at a short-term price, we believe they position Bendigo and Adelaide Bank to deliver a future-proof banking experience that's built for the long-term.

### **Short-term pain, long-term gain**

In H1 FY20, Bendigo and Adelaide Bank's income from operations increased by 5.6% to \$834.2m, while its Total Tier 1 Capital ratio increased from 11.15% to 11.40%. Conversely, NPAT fell by 28.2% to \$145.8m and cash earnings declined to \$215.4m. However, we believe the rising costs are a function of the bank's technology investments. And despite the near-term headwinds, the investments will significantly reduce costs going forward. Furthermore, we expect the bank's net-interest margin (NIM) to remain at current levels – with loan growth partially offsetting declines in the Reserve Bank of Australia's (RBA) cash rate.

During the first-half of FY20, the RBA cut its overnight lending rate three times, pressuring the bank's NIM. However, Bendigo and Adelaide Bank was still able to improve margins and generate loan growth.

Despite investors expecting the worst, we're bullish on Bendigo and Adelaide Bank. The three-star rated shares are poised to outperform in the coming years, as costs decline and front-loaded investments begin to payoff. Moreover, the bank trades at a P/E of 12x (NTM) – which we believe offers an attractive entry point for value investors. And the shares currently offer a yield of more than 8% on FY21 numbers, which are obviously subject to change during these turbulent times.

## **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

