24 APRIL 2020

# Stocks Down Under

*In most betting shops you will see three windows marked "Bet Here", but only one with "Pay Out".*

**- Jeffrey Bernard (1932-1997), English journalist**

## THE STAR ENTERTAINMENT GROUP

Still not cheap all things considered

## STOCKLAND

Coronavirus Crisis highlights need to move away from Retail

## BSA

Valuation doesn't reflect strong prospects

# THE STAR ENTERTAINMENT GROUP

## Still not cheap all things considered

Stocks Down Under rating: ★★★

**ASX: SGR**
**Share price: A$ 2.36**
**Market cap: A$ 2.1BN**

Based in Brisbane, The Star Entertainment Group is one of Australia's largest gaming and entertainment groups. Due to the impact of the coronavirus crisis on the tourism and leisure industries, the stock is now trading close to the value of its net tangible assets (NTA), which were around $2.9bn as of 31 December. This suggests that the market has priced in a nearly no-growth scenario in valuing the company near the liquidation value of its properties. Although near-term Coronavirus Crisis uncertainties make this a risky investment, an improvement in the global economic environment should enable Star to eventually emerge as a long-term winner.

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# STOCKLAND

## Coronavirus Crisis highlights need to move away from Retail

Stocks Down Under rating: ★★

**ASX: SGP**
**Share price: A$ 2.63**
**Market cap: A$ 6.3BN**

Sydney-based Stockland Corporation Limited is a property developer with interests in shopping centres, housing estates, industrial estates and retirement villages. Shares of Australia's largest listed developer are trading at a near-all-time low amid negative investor sentiment around property stocks during the Coronavirus Crisis. Stockland's portfolio includes heavy exposure to the retail sector and the need to diversify away from shopping centres has never been more evident. Management has proven resilient and delivered strong growth over time, but the mounting near-term challenges suggest things may get worse before they get better.

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# BSA

## Valuation doesn't reflect strong prospects

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**Share price: A$ 0.31**
**Market cap: A$ 134M**

Sydney-based BSA Limited is one of Australia's leading technical service contractors. It is in the businesses of helping clients implement their technical assets in telecommunications, building services and infrastructure areas. The thinly traded stock has slumped since its September 2019 peak despite some solid financial results. We believe the company has good business fundamentals including a strong balance sheet and an experienced management team. It has a growing footprint across Australia and opportunities to enter multiple new markets that make the stock an intriguing value proposition here.

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### Share price chart

*Source: Tradingview*

### Potential for post-crisis catch-up effect

The coronavirus crisis has had a profound impact on hotel and casino companies and Star has been no exception. International and domestic visitation is way down, particularly in Sydney. The timing of the virus outbreak was particularly unfortunate for Star and other Australian casino operators because it coincided with the historically busy Lunar New Year holiday.

With casinos and hotels mostly quiet, near-term revenue will undoubtedly come in well below Star's pre-COVID 19 forecasts. The Treasury Brisbane, The Star Gold Coast and The Star Sydney are struggling from the lack of tourism and domestic visitation. Not to mention the company's Gold Coast Convention & Exhibition Centre, which has been void of the usual large group events. Management recently noted that early 2HY20 trading has been characterized by a cautious consumer environment that stemmed from the bushfires and has been magnified by the coronavirus.

The timing of when the Australian economy re-opens and the degree to which entertainment seekers will return are unknown. However, it is reasonable to consider a potential catch-up effect for these businesses once the crisis subsides. Pent up demand to get out of the house and be entertained will likely create an initial burst of consumer activity. Whether this is sustainable and can make up for the lost revenue during the pandemic remains to be seen. In the meantime, Star has done a good job of managing the crisis especially in its all-important VIP program by doing what it can to focus on customers that are not affected by travel restrictions.

### Barangaroo launch holds much promise

Once business conditions do begin to normalize, Star should benefit from its well established and loyal customer base. Its existing properties have recently received guest satisfaction scores that are at record highs. Star has upgraded and expanded its Sovereign Sydney property as well as the luxury Oasis casino, which are both scheduled to open later this year. The company's focus on service and having best-in-class customer relationship management (CRM) systems bode well for maintaining its strong customer base at existing and new locations once economic conditions improve.

Another source of optimism is the potential for a strong launch at the company's newest property at Barangaroo in Sydney. The project is expected to be completed ahead of schedule and open in 2021. The $530m, 220-room Ritz-Carlton complex at Pyrmont across the water owned by casino operator Crown Resorts, One Barangaroo will add some much-needed tourism infrastructure to the area. Once border restrictions are lifted and foreign travellers return to Australia, this area is expected to become a primary entertainment destination.

### Solid balance sheet to help Star through the crisis

Star has a strong balance sheet that allows it to fund its growth investments. Gearing is a healthy 1.9x based on its normalised 12-month trailing EBITDA. Its recent capital spending programs have progressed well. Property, plant, and equipment assets are increasing and growth projects are being funded by a combination of free cash flow generation, debt facilities, and partner contributions.

Much uncertainty remains around the hotel and casino industry during this unprecedented time in history. Therefore, investors may want to wager their bets on Star very conservatively in the near term. However, once the Coronavirus Crisis is over, the company is well positioned to capitalize on pent up demand for global travel and entertainment. It has several new hotels and casinos that are expected to open over the next couple years and a pipeline of new projects beyond 2021. In whatever way the "new normal" economy is eventually defined, Star should be a beneficiary of continued global demand for high-end travel and entertainment.

In the near term, though, the company's EV/EBITDA multiple of 9.3x for FY21, starting in July, is not cheap. Especially considering EBITDA growth from FY20 to FY21 is expected to be non-existent. Which is why we are neutral on The Star Entertainment Group for now with 3 stars.

# STOCKLAND

## Coronavirus Crisis highlights need to move away from Retail

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### Share price chart

*Source: Tradingview*

### Coronavirus Crisis impacts shopping centres, residential

The COVID-19 crisis has weighed heavily on the property space. Investor sentiment has understandably been negative amid retail closures, a slowdown in industrial activity and concerns around residential safety. At Stockland's residential communities, most events have been cancelled for the foreseeable future. The company faces a potential crunch in the residential property business post-COVID-19 when demand for residential property is likely to be tepid. People may be reluctant to move into large community settings. At the same time, many current residents may seek to relocate to more spacious, private settings. Stockland has closed its residential sales centres to the public in favour of one-on-one video consultations and display villages are open to private appointment only.

Stockland shopping malls have seen not only minimal foot traffic in recent months, but tenant departures as well. Many tenants have gone into administration, such as retail chain Harris Scarfe. Occupancy was a stable 99.4% and tenant retention 63% as of 31 December, but these figures are likely to decline dramatically when the company reports full year-results. The timing will be especially harsh for Stockland who, after a weak

1HY20, was counting on a strong second half. Like many listed Australian property companies, it withdrew its full-year guidance due to uncertainty around the impact of the COVID-19 crisis.

Today's unprecedented retail environment poses a new challenge on top of pre-COVID-19 pressures surrounding a consumer shift to e-commerce. Even once the pandemic subsides, Stockland and other shopping centre landlords will have to convince cautious shoppers to return to their malls. Meanwhile, many of these consumers are growing accustomed to online shopping and may see less of a need to return to the shops.

### Targeting reduced retail exposure

Stockland manages 32 retail town centres across Australia valued at $6.6bn. Retail town centres comprise 43% of its overall portfolio and the company has acknowledged the need to reduce its retail footprint. It is aiming to reduce its retail weighting to less than 40% over the next five years. Increasing its exposure to the Workplace and Logistics segments is a key strategic priority. The portfolio weighting in these areas increased from 23% to 26% in the six-month period ending 31 December 2019. Last year Stockland acquired the remaining 50% interest in Stockland Piccadilly for $347m. It also entered contracts to acquire $121m in North Sydney office developments and bought two logistics developments in the prime industrial area of Brisbane. The Workplace and Logistics development pipeline doubled to $4.3bn.

Although near-term pressures are mounting, investors can find some solace in the fact that management has delivered strong growth over time. Funds from operations increased 4% in FY19 to $897m and the company delivered an 11.9% return on equity. Its healthy balance sheet suggests it can meet the current challenges with resiliency. Stockland has received strong investment grade credit ratings from S&P and Moody's (A- and A3 respectively). It has a strong interest cover ratio of 5:1 and decreasing gearing of 26.1%. Management expects its low 4.4% weighted average cost of debt to become even lower in FY20 amid falling interest rates.

### Retail, residential represent formidable challenges

Stockland will need to address the structural changes in retail. Australian shoppers are moving online at a rapid pace and this paradigm shift is being accelerated by the coronavirus crisis. The company is moving in the right direction by shifting away from retail, but much work remains.

Longer term, however, the diversified property company should benefit from a shift to higher margin Community developments, especially in Sydney. It should also benefit from its growing Workplace development pipeline of over $2.2bn. While the company has successfully navigated several challenges in its rich history, the current coronavirus crisis will be particularly daunting. Its ample liquidity and overall financial health give it an advantage over most peers, but we believe working through challenges in the retail and residential businesses will take some time. So only 2 stars for now.

# BSA

## Valuation doesn't reflect strong prospects

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### Share price chart

*Source: Tradingview*

### Solid FY19, 1HY20 performance

BSA's core business units include BSA Build, BSA Connect and BSA Maintain. Build provides heating, ventilation and air conditioning (HVAC) solutions as well as fire systems to industrial buildings and infrastructure projects. BSA Connect is the company's technical services contracting segment and its largest contributor to revenues. It offers implementation and installation services to the telecommunications and television industries and can manage large contractor workforces. The BSA Maintain group specialises in HVAC, refrigeration, electrical, fire and plumbing services to the property industry. Its maintenance programs are designed to provide low life cycle costs, minimize downtime, and maximize the serviceable life of its customers' physical assets.

The company recently changed its leadership team as part of a broader business transformation. Former CEO Nicholas Yates stepped back from his role as CEO, but has remained on the company's Board of Directors. Former COO Tim Harris became the company's new CEO as of 9 March. Former Head of Finance Arno Becker was also promoted as the company's new Chief Financial Officer.

BSA posted strong results in FY19. Revenue was up 9.7% to $469m and EPS from continuing operations increased 20.9% to $0.03 The favourable business momentum continued in 1HY20. New contract wins drove revenue up 30.4% and EPS grew 14.3% over 1HY19. Perhaps most appealing from an investor's standpoint, recurring revenue accounted for 81% of overall revenues, jumping dramatically from 62% at the end of FY19. This was a result of the company's divestment of the HVAC Build Major Projects construction business, which has served to significantly reduce its risk profile.

## NBN contract extension bolsters order book

Much of the recent revenue growth has been due to BSA's relationship with National Broadband Network (NBN). The key customer recently extended its contract with BSA through December 2020 to provide operations and maintenance services. BSA recently announced that it signed an additional contract with NBN to deliver HFC Deployment Services in Brisbane and Melbourne. This has contributed significantly to BSA's order book. NBN has relied on BSA to provide activation services for which demand has been strong.

Over the last few years, the Connect and Build businesses have stood out as areas of strength. Connect has partnered with some of Australia's largest telecommunications, technology and broadcast companies for large scale infrastructure projects. Within the Build business, there has been strong demand for fire equipment as well as fire suppression, maintenance, detection and emergency evacuation systems. Build revenues grew 27.3% year-over-year in FY19 due to several big project wins including the Crown Casino Sydney, Grafton Prison and the Wynyard Commercial development. The fire infrastructure market is a key area of focus for BSA. It entered FY20 with a strong Build order book and a robust pipeline of potential new customers.

## Infrastructure, 5G networking are untapped growth markets

BSA has long-tenured relationships with large businesses that are increasingly looking to reduce costs and turning to BSA's solutions. The Australian multi-service maintenance market continues to be a key part of its growth strategy. It is also expanding into new markets that fit well with its technical capabilities. This includes smart metering, energy and building management systems (BMS). As part of this strategy, BSA is actively exploring acquisitions that complement its existing businesses and can be seamlessly added to enhance organic growth.

We believe BSA is well positioned for growth given its opportunities in both existing markets and new markets nationally. The HVAC Build divestment has reduced business risk and has allowed management to focus on these growth opportunities. There are several untapped markets with huge upside potential such as 5G networking, infrastructure and asset management.

At an EV/EBITDA of 5.2x and a P/E of 10x, both for FY21 that starts in 2 months, there appears to be a dis-Connect between BSA's fundamental growth story and its share price.

**Pitt Street Research Pty Ltd**

95 Pitt Street, Sydney, NSW 2000, Australia

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