15 JUNE 2020

Stocks Down Under

I used to sell furniture for a living. The trouble was, it was my own.

- Les Dawson (1931-1993) English comedian

AVENTUS GROUP

Rapid urban growth supports large format retail

JUPITER MINES

Out of the lockdown

INTEGA

Inheriting the Crown Jewels

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Rapid urban growth supports large format retail

Stocks Down Under rating: ★★★★

ASX: AVN
Share price: A$ 2.08
Market cap: A$ 1.2BN

Sydney-based Aventus Group is Australia's largest fully integrated shopping centre owner focused on the development of large format retail parks. Back in February, the share price was cut in half in a matter of weeks as retail-related companies were among the hardest hit by the Coronavirus pandemic. In hindsight, the reaction may have been unjustified considering the company's meaningful exposure to essential consumer goods and high-quality national retailers. As the Australian economy re-opens and shoppers return to its centres, Aventus is in a good position to grow. Its robust development pipeline and disciplined capital management bode well for the expansion of its diverse property portfolio.

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Stocks Down Under rating: ★★★★

ASX: JMS
Share price: A$ 0.265
Market cap: A$ 549M

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Share price: A$ 0.24
Market cap: A$ 111M

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Share price chart

Source: Tradingview

High occupancy rates, increasing rent

The group's portfolio consists of a broad range of shopping centres located across Australia but focused on the east coast and metropolitan areas. With a $240m property valuation gain over the last two and a half years, its 20 centres are now valued at approximately $2.2bn. Investors can take comfort in the fact that the vast majority of tenants (roughly 87%) are well-established national retailers such as Bunnings, Chemist Warehouse, Domayne, Officeworks and The Good Guys. Importantly, it does not have any exposure to the struggling department store space and minimal exposure to the fashion and apparel industry.

The rapid growth of urban areas like Sydney and Melbourne have contributed to a record level of leasing deals in recent years. Retailer tenancy demand has been strong because consumers have been flocking to Aventus' popular centres. This has been supportive of high occupancy rates, which reached 98.6% in 1HY20. It has allowed the group to raise rental prices. All portfolio leases had their rent increased in the most recent interim period, three-fourths of which were fixed increases. With the supply of large format retail centres expected to remain low, Aventus is in a favourable position to execute on its growth strategy.

Its strategy is centred around owning, managing and developing large format retail centres. The centres' tenants sell a broad range of homewares and hardware as well as everyday needs. The everyday needs category accounts for nearly 40% of rental income which gives the portfolio a foundation of reliable revenue. Furniture & bedding is the next largest segment at 31% of gross income, followed by electrical, homewares and hardware & coverings at roughly 10% each. No single tenant accounts for more than 4% of portfolio income. The group has found success with this formula and will continue to seek ways to diversify and grow its tenant base.

Development pipeline supports next wave of growth

Shopping centres have been significantly impacted by the COVID-19 crisis as lockdowns kept people away and turned them to online shopping alternatives. The uncertainty of the environment and sudden need to preserve cash forced Aventus to cut its March 2020 quarterly dividend by 25%. Although shopper traffic is slowly returning, it remains unknown to what extent people will embrace crowd-filled centres and if there will be a second wave of the outbreak. Nevertheless, the group's performance prior to the pandemic was strong and it should gradually see a return to normalised trading conditions as the year progresses.

Looking down the road, Aventus has a robust development pipeline that will serve as its growth engine over the next several years. In 1HY20 it invested $15m across five new projects and forecasts that development spending will top $38m in FY20. Much of these dollars will go towards the development of the recently launched Caringbah project in Sydney, which is expected to generate an internal rate of return (IRR) of at least 10%. The Logan development in Brisbane and the Mornington Peninsula development in Melbourne are also promising new growth opportunities.

Property syndicate diversifies income

The condition of the group's balance sheet is healthy, largely owing to a near-term focus on reducing leverage. Gearing was lowered by 3% to 35.7% in 1HY20 after a decrease in borrowings of $60m. Aventus has more than $10m in cash and untapped loan facilities, there is no debt maturing before May 2022 and the group's weighted average cost of debt declined to 3.1% in 1HY20.

Aventus is also finding ways to diversify its revenues streams to generate incremental income growth. One such approach has been third party funds management. It recently launched its first dedicated large format retail syndicate since listing on the ASX in FY16. The Aventus Property Syndicate 1 will allow the group to recycle capital and broadens its income stream by creating external funds management fee income. Aventus has a 25% cornerstone interest in the syndicate to ensure the alignment of long-term goals. With a 6.4% dividend yield, we believe the company is well positioned for income growth and should continue to garner interest from income investors amid a low rate environment.

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Share price chart

Source: Tradingview

Sometimes it pays to be away from the public equity markets for a while. Back in 2013 Jupiter Mines chose to delist from the Australian Securities Exchange because the company felt that the market was undervaluing the potential of Tshipi Borwa. Jupiter had Tshipi Borwa – which means 'southern iron' in the local Tswana language – as its flagship asset since 2010, when it acquired its 49.9% stake in a deal worth A$245m.

Local knowledge

The Tshipi Borwa transaction brought in Brian Gilbertson as a Jupiter director. He was well-known to Australian investors because he had led South Africa's Billiton into BHP Billiton (ASX: BHP) in 2001 and was CEO of the merged group for six months from mid-2002 until an apparently stormy exit in early 2003. Tshipi Borwa sat right next to the Mamatwan manganese mine that Gilbertson had overseen at Billiton and that is now part of South32 (ASX: S32 - see Stocks Down Under for 5 May 2020). So, he knew the potential of this manganese field in the Kalahari very, very well.

The seemingly high A$245m price tag for an as-yet-undeveloped mine reflected the fact that the Tshipi Borwa resource, estimated at the time at 163 million tonnes at 37% manganese, could probably be mined for 50 years after start-up, and that start-up wasn't expected to be far away. Indeed, it took place in late 2012. However, by late 2013 Jupiter's market capitalisation was only about $170m.

Australian investors missed Jupiter Mines

When the company returned to the ASX in early 2018 it was a different story. The company sold $240m worth of stock from existing shareholders at 40 cents per share, which valued Jupiter Mines at $779m as it re-entered the Official List. Both the mine and Jupiter were debt-free and Tshipi Borwa was moving well over 3 million tonnes of manganese ore a year. In the year to February 2018 the mine earned $721m in revenue and NPAT of $187m, so effectively Jupiter stock came on the boards at a P/E of 8x.

Now fast forward to almost the present time. Right before the lockdown in South Africa, Jupiter announced that Tshipi Borwa's output in the year to February 2020 had been 3.4 million tonnes, leading to sales of $628m and NPAT $203m. However, two months before that a feasibility study had commenced on an expansion of Tshipi Borwa to 4.5 million tonnes, something that was expected to cost only another US$70m in capex. That expansion made sense given the expected ongoing decline in Chinese production (due to low grades and environmental problems) and manganese's increasing use not just in steelmaking but as a battery mineral. However, the February-March Corona Crash in equities caused both the strong production number and the expansion study to be temporarily forgotten. By 19 March Jupiter stock, at 19.5 cents, put the company on a P/E of about 4x. Now, Jupiter Mines has re-rated slightly since then, but we still think the multiple is only about 6x forecast earnings for the February 2021 year. That seems inexpensive to us, and Brian Gilbertson and his fellow Jupiter director Hans Mende seem to agree, because both have been recent on-market buyers of stock.

A 21st century metal

The reason why the current 6x multiple for Jupiter seems low is that manganese, chemical symbol Mn, atomic number 25, is rapidly becoming a 21st century metal. Sure, its main use is still in steel production, where it enhances the hardenability and tensile strength of the steel, but a lot of manganese is now going into lithium-ion batteries where the most likely lithium metal used in the cathode today is lithium manganese oxide (LiMnO2). The use of manganese in batteries can only increase in the years ahead. Lithium manganese oxide batteries are notable for their high thermal stability and are safer than other types of lithium-ion batteries. Also, if you've heard of the NMC 811 battery that is designed to reduce the cobalt content of many of today's batteries, the good news is that the 'M' in that battery is manganese.

Manganese has jumped quite nicely ever since the Chinese economy began to re-open back in March. The metal is now above the previous peak of November 2018. With Jupiter Mines owning half of one of the world's Top 5 manganese mines, we believe it's a great way to play the post-COVID rebound in the metal.

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Source: Tradingview

For a long time, Cardno was one of those rare engineering companies that had the Midas touch. Long-time CEO Andrew Buckley, when he got the job in 1997, was running a private company with just $14m turnover and 180 employees. By the time of his exit from Cardno 16 years later the company had both a turnover and market capitalisation on ASX of over $1bn. Shareholders who backed Cardno at the company's 2004 IPO made over six times their money before dividends, with their stock rising 122% p.a. over 9.5 years. The secret to Buckley's success was basically his overseeing a well-planned series of acquisitions in infrastructure and environmental services. Over time thousands of skilled and talented engineers from a range of disciplines ended up working for Cardno. They were located around the world and their clients were generally companies in expansion mode, so the margins were good. By all accounts Cardno was a great place to work.

Why Cardno spun out the Crown Jewels

And then in 2014 it all started to fall apart for Cardno. In March 2014 the company made its biggest acquisition ever, laying out US$145m to buy a US oil and gas engineering services provider called PPI just months before oil entered the terrible 2014-2016 downturn. The only thing Cardno management were able to rescue from the wreck that followed was a solid Quality Assurance business where the engineers would check that an item of equipment intended for oil rigs or other facilities was working properly.

Meanwhile Cardno lurched from one disaster to another. There were major profit warnings in November 2014 and November 2015, as organic growth got harder. And one CEO was even sacked in April 2018 over issues related to a corruption investigation. By August 2019, when the Cardno/Intega split was first announced, Cardno stock was down 76% and the company was on to its fourth successor to Andrew Buckley.

The reason this background is important is because it explains why Intega is worth backing right now. We've noticed over the years that when companies lose their growth mojo, they often let go of their best assets in a bid to restore shareholder value. We reckon that's what's happened with Cardno and Intega.

In the engineering world the most dependable job you can have is in either Quality Assurance or testing, because without those services your project notionally comes to a screaming halt. We noted how PPI was salvageable because of its Quality Assurance expertise. However, when we explain to investors why Intega has legs we like to use the following hypothetical involving Bowler Geotechnical, a company Cardno acquired in 2008 and subsequently called Construction Sciences: Say you're a residential developer in Sydney and you've just heard about the Opal Tower debacle in that city, where a big new apartment building had to be evacuated over safety concerns on Christmas Eve 2018. Right after Christmas the guy from Cardno's Construction Sciences unit calls you and tells you he's raising the price being charged to check that your cement is fit for purpose. Are you going to stop doing that testing? No, we didn't think so.

A business with scale, and growth

Construction Sciences and the pared-down PPI were two of Cardno's Crown Jewels that went into Intega. The other Crown Jewel was Raba Kistner, a US business Cardno bought in 2018, which was basically a much bigger version of Bowler Geotechnical. The only relative non-performer in the new company is T2, a business whose raison d'être is making sure pipes and cables don't interfere with buildings and which, as relative newcomer to the US market from its traditional home base in Canada, is still working to gain traction there.

Added together the four Intega businesses could stand tall in financial terms, with FY19 revenue of $418m and EBITDA of $30m. And, more importantly, they were enjoying some good organic growth – indeed, in the December 2019 half, revenue was up 17% on a pro-forma basis. EBITDA growth for the half was only 4% but that's only because T2 wasn't doing well in the period. Management are now executing a turnaround strategy for T2.

Intega went into the Coronavirus Crisis expecting to grow revenue and EBITDA for the FY20 full year. It subsequently withdrew that guidance, but we think the more or less dependable nature of the businesses means that it will come out in reasonably good shape. It had only $65m in net debt at December 2019. At least one senior executive of the new company has been optimistic about Intega's prospects. CEO Matt Courtney, who grew up with Bowler Geotechnical, was an on-market buyer of stock in late April. Intega is currently trading on a P/E of 9.3x forecast FY21 earnings, dropping to 7.2x FY22 earnings. Seems inexpensive to us given the growth potential.

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Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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