22 JUNE 2020

Stocks Down Under

The hottest place in hell is reserved for those who remain neutral in times of great moral conflict.

- Martin Luther King Jr. (1929-1968), American civil rights activist

WOODSIDE PETROLEUM

Sunrise coming

HELLOWORLD TRAVEL

Hello, goodbye

KEYTONE DAIRY

Milking the Asia opportunity

WOODSIDE PETROLEUM

Sunrise coming

Stocks Down Under rating: ★★★★

ASX: WPL
Share price: A$ 21.88
Market cap: A$ 20.9BN

Let's face it: The opening months of 2020 were not a good time to be an oil and gas company. Indeed, in April we at Stocks Down Under joked with each other that Hollywood producers were talking about a remake of the 1987 film 'Less Than Zero', with West Texas Intermediate in the title role. Woodside Petroleum, which in 2020 produced 89.6 million barrels of oil equivalent, didn't go to zero but it did crash 58%, from around $36 a share on 8 January to $15 on 23 March, whereas the S&P/ASX200 "only" crashed 33%. However, with oil now recovering alongside the general market, we believe Woodside is well placed to recover with it.

READ MORE

HELLOWORLD TRAVEL

Hello, goodbye

Stocks Down Under rating: ★★

ASX: HLO
Share price: A$ 2.80
Market cap: A$ 349M

Helloworld Travel is everything you'd expect from a company with that name. It is a collection of more than 30 travel-related brands for the retail, corporate and wholesale markets, including Magellan Travel, Helloworld Travel, Skiddoo, Traveledge and Viva Holidays. Coronovirus has temporarily knocked the life out of Helloworld and despite the rebound in the share price, we believe the key question for investors is when international travel markets will open up again? We are not very optimistic on that…unless a vaccine is found very soon and the majority of populations in Europe, Australasia and North America can be vaccinated within the next 12 months. But we're not very optimistic about that either.

READ MORE

KEYTONE DAIRY

Milking the Asia opportunity

Stocks Down Under rating: ★★★★

ASX: KTD
Share price: A$ 0.27
Market cap: A$ 49M

Based in Christchurch, Keytone Dairy is a manufacturer of dairy and nutrition products for local and international markets. In addition to making its own dairy and nutritional powdered brands, it provides contract manufacturing services for well-known private label brands. After plummeting more than 50% in the past year, the share price has returned to where it was when the company went public on the ASX in July 2018. Although it has yet to turn a profit, Keytone is executing on its growth strategy by securing larger, more frequent contract wins and adding scale and higher-margin products through complementary acquisitions. As it works to skim its cost structure, the dairy manufacturer appears well positioned for sustainable profitability.

READ MORE

WOODSIDE PETROLEUM

Sunrise coming

Stocks Down Under rating: ★★★★

ASX: WPL
Share price: A$ 21.88
Market cap: A$ 20.9BN

Let's face it: The opening months of 2020 were not a good time to be an oil and gas company. Indeed, in April we at Stocks Down Under joked with each other that Hollywood producers were talking about a remake of the 1987 film 'Less Than Zero', with West Texas Intermediate in the title role. Woodside Petroleum, which in 2020 produced 89.6 million barrels of oil equivalent, didn't go to zero but it did crash 58%, from around $36 a share on 8 January to $15 on 23 March, whereas the S&P/ASX200 "only" crashed 33%. However, with oil now recovering alongside the general market, we believe Woodside is well placed to recover with it.

Share price chart

Source: Tradingview

For the last 35 years or so, when investors talked about Woodside Petroleum, most of the conversation centred around LNG. Liquified Natural Gas, which is simply gas cooled to the point where it has become liquid, and therefore more economically transportable in tankers, enabled a minor revolution in the energy industry in the 20th century by allowing countries or regions to get gas when they are too far away to be reached by conventional gas pipelines, or where those pipelines come from or run though hostile territory.

A great Australian success story

Down Under, LNG enabled a truly great success story. Woodside evolved from the celebrated discovery of the North West Shelf gas riches in 1971 to the first LNG shipments from the Burrup Peninsula near Karratha in the Pilbara region of Western Australia in 1989, to the point three years ago where there were three LNG operations in WA. There was the foundation North West Shelf operations, followed by Pluto in 2012 (next door to the North West Shelf) and then the Chevron-operated Wheatstone in 2017.

Of course, there was oil along the way, beginning with Cossack-Wanaea (from 1995), and continuing with Laminaria-Corralina (between 1999 and 2016), Legendre (between 2001 and 2011), Enfield (from 2006 to 2017), Vincent (from 2008) and Greater Enfield (from mid-2019). But as 2019 ended, Woodside was still very much an LNG company, constituting about 80% of its output. And LNG remains good for Woodside, In the 2019 calendar year the company enjoyed A$1.06bn in underlying NPAT off $ $4.8bn in operating revenue. Free cash flow was $2.1bn and gearing was a mere 14%. So this company was well set up to deal with the coming Coronavirus Crisis and oil price crash.

Are they going to Scarborough fair?

Being an LNG company means that Woodside stock can snap back fast with a recovering oil price, in our view. LNG pricing is linked to oil but the contracts tend to be long-dated and therefore not fluctuating day to day for the producers. And LNG will remain important to Woodside going forward, thanks largely to work done decades ago. Way back in 1971, Woodside discovered a gas field called Torosa, north of the Western Australian fishing town of Broome. The North Rankin and Angel discoveries near Karratha that same year were considered more important, and that's how we ultimately got the North West Shelf LNG.

However, Woodside held onto Torosa and added Brecknock in 1979 and Calliance in 2000. The company now wants to feed gas from there into the North West Shelf. Meanwhile, another field called Scarborough, discovered in 1979, is expected to ultimately feed into Pluto. For Scarborough, Woodside was able to announce a 52% resource increase late last year.

We believe Woodside has huge potential from two other major developments outside of LNG. We wrote about one of them in Stocks Down Under on 5 May when we looked at an emerging oil player called FAR Ltd (ASX: FAR). FAR owns 15% of the Sangomar oil field offshore Senegal, where Woodside, a 35% holder, has been operator since 2016. The attraction of Sangomar for Woodside was the 230 million barrels from just the first phase of the development. The other major development for Woodside could be its 40% interest in some large offshore blocks in Myanmar, where a major gas discovery called Shwe Yee Htun was made in 2016 in a block called A-6 and where the early engineering and design work started late last year.

Strong, decade-long growth to come – if all goes to plan

When you put Sangomar and A-6 into the mix with Scarborough and Browse, then it's not unreasonable to expect Woodside to grow its output in oil equivalent barrels by 6% p.a. every year for the next nine years, to over 150 mmboe in 2028. Now, the trouble with that view is that in 2020 things have not gone to plan. Covid-19 and the oil price crash has brought Sangomar development to a screaming halt. Now, Sangomar is actually economic at the current price of Brent crude. However, even if oil didn't recover quickly, the thing about oil and gas is that once you've discovered a field it's hard to lose it even if you can't develop it.

For a good example of that, consider Greater Sunrise. Woodside discovered the Sunrise and Troubadour gas and condensate fields in the Timor Sea between Indonesia and Australia way back in 1974. Thanks to shifting maritime boundaries a small part of Greater Sunrise now belongs to East Timor, and until the government of that sovereign but very poor nation agrees with Woodside that it would be better for them to send the gas to Australia rather than process it locally, Woodside can't develop the field. One can see East Timor coming round to that opinion pretty soon given recent gyrations in energy markets.

We take the view that Woodside will ultimately develop all the projects mentioned above including Greater Sunrise during the current decade, helped by a rapid post-Covid recovery in energy markets.

However, currently the market is taking a dim view of Woodside's prospects. You can get the stock on an EV/ EBITDA multiple of only 6.5x forecast calendar 2020 earnings falling to 4.2x by 2023. Not bad when EBITDA can potentially rise by more than 50% between 2020 and 2023.

HELLOWORLD TRAVEL

Hello, goodbye

Stocks Down Under rating: ★★

ASX: HLO
Share price: A$ 2.80
Market cap: A$ 349M

Helloworld Travel is everything you'd expect from a company with that name. It is a collection of more than 30 travel-related brands for the retail, corporate and wholesale markets, including Magellan Travel, Helloworld Travel, Skiddoo, Traveledge and Viva Holidays. Coronovirus has temporarily knocked the life out of Helloworld and despite the rebound in the share price, we believe the key question for investors is when international travel markets will open up again? We are not very optimistic on that…unless a vaccine is found very soon and the majority of populations in Europe, Australasia and North America can be vaccinated within the next 12 months. But we're not very optimistic about that either.

Share price chart

Source: Tradingview

Helloworld Travel is the product of a consolidation of travel brands back in 2013. At the time, Harvey World Travel, Travelscene, Jetset and Travelworld joined forces and merged with The AOT Group three years later. The company has acquired several other companies in the last few years, the latest one being TravelEdge Group in October 2019. Helloworld is currently active in Australia, New Zealand, Europe, the US and Asia.

Total Transaction Value, i.e. what customers spend on travel through the company's network, is the basis for Helloworld's revenues. Simply put, when Helloworld sells a holiday package or a business trip to a customer, that package comprises of third party services, like a hotel room and air travel, from the likes of Qantas and Hilton Hotels. Helloworld clips the ticket.

That ticket clipping brought in $200m in revenues in the first six months of FY20, through December, which was up 9.8% year-on-year. EBITDA grew almost 15% to $48m, representing a nice 24% operating margin. This margin was up from 22.9% the year before. By all measures, you could say business was good. Then disaster struck.

What a difference a virus makes

As late as 24 February, Helloworld was reaffirming its previous EBITDA guidance for FY20 of $86-90m, albeit at the bottom end of the range. The rest is history, as they say. The fallout from the Coronavirus Crisis was about to put Helloworld's business on its head. In its trading update on 1 May for the March quarter, Helloworld indicated a 17.6% drop in Total Transaction Value with EBITDA plummeting to just $2m. However, the March quarter still included the still relatively "good" months of January and February. We can only imagine what the June quarter will look like.

COVID-19 will remain disastrous for Helloworld for a while longer

A simple look at the projected numbers for Helloworld in FY20 and FY21 will tell you everything you need to know about a potential investment in the company. Revenues took a major hit from late February onwards, as the Coronavirus started spreading throughout the world. Revenues are expected to fall to $256m this financial year, from $358m last year. Mind you, this drop is completely attributable to the COVID-19 downturn in the last few months, because 1HY20 revenues through December were up almost 10% year-on-year.

The picture for FY21 is even more horrifying with revenues expected to drop to just $128m. That's another 50% down! Naturally, FY21 EBITDA is expected to fall as well, to $17m from an expected $41m in the current financial year, which ends next week.

Too much uncertainty in the near to medium term

Because of the unusual circumstances and the unusual movements in the company's expected numbers for FY21, the valuation multiples have become distorted. For instance, Helloworld's EV/EBITDA for FY21 now stands at 19.2x, while for FY22 it drops back to 5.7x as revenues and the operating result are expected to rebound by then.

"Looking through" this crisis to a potential recovery in FY22, you could argue that an EV/EBITDA multiple of 5.7x is not high for a company that is expected to see its revenues double in FY22. However, that is more than 12 months of uncertainty away. With uncertainty we mean uncertainty about how COVID-19 will play out in the next year. Just looking at what's happening in China, the US and parts of Europe at the moment, where flare ups of infections are triggering renewed lockdown restrictions, we believe investors shouldn't buy that sort of risk at the moment. International travel will remain heavily depressed well into 2021, in our view, and with that the likelihood of a fast share price recovery for Helloworld. So, just 2 stars from us.

KEYTONE DAIRY

Milking the Asia opportunity

Stocks Down Under rating: ★★★★

ASX: KTD
Share price: A$ 0.27
Market cap: A$ 49M

Based in Christchurch, Keytone Dairy is a manufacturer of dairy and nutrition products for local and international markets. In addition to making its own dairy and nutritional powdered brands, it provides contract manufacturing services for well-known private label brands. After plummeting more than 50% in the past year, the share price has returned to where it was when the company went public on the ASX in July 2018. Although it has yet to turn a profit, Keytone is executing on its growth strategy by securing larger, more frequent contract wins and adding scale and higher-margin products through complementary acquisitions. As it works to skim its cost structure, the dairy manufacturer appears well positioned for sustainable profitability.

Share price chart

Source: Tradingview

COVID-19 crisis spurs demand for health & wellness nutrition

Keytone makes and exports a range of formulated dairy and nutrition blended products. It sells its own dairy, nutrition powder and acne treatment supplement products under the KeyDairy, KeyHealth and FaceClear brands. It also has longstanding contract manufacturing relationships with dairy producers, retail chains and supermarkets such as Woolworths (Countdown) in New Zealand and Metro in China to provide manufacturing and packing services for private label brands. With operations in Australia and New Zealand, it is largely focused on the production of powdered baby formula, which represents a key growth opportunity for the company. The China market, although it comes with heavy regulatory risk, is a source of strong baby formula demand. Sam's Club in China (Walmart) and state-owned Chinese animal husbandry group Nouriz have recently emerged as key customers.

The COVID-19 crisis has had a mostly positive impact on Keytone's performance. According to the company, the Coronavirus outbreak increased global demand for "clean, green, pristine food staples and a range of health and wellness products". In April 2020 it received a purchase order from Walmart China and Nouriz for a combined $1.69m. On 11 June it announced the receipt of a $1.39m follow-on order from Nouriz for whole and skim milk powders as ingredients for its private label products. The order marked a sizeable increase from previous purchase orders. We believe the fact that the orders are increasing in both size and frequency is a good sign for Keytone.

Acquisitions to help drive long-term growth

The company's proprietary product strategy is focused on delivering higher value, higher margin products. With consumers clamouring for trustworthy, healthy consumables, Keytone has a golden opportunity to fulfill global demand for healthy dairy and powdered formulas and beverages, in our view. A big part of the growth strategy has been geared towards increasing production capacity so it can meet the demand and have the resources to accommodate its expanding product portfolio. This is being accomplished through the construction of a pair of new purpose-built manufacturing plants. It recently completed the construction of its second manufacturing facility in New Zealand where it began the facility's first commercial run in late FY20.

The inorganic component of Keytone's growth strategy has been evident following its most recent acquisitions. In June 2019, it purchased specialised health and wellness blend and powder drink maker OmniBlend. This gave it access to a profitable business that sells its blended powder products and long-life drinks to top health food brands such as Aldi, Bellamy's Organic, Muscle Milk and Tony Ferguson. It also increased the company's exposure to the all-important China market.

It went on to acquire premium health and wellness brand Super Cubes in October 2019. The maker of all-natural, frozen fruit, vegetable and plant-based protein cubes for smoothies broadened Keytone's portfolio in the fast-growing premium nutrition segment. Super Cubes, which sells its products to Woolworths, hundreds of independent supermarkets and online, generated $650k in FY19 revenue. It is likely to become another complimentary acquisition and growth catalyst. Super Cubes, which has posted strong sales growth since being acquired, will significantly enhance the group's distribution footprint and channels.

Baileys licensing agreement enhances industry reputation

The revenue-boosting headlines continued on 28 May 2020 when Keytone announced a licensing agreement for a variety of Baileys iced coffee drinks which gave the company distribution rights to Australia, New Zealand, Hong Kong and Taiwan. The ready-to-drink products are currently sold across Australia at Caltex petrol stations and are soon expected to be available at Woolworth's liquor arm Beer Wine Spirits. The agreement also includes a line of new Baileys powdered beverages that are expected to hit the market on 1 August 2020. Keynote will pay a minimum royalty of $280k for the license through the end of CY22 but given the widespread distribution opportunities, sales derived from the agreement should far outpace the cost and drive margins higher. Forming a relationship with such a well-known global brand as Baileys is likely to enhance Keytone's visibility and may potentially lead to additional licensing agreement wins.

We believe Keytone's strong balance sheet puts the company in a good position for growth. It has a cash balance of $4.4m as of 31 March 2020 and a manageable debt level. Last month it completed a $12.5m capital raise to institutional and sophisticated investors to further strengthen the balance sheet. Although it continues to operate at a loss, we believe recent contract wins from major companies and robust consumer demand for health and wellness consumables have brightened the path to profitability. Following the $22.5m in revenues in FY20 (ended March), which was up from just $2.5m in FY19, and strong sequentlial quarterly revenue growth, we believe Keytone is well-positioned for future growth.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd 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