17 AUGUST 2020

Stocks Down Under

A two-year-old is kind of like having a blender, but you don't have a top for it.

- Jerry Seinfeld (b. 1954), American comedian and actor

SPARK NEW ZEALAND

Don't say price is no object

HOME CONSORTIUM

The Moby Dick of REITs

CLEARVIEW WEALTH

When life insurance needs life support

SPARK NEW ZEALAND

Don't say price is no object

Stocks Down Under rating: ★★

ASX: SPK
Market cap: A$ 8.2BN
Dividend yield: 4.9% (unfranked)

52-week range: A$3.35 / A$4.72
Share price: A$ 4.49

Dual listed on both the ASX and NZX, Spark New Zealand is one of New Zealand's largest listed companies. Its history is impressive as Spark can trace its roots back to New Zealand's Post Office. In 1987, the New Zealand Post Office was replaced by three companies, one of which would eventually become Spark. However, despite its roots as the Post Office, Spark is an innovative company with interesting growth prospects. Unfortunately, when it comes to equities, price is the object and for Spark it's just too high, in our view.

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ASX: HMC
Market cap: A$ 758M
Dividend yield: 3.1%

52-week range: A$1.14 / A$4.05
Share price: A$ 3.06

Home Consortium is a massive Australian shopping centre real estate investment trust (REIT) with 38 centres covering approximately 3 million square meters of land and boasting 140 unique brands as tenants. With most centres being anchored by a large national company, even Home Consortium's Victoria assets are still operating. With its initial public offering on 14 October 2019, at an ambitious $3.35, we believe the current discount to net tangible assets (NTA) provides a more accurate representation of the continuing strengths and risks of Home Consortium's property portfolio.

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Market cap: A$ 233M

52-week range: A$0.185 / A$0.75
Share price: A$ 0.36

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Share price chart

Source: Tradingview

What pandemic?

Spark New Zealand’s name really says it all, all of Spark’s business is in New Zealand and therefore, due to their success in stamping out COVID-19, guidance from Spark is the pandemic had little impact on the company’s 2HY20 results. Therefore, its most recent guidance puts earnings before interest, taxes, depreciation, amortisation and impairments (EBITDAI) around NZ$1bn. The dividend is projected to be NZ$0.25 for FY20. Even if New Zealand had not crushed the virus as successfully as it did, Spark’s business would not likely be all that affected. The majority of the company’s revenue comes from three sources; mobile, broadband, and cloud, security and services. None of these segments have shown to be particularly vulnerable to lockdowns in Australia and in the unlikely, but still possible, scenario that New Zealand sees a significant resurgence in the virus this would be an important fact to remember.

Innovate or die

Spark is not, currently, a growth company. Its fastest growing customer segment on a year-over-year basis was Consumer and that only saw a 2% increase. Business increased 0.5% while Wholesale and Other dropped 5.1% across the same period. Out of the seven main revenue segments that make up Spark, Voice is the biggest concern. As a business, Voice is dying and its year-over-year revenue losses have dragged down Spark's overall growth.

The company's main source of revenue, Mobile, has seen increases of only 2.7%. This has caused total EBITDAI growth to be steady, but low. Current guidance estimates year-over-year growth in EBITDAI for FY20 to be approximately 1.8% and 2HY20 to be around 1.5%.

There is one significant bright spot on the income statement, however. Cloud, security and service management is quickly becoming the second largest segment as measured by yearly revenue with strong future growth aspects. During FY19, on a year-over-year basis, Cloud, security and service management grew 8.1%, consistent across both halves. For the 1HY20, year-over-year results at Cloud, security and service management grew 8.9% and with the increase in working from home due to lockdowns, as well as the sharp increase in global cybercrime, 2HY20 likely saw similar, if not better, results. If Spark can stabilise Voice's rabid decline, as well as consistently raise growth in some of its other operating revenue segments, Cloud, security, and service management could possibly lead a wave of significant growth.

The name of the game is price

While Spark did issue NZ$106.8m worth of debt in the Australian market on 5 June 2020, its liquidity and balance sheet are solid. Interestingly enough, none of Spark's debt has any financial covenants attached. This is likely due to their current S&P Global debt rating of A-, which is quite a high rating. This also allows Spark to access cheaper debt than most other companies in the future if needed.

Spark dominates its industry in New Zealand and the likelihood of a significant competitor arising in the near future is rather slim. Additionally, their Cloud, security and service management business has a lot of potential and, assuming some other dominos fall into place, could cause the market to see a significant increase in Spark's annual growth.

We believe the dividend is quite safe and FY20 will see an increase putting it at NZ$0.25 a share, according to guidance. For Australian investors, however, it is important to note that the majority of Spark's liquidity is on the NZX with only around 14% of the shares listed on the ASX actually being held in Australia at the end of June 2020, according to the ASX's monthly foreign entity report.

As investors it is important to remember that nobody who says 'price is no object, I'll buy it all' makes any money. While there are a number of significant positives surrounding Spark, the company's foreseeable growth as well as its dividend do not warrant a valuation as high as it is today. Spark's EV/EBITDAI of 9.9x is rather significant, especially since EBITDA growth is only expected to amount to 2.2% in FY21. Therefore, it has to be a two-star rating for us.

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Source: Tradingview

When picking an anchor make, sure it's a sturdy one

Home Consortium's properties are geographically diverse across Australia. While this was certainly an accidental hedge on the pandemic, the benefits to risk concerns are still valid. Of the 38 properties owned by Home Consortium, 13 are in NSW (three under construction), 11 are in Victoria (two under construction), 10 are in Queensland (three under construction), three are in WA (one under construction) and one is in SA. The majority of Home Consortium's centres feature what is known as an anchor store. An anchor store is, usually, a major retailor that brings demand specifically to the shopping centre. For example, Woolworths, Coles, Aldi and Chemist Warehouse are some of the main anchor stores at Home Consortium's centres. This decision to actively anchor their centres is probably a significant reason why foot traffic for April 2020 only declined approximately 10% on a year-over-year basis.

Home Consortium? More like Moby Dick

With a WALE of 8.2 years Home Consortium should really consider changing its name to Moby Dick. Let us explain, WALE stands for weighted average lease expiry (WALE) and is an important metric to consider when reviewing any real estate investment trust. Since Home Consortium's WALE is 8.2 years, we can be assured that the rental income they receive is solid into the far future. A WALE of 8.2 years is quite good. Home Consortium's WALE is not the only solid fundamental; the company has no debt maturing until FY23 and approximately $146m cash and undrawn bank facilities as of 22 March 2020.

Home Consortium's fundamentals mean we can be confident in their ability to make improvements, acquisitions and maintain the dividend, growth and shareholder value into the future. Additionally, the company's dividend is 100% franked, a usual occurrence for a REIT.

Battening down the hatches in Melbourne? No problem

The last update we received from the company was 30 April 2020 when it stated all their centres remained open. However, since the COVID-19 situation in Victoria has unfortunately worsened, we wanted to confirm that Home Consortium's centres were still operating in Victoria. On 13 August 2020 we called a few different stores in each centre in Victoria to confirm that they were still open to the public. We found that at least one store remained operational, and open to the public, in each centre.

During the latest guidance from management, released on 13 August 2020, several supportive statistics were issued By gross income, 90% of tenants are open and trading while 95% of tenants have agreed upon a forward position relating to COVID-19. The guidance on rental support's cost was $6-7m. However, this will be more than offset by cost cutting measures, especially the directors agreement to take significant, temporary, pay cuts in response to the need to provide rental support. The CEO and executive chairman, David Di Pilla, agreed to wave 100% of his pay for April, May and June. We believe this also indicates Home Consortium has a strong and dedicated management team going forward, willing to make the hard choices.

Put down your harpoons, for now, the white whale is beached

The adjusted NTA for Home Consortium is currently $3.08 a share and, therefore, shares are currently trading at an approximate discount of 1.5%. Looking at the current situation for property, retail and COVID-19 add a degree of risk to Home Consortium. So, despite the success it has had in mitigating these risks so far, we believe this requires a discount to NTA. However, the fully franked dividend should remain relatively stable as guidance puts it at $0.05 for 2HY20. We believe Home Consortium's properties are well placed and the strength of its fundamentals must be considered. Therefore, a discount of between 1-3% is reasonable at this time and our star rating must be three out of five.

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Share price chart

Source: Tradingview

COVID-19 is a thorn that you just can't find

Clearview Wealth's life insurance policies have a few main offerings, life cover, total and permanent disability cover, trauma cover and income protection cover. The comany has made it clear, through multiple statements, that they have no specific pandemic exclusions in their policies, especially income protection cover. While this is fantastic for its policy holders, this places a lot of uncertainty on Clearview Wealth for the next couple of years. This has led Clearview Wealth to discontinue guidance until further notice as well as its dividend. The Australian Prudential Regulation Authority (APRA) has made specific requests of insurance companies in Australia to 'limit' dividends and discretionary capital spending. Therefore, even if it was feasible right now, we believe it is highly unlikely Clearview Wealth's dividend will resume in the foreseeable future.

Despite FY19's year-over-year revenue growth of 9.8%, EBITDA growth of 11.5% and an EBITDA margin of 23.4%, the majority of Clearview Wealth's revenue is comprised of premiums and fees from in-force

policyholders and funds under management. The company has raised premiums for new and renewing income protection policy holders and it is uncertain if this will result in a net positive or negative effect on total premiums, with management expressing uncertainty.

Therefore, comprised with other significant concerns surrounding the costs and continuing premium collection from their policies, it is impossible to approximate how the company's revenue, EBITDA and EBITDA margin will look in the future.

Short-term liquidity is solid, but concerns about mid-long term are serious

In some positive news, Clearview Wealth, on 20 March 2020, for the first time received a long-term issuer default rating of 'BBB' from Fitch. Fitch also rated Clearview Wealth's subsidiary Clearview Life Assurance an insurer financial strength rating of 'BBB+' and a long-term issuer default rating of 'BBB.' While this is a positive sign, especially coupled with 1HY20 total liabilities/total assets at 46.4%, management has expressed considerable concerns over Clearview Wealth's mid to long-term liquidity. Short-term liquidity has been shored up after extending the compamy's funding facility to 1 April 2023 and drawing down the remaining $10m of the facility.

To be clear, the mid to long-term liquidity concerns do not relate to insolvency, but rather mean large debt and/or equity issuances are likely in the medium to longer term. The threat of dilution or significant balance sheet deterioration is not something investors should take lightly and is one of the most significant COVID-19 related mid to long-term risks for Clearview Wealth shareholders, in our view.

HUB24 partnership offers a rare positive for the future

On 19 March 2020 Clearview Wealth announced that it had partnered with HUB24 to utilise the HUB24 Superfund platform and services for Clearview Wealth's primary super life insurance portfolio. This will require the transfer of approximately $1bn of assets from Clearview Wealth's platform and will cost between $4m and $6m over the next six to twelve months. However, this would be a one-off cost. This investment would help modernise Clearview Wealth's investment products and technology.

The move is subject to trustee and responsible entity approval, but is an important move by Clearview Wealth as this is just the start of a long term collaboration. The company announced it will be working closely with HUB24 in the future to create new, Clearview branded, versions of HUB24's investment and insurance products. Additionally, they will be creating new, and 'innovative', investment and insurance products with HUB24 going forward. While the full, future benefit of this move is yet to be seen, we believe it will help Clearview Wealth compete in the currently shifting investment management landscape.

The only thing we have to fear is not fear but the unknown

Clearview Wealth is currently trading at a historically cheap trailing twelve-month EV/EBITDA of 6.9x. However, unless investors except the global COVID-19 and economic crisis to be over in the next year, a highly unlikely scenario, the risk of the unknown surrounding Clearview Wealth is too high, in our view. Therefore, it's a two-star rating from us.

Pitt Street Research Pty Ltd

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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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