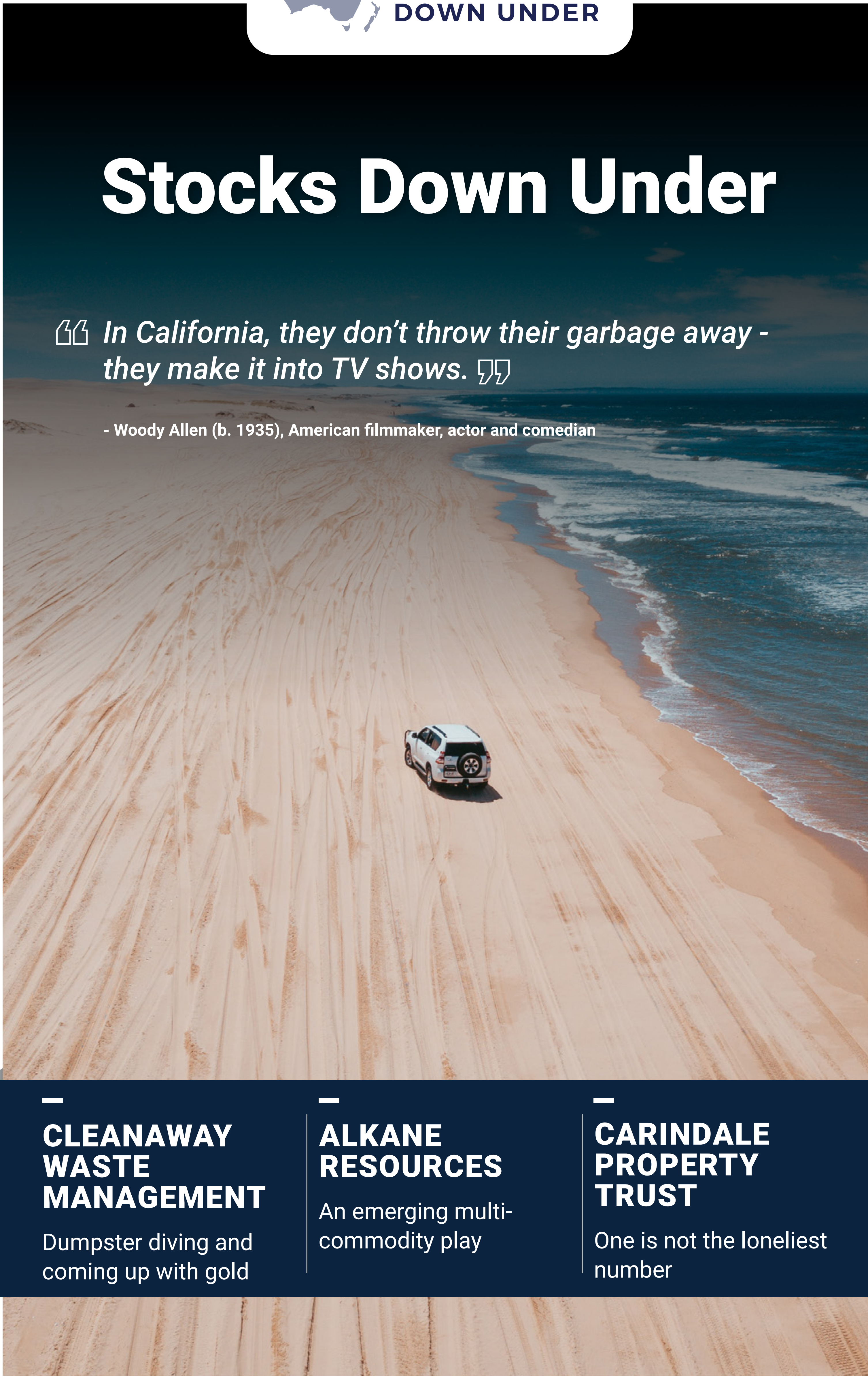
STOCKS DOWN UNDER

27 AUGUST 2020

Stocks Down Under

In California, they don't throw their garbage away - they make it into TV shows.

- Woody Allen (b. 1935), American filmmaker, actor and comedian



CLEANAWAY WASTE MANAGEMENT

Dumpster diving and coming up with gold

ALKANE RESOURCES

An emerging multi-commodity play

CARINDALE PROPERTY TRUST

One is not the loneliest number

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Stocks Down Under rating: ★★★★

ASX: CWY
Market cap: A$ 4.601BN
Dividend yield: 1.8%

52-week range: A$ 1.40 / A$ 2.45
Share price: A$ 2.43

Cleanaway Waste Management is a full-service recycling and resource management company with over 4,500 vehicles and over 260 locations across Australia. While Cleanaway does have competition from companies like Bingo Industries, the industry requires significant infrastructure, like landfills, recycling facilities and transfer stations, that would be extremely difficult to replicate. During 2019 Australia's population grew 1.4% according to the Australian Bureau of Statistics, and this trend is widely expected to continue. A larger population and larger economy mean more waste and we believe Cleanaway is perfectly situated to take advantage.

READ MORE

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ASX: ALK
Market cap: A$ 645.8M

52-week range: A$ 0.37 / A$ 1.36
Share price: A$ 1.05

With gold going through US$2,000 recently, it is gratifying to see companies investing their 'windfall' gains into future projects that will create shareholder value for a long time to come. One such company is Alkane Resources, which is a relatively small gold producer today, but has wisely invested some of its cashflows into emerging gold plays. It has also recently discovered a promising copper-gold porphyry deposit not far from Newcrest's Cadia Copper-Gold mine in central New South Wales. All this gives Alkane lots of growth opportunities going forward. We see great things ahead for this company.

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ASX: CDP
Market cap: A$ 200.9M

52-week range: A$ 2.67 / A$6.78
Share price: A$ 2.85

Carindale Property Trust is a unique real estate investment trust as it only owns two properties located in Brisbane's south-eastern suburbs 12-kilometres from the CBD. While Carindale technically owns two separate properties, Westfield Carindale (50% ownership) and Sundry property, the two buildings are managed together and the company considers them to be one. Due to COVID-19, Carindale has discontinued its dividend to preserve cash and the stock crashed, dropping 49.2% between 5 March and 25 August providing a far too steep discount to net tangible assets, in our view, of 54.7%.

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Share price chart

Source: Tradingview

Innovation comes in all packages, even waste

Cleanaway was forced to cut costs during 2HY20 due to COVID-19. However, one department the company did not cut was its sales staff. This allowed them to expand the company's client base as well as maintain the clients Cleanaway already had. Additionally, Cleanaway was able to grow its EBITDA margins by 0.6% through increased automation, data harvesting and optimisation of its current assets. This allowed the company to increase its FY20 EBITDA 11.7% year-over-year despite having net revenue fall 0.4%.

One of the ways Cleanaway is innovating is through the proposed development of a waste-to-energy facility in Sydney. This would provide clean and renewable electricity to Sydney while also allowing Cleanaway to reduce the load on its landfills in a cost-effective, and more importantly profitable, way. The company estimates the power generated would be enough for 79,000 homes and would be able to divert 95% of the waste that would otherwise go to its connected landfill. While the project has not yet received regulatory approval, the CEO was confident on the FY20's conference call, and the project is slated to be commissioned in 2024 or 2025.

Additionally, Cleanaway is looking into the development of two other waste-to-energy facilities in Melbourne and Brisbane. These projects would bring significant benefit to Cleanaway in the long run as well as generally receive backing from multiple special interest groups for the facilities ability to provide steady jobs and clean, renewable energy.

Another of Cleanaway's significant development projects is its PET plastic pelletising joint venture with Pact and Asahi to recycle approximately one billion PET plastic bottles per annum into around 20kt per annum of food-grade recycled pellets/flakes. While this has also not yet received all of its regulatory approvals, we believe it is unlikely the project will be scrapped. Commissioning is slated to be during December 2021.

The three horsemen of risk: COVID-19, infrastructure and commodity prices

The three main risks facing Cleanaway right now are COVID-19, the uncertainty surrounding infrastructure projects and the continued depression in a large portion of the global recycled commodities market.

COVID-19 is a complex and continually changing situation. While Cleanaway would certainly not be classified as a classic "opening up" investment, the lockdown had taken a significant toll on the commercial and industrial segment of solid waste services, and the restaurant shutdowns and customer limits had depressed the non-hazardous liquids segment of liquid waste and health services.

The COVID-19 economic crisis has also resulted in re-evaluating the feasibility of many infrastructure projects. And while there is considerable discussion surrounding an infrastructure-focused economic recovery package, for now, infrastructure waste has taken a hit. However, as the economy continues to open back up in many parts of the country, we believe Cleanaway is primed to take advantage. Despite this, if the COVID-19 situation in Australia deteriorates, Cleanaway, as shown with its 2HY20 performance, is unlikely to be profoundly affected.

Since China banned the import of most waste in 2017, the global recycled commodities market has taken a nosedive and had yet to recover, even before COVID-19 hit. While the global economic slump has not helped matters, this risk predated COVID-19. However, Cleanaway is fortunate to be diversified enough where commodities are only 3% of its total revenue. Therefore, the downside is rather minimal, in our view. However, this continues to be an adverse pressure on Cleanaway's revenue.

One person's trash is another person's cash

We believe Cleanaway has a bright future ahead of it, fuelled in large part by the company's innovation and vertical expansion, increasing EBITDA margins and bringing in additional revenue. The shares are currently trading at an EV/EBITDA of 11.4x FY21. Consensus EBITDA growth estimates between FY20 and FY23 stand at 21%, an assessment we find highly conservative based on the 26 August 2020 earnings call and Cleanaway's ability to increase its EBITDA margins more than expected. Therefore, we believe it is only proper to provide Cleanaway with a four-star rating.

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Share price chart

Source: Tradingview

Alkane's company-maker was the Tomingley Gold Mine near Dubbo in central New South Wales. Never heard of it? Okay, it's not Telfer, Boddington, or the Super Pit, all big and legendary gold producers, but it was a good start for this well-managed company. We're actually more interested in where Alkane goes next. In recent years it has been making investments in emerging gold plays in Western Australia, while a recent discovery called Boda, not far from Tomingley, suggests the making of Mine No. 2. And recently Alkane rewarded its shareholders by spinning off its Dubbo Zircon Project into a newly listed company called Australian Strategic Materials (ASX:ASM) that is leveraged to future booming demand for that important industrial mineral.

Tomingley– Could this company-maker keep on company-making?

The Tomingley Gold Mine has been in production since 2014 and has provided great cash flows for the company in the years since. Tomingley was a long time in coming. The Wyoming Three, Caloma and Caloma Two deposits were discovered in 2002, 2006 and 2010 respectively, but today this mine produces over 33,000 ounces of gold at a creditable All in Sustaining Cost ('AISC') of A$1,500 per ounce. Sure, it's a small mine and with higher cost than many in Australia, but at today's gold price that is still a margin of A$40m, which is not to be sneezed at.

Tomingley may not be a monster in terms of size, but continues to deliver in terms of expansion possibilities. There have been preliminary studies on the San Antonio and Rosewall deposits with both underground and open-pit options on the table. The area from Tomingley to Peak Hills has a long history of producing gold, so there is every chance that Alkanes annual production from Tomingley can be increased from 33,000 ounces per year to 75,000 – 100,000 ounces per year.

The Holy Grail – Boda

One of the great things about companies that keep exploring, even after their future is relatively secure thanks to a producing mine, is that the more they drill, the luckier they seem to get. That's what Alkane may have with Boda, which sits within a 110 square km area that Alkane is calling its 'Northern Molong Porphyry Project', about 35 km east of Dubbo. The Molong Volcanic Belt has always looked good for porphyry-related gold-copper mineralisation and at Boda, Alkane has this in spades with drill intersections regularly grading in the order of 4 g/t gold and 1.5% copper. Boda is shaping up to be a deposit of significance and the similarities to Cadia, which is only 100 km away, have not been lost on some observers. Time and further drilling will give us a better picture of this, but shareholders will definitely be in the driver seat, with near term gains.

Meanwhile, Alkane is in an enviable position of sitting on surplus cash but having stakes in up-and-coming gold companies. As of 30 June, there was A$72m in cash and gold bullion with no debt. In addition, it had equity positions of more than $40m in two emerging Australian gold companies.

Will Ulysses make it back to Ithaca?

There is a 15% stake in Genesis Minerals (ASX:GMD), which has a 760,000 ounce high grade gold deposit near Leonora in WA called Ulysses. And there is also a 13% equity stake in Calidus Resources (ASX:CAI), which has a 1,250,000 ounce resource at Warrawoona in the East Pilbara and is on track to becoming a 100,000 ounce per year producer. Both these investments will not only create shareholder value, but could give the company options to grow through acquisition down the track.

Recently, Alkane shareholders were beneficiaries of the demerger of its zircon project in Dubbo into Australian Strategic Materials. This not only ensures that both the base metal and zircon business run independently, but enables them to be rerated and gives shareholders the option of liquidating holdings in the zircon business while still keeping a holding in the base metals business. This ia another example of management sharing the upside with shareholders.

Alkane stock has run hard since the 50-cent low of 16 March, but with gold continuing to reward its followers we see further upside ahead, in particular as the Boda picture becomes clear. Four stars from us.

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Devaluation may not be done, but normalisation has begun

During FY20 Carindale Property Trust issued a property revaluation, which decreased its assets by $125.4m, a 14.5% decrease in the value of the property. While this was significant and saw a net tangible assets per share reduction from $8.01 on 31 December 2019 to $6.33 on 30 June 2020, the property has already seen a relative return to normal. Customer visitation during July was approximately 90% of normal volumes and 91% of Carindale Property Trust's tenants were open and trading. Westfield Carindale, Carindale Property Trust's sole property, is 97% leased. While this is a decrease from the last two financial years consistent 99%, we believe this shows the strength of Westfield Carindale's leases.

While there was a new cluster at a Brisbane Youth Centre that rose to a total of ten cases on 26 August 2020, we believe the risk of a new lockdown in Brisbane is very low. However, even in the worst-case scenario, where another 14.5% negative property valuation adjustment is required, a situation we find extremely unlikely, net asset value would still be approximately $336.5m or $4.81 a share. As Carindale Property Trust closed at $2.87 per share on 25 August 2020, we believe there is a more than significant margin of safety for shareholders at the current price.

REITs are not just about the dividend

We believe the main reason for Carindale Property Trust's substantial discount right now is the decision by management to not payout a dividend for the second half of FY20. The reasoning behind this was saving capital, and we believe that was the right call as the other alternatives were issuing shares and diluting shareholders or taking on more debt. Carindale Property Trust's financial position is stable as they currently have $4.8m in cash and operating cash flow is presently more than enough to pay the interest rate of its floating secured bank loan, even at its reduced 2HY20 rate.

While the company does not issue specific figures on the average interest rate paid during FY20, we calculated it in between 2.5% to 3% and were able to confirm this range with Carindale Property Trust's investor relations. Due to the credit rating and guidance issued by the Reserve Bank of Australia on interest rates, we believe this range will likely stay the same for the foreseeable future.

Between FY15 and FY19, annual distributions from Carindale Property Trust were in the range of $0.35 to $0.40 per share. While there is no current guidance on a FY21 dividend, we believe there is a strong possibility of dividend returning, conservatively, around 2HY21, so long as there is no deterioration in Brisbane or Queensland's overall COVID-19 situation. Our opinion on the dividend is based on several things, including the stability of Carindale Property Trust's total rental space, the continued strength of its operating cash flow, the continued containment of COVID-19 in Queensland and the anchoring of Westfield Carindale by ALDI, Woolworths, Coles, Event Cinemas and Apple in one of Brisbane's wealthier suburbs.

While investors focus heavily on the dividends coming from real estate investment trusts, and rightfully so, we believe investors can sometimes be blind to the value of a trust's net tangible assets and push the stock price to an unreasonable discount.

Sometimes just one can be better than many

Carindale Property Trust is trading at too significant a discount to be considered reasonable, or even conservative, in our view. There is no risk of default, and while the company is certainly not a growth stock as future acquisitions are most likely not going to happen, the company's single property is well placed. We expect it to provide stable cash flows for the foreseeable future.

Through COVID-19, Carindale Property Trust still returned a net profit as well as positive cash flows, excluding the non-cash property valuation adjustment. Under a worst-case scenario where a further devaluation is required, the current share price still offers a more than sufficient discount. Therefore, we believe there is plenty of room for upside as we work through the current COVID-19 situation. Consequently, it is a four-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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