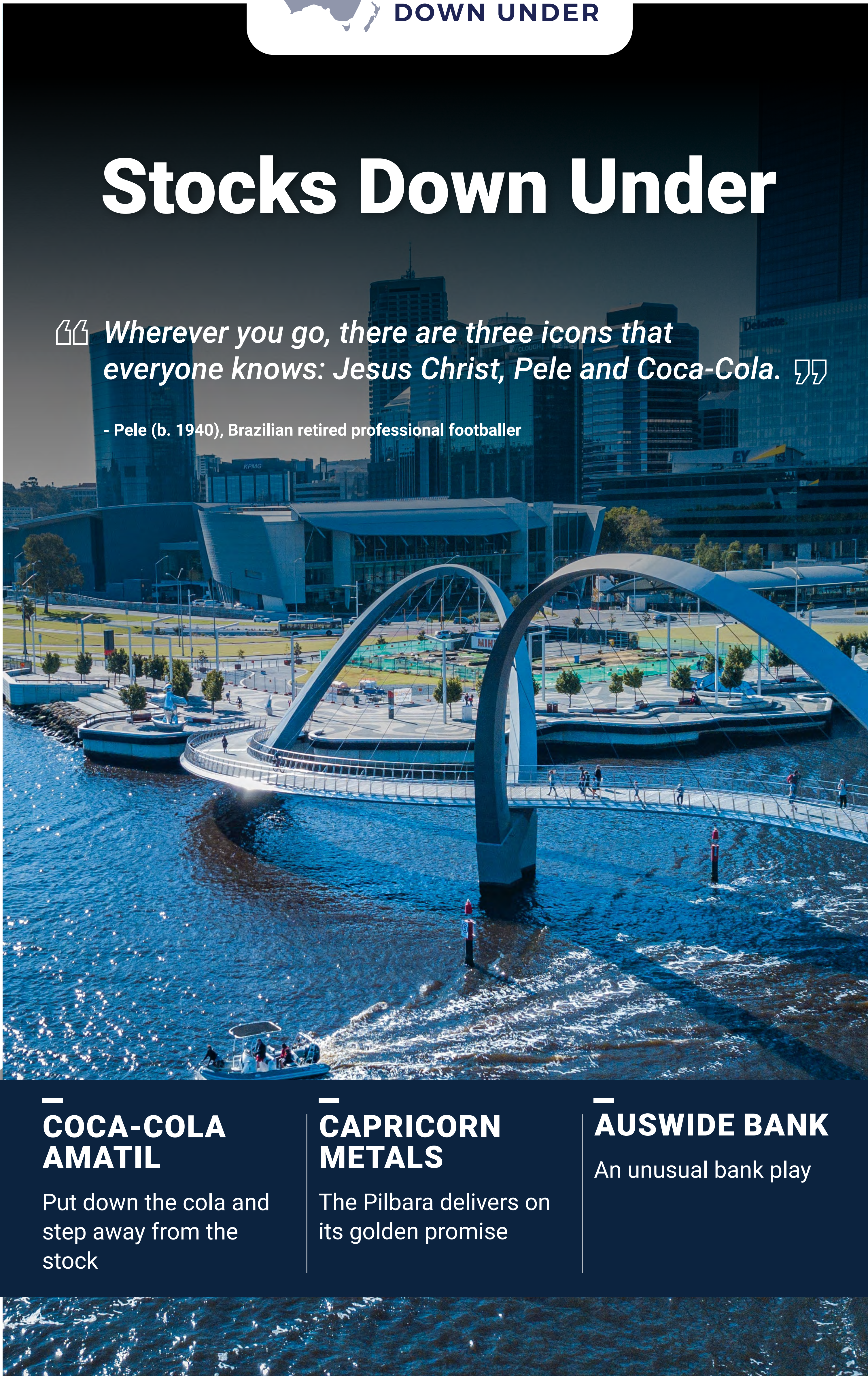
Stocks Down Under



> *Wherever you go, there are three icons that everyone knows: Jesus Christ, Pele and Coca-Cola.*

- Pele (b. 1940), Brazilian retired professional footballer

COCA-COLA AMATIL

Put down the cola and step away from the stock

CAPRICORN METALS

The Pilbara delivers on its golden promise

AUSWIDE BANK

An unusual bank play

COCA-COLA AMATIL

Put down the cola and step away from the stock

Stocks Down Under rating: ★★

ASX: CCL
Market cap: A$ 6.690BN
Dividend yield: 5.1%

52-week range: A$7.77 / A$13.18
Share price: A$ 9.24

Coca-Cola Amatil prepares, distributes and sells the non-alcoholic Coca-Cola branded drinks and ready-to-drink alcoholic drinks throughout Australia, New Zealand, Indonesia, Papua New Guinea, Fiji and Samoa. Coca-Cola Amatil is headquartered in North Sydney. The company, like all partners, receives its exclusive selling designation from the main company, The Coca-Cola Company in Atalanta, Georgia, USA. However, the Coca-Cola business is significantly larger than the non-Coca-Cola alcohol and coffee business. With a high valuation we have to say, "put down the cola and step away from the stock".

READ MORE

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Market cap: A$ 684m

52-week range: A$2.15/ A$0.85
Share price: A$ 1.97

With gold now hovering around US$2,000 an ounce, some investors might be assuming that all ASX-listed gold stocks are fully valued or, indeed, overpriced. And many investors will also be labouring under the outdated assumption that there is no gold in the Pilbara. Capricorn Metals may change people's minds on both counts. This company is less than a year away from becoming a gold producer in the Pilbara. Its Karlawinda Gold Mine near Newman will produce more than 100,000 ounces a year at a healthy margin in line with other Australian producers. With funds pouring into gold, there remains, in our view, a lot of life in this stock.

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Market cap: A$ 205M
Dividend yield: 7.6%

52-week range: A$3.30 / A$6.83
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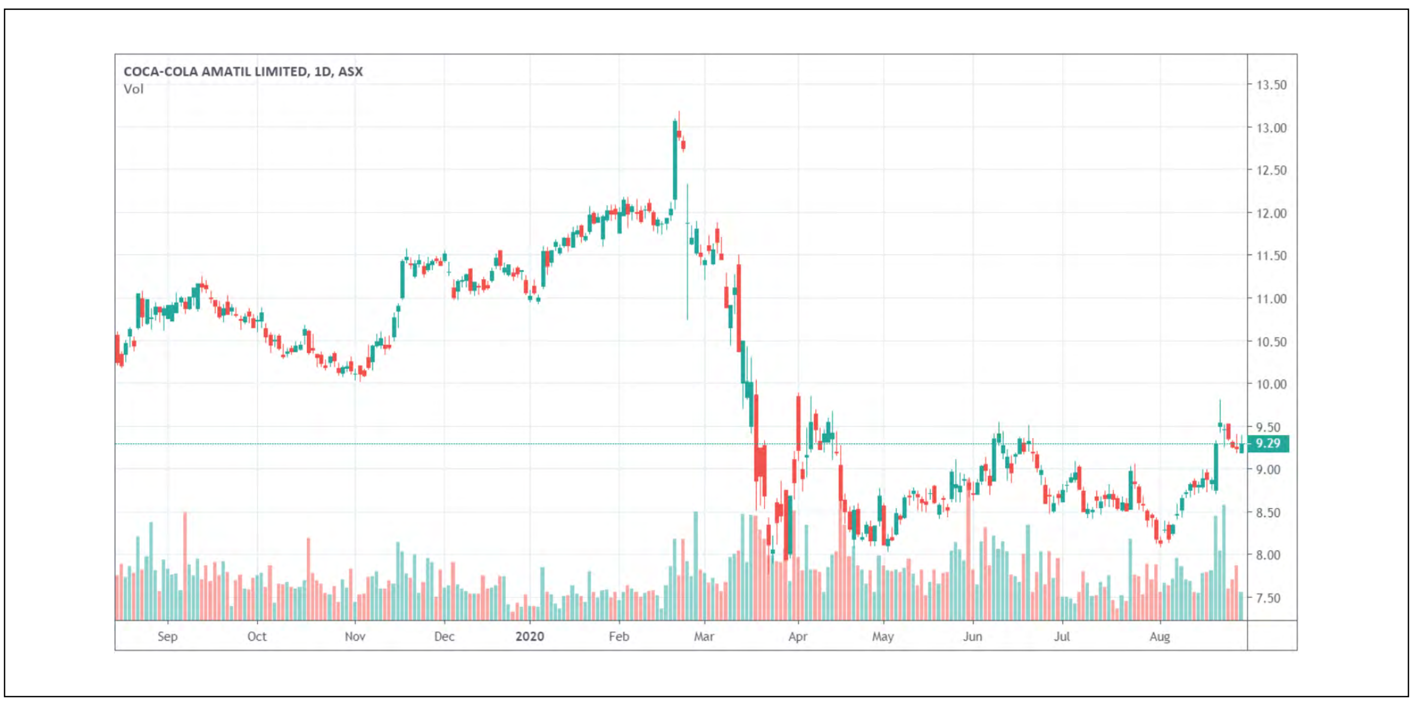

Source: Tradingview

Crack open this company like we do a cola

Coca-Cola Amatil has two overarching revenue categories as of 1HY20, non-alcohol ready to drink (85% of revenue) and alcohol and coffee (15% of revenue). Non-alcohol ready to drink is the category that covers the Coca-Cola branded business, while the alcohol and coffee business originates from the Amatil business. However, as shown above, the business is basically run as a Coca-Cola partner with 'other' revenue.

To further illustrate this point, the trading revenue from non-alcohol ready to drink declined 9.3% year-over-year in 1HY20, while the alcohol and coffee business declined 5.3%. Despite the sharp difference in revenue decline between the two revenue categories, total trading revenue declined 8.8%. Coca-Cola Amatil's earnings performance is almost entirely based around the success of the Coca-Cola branded products.

To take a bit of a deeper dive into the non-alcohol ready to drink side of the business we find that there are four main selling streams, Grocery (57%), convenience and petroleum (8%), on the go (17%) and national on premise (18%). While the volume of million-unit cases sold declined 8% during 1HY20, a more concerning fact is the revenue per unit case declined 1.4%. During COVID-19 there have been consistent concerns over the integrity of global supply chains, and this was one of the main reasons for the margin squeeze Coca-Cola Amatil found itself in during 1HY20. We find it unlikely, due to geographical diversification of Coca-Cola Amatil's EBITDA across the Asia Pacific region that the margin issues will reverse themselves for the remainder of 2020 and even, at least, for 1HY21.

COVID-19 takes the air out of our cola

Consensus estimates for Coca-Cola Amatil's EBITDA growth for the year end 31 December 2020 are a decline of 6.6% year-over-year. While we believe this is not without reason, our main concern is the assumption that EBITDA margins will recover and grow from 17.6% in 2019 to 17.8% during 2020. Based on 1HY20's EBITDA margins of 16.3% and the lack of recovery from international supply chains, we find that assumption to be unrealistic. While there was a noticeable recovery in the year-over-year revenue growth of both New Zealand and Australia during July 2020, things are still not looking up.

Approximately 20% of Coca-Cola Amatil's EBITDA comes from outside of Australia and New Zealand, and while that may not be an overwhelming figure it still can have a significant impact on the company's annual results. With Auckland back in lockdown, Victoria still in lockdown, many Australian states keeping their border restrictions and the continued restrictions with occupancy in restaurants, pubs and cafes, we do not believe Coca-Cola Amatil will offer a surprise earnings beat for full-year 2020. In fact, we believe there is a chance the company could offer a slight earnings disappointment.

Even Coca-Cola Amatil needs to lose some weight

Coca-Cola Amatil is currently trading at a FY20 estimated EV/EBITDA ratio of 10.7x while offering an annual dividend of 5.1%. We believe that based on the current global and domestic health and economic situation the valuation of Coca-Cola Amatil does not meet the reality on the ground. Supply chains are still a mess and the likelihood of this continuing to put significant pressure on Coca-Cola Amatil's margins through the remainder of 2020 and into 2021 remains high, in our view. Additionally, until the restrictions on the number of people who are allowed in restaurants, pubs and cafés in Australia are removed, this will continue to restrict the growth we were seeing from Coca-Cola Amatil pre-COVID-19.

This is a brave new world we are living in and while Coca-Cola Amatil has adapted, there is only so much the company can do. Therefore, at its current valuation, we have no choice but to rate it two out of five stars.

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Share price chart

Source: Tradingview

When we wrote about De Grey Mining (ASX:DEG) last week and back in April, we talked about how the Pilbara has traditionally not been associated with gold even though the area has occasionally turned up some good gold mines over the last 130 years. However, gold is still out there in company-making numbers. Capricorn Metals's company-maker, the Karlawinda Gold Mine, is just 70 km by road south-east of Newman, a major Pilbara town. The deposit that became Karlawinda was initially discovered back in 2008 by Independence Group (now IGO Ltd, ASX:IGO) and Capricorn Metals bought it in 2016. It'll be in production as a 100,000 -120,000 ounce a year mine from the second half of the next calendar year.

A high margin mine

The nice thing about Karlawinda is that it will be high margin and reasonably long life, producing at an All In Sustaining Cost ('AISC') of between A$1,150 – A$1,200 per ounce over a 12-year period. And mine life will likely be greater than 12 years because the current JORC resource is 2.15 million ounces. The reason the mine is low cost, and yields a A$1,500 an ounce margin, is that it is open pit. That not only allows mining at lower grades than underground projects, but gives substantial exploration upside in surrounding areas.

Construction of Karlawinda is now underway. The capital expenditure is between $145m and $155m and this is fully funded through cash and a project finance facility. There was $45m cash as at 30 June 2020. In order to acquire project financing, Capricorn sold forward some 200,000 ounces at A$2,250 per ounce. This is a conservative amount when you consider the 12-year mine life we referred to above.

Superior management and a record of delivering value

In 2018, the major gold miner Regis Resources (ASX:RRL) attempted to take over Capricorn Metals, but was unsuccessful. A number of senior Capricorn management, including the Chairman, Matt Clark, were formerly employed by Regis and have a strong record of shareholder value creation through other companies, such as Samantha Gold (eventually taken over by Resolute) and Equigold (taken over by Lihir Gold). What is even more impressive is that this team has invested their own funds into the company.

An aspect of superior management relates to the construction of the 4 million tonnes per year processing plant. This plant is expected to operate at recovery rates of over 90%. When combined with the use of natural gas as a power supply, it will allow the mine to operate efficiently and maximise margins.

There is no shortage of good mining infrastructure in the area

One of the major benefits to this mine is its location right in the middle of the Pilbara. Around here are sealed highways and an airport at Newman. The company is still planning on building its own airstrip, which will allow workers to fly in and out, but the major benefit is that it ensures that supplies and materials can be easily transported onto the properties, ensuring no material delays in construction and in ongoing operations.

One of the other opportunities related to the Pilbara location is the project geology, which gives rise to further exploration and may allow the Karlawinda mine life to be extended considerably.

Undervalued compared to the peers

One of the amazing aspects of this stock is that it is trading at a considerable discount to some other WA miners. Whilst a discount is somewhat reasonable due to the fact that Karlawinda has not yet started production, there are other measures, such as Enterprise Value to Reserves that are a lot lower in Capricorn's case. If we look at Silver Lake Resources (ASX:SLR), Ramelius Resources (ASX:RMS) and Gold Road Resources (ASX:GOR), they have EV/Reserves of at least 2 – 3 times that of Capricorn Metals.

Another difference in the valuation could be related to the reserve and, more importantly, the grade. This project has a gold reserve of 1.2 million ounces at 0.8 grams per tonne. Traditionally open pit gold projects that have gold at below 1 gram per tonne struggle to operate efficiently. Low grade gold deposits require more ore to be processed than higher grade deposits. However, with advances in technology as well as metallurgical results that have been achieved so far, this company is confident that grade will not be an issue.

With superior management, production of over 100,000 ounces a year, one of the safest mining jurisdictions in the world, long mine life and full funding for a project commencement, Capricorn Metals is well placed to reward shareholders handsomely. With production less than a year away, this company could really take off, even after the recent run. Four stars from us.

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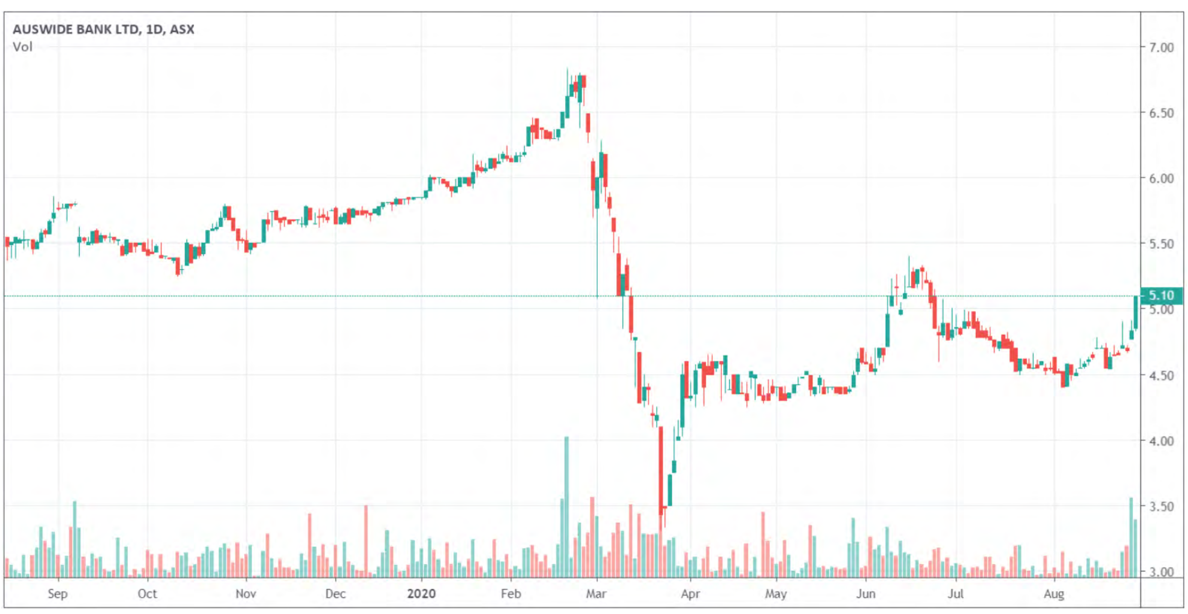

Source: Tradingview

The devil is in the details

We completely understand how boring numbers and metrics can be but especially with banks the devil is often in the details. FY20 was a stellar year for Auswide Bank, even after taking into account the costs associated with COVID-19. We're going to focus on three important aspects of Auswide Bank's results, i.e. loan book growth, improvement in net interest margin and consumer deposit growth.

Auswide Bank's loan book grew 4.3% year-over-year during FY20 due in large part to the company's success in growing its book outside of Queensland without sacrificing growth in Queensland. Auswide Bank's highest growth area for its loan book, on a percentage basis, is Australia Other. Australia Other excludes Victoria, NSW and Queensland. During FY20, Australia Other saw a 17.1% growth in its loan book while NSW and Victoria each saw 8.2% and 5.5% growth respectively. Combined with Queensland's 2.3% year-over-year loan book growth, this leaves a very appealing picture.

However, Queensland grew from 74.7% of Auswide Bank's loan book distribution in FY19 to 74.9% in FY20, while the bank has done an impressive job growing its loan book outside of Queensland. We would like to see the company continue its diversification and eventually start to decrease Queensland's overall dominance of its loan book, however.

One of the most impressive aspects of Auswide Bank's FY20 results was its improvement of its net interest margin (NIM) from 1.87% in FY19 to 1.97% in FY20. For the second half of FY20, Auswide Bank's net interest margin actually grew to 1.99%.

Net interest margin is an important metric for a bank as it gives the percentage difference between the interest income it generates and the amount of interest it has to payout to its funding sources. Net interest margin growth is one of the main reasons Auswide Bank's net interest revenue grew approximately 11.6% year-over-year during FY20. The guidance released by management for FY21 is a stable net interest margin, which at 1.99% puts it closer to fully competing with the big four.

Commonwealth Bank's net interest margin currently sits at 2.1%. The main way a bank can increase its net interest margin is by increasing the percentage of its funding that comes from consumer deposits. Auswide Bank has been working hard on this and between FY17 and FY20 it has grown the percentage of its funding from consumer deposits from 67.7% to 74.5%, a percentage we believe will only continue to rise.

The reason we believe the percentage of Auswide Bank's funding from consumer deposits is going to continue to improve is the consistent growth of its consumer deposits. During FY20 consumer deposits grew 10.4%, which is a strong measure of the success Auswide Bank has had in expanding its footprint across Australia while remaining true to its Queensland roots. While there has been no guidance on consumer deposit growth in FY21, Auswide Bank has been hard at work expanding its brand awareness and has made significant inroads with brokers, leading to a consistent increase in broker inflows. Therefore, we remain optimistic on the bank's FY21 consumer deposit growth.

Auswide Bank may be growing but it fails in two classic metrics

When valuing a bank there are three main financial ratios investors look at, return on equity, return on assets and price to tangible book value. During FY20, Auswide Bank issued a return on assets of 0.5% and a return on equity of 7.7%. Both return on assets and return on equity lagged compared to some of the other banks in the industry, like Commonwealth Bank at 0.7% and 10.5% and Heartland Group, who we wrote about on 20 August 2020, at 1.4% and 10.3%. While the Commonwealth Bank might seem like an unusual peer to Auswide Bank, seeing as it is one of the best performing of the 'Big Four.' Due to the standard set by the Commonwealth Bank, using it as a peer comparison will allow for a better market comparison basis. However, in terms of consumer deposits and loan book growth Auswide Bank outperforms the Commonwealth bank which grew its deposits 9.8% in FY20 its loan book 2% during FY20. Heartland Group has yet to release its FY20 results.

The price is right

Auswide Bank is currently trading at a price to tangible assets, or price/book, of 1.1x. Combine this with its stellar loan delinquency rate, high liquidity and strong growth and we believe Auswide Bank is at the perfect price. Auswide Bank is a long-term growth play and while we are not saying you will earn 20-30% in the next 12-months, we do believe, compared to other banks, Auswide Bank is an excellent example of strong dividend and even stronger organic growth in the business. We would recommend Auswide Bank over many of its peers, like the Commonwealth Bank. Commonwealth Bank might have a stronger return on assets and equity, however, is valued at a price to tangible assets of 1.9x and has significantly less growth in its loan book and consumer deposits. Due to these important differences in Auswide Bank we believe that long-term investors will not be disappointed. Therefore, it's a four-star rating from us.

Pitt Street Research Pty Ltd

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