STOCKS DOWN UNDER

4 SEPTEMBER 2020

Stocks Down Under

"Life is a sexually transmitted disease and the mortality rate is one hundred percent."

- R.D. Laing (1927-1989) – Scottish psychiatrist

AMP LIMITED

In a toxic relationship breaking up is the right thing to do

GDI PROPERTY GROUP

A combination of luck, planning, and timing can make any business

NEXT SCIENCE

Good technology but wait till Next time

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Stocks Down Under rating: ★★★★

ASX: AMP
Market cap: A$ 5.7BN

52-week range: A$1.08 / A$2.09
Share price: A$ 1.66

Headquartered in Sydney, AMP Limited is an Australian wealth management giant. However, it has had a disastrous couple of years after being rightfully crucified during the Hayne Royal Commission and culminating with the ousting of its Chairman after appointing Mr Pahari to CEO of AMP Capital. Therefore, on 2 September 2020 AMP Limited announced a review of its assets with an eye on a sale or break-up of the company. We believe this is the right move for shareholders and presents a high-risk opportunity that will be easy to miss.

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ASX: GDI
Market cap: A$ 567M
Dividend yield: 7.6%

52-week range: A$0.82 / A$1.63
Share price: A$ 1.05

GDI Property Group is an owner and manager of a wholly-owned property portfolio and creator of unlisted funds headquartered in Sydney. In 2017 GDI Property Group initiated a massive shift in its business plan that has saved it from the majority of COVID-19's damage. In 2017 GDI Property Group shifted its entire focus to the Perth property market. GDI Property Group has not discontinued its dividend and has issued guidance for $0.0775 a share distribution for FY21. This highlights the strength of GDI Property Group despite all COVID-19 has thrown at it.

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Share price chart

Source: Tradingview

Back in 2018, AMP Limited was one of the main institutions on the Hayne Royal Commission's grindstone after labelling the company as suffering from "widespread misconduct". While this was around two-years ago, AMP Limited is still not out of the frying pan, as the AFR reported on 2 September 2020 rumours of the Australian corporate regulator preparing criminal charges against the company to be filed before Christmas. Since the Royal Commission, AMP Limited's shareholders have seen an approximate 70% destruction in the value of their holdings. This decline has also been compounded by a general lack of leadership on the part of management as they have struggled to turnaround the company which suffered an earnings loss from continuing operations of $2.4bn for 2019.

As if the misconduct unearthed during the Royal Commission was not enough, two major AMP Limited executives have left their position due to improper conduct in 2020. Investors need to remember that often a company is only as good as its image and the AMP brand has been heavily marred by these constant, and clearly avoidable, scandals. Executives who engage in inappropriate and unethical conduct, as well as those who look the other way, are directly hurting the company and since it is their own actions that are the cause, they can only be labelled as incompetent stewards of shareholder value.

IOOF's takeover of MLC Wealth was a wakeup call

Further highlighting the decline AMP Limited has inflicted upon itself was the takeover by IOOF of MLC Wealth for $1.4bn (including debt acquired) which doubled IOOF's funds under management and eclipsed AMP Limited for the spot of largest Australian financial advice provider. While this was a merger of two large financial advice entities and therefore, AMP Limited cannot be entirely blamed for losing the number one spot, this does highlight the change we have seen in the industry since the Royal Commission and the further consolidation and increased competition we can expect. Due to a combination of poor managerial stewardship and reputational damage, AMP Limited, in its current form, is not well suited to compete in this new landscape.

Show me the asset value!

There have been reports lately that AMP has received a number of unsolicited non-committal offers for all subsidiaries, even the struggling wealth division. This suggests to us that the sum of AMP's parts is worth a lot more than the current share price. The high valuation estimate for AMP Capital is due in no small part to its sizable, market-leading position in the Australian unlisted real estate market.

AMP Bank focuses mostly on the residential mortgage market and has seen a Compounding Average Growth Rate in its residential mortgage portfolio of 6.4% between FY16 and 1H20. Meanwhile, total deposits have also been on the rise, increasing 18% year-over-year, and 90+ day loan arrears numbers remain low at 0.78% on 30 June 2020. AMP Bank provided retained operating earnings of $120m over the last 12-months.

The Australian wealth management division's appeal would be its North platform; however, this division is widely considered to be AMP Limited's worst asset and was one of the main targets of the Royal Commission. As of 30 June 2020, assets under managed were $121bn, a year-over-year decline of approximately 9%. However, the North platform reported a positive cash flow increase of approximately 52% year-over-year to $2bn. Retained operating earnings over the last 12-months were $138m.

Meanwhile, the New Zealand wealth management division has captured approximately 9% of the KiwiSaver market on 30 June 2020 and issued retained operating earnings of $40m over the last 12-months.

Not a done deal yet

While the current review has strong support from major institutional investors, if the board does not actively include shareholders in the decision to break-up or sell any part of AMP Limited, and shareholders disapprove of the deal, we would not be surprised if a protracted legal battle ensues.

As of market close on 3 September 2020, AMP Limited was trading at a market cap of $5.7bn or a price/tangible book value of approximately 1.2x. Assuming a valuation of approximately $5bn for AMP Capital and around $1bn to $1.2bn for the other segments, one is presented with a clear case of the parts being worth more than the whole. This situation is a significant indictment of management's destruction of the AMP Limited brand in the eyes of both investors and the public. Therefore, we see an opportunity for investors who have a high-risk tolerance: Buying AMP Limited now is a bet on the break-up of the company, not on the turnaround being attempted by the current CEO. If a break-up does not materialise, or the board fails to consult investors on any sale, then we believe the company deserves a solid Two Star rating. However, due to the likelihood of a break-up happening, we are issuing a Four Star rating at this time.

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Foresight and a little luck can make a business

The 2017 shift in focus to Perth may seem confusing to many, however, as outlined in the FY20 directors report, Perth is the only major Australian market lacking in an oversupply of office buildings through 2023. This means that GDI Property Group's prime office buildings are going to be in demand for the next two years. This niche strategy has served GDI Property Group well during COVID-19 as the company's Net Tangible Assets rose from $1.26 a share during FY19 to $1.30 during FY20. While rent relief was required during FY20 certainly, the costs were relatively minimal and are expected to be significantly reduced during FY21 due to the lack of damage done to Perth by COVID-19.

Cracking open the nut

GDI Property Group has two main operating segments: Management and ownership of its wholly-owned property portfolio; and the creation, sale, and management of unlisted property portfolios.

GDI Property Group's wholly-owned property portfolio consists of six properties, five in Perth and one in the Surfers Paradise tourism precinct on the Queensland Gold Coast. All six buildings are offices with an occupancy of 81.1% at 30 June 2020, a slight decrease from 84.9% a year before. Meanwhile, the weighted average capitalisation rate only fell 0.10% year-over-year to 6.92%. Even though the east coast of Australia has borne the brunt of the COVID-19 crisis, Perth has not been completely spared, and the economic reality of FY20 and FY21 are largely different than during FY19. Therefore, the lack of significant declines in GDI Property Group's properties during FY20 shows the quality of the offices. However, a positive note is the weighted average lease expiry of GDI Property Group's wholly-owned portfolio. This increased from 2.4 years at 30 June 2019 to 2.6 years as of 30 June 2020.

GDI Property Group's funds management division creates unlisted property funds and then manages the buildings for those funds. Two of the unlisted property funds, GDI No. 46 Property Trust and GDI No. 42 Office Trust, are respectyvely 47% and 44% owned by GDI Property Group. GDI's fund management division has operated for 27-years establishing approximately 40 unlisted management investment schemes, of which 10 are still active. The Funds From Operation from the division increased 33.3% year-over-year. While the majority of the Funds From Operation comes from ongoing management fees, 40% comes from distributions from the two unlisted property funds still partially owned by GDI Property Group.

A balance sheet as solid as a brick building

The main reason GDI Property Group has not reduced its dividend during FY20 and will not in FY21, according to forward guidance, is because its balance sheet has remained so solid without the need for substantial equity dilution. At the end of FY20 cash from operations to current liabilities ratio was 1.8x, total debt/EBITDA was 4.2x, and total liabilities/total assets was 19.2%. Additionally, both of GDI Property Group's portfolio debt facilities are due during July 2022 and while the total of the two facilities is $210m, only $120m has been drawn as of 30 June 2020. GDI Property Group has high liquidity, after factoring in its undrawn total debt facility, and also has plenty of room for additional debt if necessary. This means the likelihood of shareholder dilution in the mid-term is extremely low, a factor investors need to consider more than usual during these unusual times.

Sometimes the best things come in small packages

GDI Property Group is not the largest Real Estate Investment Trust on the ASX, nor is it the most exciting. However, we do not believe GDI Property Group deserves any discount to Net Tangible Assets per share, despite the approximate 21% discount GDI Property Group's shares are currently offering. Given the strength of its property portfolio (both listed and unlisted), the high liquidity and depth of its balance sheet, and the stable dividend, we believe GDI Property Group deserves a Four Star rating.

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Source: Tradingview

If you want scare yourself witless one evening but you've exhausted the Complete Works of Stephen King and you've already watched the 7 PM news bulletin, try plugging the words' Antibiotic Resistance' into the archive of the mainstream media publications to which you subscribe. You'll get headlines like 'Superbugs toll worse than thought, CDC says' (The Wall Street Journal, 13 November 2019) or 'Antibiotics - When the drugs don't work' (The Economist, 21 May 2016). The horror story that follows will read something like this: Bacteria have a habit of dodging antibiotics that are sent against them. That means that the arsenal of drugs we've been using ever since we got penicillin in the 1940s are getting progressively less effective. That in turn has led to the rise of bacteria that are resistant to just about anything the doctors throw at them. If this keeps up, the old infectious diseases that used to be a big problem like whooping cough and tuberculosis will become serious global health problems again.

Next may be one of the heroes in this horror film

You may also read about some of the heroes that are working to save the day in this horror movie because antibiotic resistance has a lot of great scientific minds busy right now. One of the potential heroes, in our view, is Next Science with its Xbio technology. Xbio is the brainchild of Dr Matthew Myntti, a biomaterials scientist from near Jacksonville in northeastern Florida whose previous port of call, before founding Next Science, was the medical device major Medtronic. Around 2011 or 2012 Myntti figured out (and patented – see WO/2013/052958) an elegant way to blow up 'biofilms', which are basically communities of bacteria living together and covered in sticky goo which are composed of what the boffins call 'extracellular polymeric substances', or EPS for short. These EPS and the protective shield they cast over bacteria are one reason that antibiotic resistance has come to be an issue in medicine in these uncertain times in which we live.

Myntti envisaged a 'high osmolarity surfactant', not unlike the chemicals used in cleaning products (surfactants), but with a lot of them crammed into a small space (the high osmolarity bit). The surfactant would bind to metals within the EPS, and thereby tear apart the superstructure of the protective goo, after which the same surfactant would attack the exposed bacteria themselves. Various studies found that Xbio formulations could inhibit biofilm development from a variety of bacterial bad guys. Next Science proceeded to get these approved so that they could be used in the clinic.

A great early start, but then what's Next?

The market really liked this story at IPO in April last year. The stock was offered at $1.00 a share but it raced to a peak of $4.60 in just a couple of months. And no wonder. Over 80,000 patients had been treated with Xbio by then, and there were three FDA-approved products – a couple of wound gels called BlastX (for chronic wounds) and SurgX (for surgical incisions) and a 'lavage' called Bactisure for cleaning of open body parts during surgery. These products had been good for US$2.8m in calendar 2018 revenue, and there was plenty of growth expected given the efficacy of the products as per the published literature.

The trouble with most early runs for new ASX-listed companies is that they tend to come to an end, and quickly too. After Next Science's start, the stock has spent the last twelve months cooling off. There has been some stabilisation since May 2020, but in the comedown, from $4.60 to the $1.40 average of July 2020, some investors lost a lot of money.

A base building stock

We think Next Science stock will base build for a while longer, and not just because long-and-wrong investors are sulking. Sure, there are more Xbio products to come, and the company did US$4.1m in calendar 2019, but 2020 has seen sales efforts impacted by COVID-19, with hospitals, while cognisant of the need for reasonable infection control, more worried about viruses that bacteria during the ongoing crisis.

US$4.1m in sales is a long way from what Next Science needs to be at – the underlying loss at the EBITDA line was US$11.1m, and there was only US$11.9m cash left as at June 2020. So while we like Next Science and think it's got solid technology and products, the current market cap of around A$250m is still too high given the risk. Next Scienc e Two Stars from us right now. But watch this one closely… the other horror story of a declining share price will also come to an end at some point.

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