STOCKS DOWN UNDER

28 SEPTEMBER 2020

# ASX Top 200 Stocks Down Under

*Education is a progressive discovery of our own ignorance.*

**- Will Durant (1885-1981), American writer, historian and philosopher**

ASX

EXCHANGE CENTRE

## ATLAS ARTERIA LIMITED

Put that road trip on pause

## IDP EDUCATION LIMITED

A geopoltical and economic mess

## AUSNET SERVICES LIMITED

You've got to know when to hold'em

## ATLAS ARTERIA LIMITED

Put that road trip on pause

Stocks Down Under rating: ★★

**ASX: ALX**
**Market cap: A$ 6BN**
**Dividend yield: 4.1% (0% Franked)**

**52-week range: A$3.51 / A$8.54**
**Share price: A$ 6.14**

Atlas Arteria owns, operates and develops toll roads around the world. While the company is headquartered in Melbourne, its current portfolio consists of four toll roads in France, Germany and the United States. Unlike its more famous peer Transurban (ASX:TCL), Atlas Arteria does not own any toll roads in Australia and, therefore, has a higher level of COVID-19 exposure. Toll road developers and operators' value is highly dependent on their dividend payouts, which come from operating cash flow. Due to the nature of COVID-19, we are not comfortable with the risk to Atlas' dividend at the moment.

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## IDP EDUCATION LIMITED

A geopoltical and economic mess

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**ASX: IEL**
**Market cap: A$ 5.3BN**
**Dividend yield: 1.24% (17.03% Franked)**

**52-week range: A$9.90 / A$25.17**
**Share price: A$ 19.41**

IDP Education is an education placement service for international students looking to study in Australia, the United Kingdom, Canada, the United States, New Zealand and Ireland, headquartered in Melbourne. The company also provides add-on services, such as visa assistance, to its clients. When looking at the different industries listed on the ASX, an investor would be hard pressed to find one as fundamentally damaged by COVID-19 as international student placement. While the company has fundamentally changed the way it operates, we are not convinced it will be enough.

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## AUSNET SERVICES LIMITED

You've got to know when to hold'em

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**Market cap: A$ 7.2BN**
**Dividend yield: 5.3% (40% Franked)**

**52-week range: A$1.465 / A$2.015**
**Share price: A$ 1.935**

AusNet Services is a growing electricity and gas utility based in Victoria and headquartered in Melbourne's Southbank. In addition to its electricity and gas business, AusNet Services also operates a subsidiary called Mondo, which provides businesses with infrastructure asset and technology services. As a utility, investors care about the dividend it can provide and while the guidance surrounding 2021's dividend shows considerable growth, it is still less than 2019's. AusNet Services is a solid company. However, we believe the market has already priced in future growth expectations.

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### Share price chart

*Source: Tradingview*

### Take a global toll trip with us

Atlas Arteria's assets are made up of four businesses, APRR toll road group, ADELAC toll road group, Dulles Greenway and Warnow Tunnel. The vast majority of revenue generated by Atlas Arteria is derived from its 31.14% ownership of the APRR and ADELAC toll road groups (about 88.2%). These groups own and operate 2,318km of motorway in the East and South-East of France.

Dulles Greenway generates around 9.1% of annual revenue and consists, unsurprisingly, in the 100% ownership of the Dulles Greenway, a 22km toll road in the United States state of Virginia. The Warnow Tunnel is the smallest revenue generator for Atlas Arteria at around 2%. This business is made up of the 100% ownership Atlas Arteria has in the Warnow Tunnel situated in the city of Rostock in the German state of Mecklenburg-Vorpommern (try saying that ten times fast).

### Atlas Arteria started its dividend engine far to early

Atlas Arteria bases its dividend off of the cash flows management expects the business to generate over the next-six months. Importantly, Atlas Arteria operates on a calendar year basis and, therefore, its ASX semi-annual filling for the period ending 30 June 2020, was for the 1HY20 rather than 2HY20.

Due to COVID-19, Atlas Arteria discontinued its 2HY19 dividend on 23 March 2020 during the COVID-19 market update. However, the company feels the situation has currently improved enough for the next 12 months to reinstate dividend at $0.11 a share. This represents a sharp decline from the last declared dividend during 1HY19 of $0.15 a share, i.e. a decline of approximately 26.7%, indicating just how different the situation has become from a year ago.

Additionally, it is important to remember that for companies like Atlas Arteria, dilution of shareholders has a more significant impact due to the valuation of the company being based predominantly based on its dividend. Since the dividend, on a per share basis, is determined by the next six-months projected operating cash flow, an increase in the total number of shares means that maintaining dividend per share requires a more significant boost to operating cash flow or a higher pay out. Therefore, the issue of 12 million new shares announced upon the completion of the Security Purchase Plan on 29 June 2020, despite only increasing total outstanding shares by approximately 1.3%, makes it harder for the company to reach the $0.15 per share dividend payout it made following the 1HY19 results release. A dilution of 1.3% isn't much, but it just adds to the challenges Atlas is currently facing.

## Cash flow is not injecting enough fuel into the dividend engine

Due to the nature of toll collection, Atlas Arteria's operating cash flow is dependent on the amount of road traffic that passes through its toll gates during the reporting period. Due to government restrictions, the decrease in demand for commercial goods and individuals not moving around as much as usual, the volume of traffic worldwide has seen a significant drop during the first half of 2020. Traffic across the APRR and ADELAC toll roads in France declined more than 30% year-over-year, while the United States based Dulles Greenway saw a reduction in traffic of around 41.8%. The Warnow Tunnel in Germany saw a traffic decline of only 4.8% year-over-year. This led operating cash flow for the 6-months ending 30 June 2020 to decline around 40.7% year-over-year. Since the company has historically paid out dividends greater than operating cash flow in the first half of any financial year, due to seasonal traffic, which is higher in the Northern summer, this has further compounded the impact to the company's dividend.

## A quick check under the hood before we go

Atlas Arteria's ability to pay its current debt obligations remains in check with a 0.8x ratio for cash from operations to current liabilities and a 44.2% debt to equity ratio on a last 12-month basis ending 30 June 2020. While Atlas Arteria's balance sheet remains well within a reasonable range, we are concerned about its strength when factoring-in the cost of dividends. While we are not concerned from an insolvency perspective, we do believe the company will need to continue to issue new equity to fund its dividend as the balance sheet cannot fund the cost of dividend payouts by itself. To summarise, the balance sheet remains strong, but not strong enough to fund the continuing cost of dividends through debt issuance alone.

## Don't gas up the car just yet, there's too much unknown down these roads

Atlas Arteria has a bumpy road ahead of it with many unknowns because of COVID-19. Total traffic is highly unlikely to see any growth on a year-over-year basis during 2HY20, and we remain concerned about the future of the company's dividend payouts. Atlas Arteria has historically not generated enough cash from operations to pay its dividend costs and the COVID-19 situation in Europe and the United States is not going away. Therefore, we believe the company was premature in the reinstatement of its dividend and we remain pessimistic about the company's ability to reach pre-COVID-19 dividend levels without causing significant harm to the financial stability of the company. Therefore, we have to give a rating of two stars.

# IDP EDUCATION LIMITED

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### Share price chart

*Source: Tradingview*

### Let's go study in a distant land

During FY20, IDP Education helped enrol students in 50,950 courses in New Zealand (3%), the United States (5%), The United Kingdom (22%), Canada (22%) and Australia (47%). Surprisingly, this represented a 3% increase versus the number of courses students enrolled in during FY19.

The majority of the students who enrolled in international courses during FY20, unsurprisingly, originated from India and China at 43% and 21% respectively. Outside of India and China no other country produces over 6% of the students enrolled during either FY19 or FY20. This leaves IDP Education exposed heavily to the situation, both political and economic, in India and China. During FY20, IDP Education's Asia operating segment, which includes both India and China, produced 76% of total company EBIT. While it noted that there is growth in Asian countries outside of India and China, this does not change the fact that IDP's Asia segment is basically exclusively India and China at the moment.

### India and China, not two countries to be dependent on right now

During FY20, the majority of student enrolment growth was sourced from India with an 18% year-over-year increase in course enrolments. However, COVID-19 has changed the situation drastically for India with the economy now predicted to contract at least 9% between FY20 and FY21, according to the Asian Development bank. While strong growth is expected to return during FY22, the situation is currently highly fragile and fluid, and it is within the realm of possibility that India could be in for a protracted, and deep, recession if the federal government fails to get its act together. We believe that a harsh economic recession for India will stifle the amount of its citizens who are able to study abroad and therefore, we remain pessimistic about IDP Education's performance in India for FY21 and FY22. If the economic situation in India does stabilise prior to the end of FY21, then we would revisit our analysis.

The majority of IDP Education's course enrolment destinations are within Australia and Australian universities provide the largest source of placement income for the company. Therefore, it is concerning that such a large portion of its course enrolments are from China. Due to the significant souring of relations between Australia and China during FY20, which is continuing in FY21, China has clamped down hard on Chinese students enrolling in Australian universities. It also started domestic propaganda campaigns against Australian universities. This situation is unlikely to be resolved in the near-term and will have an unknown negative affect on IDP Education's results going forward.

### Magic 8-Ball says: Outlook not so good

IDP Education is currently valued at a consensus FY21 EV/EBITDA of around 41x. This valuation comes on top of the predicted 18% decline in EBITDA for FY21 on a year-over-year basis. It seems the market is already looking past FY21 and into FY22 where the company is expected to see a massive rebound in EBITDA with growth of 30% compared to FY20. However, due in large part to the economic uncertainty surrounding India and the geopolitical uncertainty surrounding Australian and Chinese relations going forward, we believe these growth predictions are likely to be too optimistic.

Additionally, we believe the market is currently operating under the assumption that IDP Education will beat its consensus EBITDA estimates for FY21 and FY22 as it did for FY20. However, FY20's EBITDA beat was due to the significant cost cutting measures taken by the company, the majority of which are not sustainable, like bonus reductions.

IDP Education provides a valuable service for both education institutions and students worldwide. However, the global situation today is vastly different than it was a year ago and we must adapt our analysis accordingly. We believe the market is expecting too much from IDP Education and will likely be disappointed, in our view. Therefore, the only reasonable rating at this time would be two out of five stars.

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### Electricity and gas: growing, but thankfully not sparking

AusNet operates on a calendar year basis. Electricity and gas operations consist of three divisions, electricity transmission, electricity distribution and gas distribution. Electricity transmission, distribution and gas distribution operations are based solely in Victoria.

Electricity transmission consists of the company's wholly-owned network of coal, gas and renewable electricity generation, pumped hydro and battery storage, terminal stations and high-voltage transmission powerlines. AusNet Services has been transitioning towards renewable energy sources, connecting around 1,360 MegaWatts of renewable power generation during 2020.

The company is currently undergoing a significant transmission network upgrade and, therefore, capital expenditures for this division increased around 8.1% year-over-year. This is a trend that will continue in the near-term, however, it should pay off in the long-term with increased efficiency and the ability to meet peak demand more reliably. While Replacement Expenditures were supposed to be lower during 2020, due to the

bushfires and other weather incidents, the expected saving earlier announced by the company was taken-up by these new repair expenses. EBITDA increased 7.9% year-over-year due to increased cost efficiency as well as increased revenue from customer-initiated projects.

The EBITDA margin is an unreliable metric for electricity transmission as revenues can swing due to pass-through-charges. These charges match exactly with expenses that the customer is contractually obligated to cover, but are counted as revenue.

Electricity and gas distribution make up the largest portion of AusNet Services' revenue and EBITDA. EBITDA for electricity distribution grew 6.7%, while gas distribution EBITDA grew 4.3%. However, the volume of gas delivered grew significantly more than the electricity delivered, 7.9% and -1% respectively, due in part to the 3% increase in connections made in the gas distribution network. We believe the increase in the price per GigaWatt hour of electricity played a part in decreasing the electricity volume while still increasing revenue by 8.2%.

### Mondo: text-book vertical integration

AusNet Services' Mondo subsidiary owns a portfolio of assets, which it typically will lease for a fixed fee over the contracted period for the infrastructure and operational services. AusNet Services has set a goal to expand Mondo's Contracted Asset base to $1.5bn by 2024 and has recently reaffirmed that Mondo is on track to meet this goal.

Mondo is an interesting division although looking at its EBITDA would not provide an accurate picture due to the exclusion of leasing income. Therefore, we believe that EBITDAaL or Earnings Before Interest Taxes Depreciation Amortisation after Lease Income is the most appropriate metric. Mondo's EBITDAaL margin increased from 40.5% during 2019 to 42.5% for 2020. This was achieved by continuing to shift away from low-margin projects and increasing leasing interest income around 111.1% year-over-year. However, leasing interest income is still a small portion of Mondo's total revenue at 15.8% for 2020.

Mondo is a growing operating segment for AusNet Services and we believe it has high potential going forward. However, in terms of total revenue, Mondo is still a very small contributor providing only around 7.9% of the company's total revenue during 2020.

### A rebound to pre-COVID-19 levels makes AusNet Services perfectly priced

AusNet Services is currently trading right below its pre-Corona Crash high of $2.00. At $2.00 a share and using the high end of the FY21 dividend guidance of $0.095 a share, it places the annual dividend yield at around 4.8%. However, it is important to keep in mind that this dividend is only 40% franked. While 4.8% is a solid yield, especially with interest rates where they are today, the FY21 EV/EBITDA is currently 14.3x.

Based on the assets and EBITDA growth that AusNet Services can bring to bear we find this to be on the high side, even taking the dividend yield into account. EBITDA is expected to be flat to slightly down in FY21 and FY22, so we believe AusNet's dividend is holding up the share price right now. Therefore, we are currently issuing a three out of five star rating with a note to keep an eye on Mondo's growth.

We do not believe Mondo will have a significant impact during FY21, or even FY22, but starting in FY23 this subsidiary could begin to have a sizable impact on AusNet's earnings.

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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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