STOCKS DOWN UNDER

5 OCTOBER 2020

ASX Top 200 Stocks Down Under

I believe in equality for everyone, except reporters and photographers.

- Mahatma Gandhi (1869-1948), Indian lawyer, anti-colonial nationalist and political ethicist

REGIS RESOURCES

Producing gold at under US$900 an ounce

ORORA

Not much growth, but dependable cash flows

SPARK INFRASTRUCTURE GROUP

Another one for the yield junkies

REGIS RESOURCES

Producing gold at under US$900 an ounce

Stocks Down Under rating: ★★★★

ASX: RRL
Market cap: A$2.6BN

52-week range: A$2.90 / A$6.18
Share price: A$5.04

The magic seems to have come out of Regis Resources stock in recent days. This mid-tier gold miner saw its stock rally from $2.91 per share on 16 March to $5.98 on 28 July, but the market has since cooled on the Regis story. We think the only real problem is the price of gold, which has recently paused for breath. Operationally, Regis is a low-cost gold miner with clear expansion plans.

READ MORE

ORORA

Not much growth, but dependable cash flows

Stocks Down Under rating: ★★★

ASX: ORA
Market cap: A$2.3BN
Dividend yield: 4.6%

52-week range: A$2.19 / A$4.21
Share price: A$2.40

Now that the Melbourne-based packaging company Orora has completed its mammoth $600m return of capital, the market can get back to pricing the actual business. At the moment you can get Orora at an EV/ EBITDA multiple of about 8.3x forecast FY21 earnings. Earnings probably won't grow much in the medium term, however, Orora is compensating for this by returning as much capital to shareholders as possible.

READ MORE

SPARK INFRASTRUCTURE GROUP

Another one for the yield junkies

Stocks Down Under rating: ★★★

ASX: SKI
Market cap: A$3.6BN
Dividend yield: 6.9% (0% Franked)

52-week range: A$1.69 / A$2.36
Share price: A$2.07

Headquartered on Sydney's famous George Street, the Spark Infrastructure Group owns varying amounts of ownership interests in $18bn of electricity network assets across Australia. While the infrastructure is based in Victoria, South Australia, New South Wales and the Australian Capital Territory, electricity produced via Spark Infrastructure's assets make its way across all of Australia through the National Electricity Market. While the company's dividend remains attractive, we have concerns around the growth potential and current valuation of the stock.

READ MORE

REGIS RESOURCES

Producing gold at under US$900 an ounce

Stocks Down Under rating: ★★★★

ASX: RRL
Market cap: A$2.6BN

52-week range: A$2.09 / A$6.18
Share price: A$5.04

The magic seems to have come out of Regis Resources stock in recent days. This mid-tier gold miner saw its stock rally from $2.91 per share on 16 March to $5.98 on 28 July, but the market has since cooled on the Regis story. We think the only real problem is the price of gold, which has recently paused for breath. Operationally, Regis is a low-cost gold miner with clear expansion plans.

Share price chart

Source: Tradingview

In markets nothing ever goes up in a straight line for too long, so it was only natural that the recent bull run in gold should come to an end…at least temporarily. Let's face it, gold had risen from just under US$1,500 an ounce in March 2020 to over US$2,000 by early August before the current retracement. We think the bull run will resume shortly. There's just so much new fiat money out there, hastily printed by central banks to keep the world economy out of trouble, that US$3,000 an ounce looks like a reasonable medium-term target for the yellow metal. However, in August it looked like things were not getting any worse economically, hence the drop back to the current price below US$1,900. The resulting shakeout should, in our view, be good for cashed-up companies, like Regis Resources.

Gold at under US$900 an ounce

Regis is, in the universe of gold miners, a mid-tier company. Big enough to get an invite to present at the prestigious Denver Gold Forum that happens in Colorado every September. Regis has 3.6 million ounces in reserves out of 7.7 million ounces in resources and has guided to 355,000-380,000 ounces of production in the year to June 2021. What's impressive to us is the cost base. FY21's All-In Sustaining Cost is expected to be in the order of only US$860-910 an ounce, which leaves a pretty fat margin, even at the current gold price.

Ordinarily you've got to go to West Africa to get that sort of cost base. Regis got it from three major gold mines in Western Australia – Moolart Well, Garden Well and Rosemont – that together with a few smaller mines comprise the company's Duketon Gold Project. If you look at a geological map of the southern half of Western Australia, the dominant feature is the Yilgarn Craton, whose various greenstone belts created the Eastern Goldfields. The Duketon Greenstone Belt up in the northeast of the Yilgarn, near the town of Laverton, is one of about seven belts where most of the gold has been found and Regis more or less controls that belt thanks to various transactions over the years. Regis' foresight in building its Duketon portfolio should be good for many years of low-cost gold. In FY20 the EBITDA generated at Duketon was A$394m.

Keeping the farmers happy at Blayney

Like any gold miner worth its salt, Regis is not resting on its company-maker laurels. At Kings Plains in central-western New South Wales, around 8 km north-east of the town of Blayney, the company's McPhillamys Gold Project has now reached the 2-million-ounce reserve mark and a potential open pit mine producing close to 200,000 ounces per annum is on the cards. McPhillamys is one of Australia's largest open-pittable gold projects that has yet to be developed and Regis owns 100% of it. The various development applications to get this mine up and running are now in train and once they've been approved Regis will complete the Definitive Feasibility Study. Mind you, those applications might take a while. McPhillamys is in the middle of farmland and the locals understandably have concerns about groundwater. Regis is treading carefully on this front and has designed its mine to use minimal water.

It won't be hard to raise the capital to bring McPhillamys into production once the DFS is published because Regis has no debt and about A$209m in cash as at June 2020. We believe that clean balance sheet may give rise to some M&A activity in the near term and the current temporary weakness in gold may provide the opportunities.

Very reasonably valued given the growth outlook

Regardless of M&A, Regis retains a strong exploration ethic from its years as a junior miner and has increased its exploration budget for FY21 to $35m. We think that kind of money can generate a lot of excitement over the course of the year. There remain plenty of new targets in the Duketon and in the neighbourhood of McPhillamys worth looking at.

Currently, for all this Regis is trading at an EV/EBITDA multiple of just 4.5x FY21. Given the expected big EBITDA jump of about 36% in FY21 and the subsequent 5% increase in FY22, thanks to McPhillamys and brownfield expansions at Duketon, that 4.5x multiple looks very reasonable to us.

Regis stock may be a little weak in the near term along with gold. However, looking forward one suspects that McPhillamys is not really discounted into the share price right now. And any M&A activity could help Regis make an even bigger step change. Consequently, this stock is four stars for us.

ORORA

Not much growth, but dependable cash flows

Stocks Down Under rating: ★★★

ASX: ORA
Market cap: A$2.3BN
Dividend yield: 4.6%

52-week range: A$2.19 / A$4.12
Share price: A$2.40

Now that the Melbourne-based packaging company Orora has completed its mammoth $600m return of capital, the market can get back to pricing the actual business. At the moment you can get Orora at an EV/EBITDA multiple of about 8.3x forecast FY21 earnings. Earnings probably won't grow much in the medium term, however, Orora is compensating for this by returning as much capital to shareholders as possible.

Share price chart

Source: Tradingview

In late 2013 the venerable Australian packaging company Amcor demerged its Australasia and Packaging Distribution business into a separate company called Orora. The spin-off allowed Amcor to focus on flexible and rigid plastic packaging and tobacco packaging, mostly for overseas markets, where the big money was expected to be made. Orora inherited Amcor's legacy fibre, glass and beverage can packaging operations in Australia and New Zealand, as well as a North American distribution business.

The growth stopped two years ago

Investors who backed the spin-out made out reasonably well over the next few years as the company enjoyed organic growth and gradually brought its cost base down. Orora stock rose from about 75 cents in December 2013 to over $2.50 by mid-2018. However, since 2018 Orora hasn't done shareholders many favours. The key issue has been North America, where the various packaging markets have been in oversupply lately. That meant that in FY19 EBIT only rose 3% on a 12% revenue increase. When that result came out Orora stock sold off accordingly and only recovered in time for the Corona Crash to bash it down again.

In FY20 Orora grew revenue by 5% but EBIT was down 14%, to $224m. The company had managed to stabilise its North American business as 2020 rolled around, but it was being hit by higher gas prices and also costs

related to a major rebuild of a glass factory at Gawler in Adelaide's outer northern suburbs. More importantly, Covid-19 had arrived by March, with all the economic uncertainty that entailed. Luckily Orora had paid down debt during FY20 to just $292m, as against $890m a year previously, so it was well placed to weather the storm. The market, however, was mildly displeased with the result and marked Orora stock down from $2.38 on the day to $2.23 by 9 September.

Dependable earnings

The thing to like about Orora is that the earnings are dependable. People aren't about to stop drinking out of bottles or cans any time soon and Orora is the established supplier of beverage packaging in Australia and New Zealand. Now that the company is out of the fibre game, having sold that business to Nippon Paper, it isn't at the mercy of fluctuating pulp and paper prices or demands from the Greens to be more 'sustainable'. As for the North American businesses, we expect Orora Packaging Solutions will come out of this crisis in reasonably good shape given the ongoing need by corporates to manage packaging costs, while Orora Visual will remain a leader in in-store visual displays.

Dependable earnings, however, doesn't mean strong earnings. The best way to think about Orora in 2020 and going forward is this: Demand for packaging in a post-Covid world hasn't changed all that much, but the business is still semi-commoditised, meaning the earnings outlook is for growth, but in single digits only. The flipside is that it doesn't take much in the way of capital expenditure, even after the Gawler capital works, to keep this company growing.

As a result Orora has plenty of free cash that it can return to shareholders – in FY19 it was over $100m. That's why, at the time of the full year result for FY20, the company announced that it was buying back another $230m worth of stock, on top of the $600m capital return in June.

Currently, Orora is trading on an EV/EBITDA for FY21 of 8.3x.That's high when you consider that consensus EBITDA growth for the next couple of years is only expected to amount to 4.5% to 5%. On the other hand we can probably look forward to a regular stream of share buybacks unless business really gets tough. That's why we rate this stock 3 stars. One of these days, when management does something silly and the EBITDA multiple drops to 3x or 4x, it can probably be a four star opportunity, but not now.

SPARK INFRASTRUCTURE GROUP

Another one for the yield junkies

Stocks Down Under rating: ★★★

ASX: SKI
Market cap: A$3.6BN
Dividend yield: 6.9% (0% Franked)

52-week range: A$1.69 / A$2.36
Share price: A$2.07

Headquartered on Sydney's famous George Street, the Spark Infrastructure Group owns varying amounts of ownership interests in $18bn of electricity network assets across Australia. While the infrastructure is based in Victoria, South Australia, New South Wales and the Australian Capital Territory, electricity produced via Spark Infrastructure's assets make its way across all of Australia through the National Electricity Market. While the company's dividend remains attractive, we have concerns around the growth potential and current valuation of the stock.

Share price chart

Source: Tradingview

Return on equity is not Spark's strong suit

Spark Infrastructure operates on a calendar year basis. The company is broken up into three different, partly owned, divisions; Victoria Power Networks, SA Power Networks and Transgrid. Victoria Power Networks consists of two different electricity distribution companies, CitiPower and Powercor. CitiPower operates the electricity network in Melbourne's CBD and inner suburbs with 7,500km of power lines.

Powercor, on the other hand, is the largest electricity distribution network in Victoria, operating more than half a million poles and 89,000km of power lines. Despite total consumption declining approximately 4.8% year-over-year, total revenue and EBITDA still increased 2% and 5.6% respectively in 1HY20. This can be attributed to higher electricity costs and customer growth of 1.2%. The Victoria Power Networks are a mature asset and investors should not expect much higher year-over-year growth than it achieved this past six-months.

SA Power Networks covers 178,000 sq km of South Australia with 89,000 km of power lines. Total revenue and EBITDA for this division increased 2.3% and 7% during 1HY20 respectively. This was also due to higher

electricity costs and 1.2% customer growth since overall consumption declined 4.4%. However, the dividends Spark Infrastructure received for its partial ownership of the SA Power Networks division declined 15.2% year-over-year due to a $4.1m loss on a credit valuation hedge. During 1HY19, this division also suffered a loss on a credit valuation hedge, although it was significantly less at $2.1m.

The TransGrid division operates 13,000km of high voltage electricity transmission lines across New South Wales and the Australian Capital Territory. TransGrid is an interesting division as its lines are vital to the transition to a renewable energy powered future for Australia. The reason for this is rather simple. Most major solar, wind and hydro developments are not right next to the major population centers and, therefore, these high voltage lines are vital to quickly transferring the electricity without losing a significant portion in the process.

TransGrid has two major revenue segments, regulated revenue and unregulated revenue. Regulated revenue is the use of the lines, while unregulated revenue is the connection, construction and modification customers and end-users require. Due to the completion of a significant number of line modification, one-off projects last year, line modification revenue declined $34.4m in 1HY20. This was responsible for the majority of the 3.1% decline in revenue and the 7.2% decline in EBITDA for this division. Spark's ownership distributions were significantly diminished due to the need for a 64.6% increase in capital expenditure for this division. Therefore, Spark Infrastructure's distributions from TransGrid actually declined 46%, year-over-year.

Despite assets totalling around $3.1bn as of 30 June 2020, the company's Net Profit After Tax continued to decline during 1HY20, to $49.7m from $52.8m in 1HY19.

The new addition to the family, Bomen Solar Farm

The Bomen Solar Farm is 100% owned and operated by Spark Infrastructure and was completed and brought online in June 2020. Total capacity is approximately 120.5 MegaWatts of Direct Current and is expected to produce around $13.5m in revenue per annum for the first five years. Therefore, assuming the total revenue stays consistently at $13.5m per annum in perpetuity, it will take around 13-years to generate revenue equal to the total cost. However, we must remind our readers that the $13.5m revenue estimate is only good for the first five years, afterwards we are not provided any guidance.

Spark has made it clear that this was just the first in renewable infrastructure and it plans to invest in additional solar, wind and electricity storage infrastructure over the coming years. Other investment areas it is considering are Renewable Energy Zones, Green Hydrogen and Virtual Power Plants.

A solid dividend, but not much else

During 1HY20, Spark's total equity and Loan Notes book value declined by around $44.7m to $2.7bn, or $1.55 per stapled share. Therefore, the current premium of around 35.5% is due almost entirely to the 7.1% annual dividend yield. However, we would remind Australian tax resident investors that this dividend is currently 0% franked.

With interest rates likely to stay where they are for the foreseeable future and given the current dividend yield, we believe Spark is fairly value in the current market conditions. However, for now, we believe Spark Infrastructure should only be considered as a pure dividend play. If its investments in renewable assets continue to grow, we may have to reconsider our position. Taking all this into account, we believe a three-star rating is appropriate at this time. One for the yield junkies.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

You are receiving this email because you subscribed to our Stocks Down Under newsletter.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document