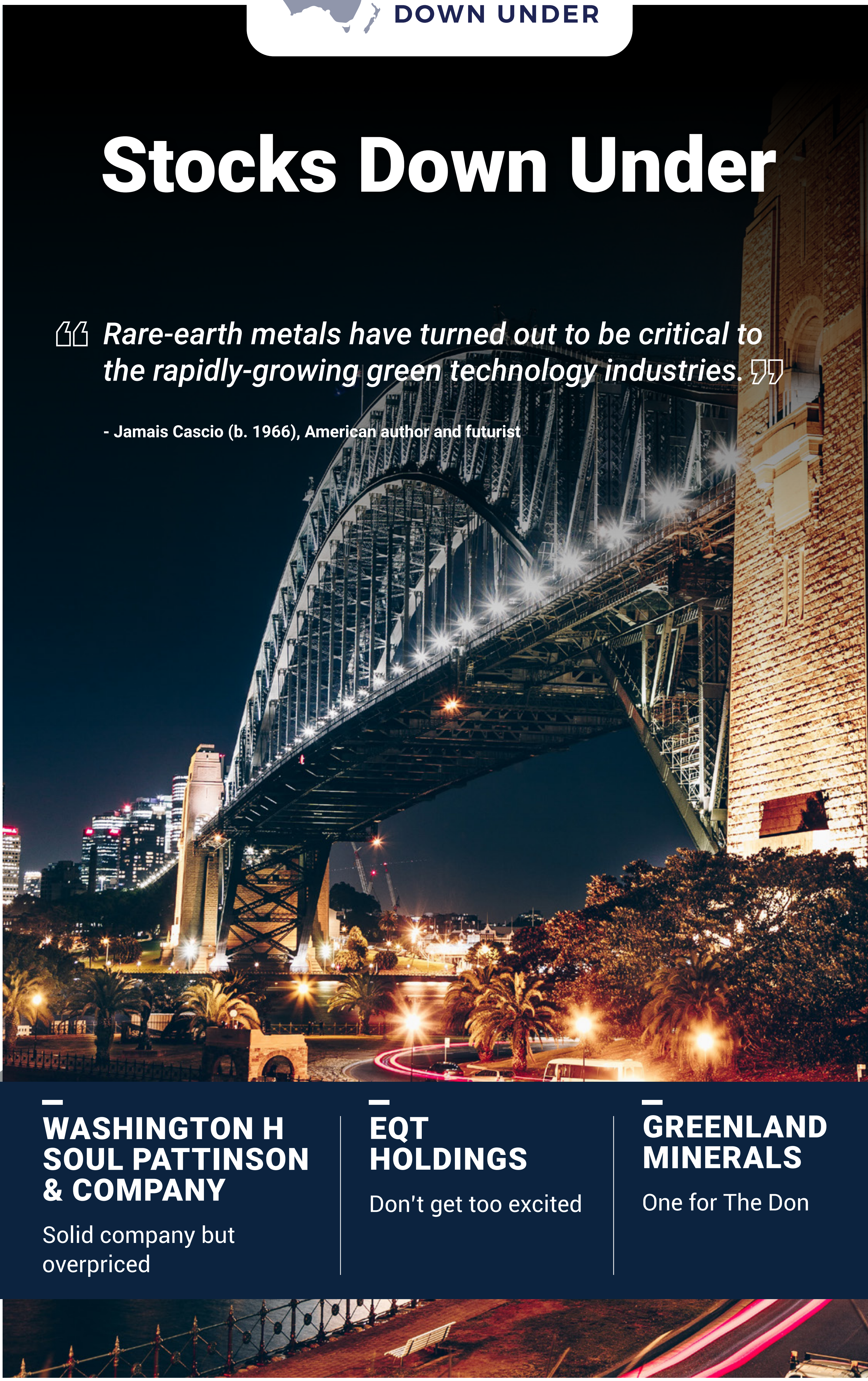
STOCKS DOWN UNDER

14 SEPTEMBER 2020

Stocks Down Under



“Rare-earth metals have turned out to be critical to the rapidly-growing green technology industries.”

- Jamais Cascio (b. 1966), American author and futurist

WASHINGTON H SOUL PATTINSON & COMPANY

Solid company but overpriced

EQT HOLDINGS

Don't get too excited

GREENLAND MINERALS

One for The Don

WASHINGTON H SOUL PATTINSON & COMPANY

Solid company but overpriced

Stocks Down Under rating: ★★

ASX: SOL
Market cap: A$ 5.1BN
Dividend yield: 2.7%

52-week range: : A$16.66 / A$23.34
Share price: A$ 21.02

Washington H Soul Pattinson & Company (WHSP) is a broad industry investment house listed on the ASX on 21 January 1903 (called Sydney Stock Exchange back then). In an impressive statement on WHSP's effectiveness the company has consistently paid a dividend to shareholders since 1903. The company has no specific mandate for which industry it can invest in, allowing a portfolio with listed companies, private equity, property and loans. The company is currently priced at a premium to price to tangible book value (P/B). However, we believe that is putting the cart before the horse.

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EQT HOLDINGS

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ASX: EQT
Market cap: A$ 563M
Dividend yield: 3.3%

52-week range: A$16.18 / A$34.68
Share price: A$ 26.55

Founded in the late 1800s, EQT Holdings is an in-house asset manager with two main operating segments, Corporate Trustee and Securitisation and Trustee and Wealth Services. Despite having offices in Sydney, Brisbane and Perth, EQT Holding's head office is in Melbourne. Unlike many in the industry, EQT has a solid reputation and has been working hard on improving it with great success. However, the market can get excited at times and overreact to the solid performance of a company. We believe EQT Holdings is an example of just that.

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GREENLAND MINERALS

One for The Don

Stocks Down Under rating: ★★★★

ASX: GGG
Market cap: A$ 310

52-week range: A$0.07 / A$0.31
Share price: A$ 0.27

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Share price chart

Source: Tradingview

Show me the investments!

Unfortunately, we are unable to know for certain all of Washington H Soul Pattinson's investments at this time as the company does not announce its full year FY20 results until 24 September 2020. However, we do know 12 of the company's more significant investments. While we are not going to list them all here, we will highlight some of the more interesting ones. Washington H Soul Pattinson owns 25.3% of the outstanding shares of ASX listed company TPG Telecom Limited (ASX:TPG). We actually wrote about TPG Telecom in our 11 August 2020 edition and rated TPG Telecom two out of five stars. We stand by that rating and therefore, do not look positively on Washington H Soul Pattinson's significant position in this company.

Brickworks Building Products (ASX:BKW) is another one of Washington H Soul Pattinson's significant holdings. The company owns approximately 43.9% of Brickworks Building Products at a value of approximately $1.2bn as of Friday, 11 September 2020 market close. On a year-to-date basis Brickworks has resulted in a decline in shareholder value, excluding dividends, of approximately 3.9%. However, the bullish case for Brickworks is the potential for an infrastructure led COVID-19 recovery as the company specialises in property, investments and the manufacture and distribution of residential and commercial building products.

The last company we want to highlight is New Hope Corporation (ASX:NHC). Washington H Soul Pattinson currently owns approximately 50% of the outstanding shares at a value of approximately $470m as of the Friday, 11 September 2020 market close. The company has businesses across coal, oil, agriculture and port operations, but has had a highly rough 2020 so far. On a year-to-date basis, New Hope Corporation has seen a decline in shareholder value of approximately 45.6%.

It is important to note that Washington H Soul Pattinson also owns a variety of private corporations, like its 100% ownership of Pitt Capital and Round Oak Minerals. Therefore, we are not able to analysis its holdings as well as we would normally like to.

What is under the hood?

As of 31 January 2020, Washington H Soul Pattinson has very little debt as a company. Additionally, most of the companies that it owns offer sizable dividends and combined with the income it receives from its other investments, Washington H Soul Pattinson's debt shouldn't be of any concern to investors. While we do have to mention that many companies on the ASX have decided to temporarily suspend dividends due to the disruptions to operations caused by COVID-19, we believe Washington H Soul Pattinson's debt is low enough that this won't be an issue. More importantly, we also expect that Washington H Soul Pattinson will be able to continue its over 100-year streak of continually paying dividends during 2HY20.

A great company at the wrong price is worse than a poor company at an amazing price

Washington H Soul Pattinson is a solid company with an extremely strong track-record. However, when utilising the tangible book value as of 31 January 2020, we get a P/B ratio of approximately 1.5x. We believe this is far too high a price for a bet on Washington H Soul Pattinson's FY20 full year results. As we mentioned above, many of the companies Washington H Soul Pattinson is invested in that are listed on the ASX have not yet fully recovered from the Corona Crash we saw earlier in the year and some have continued to trend downwards. Additionally, it shouldn't be forgotten that red Washington H Soul Pattinson's $5.1bn market cap consists of approximately $3.5bn worth of TPG Telecom, a company we believe will not provide significant shareholder returns in the coming years.

Therefore, we can only give Washington H Soul Pattinson a two out of five star rating, especially so close to its earnings release date of 24 September 2020.

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Share price chart

Source: Tradingview

Breaking open the Corporate Trustee and Securitisation

The Corporate Trustee Service provides a global range of services on behalf of local and international fund managers, sponsors and specialised trustee services for corporate and structured multi-party transactions. Important to note is that these services come with a fiduciary obligation on the part of EQT Holdings, an obligation the company is known for upholding.

By the end of FY20, funds under supervision had grown by approximately 19.1%. This was mostly due to the successful attraction of four specific clients, Australian Corporate Bond Company, Ethical Partners, Morgan Stanley and Quest. This led to an increase in revenue derived from the Corporate Trustee Service of approximately 6.8% year-over-year after adjusting for funds that have closed or left EQT Holdings. Funds under supervision have solid momentum behind it, and we believe, especially in the aftermath of the royal commission, that EQT Holdings will continue to see strong growth in this division in the years to come.

Exposing the Trustee and Wealth Services operation

The Trustee and Wealth Services Operation provides private clients, charitable and superannuation funds a range of trustee services which include estate planning and management as well as charitable, compensation, community and personal trust services. This division also provides wealth management and advice.

By 30 June 2020, the Trustee and Wealth Services division had seen Funds Under Management, Admin, Advice and Supervision increase by 14.9% year-over-year. This led to organic growth in revenue of approximately 2.9% year-over-year. It is important to note that with the exception of superannuation, Trustee and Wealth Services' Funds Under Management, Admin, Advice and Supervision remained approximately at the same levels as in FY19. Therefore, the entire rise in Funds Under Management, Admin, Advice and Supervision can be attributed to the growth in superannuation after the acquisition as a client of AIA and CMLA. However, after 30 June 2020, the company's Trustee and Wealth Services operation received the business of two more large clients, AMP Life and HUB24.

We were concerned about the AMP Life appointment, which brought in approximately $7.5bn assets under service, as AMP Life was recently sold to Resolution Life by AMP Limited (ASX:AMP). However, we received a reply to our inquiry from Mick O'Brien, the Managing Director of EQT Holdings, who clarified that this client acquisition, while formally completed by AMP Limited, was in practice initiated by Resolution Life. Therefore, we are confident that the AMP Life business is here to stay.

Client acquisitions provide a strong revenue base for FY21

During FY20 and at the beginning of FY21, EQT Holdings was given the business of several important clients, AIA and CMLA, R&M, Partners Group, AMP Life and HUB24. These new clients alone are estimated to provide $5-6m in revenue during FY21, indicating revenue growth of at least 5% year-over-year. Due to the changing landscape of trustee services across Australia in the aftermath of the Royal Commission and subsequent scandals, we believe EQT Holdings has positioned itself wisely to take advantage of the demand for independent trustees with positive track records.

Working hard to keep the customer happy is always good business

One of the more interesting metrics provided by EQT Holdings during its annual presentations is the Net Promoter Score and Net Loyalty Scores it polls from clients on an annual basis.

The Net Promoter Score measures how willing clients are to recommend EQT Holdings to the client's peers. A score above 10 indicates that most clients are willing to promote EQT Holdings to others. EQT Holdings has achieved a score of 24 during FY20, presenting another year of solid gains in this metric.

The Net Loyalty Score measures a client's willingness to purchase another EQT Holdings product or service. In this case, a score above 0 shows a willingness among clients. EQT Holdings received a score of 29 for FY20, also showing a strong upward trend in its clients' loyalty.

Stocks Down Under, the verdict, please

EQT Holdings is an excellent company with a bright future ahead. However, we believe the market has gotten ahead of itself here. The current consensus estimates show an expected EBITDA and revenue decline during FY21 and a more or less flat FY22. We do not believe an EV/EBITDA ratio of 15.4x is an accurate representation of that future performance, i.e. that's a high multiple to pay for a flat or declining EBITDA, although there is a good chance the current consensus is too negative given EQT's new client wins.

However, we also recognise the shifting landscape in the trustee marketplace right now and, therefore, expect EQT Holdings to achieve more client acquisitions during FY21. So, despite the high current valuation, we believe a three-star rating for EQT Holdings is appropriate. Should the stock pull back in the next little while, four stars may be in order, but at the current valuation we are unable to issue that.

GREENLAND MINERALS

Rapid diagnostic pioneer

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Share price chart

Source: Tradingview

As the name suggests, Perth-based Greenland Minerals' strategy revolves around a large-scale rare earths project in Greenland, the large island nominally owned by Denmark. The project, called Kvanefjeld, can be found in the most southerly part of the island, overlooking the nearby village of Narsaq. In this particularly chilly part of the globe, the Ilimaussaq Alkaline Complex hosts the world's second largest deposit of rare-earth minerals and the sixth-largest deposit of uranium. Kvanefjeld was originally of interest as a potential uranium mine in the 1950s, but work ceased when the Danish government decided to forego nuclear power altogether.

A rare-earth plan more than 10 years in the making

Within the Ilimaussaq complex, a crystalline plutonic mineral called Lujavrite contains what Greenland Minerals has found to be one of the highest grades of rare earth elements (REEs) on the planet. REEs are something we're likely to hear a lot more about in the years ahead, given their use in electric cars, computing, and solar and wind power. The demand for key magnet REEs, critical to the technology and power industries (including neodymium, praseodymium, dysprosium and terbium), is likely to be strong coming out of COVID-19. Indeed, we've seen predictions of 150% increases in demand between now and 2030.

Though Kvanefjeld is first-and-foremost a rare earth resource, the site also contains, as we've seen, plenty of uranium and there's also zinc and fluorspar. So long as the Danish and Greenlandic governments are comfortable with the way the uranium is handled, these by-products could potentially generate an extra US$60m in revenue and reduce the cost of producing rare earth metals by 40% (US$1.90 per kilogram). When it is eventually up and running, Kvanefjeld is expected to become a world-leading producer with annual rare earth oxide output in the order of 30,000 tonnes.

Results on the horizon, but concerns remain

Greenland Minerals has been proactive in allaying concerns over plans for an open pit mine, which remains somewhat controversial to the people of Narsaq. And the company has worked hard to satisfy environmental concerns in Greenland. On 27 August the company announced that it was still waiting to have its Environmental Impact Assessment (EIA) approved. However, no problems are anticipated here, since Greenland Minerals has made various improvements to its flotation and refinery circuit plans to support the EIA.

The mid-year appointment of Jorn Skov Nielsen – a local Greenlander who was previously Deputy Minister for trade, mineral resources and energy – highlights how far this company will go to convince local regulators of the potential economic and environmental benefits in the region. From what we're hearing, most Greenlanders would agree with the notion that a healthy mining sector will help the country become more economically independent from Denmark in the long run.

The isolation of a place like Kvanefjeld might trick the uninitiated into believing that Greenland Minerals is working alone, but it's not the only company (or country) turning its eye toward an energy-efficient future. Shenghe Resources is Greenland's biggest investor and a major rare earth metals and oxides supplier. Although China has 23% of the world's REE's and mines just over 95% of total production, it has severely depleted its own sources with about a third left. Greenland Minerals' and Shenghe's plans to establish new supply chains to and from the region will help countries like China and Australia, but could leave others, including the US, in the corner. President Trump has raised the idea of buying Greenland more than once, as did President Harry Truman before him back in 1945. As ridiculous as the Trump suggestion sounds to most 21st century ears, the level of desperation for natural resources, which we believe partly motivated the offer, will only continue.

Everything depends on Greenland – the country

With a predicted mine life of 37 years, the future for Kvanefjeld and Greenland Minerals looks robust as a potential long-term investment. Environmental permit issues and resource demands have allowed Greenland Minerals stock to remain undervalued, despite the July 2019 Feasibility Study update showing a reduction in capital costs from US$832m to US$505m. The original cost estimate was US$1.36bn in 2015, but that still allowed a US$1.4bn NPV. It will be interesting to see how these billions help shape a small Artic country in the coming years. Greenland Minerals is four stars from us.

Pitt Street Research Pty Ltd

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