STOCKS DOWN UNDER

23 NOVEMBER 2020

ASX Top 200 Stocks Down Under

Talent is the lifeblood of a fast-growing company.

- Taavet Hinrikus (Born 1981), CEO and co-founder of TransferWise

ASX

EXCHANGE CENTRE

GROWTHPOINT PROPERTIES AUSTRALIA

Still some growth left

VOCUS GROUP

Too many balls in the air

EVENT HOSPITALITY AND ENTERTAINMENT

An event too far

GROWTHPOINT PROPERTIES AUSTRALIA

Still some growth left

Stocks Down Under rating: ★★★★

ASX: GOZ
Market cap: A$ 2.9BN
Dividend yield: 5.8% (0% Franked)

52-week range: A$2.26 / A$4.50
Share price: A$ 3.72

Headquartered in Melbourne, Growthpoint Properties Australia focuses on industrial and office properties. The properties owned by the trust have long-term leases and the company ended FY20 with an 85% tenant retention rate, up from 66% during FY19. The trust managed to keep its Net Tangible Assets per share decline during FY20 to only 0.3%. The stock has had an extremely strong November, jumping from $3.40 to over $3.70. The question remains, does it have more room to go?

READ MORE

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ASX: VOC
Market cap: A$ 2.7BN

52-week range: A$1.80 / A$4.42
Share price: A$ 4.25

Headquartered in Melbourne, Vocus Group is a fully integrated telecommunication and energy provider across Australia and New Zealand. The company receives the majority of its revenue from a combination of data network usage fees and NBN fibre optic lines. The most significant development for Vocus was announced to the market on 19 November 2020 when management announced it was planning on spinning off the company's New Zealand division through an IPO before the end of FY21. This IPO could be a great way for the company to reduce its debt load and return some value to shareholders, but a lot has to go right and it is far from a certainty.

READ MORE

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Share price chart

Source: Tradingview

Opening the book

Growthpoint's property portfolio is split between office and industrial properties with only 4% of the total portfolio not occupied as of 30 September 2020.

At 69% the majority of Growthpoint's property portfolio value is made up of office buildings. 97% of the trust's office properties are currently classified as A-grade and COVID-19 really showed just how important this is to a company's stability. The main reason for the 0.3% decline in Net Tangible Asset Value per share to $3.65 was the $0.05 decrease in the value of Growthpoint's office properties. We expect this decline in value will reverse over the next financial year as property values across Australia have seen significant recovery in value since the Reserve Bank of Australia decreased interest rates to 0.10%.

Additionally, as the risk of a second, nationwide, wave of COVID-19 sweeping Australia continues to diminish, we believe the lack of major vacancies and the trust's focus on metro offices instead of major city CBD's will increase the desirability of the office properties. Even in the worst-case scenario where a second wave does materialise, we would point out that during the worst months of COVID-19 in Australia, April through June, the trust's office properties collected 96% of the rent owed to them.

Growthpoint's industrial property portfolio really lives up to the trust's name as it continues to see steady increases in value, even during the height of COVID-19. During both the 31 December 2019 and 30 June 2020 property revaluations, the trust's industrial property portfolio added $0.02 to the overall Net Tangible Asset value per share of the REIT. The reason for this slow, but consistent, growth is the essential nature of the majority of these properties to Australia's daily business operations. As of 30 June 2020, 93% of the industrial portfolio by value consists of warehousing and logistics facilities. The majority, 41% are involved in grocery distribution and 27% are involved in general logistics. As the Australian economy continues to get back on track, we expect logistics and warehousing needs will continue to rise. While we are not willing to speculate that this will cause an unusually large increase in property value, we are confident that this segment of the portfolio will continue to at least steadily increase in value.

A WALE of a time

Growthpoint is certainly having a WALE of a time as 65% of its portfolio, measured by income, has leases expiring during or after FY24. Even more impressive is the 34% that expire after FY27. The breakdown of the trust's Weighted Average Lease Expiry (WALE) is important to understand because between FY19 and FY20 Growthpoint's total portfolio WALE increased from 5 years to 6.2 years. Occasionally we will look at a REIT and see an impressively large WALE, only to see that, upon closer inspection, the trust was able to inflate the number through a few of its properties having extremely long lease expiration dates. We are satisfied that a WALE of 6.2 years is a relatively accurate depiction of Growthpoint's property portfolio stability.

Are we there yet?

Growthpoint has a solid property portfolio that we believe will perform well as the country recovers and the Reserve Bank of Australia keeps interest rates at historic lows. The current Net Tangible Asset value per share for the trust is $3.65 versus Friday's close of $3.72 per share. While this represents a premium to the trust's value of 2.2%, we believe Growthpoint's long WALE, dividend yield and it's performance during COVID-19 indicate the company deserves around a 5% premium.

One of the major contingencies to this rating is interest rates staying at historic lows for the near to medium-term. We believe this is the most likely scenario. However, there has been recent market speculation that the faster than expected recovery of the Australian economy might cause the Reserve Bank to move rates slightly off 0.10% sooner than the minimum three year time frame the general market currently believes. If this happens, we would place a fair value on Growthpoint around its Net Tangible Asset Value per share, i.e. $3.65. However, as we currently see it, we believe this stock still has room to run and therefore, it's a four star rating from us.

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Share price chart

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The three musketeers and their pet

Vocus has three main sources of revenue: data networks, NBN and other. While these are the three main, recurring sources, the company also has a major infrastructure revenue line that, while not as important as the three mentioned above, still provided $25m in revenue during FY20.

Data networks provides the largest source of recurring revenue after growing 3% to $409m during FY20. This represents 65% of total recurring revenue and 63% of total revenue generated during FY20. This division's revenue is derived from the provision of Fibre and Ethernet services to customers. While we don't believe this division will produce significant growth in the future, it still provides the company with an important, and consistent, stream of cash flows.

NBN provides a smaller portion of revenue with its $73.6m only accounting for 12% of recurring revenue and 11% of total revenue in FY20. The NBN revenues come from, well, the provision of NBN internet to customers. As the NBN rollout continues apace in Australia we expect this division will continue to become a larger portion of revenue generated. However, it is important to note that 5G poses a significant risk to NBN, in our view, and investors will need to pay close attention to its rollout across Australia.

The “Other” division saw a 2% increase in revenue growth year-over-year to $144m in FY20. This represents 23% of recurring revenue and 22% of total revenue. The other division has three main revenue generators: the company’s data centre operations, sale of electricity in New Zealand and Voice. While the data centre operation might sound exciting for investors who are familiar with companies like NextDC (ASX: NXT), the truth is this division has been rather stagnant and actually declined 7% during FY20. There has been no indication from management of a turnaround plan for the data centres.

The sale of electricity in New Zealand is a very small part of the company’s operations at $12.7m in revenue for FY20 and would be part of the company’s New Zealand division IPO spin off. While Voice did see a 4% increase in revenue during FY20, to $93m, the landscape in Australia for this service is highly competitive and we are not confident in management’s ability to lead this operation to any breakout success. Overall, the Other division provides another source of steady, low growth, recurring revenue and we do not believe that is likely to change in the future.

New Zealand bound? Not so fast.

As we mentioned above, on 19 November 2020 the company announced plans to spin off its New Zealand division in an IPO. One of the most important lines in the announcement was: “subject to prevailing market conditions.” While the market conditions look highly favourable at this point in time, Australia, New Zealand and certainly the world, are not out of the deep end just yet. Therefore, while we may ere on the optimistic side of the fence that says FY21 will prove to be a strong year for the market, the risks are still there and still significant. We agree that an IPO would certainly allow shareholders to take some money off the table and the company to strengthen its balance sheet. However, we remain sceptical of Vocus’ claim that this will allow it to focus on its network services operations to the degree that we would consider this a four star company. Until we see a more substantial plan of action for this IPO to occur and for what the company plans on doing next, we believe the situation is too murky for any type of IPO spinoff investment play.

Situation hazy, try again later

To paraphrase the magic eight ball, situation hazy, try again later. The truth is we remain sceptical of Vocus at this time. The company seems to be rather stagnant and is not currently paying a dividend and hasn’t given any guidance on when the dividend will be reinstated. The company has mentioned that they are expecting to see a sizable increase in EBITDA margin during FY21 as they have had strong success in reducing overhead and costs so far this year. We believe this is where the majority of the company’s FY21 EBITDA growth will come from, especially since revenue growth is supposed to slow to less than 1% in FY21.

However, consensus estimates for Vocus put EBITDA growth at 3.5% for FY21, which implies an EV/EBITDA for FY21 of 10x. For us, these numbers don’t stack up as a 10x EV/EBITDA multiple should be accompanied by a minimum EBITDA growth of around 7% to 8%.

All-in-all, there is a lot of uncertainty surrounding Vocus and the potential IPO at the end of the financial year is really what saved it from a two star rating. If the IPO goes ahead, it will provide investors with an interesting liquidity event. However, the market is currently changing fast and we have no idea at what price the IPO will be at. Therefore, it’s a three star rating from us.

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Share price chart

Source: Tradingview

Hotels and cinema fit surprisingly well together

Event Hospitality and Entertainment (Event) operates in two main industries: hotels and cinema. While the company does own a cinema chain in Germany, they are currently looking to sell it. Therefore, we will be focusing on the Australian and New Zealand operations in this article.

The entertainment division includes all cinema operations as well as the company's cinema technology and loyalty program companies. Unsurprisingly, this division's profit dropped from $70.2m during FY19 to a loss of $8.7m during FY20. This was exclusively due to COVID-19 forcing the cinema operations to close down for the majority of 2HY20. While we certainly expect this division's profits to rebound after COVID, we don't expect things to go straight back to normal.

The entertainment division will still be forced to incur significantly more expenses through hygiene protocols and, as Adelaide has shown, even Australia still runs the risk of an occasional new lockdown or restrictions. While the recent vaccine news is obviously a very positive sign, we believe it would be naive to think it will have an immediate effect on FY21 as the rollout will go on well into 2021. Additionally, it remains to be seen if

the population, now out of lockdown, will flock to sit in a room and watch a movie like they used to. For these reasons we think it will likely be a couple years before the entertainment division's profit revisits its FY19 highs.

The hospitality division includes all of the hotels and resorts owned and operated by Event. This division provides more of a challenge than its entertainment counterpart as it is unknown when international travel will be allowed into Australia and New Zealand again. Even the once vaunted New Zealand and Australia travel bubble has been put on hard ice by New Zealand's Prime Minister since the cluster in Adelaide reared its head. It is important to remember that hotels and resorts have more or less still been operating and Australians and Kiwis are widely believed to be rearing for a chance to travel interstate. Therefore, we are cautiously optimistically on this division for 2HY21. Overall, the current FY21 outlook from management for this division is relatively positive compared to FY20, but things won't return to FY19's levels until international travel reopens. Hence, our cautious stance.

The good and the neutral

So far during FY21, two major pieces of information have come down to investors from Event. The first is the company's addition to the S&P/ASX 300 and the second is the German Federal Cartel Office granting a further extension, to 14 December 2020, for the completion of the divestment of Event's German operations.

The S&P/ASX 300 is the good news. The fact the stock is being added to the ASX 300 provides a strong liquidity boost to any company and as of the S&P's 21 September 2020 rebalance, Event is in. During the difficult times the company is currently operating in we don't think the added liquidity will be the company's saviour, but it definitely can't hurt. This is especially true if Event decides it needs to issue fresh equity, although there has been no indication of one in the works at this time.

The extension to complete the German divestment is good new for Event but it is also bad in that it confirms the trouble the company is having in offloading its German cinema business. All-in-all we expect Event will meet the new deadline, its just another issue for management on top of an already complicated calendar year.

Don't get to excited

Event is fairly well-followed company with six analysts currently covering the stock. What the current market consensus suggests is Event's EBITDA not recovering to its pre-COVID high until after FY23. The market currently believes FY21 will result in $126.3m in EBITDA, putting the current FY21 EV/EBITDA ratio at 21.2x. We think this EBITDA projection is within the realm of possibilities, but without a dividend Event is currently priced way too high, in our view.

We would recommend investors not get caught up in the reopening and vaccine hype and take a hard look at the actual holdings of individual investments. Event has a long and hard road ahead of it and for now it's a two star rating from us.

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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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