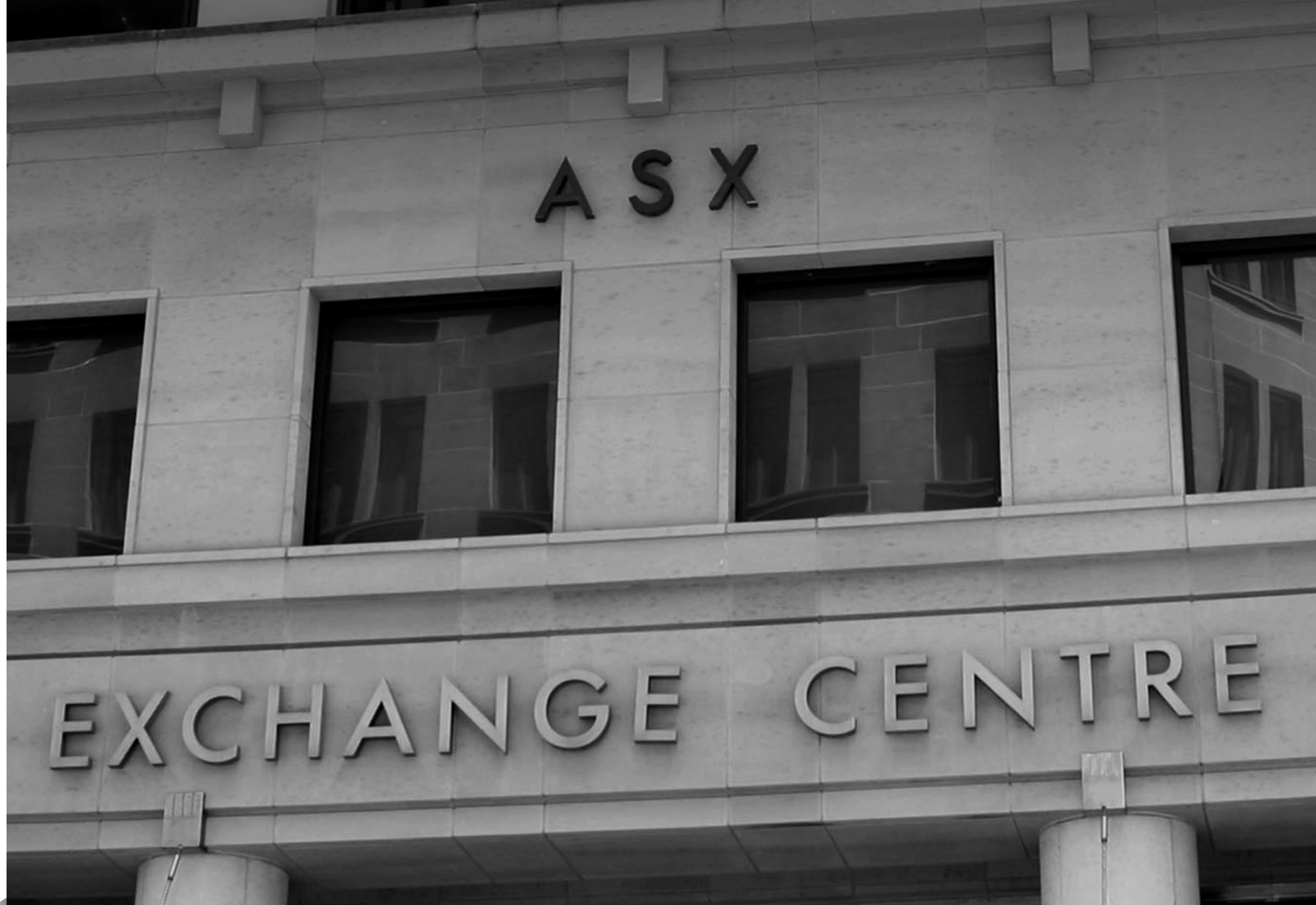
STOCKS DOWN UNDER

2 NOVEMBER 2020

ASX Top 200 Stocks Down Under

> *Never waste a good crisis.*
>
> - Winston Churchill (1874 - 1965), British Prime Minister and statesman



ZIP CO
Backstabbed but still kicking

BWP TRUST
Nothing to see here

EBOS
Care for all is a profitable business

COCA-COLA AMATIL
Man plans and God laughs

ZIP CO

Backstabbed but still kicking

Stocks Down Under rating: ★★★★

ASX: Z1P
Market cap: A$ 3.1BN

52-week range: : A$1.05 / A$10.64
Share price: A$ 5.77

Headquartered in Sydney, Zip Co has had a rough start to FY21. Not only did Westpac (ASX: WBC) very publicly sell its 10.7% stake in Zip, but it decided to grant AfterPay (ASX: APT) the privilege of being the first in the Buy Now Pay Later space to offer savings and transaction accounts to its customers. Since Westpac's announcement on 21 October 2020, Zip's shares have fallen by over 19% and still seem to be in freefall. However, we believe the market has misinterpreted Westpac's actions and the potential Zip still shows.

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EBOS

Care for all is a profitable business

Stocks Down Under rating: ★★★★

ASX: EBO
Market cap: A$ 4BN
Dividend yield: 2.7% (95% Franked)

52-week range: A$18.80 / A$25.19
Share price: A$ 24.25

Headquartered in Christchurch, New Zealand Ebos is a wholesaler and distributor of medical and pharmaceutical products as well as animal care brands. COVID-19 has had no negative impact on Ebos so far, due in large part to the 87% of its earnings that are generated from the healthcare sector. While Ebos benefited from increased healthcare activity during COVID-19, now that Australia and New Zealand are coming out of lockdown, we expect both the animal care and healthcare divisions to benefit.

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BWP TRUST

Nothing to see here

Stocks Down Under rating: ★★★

ASX: BWP
Market cap: A$ 2.6BN
Dividend yield: 4.5% (0% Franked)

52-week range: A$2.59 / A$4.30
Share price: A$ 4.01

Headquarter in Perth BWP Trust does one thing, owning the warehouses required by the Bunnings Group. However, BWP Trust does not operate the warehouses as this is left to BWP Management. BWP Management and Bunnings Warehouses are both wholly owned and operated by Wesfarmers Limited (ASX: WES). BWP Trust doesn't appear to have any inclination to move past its non-growth strategy and therefore, investors should view it as strictly a dividend play.

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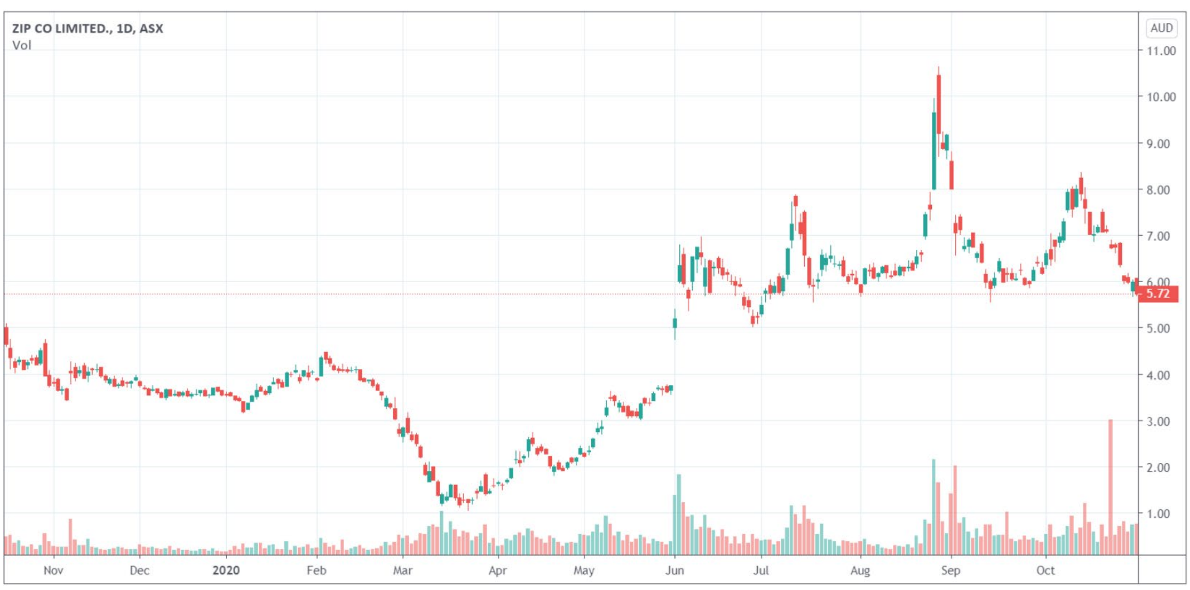

Source: Tradingview

Financially FY21 has been off to the races

On a year-over-year basis 1QF21 revenue saw extremely strong growth across both the Australia and New Zealand region, but especially in the United States. The Australia and New Zealand region is unsurprisingly not where the majority of Zip's growth is projected to come from. However, 45% revenue growth is not something to sniff at. While customer signups were in line with revenue growth, merchant signups outpaced customer signups by approximately 1%. Merchant signups are an extremely important metric for Buy Now Pay Later companies as it increases the likelihood of mass consumer adoption and usage. We would prefer for customer signups to be below expectations for one half if it meant merchant signups smashed expectations.

The United States is truly the land of gold and riches for this sector as all Buy Now Pay Later companies have been scrambling for a piece of American pie. Zip has continued to do extremely well in the States with merchant signups reaching 467% during 1QF21 on a year-over-year basis, while customer signup growth was 340%.

While 91% revenue growth is below the market's full year revenue growth expectation of 115%, we believe the strong showing in merchant signups in the United States will allow 2QF21 to really prove its metal with the holidays.

Side by side, let's compare growth

With all this talk about AfterPay, we thought it would be a good idea to briefly mention its 1QF21 performance and compare it to Zip's. While sales grew 115% during 1QF21, AfterPay is a more established company with a stronger brand than Zip and therefore Zip's 91% sales growth is still impressive given how close it is to AfterPay's. AfterPay was relatively equal to Zip during 1QF21 in terms of its merchants and customers growth as well. During 1QF21, AfterPay saw a year-over-year increase in merchants and customers of 98% and 70%, respectively.

While Zip is most certainly not the giant AfterPay is yet, we do believe Zip is certainly able to hold its own when it comes to growth metrics. After all, there's a reason Zip has a market cap of around $3.1bn and AfterPay is at $28.3bn.

The Westpac deal, is it really a blow to Zip?

Honestly, we don't think so, while it certainly gives AfterPay a considerable edge, we don't believe Zip ever stood a chance of winning Westpac's favour. The truth is, Zip is still in its emerging growth phase and is too small for the needs of Westpac's new platform. In regard to Westpac's decision to sell its 10.7% stake in Zip at the same time, we believe this has more to do with the current economic climate and the regulatory requirements of a bank than a loss of confidence. While we don't want to get too heavy into the weeds of Westpac's situation, this is an article about Zip after all, we would remind investors that Westpac gave a reason for its sale of Zip, improving its common equity tier 1 (CET1) capital ratio.

Additionally, this was also within the same week that the ACCC chairman Rod Sims warned the banks, very publicly, that they would be strictly prevented from buying FinTech's in order to facilitate a continuing atmosphere of competition. When we look at all three of these situations, COVID-19's financial stability disruption, AfterPay being granted the position and the ACCC's warning, it seems to us this was simply Westpac booking a significant profit in order to improve its damaged financial situation, avoid competitive issues with the AfterPay's deal and warm itself to the ACCC. We don't believe Westpac has simply given up on Zip, and neither should investors.

Buy. That. Dip.

Zip is well on its way to achieving EBITDA profitability during FY22 after its strong 1QF21 and is currently trading at an FY21 EV/Revenue multiple of approximately 12x. Based on the company's quick path to profitability and the 115% estimated year-over-year revenue growth during FY21, we believe the market has jumped to a conclusion from the Westpac deal that is not based on reality. Therefore, we are reiterating our four-star rating at this time.

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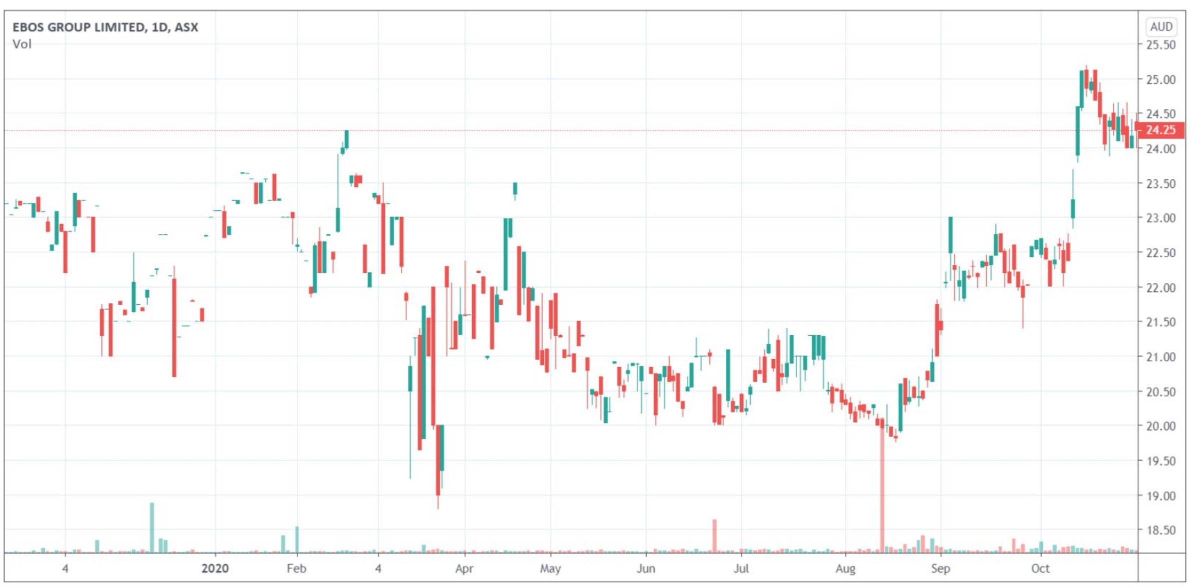

Source: Tradingview

Delivering the needs for all human and animal kind

Ebos' business is fulfilling the wholesale needs of human healthcare and animal care products for Australia and New Zealand and generated revenues of around $8.8bn during FY20. Healthcare is split into three main division, community pharmacy, institutional healthcare and contract logistics. The community pharmacy division was a large driver of healthcare's 27.4% earnings growth. This is due to the successful completion of the first year of the company's contract with Chemist Warehouse and the strong performance of many of Ebos' retail brands. We believe this indicates that the successful growth achieved during FY20 is likely to continue throughout FY21.

The institutional healthcare division saw 11.9% revenue growth during FY20 due in large part to the demand for specialty medicines and consumable medical equipment like Personal Protective Equipment and ventilators. We believe this division will continue to see growth during FY21 as hospitals have begun to resume normal operations in Australia and New Zealand.

The contract logistics division saw revenue growth of approximately 15.6% mainly due to the completion of a new 25,000m2 facility in Sydney allowing for additional business and the continued expansion of business in Auckland.

We are optimistic about the healthcare division's ability to growth as the industry returns to normal operations. Importantly, we believe it is important to note that since Ebos is central to the logistics and wholesale needs of Australia and New Zealand, a potential new wave of COVID-19 is unlikely to reduce FY21's earnings growth.

Everybody loves their pets

The animal care segment saw its revenue increase approximately 11.3% during FY20. While impressive, we believe FY21 is more primed for growth. One of the major changes COVID-19 has brought on is the significant increase in Australia's pet adoption rate. May recorded the highest rate of adoptions in Melbourne in over two years and Australia as a whole has seen recorded pet adoptions increase during 2HY20. We believe this will lead to significant demand growth for Ebos' animal care segments products.

While we mentioned the growth in pet adoption that has occurred due to the lockdowns and restrictions imposed by the pandemic, Australia has been experiencing a gradual shift towards higher rates of pet ownership for a while now. As of the end of 2019, Australia had one of the highest rates of pet ownership in the world with over 29m animals, according to the RSPCA. In 2019 this led to expenses of approximately $13bn, 50% of which was spent on food, products and accessories, and pet healthcare products. Overall, we expect the animal care segment will experience significant growth far beyond the COVID-19 lockdown bump and we believe that investors should expect this division to grow in importance going forward.

COVID-19 was a growth opportunity and so is the recovery

The market is expecting Ebos to achieve EBITDA growth between 12% and 13% during FY21, compared to 13.4% during FY20 and Ebos is currently valued at a FY21 EV/EBITDA ratio of approximately 13.5x, which would imply a fairly valued company judging by our preferred EV/EBITDA-to-EBITDA-growth metric.

However, we believe the market consensus may be underestimating the growth potential of Ebos' animal care division during FY21 as pet ownership has seen significantly higher than average growth during 2HY20. Additionally, we remain confident that as hospitals and doctors resume normal operations, the initial uptick in appointments and procedures will likely cover for the majority of the pandemic's dissipating demand surge.

Ebos is a vital part of the healthcare ecosystem and we believe it's well placed to benefit on both sides of the pandemic. In the worst-case scenario, where the pandemic re-emerges in Australia and New Zealand, we believe Ebos would be able to continue supplying the vital equipment and specialty medicines required. No matter which way things turnout, we expect Ebos will continue to see a high degree of earnings growth and therefore, we are issuing a four star rating at this time.

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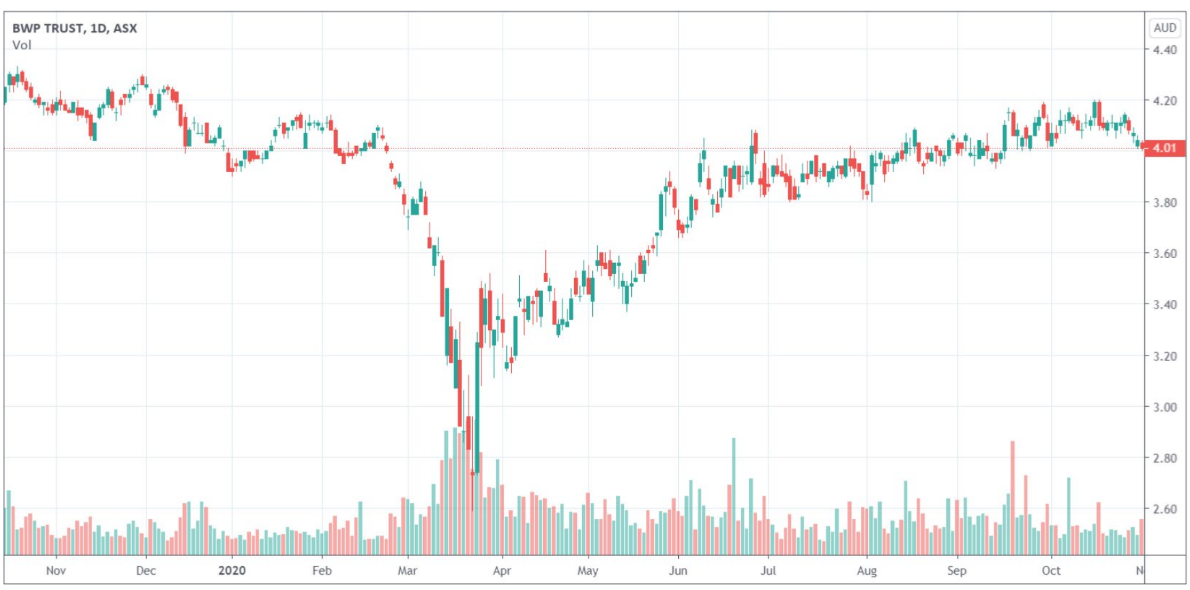

Source: Tradingview

A REIT like no other

BWP Trust generated $XX in revenues in FY20 and is not expected to grow its income significantly due to a lack of acquisitions. As the company says in its FY20 annual report, "BWP Trust aims to provide unitholders with a secure and growing income stream and long-term capital growth." The trust provides this by paying out the majority of its earnings from its 75 properties. On an annual basis 88% of its earnings are generated from Bunnings. The remaining rental income is almost exclusively derived from national tenants and this has allowed FY20 to be almost completely unhindered by COVID-19.

The company's rental growth is broken into two categories, CPI adjustments and fixed annual adjustments. Around 57% of the trust's rental income is backed by CPI adjustment agreements while the remaining 43% has a set, fixed, annual increase. We believe the 57% is preferable to investors as it allows for a better hedge against the economic conditions. CPI rental adjustments are actually quite simple, each year the rent is increased by a percentage that is determined by the increase in the Consumer Price Index for All Urban Consumers, also known as CPI-U. We believe this is better for shareholders as, in the long run, the rent will remain within market averages more consistently. Meanwhile a fixed rental increase has the risk of falling behind the market averages.

The earnings profile for BWP Trust is really as simple as it seems, investors should expect consistent earnings that keep up with the rate of inflation. We do not expect any radical moves towards growth from the trust in the future.

So there really is no growth?

Well, there is one way the trust can experience higher than expected growth, but we don't believe investors should hold out hope. Every six months the trust has its property portfolio's value reassessed. During FY20, the company's profit increase of 24.4% was almost exclusively driven by gains in fair value of investment properties. Excluding the fair value increases saw the company only achieve an increase in profit of approximately 1% year-over-year. While this may seem low, we believe the market has come to expect this from the trust and investors should not be concerned. We do believe, however, that this 75% increase in year-over-year profit from fair value increases is unlikely to continue during FY21 as we think the Australian industrial property market is unlikely to see a boom in valuations.

As clear a dividend play as we have seen

BWP Trust is the perfect dividend play, with the singular exception that the company is 0% franked. However, it would be unusual for a REIT to be franked and, therefore, it is not a concern. We believe BWP Trust should be valued based solely on two aspects, its dividend yield and tangible book value.

The company is currently trading at 1.3x its tangible book value per share. We believe this premium has to do with the company's solid dividend yield of around 4.5%. The world currently operates in a low interest rate environment with many countries experimenting with negative interest rates. While we would be shocked if Australia went into negative interest rate territory, we believe this environment is unlikely to change for at least two years. Therefore, we believe the market will continue to pay a premium for companies, like BWP Trust, that offer stable dividends over 4%.

To put it another way, before taxes, a 4% dividend would offer an income stream of 2.39% above 2019's full year inflation. However, if interest rates were to suddenly rise, we believe the premium to tangible book value that the trust is currently commanding would quickly evaporate. All-in-all, BWP Trust is a solid dividend play that we do not believe will see considerable movement from 1.3x tangible book value over the next couple of years. Therefore, we are issuing a three-star rating.

P.S. you may want to check out our new model portfolios on the website. It includes a Dividend Portfolio you may find helpful in your stock selection.

COCA-COLA AMATIL

Man plans and God laughs

Coca-Cola Amatil update on Stocks Down Under article published on 31 August 2020.

Share price chart

Source: Tradingview

Since our two-star review of Coca-Cola Amatil (ASX: CCL) a major event occurred, throwing our entire investment thesis out the window. On 26 October 2020, Amatil announced a potential acquisition by Coca-Cola European Partners (LON: CCEP) at $12.75 per share in cash. While we still stand by our analysis that Amatil's margins are going to remain under pressure and the company will underperform because of this, this acquisition proposal makes that irrelevant.

This is not the first time European Partners has made an offer for Amatil, the last time was slightly over a year ago at $10 a share and was promptly refused by management. However, it seems this current bid has management support and at an approximate 28% premium to the one-month Volume-Weighted Average Price (VWAP) it does seem unlikely to us that there will be a shareholder revolt.

However, the stock has already risen to around $12.43 since the announcement, $1.65 on 26 October 2020 alone, and therefore, we are forced to issue a new three star rating for Amatil at this time. We believe this situation is an invaluable reminder of the risks of shorting a stock as an acquisition can come out of nowhere and blow your position out of the water. As the old Yiddish adage goes, "Man plans and God laughs."

To review our more in-depth analysis of the Bank of Queensland published on 31 August 2020, please view our previous publication here:

https://stocksdownunder.com/edition/coca-cola-amatil-capricorn-metals-auswide-bank/

Pitt Street Research Pty Ltd

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