STOCKS DOWN UNDER

14 DECEMBER 2020

# ASX Top 200 Stocks Down Under

*Fun is like life insurance; the older you get, the more it costs.*

- Frank McKinney (1868 - 1930), American cartoonist

ASX

EXCHANGE CENTRE

## NIB HOLDINGS

Millennials strike again

## PLATINUM ASSET MANAGEMENT

A platinum investment

## YANCOAL AUSTRALIA

In for the long haul

## NIB HOLDINGS

### Millennials strike again

Stocks Down Under rating: ★★★

**ASX: NHF**
**Market cap: A$ 2.4BN**
**Dividend yield: 2.9% (100% Franked)**

**52-week range: A$3.34 / A$6.97**
**Share price: A$ 5.21**

Headquartered in Newcastle, Australia (not England), NIB Holdings is one of Australia and New Zealand's largest private health insurers. The company has three main categories of clientele: Australian and New Zealand residents, international students and visitors, and global travel insurance policies. The company was hit hard by COVID-19 and its stock has only recovered by about half. The question is, can it recover to its pre-COVID-19 high?

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## PLATINUM ASSET MANAGEMENT

### A platinum investment

Stocks Down Under rating: ★★★★

**ASX: PTM**
**Market cap: A$ 2.6BN**
**Dividend yield: 5.2% (100% Franked)**

**52-week range: A$2.63 / A$4.99**
**Share price: A$ 4.28**

Headquartered in Sydney, Platinum Asset Management is a niche asset manager providing investors with access to portfolios of non-Australian equities. These portfolios are across a number of different platforms and strategies but they all have value-based investment strategies. The company's stock is right at the cusp of a full recovery from its COVID-19 crash and we think that's just the beginning.

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## YANCOAL AUSTRALIA

### In for the long haul

Stocks Down Under rating: ★★★★

**ASX: YAL**
**Market cap: A$ 3.1BN**
**Dividend yield: 13.4% (0% Franked)**

**52-week range: A$1.88 / A$3.01**
**Share price: A$ 2.56**

The fortunes of the Sydney-based Yancoal Australia may be turning. The stock of this major coal miner was $1.90 on 3 November, but it has suddenly spiked higher, buoyed by better coal prices, which have been improving since August. The earnings multiple being as low as it is, we think there's still room for a continued re-rating, particularly for a company with a track record of growth like Yancoal's.

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### Share price chart

*Source: Tradingview*

### What is NIB holding?

NIB has two main revenue sources: insurance premiums and other. The company basically operates exclusively from net premium revenue as 98% of NIB's $2.5bn in FY20 revenue was sourced from premiums paid.

Insurance premiums totalled slightly under $2.5bn in FY20 split between Australian resident's health insurance (84%), inbound international health insurance (6%), New Zealand health insurance (10%), and NIB Travel (<1%). But enough of the numbers, this division truly is the entire basis of NIB.

Other revenue, i.e agency fees, income from Sundry, travel insurance commissions, life and funeral insurance commissions and investment income is effectively negligible at less than 2% of revenues.

### Claims are expensive

NIB's number one expense should really come as no surprise; claims levied against the company's private health insurance. Net claims incurred rose 6.9% to $2bn during FY20, compared to net premium revenue rising 4.2% year-over-year. When factoring in the slight rise in additional miscellaneous expenses, the company's profit for the year declined a hefty 40.3% year-over-year to $89.2m during FY20.

Despite our hope that COVID-19 will not rear its head in the form of a sweeping wave again, we are still concerned about NIB's FY21 claims. One of the main measures the healthcare industry took during COVID-19 in order to release some of the capacity pressure was the suspension of any non-essential medical procedures. We believe this pent-up demand could cause higher than 'normal' claims to bleed well into FY21, even if we don't see another COVID-19 wave. We believe investors will need to wait until FY22 to see NIB return to 'normal' margins and growth.

### Those millennials are at it again

One of the most significant long-term trends working against NIB is the age of private health insurance participants. NIB's own internal projections show that by around 2024 the only age group that has over 50% participation will be the 75 years and older cohort. The reason this is an issue for a health insurance company like NIB is because they need members whose premiums cover the claims of the older members. Health insurance companies do not often make a profit off the older clients as they statistically have higher claims. Therefore, the younger policy holders' premiums are often needed to offset the claims of the older policy holders. Breaking this business model will force premiums to rise faster and reduce NIB's net premium margin. You can't just go around blaming millennials for this. It's the fault of all those young whippersnappers under 75 years old.

### About two months too late

We believe NIB is one of those unfortunate examples of woulda, shoulda, coulda. If the stock was still hanging around $4 a share like it was in October, we believe the valuation would have made sense for a four star rating. However, the stock has since rallied to $5.21 a share, which implies a FY22 EV/EBITDA ratio of 13.6x. Despite the fact that EBITDA growth is estimated to be around 11% between FY21 and FY22, we don't believe the company's dividend, or financial prospects warrant a forward valuation that high at this point in time. NIB has an uncertain net premium margin for FY21 and a serious problem approaching after 2024 unless the industry can reverse the private health insurance drop off trend among those younger than 75. We don't feel the company is heavily overvalued, just on the high end of what we believe would be a reasonable valuation at this time. Therefore, its three stars from us.

# PLATINUM ASSET MANAGEMENT

## A platinum investment

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### Share price chart

*Source: Tradingview*

### The income

Platinum has five main portfolio strategies all of which are ex-Australia: actively managed global, Asia ex-Japan, Japan, Europe and specific sectors. At the end of FY20 funds under management (FUM) stood at $21.4bn. We believe Platinum's funds under management is its most important figure for measuring performance as around 92% of the company's total annual revenue is derived from management fees alone. Further illustrating this point is FY20's results. Performance fees increased 302% year-over-year to $9.1m and yet, due to the $3bn in net fund outflow during the year, total fee revenue (management and performance) still declined 3.5% compared to FY19.

### The portfolios

The company's portfolios are quite diverse, so please bear with us as we talk you through them.

Platinum global runs eight different portfolios totalling around $10.2bn in FUM. Two funds are listed on the ASX (7.6%), three funds are unlisted (90.2%), one fund is listed on ASX's mFund (0.4%) and two funds are domiciled in the United States and Ireland (1.8%). These funds are a mix of long-only strategies and feeder funds for the main unlisted fund, Platinum International Fund. All of the funds focus on long-term non-Australian companies the company deems to be undervalued.

Asia ex-Japan has a total of four funds managing approximately $6.1bn in assets. Asia ex-Japan consists of one unlisted, open-ended, fund (83%), one ASX listed fund (8%), one ASX listed feeder fund that mainly invests in the first unlisted fund (3%) and one fund Irish-domiciled fund (6%). All four of these funds focus on capital growth through long-term investments in companies listed in the Asia ex-Japan region.

The Japan strategy has three funds with around $643m in funds under management. The main portfolio is an unlisted fund domiciled in Australia (92%), the second fund is domiciled in Ireland (8%), while the last fund acts as a feeder fund for the first two. While these portfolios are classified as 'Japan,' the strategy focuses on long-term, undervalued companies across both Japan and South Korea.

The Europe fund is unlisted and registered in Australia with $583m in FUM. As the name suggests, this portfolio invests in undervalued companies in Europe with a long-term time horizon.

Platinum's sector portfolios have combined FUM of approximately $1.3bn split between three sectors: well-recognised consumer brands (50%), health care (35%) and technology (14%).

The remaining $3bn in FUM is allocated via a confidential mandate, so it is unclear where they are invested.

## Fund outflow is a significant issue

Since Platinum's funds earn revenue almost exclusively from management fees, fund size is extremely important. However, fund outflow has been almost exclusively the reason behind Platinum's declining revenues. Despite the company's many portfolios producing, what we estimate to be around $4bn in profits between 1 July 2020 and 30 November 2020, total FUM saw $1.8bn in net outflows. Until fund outflows are stymied we don't see how Platinum will be able to prevent FY21 from being the fourth year in a row to see both declining revenue and declining net profit. Unfortunately, we see no indication that fund outflows will slow anytime soon.

## The buybacks are the thing

On 16 September 2020, Platinum announced the extension of its on-market share buyback program by an additional 12-months. The buyback is maximised at 10% of the company's issued share capital (58,667,890 shares) without a specified share price. The buyback is funded by cash flow.

Over the last three months, the average daily trading volume was 1.3m shares, or $5.85m in value traded per day. With the ability to purchase at most 58m shares over 12 months and with $105m in cash, we believe management has the firepower necessary to provide considerable support to Platinum's share price if it chose to.

## Declining but still a buy

Yes, it is true that we believe Platinum is likely to see both declining revenue and net profit during FY21 since fund outflows have seemingly accelerated compared to FY20. However, the company still has a solid base of assets under management and $105m in cash. Additionally, during the company's recent Annual General Meeting, the Chairman's address indicated management's intent to continue a 90% payout ratio in the form of dividends. With a current fully franked annual yield of 5.2%, we believe Platinum offers dividend investors an attractive investment option.

From a Price/Tangible Assets perspective, Platinum is currently trading at 8.2x, which on the face of it is high compared to its peer Pendal Group (ASX: PDL), which is trading at 5.9x. However, Pendal is currently trading at an implied annual yield of 5.1% and is only 10% franked. We believe this makes all the difference. We believe Platinum is a dividend investment and therefore, its higher, fully franked dividend warrants a higher than peer valuation at this time. Four stars.

# YANCOAL AUSTRALIA

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### Share price chart

*Source: Tradingview*

If there's a major ASX-listed company that's guaranteed to be a bit controversial right now, it has got to be Yancoal Australia. For a start, its ultimate parent is a Chinese state-owned company at a time when relations between Australia and China are, shall we say, a little frosty. For another, it produces mostly thermal coal, at a time when institutional investors are trying to divest themselves of these kinds of companies in order to look at little more 'woke'. No wonder you can get the stock on an EV/EBITDA multiple of just 7.8x calendar 2021 earnings and 5.3x calendar 2022's.

### A patient investor in its coal portfolio

The reason this company is called 'Yancoal' is that its 62% shareholder is the Yanzhou Coal Mining Company, which is publicly traded in Hong Kong (SEHK: 1171). Its ultimate parent is the Shandong Energy Company, a Chinese state-owned enterprise which owns just over half of Yanzhou Coal Mining.

Yanzhou Coal has been building a portfolio of Australian coal mines, both metallurgical and thermal, since 2004. Its maiden acquisition was Southland, near Cessnock in the Hunter Valley of NSW. In 2003 Gympie Gold had been building this venerable colliery into a 2 million tonnes per annum producer of quality metcoal. Then there was a fire on Christmas Eve which shut the whole thing down. Yancoal took it off the administrators

for just $25m and brought it back to life again under the new name of Austar. It was a small, but steady contributor to Yancoal until this year, when it was placed on Care and Maintenance.

### Felix and Gloucester were both good acquisitions

Austar was the testbed for much bigger things. The company-making deal for Yancoal in Australia was the acquisition in 2009 of the Moolarben mine at Ulan, north of Mudgee, in the Western Coalfields of NSW. The Global Financial Crisis had just recently passed and quality coal assets were still going cheap. Yancoal bought Felix Resources for only A$3.5bn and got a mine producing 6 million tonnes of thermal coal with a path to ramp up to 17 million tonnes. On the side it also got the Yarrabee open cut coal mine in Central Queensland's Bowen Basin.

In 2012 the Gloucester Coal deal continued Yancoal's history of buying at the right price. Yanzhou Coal was required to float at least 30% of its Australian business on the ASX by 2012 as a condition of its takeover of Felix. The way it achieved that condition was merging with Gloucester Coal. Not only did this get Yancoal its ASX-listing, but it arguably got the Stratford Duralie operation in the Gloucester Basin of NSW, a producer of semi-hard coking and thermal coals, at a relatively inexpensive price. The secret to Yancoal's success? Basically helping Hong Kong's Noble Group to exit when coal was weakening.

### When Rio Tinto sells, then buy

And how about the 2018 deal with Rio Tinto? That mining giant, in an effort to show the world that it is woker-than-thou, was selling its Coal & Allied business unit, another mainstay of coal mining in the Hunter Valley. Yancoal got the Mount Thorley and Warkworth mines just out of Singleton in the upper Hunter and the so-called 'Hunter Valley Operations' (which is what they've been calling the merger of the old Howick, Hunter Valley and Lemington Mines) about 24 km from Singleton. The price? A mere A$3.2bn for a net 17 million tonnes per year of thermal and semi-soft coking coal.

Our take away from this history lesson is that Yancoal is a keen buyer of low-cost Tier 1 coal assets when the price is right and it knows to get itself a good deal from the vendors. The world may need less thermal coal in the future, but there's enough medium-term demand for the commodity, particularly from China, to warrant Yancoal's continued expansion. And Yancoal has the financial resources to do it. In calendar 2019 its average sale price was A$111 a tonne but its average cost FOB was A$61 a tonne. Operating cash flow was north of A$1.5bn and net debt/EBITDA  was down to just 1.6x.

### In for the long haul

Yancoal is a little smaller than its ultimate parent, at just 35 million tonnes or so, of which 30 million tonnes is thermal and only 5 million metcoal. That, however, now makes it a serious coal player in Australia and, importantly, a major employer in the Hunter Valley. The fact that it has made a strong effort to 'go native' in Australia stands it in good stead at a time when China is not generally popular Down Under.

As we noted above, Yancoal Australia is currently trading on single-digit multiples. On consensus numbers EBITDA is expected to decline in the 2020 and 2021 calendar years before starting to recover in 2022. We think by then thermal coal will be back in another up-cycle, particularly with global economy growth resuming post-Covid-19. That 5x looks reasonable for investors with the patience to wait, with the added bonus that coal prices are improving now ahead of that recovery. Four stars.

**Pitt Street Research Pty Ltd**

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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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