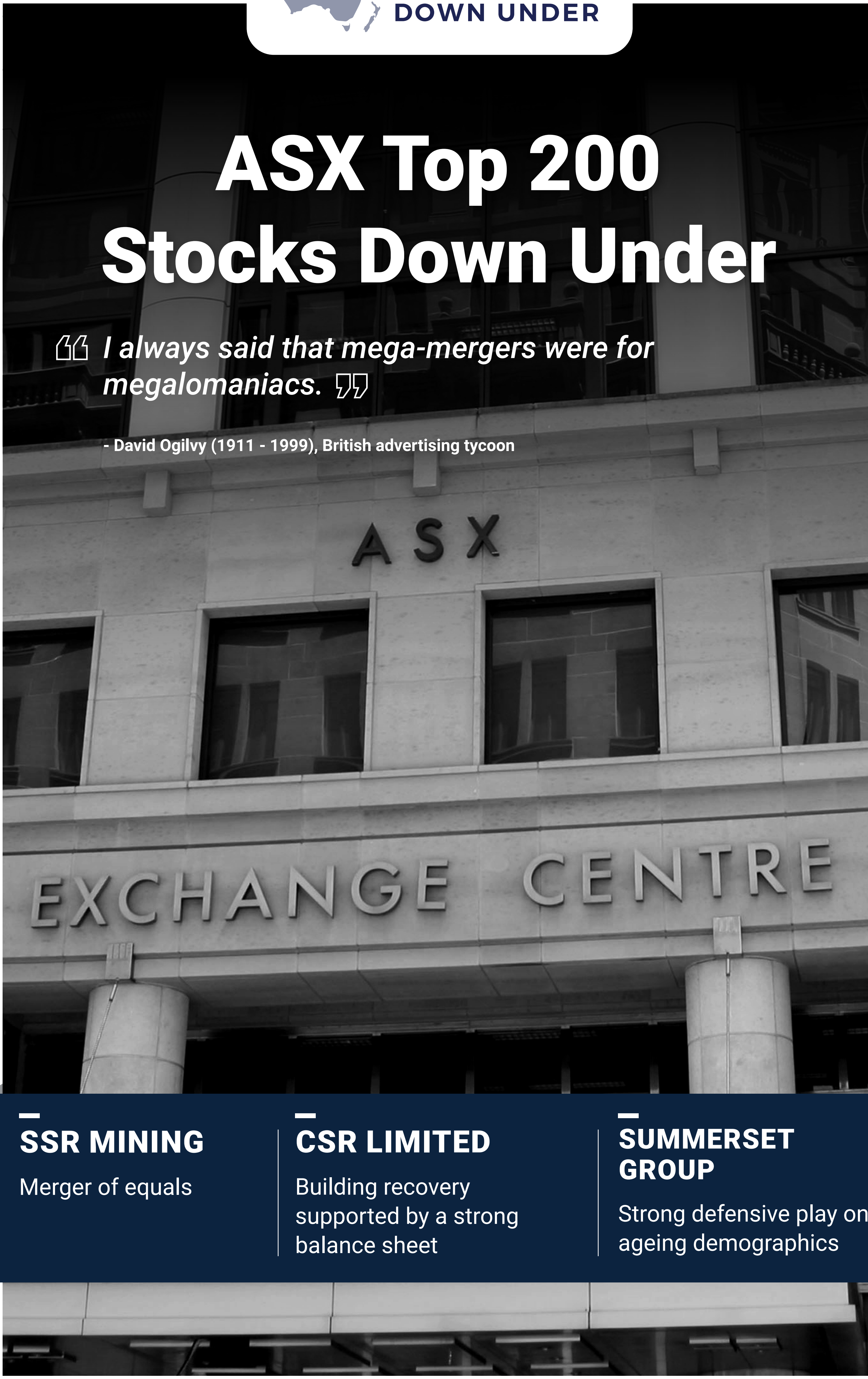
STOCKS DOWN UNDER

11 JANUARY 2021

ASX Top 200 Stocks Down Under

"I always said that mega-mergers were for megalomaniacs."

- David Ogilvy (1911 - 1999), British advertising tycoon



SSR MINING

Merger of equals

CSR LIMITED

Building recovery supported by a strong balance sheet

SUMMERSET GROUP

Strong defensive play on ageing demographics

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Stocks Down Under rating: ★★★★

ASX: SSR
Market cap: A$ 5.6BN

52-week range: A$23.12 / A$33.52
Share price: A$ 25.75

Vancouver-based SSR Mining (formerly Silver Standard Resources) hit the ASX in September as a result of its completed merger with Alacer Gold. The company is engaged in exploration, development and acquisition of precious metal projects with a gold-focus. Since its inception on the ASX and the anticipated merger, shares landed at $31.60 but have since pulled back to $24 a share.

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CSR LIMITED

Building recovery supported by a strong balance sheet

Stocks Down Under rating: ★★★★

ASX: CSR
Market cap: A$ 2.5B
Dividend yield: 1.7%

52-week range: A$2.75 / A$5.42
Share price: A$ 5.12

Headquartered in Sydney, CSR Limited is a building products company focused on Australia and New Zealand's residential and commercial construction sectors. Although COVID-19 continues to impact construction activity, a better-than-expected recovery in the residential housing market along with CSR's cost reduction programs bode well for future profit growth. In anticipation of better times to come, CSR shares are approaching a 10-year high. But given the ANZ region's pipeline of construction projects, there may still be plenty of upside. The company is in a great position to be a beneficiary of a housing cycle upswing that could last several years. And at FY21 EV/EBITDA 7.9x, we'd build a position in this construction supply leader.

READ MORE

SUMMERSET GROUP

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ASX: SNZ
Market cap: A$ 2.7B
Dividend yield: 1.1%

52-week range: A$3.89 / A$12.06
Share price: A$ 11.76

Based in Wellington, Summerset Group is an integrated retirement village operator in New Zealand. Consistent with ageing population trends in Australia and other parts of the world, the 65+ portion of the country's population is expected to rise steadily in the coming decades. With 31 retirement properties completed or in development, Summerset's leading position in this business suggests it has a long growth horizon ahead. Summerset shares are trading at a ten-year high, but still offer good upside in our view. Despite the recent COVID-19 disruptions, demand for aged care services has rebounded well and is expected to remain strong. Summerset's existing assets and construction of new facilities will be sources of steady growth as New Zealanders continue to embrace the value of medical care and other services in their later years.

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Share price chart

Source: Tradingview

SSR extending its reach

SSR Mining had a busy September quarter, starting with its completed merger with Alacer Gold, formerly ASX:AQG, the owner of the Copler Gold Mine in Turkey. As a result of that transaction, SSR has increased its full-year production guidance, bringing it closer to its target range of 680,000-760,000 ounces gold at an All-In Sustaining Cost (AISC) of US$906-1,040 per ounce. With Copler now in the mix, SSR is on track to meet its updated 2020 guidance of 491,000 ounces across its four operations in Turkey, Argentina, Canada and the US.

Copler is a boon for SRR with its average annual production of 306,000 ounces at an average AISC of US$886 per ounce and an average annual free cash flow of $249m for the first five years 2021-25. Preliminary assessments for the Copler mine have outlined a post-tax Net Present Value of $2.1bn at a 5% discount rate with an estimated mine-life of 22 years for a total production of 4.6m ounces gold.

Like many of its peers, COVID-19 forced SSR to halt production at its Seabee Gold Mine in the Canadian province of Saskatchewan and its Puna Gold Mine in Argentina, both of which have now reopened. Since the return to production, Seabee has achieved a monthly-record of 1,271 tonnes per day in September for 20,2449 ounces of gold, while Puna generated $17.8m in the third quarter through its silver production.

Money for nothing

Unsurprisingly for a mid-tier company, SSR's portfolio now extends beyond its four operations, with gold and base metal projects strewn throughout Canada, Mexico, Turkey and Peru. Since Copler is set to produce approximately half of SRR's total gold production, the company is currently examining two 'master plan' scenarios for the mine including a 'mineral reserve' case for a flotation circuit (which has already been approved with planned production to start in third quarter 2021) or the introduction of a new open pit at the newly discovered Ardich deposit, 6 km away from the Copler pit. Since recent assays have already uncovered a copper-gold porphyry below the main pit, SRR will continue to invest in the long-term potential of Copler with further exploration work.

Current SSR president Rod Antel has previously held the same role at Alacer, so it seems like a logical step for the companies to join the resources base and continue its acquisitive strategy. Now that Copler takes precedence, some of those pre-development projects (including the San Luis Gold-Silver Project in central Peru) have been on the backburner for a number of years, but as the merger is set to generate US$450m (A$618m) of free cashflow, the new SSR board looks like a sucker for choice.

Different but virtually the same

SSR has managed to strengthen its cash position to US$772.8m, ending the quarter with a consolidated net cash position of US$315m. Even with the merger, SSR is still a relatively small company with limited diversification beyond precious metals. On the other hand, the new SSR is bullish on the company's increased production, higher growth prospects, geographic potential and room to diversify.

Since the company is gold-focussed, it's fair to say that strong free cash flow is a principal concern going forward. While a quarterly cash dividend of $0.05 has been approved for the first quarter of 2021, the company is considering supplementing its quarterly dividend from excess free cash flow. While the company remains largely the same, the returns look set to get a bit better. So, four stars.

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Share price chart

Source: Tradingview

Brand strength differentiates CSR

Founded in the mid-1800's as the Colonial Sugar Refining Company, CSR Limited supplies a wide range of products to construction customers in the ANZ region. It no longer has a sugar business, but does have a sweet building products business that has become well diversified over the years. Roughly half of this business is derived from detached housing construction clients. Revenue from commercial construction, medium-to-high density housing and alterations and additions, round out a nice customer mix and gives CSR a favourable risk profile to help it withstand tough market conditions.

The company owns some of the strongest brands in the construction business that together form a very valuable intangible asset. From Gyprock plasterboard and Bradford insulation to Monier roof tiles and PGH bricks and pavers, CSR's brand strength is a significant competitive advantage in the industry.

CSR also holds an interest in the Tomago aluminium smelter, which is one of the largest in Australasia. The aluminium business is its second largest unit by operating earnings while its small property business also contributes a bit to overall company results.

COVID-19 impacts product demand and aluminium prices

CSR's half-year results to September 2020 showed a 6% decrease in revenue to $1.07bn. This was due to the slower pace of residential construction in the wake of the COVID-19 pandemic. Softer demand for aluminium tied to COVID-19 and lower aluminium prices also contributed to the revenue shortfall. Building products earnings before interest and tax (EBIT) rose a tad to $96.3m and the segment's EBIT margin expanded from 11.4% to 12.1%. However, a 76% drop in aluminium EBIT was too much to overcome. Total group EBIT fell 17% to $94.4m and underlying net profit dipped 7% to $66.4m.

Although CSR didn't have any significant earnings from property in the period, it finalized the sale of industrial land at Horsley Park in New South Wales. This is expected to bring in $226m in development proceeds over the next four years.

Meanwhile, the group's cash preservation strategy led to healthy cash flow during the interim period and produced a stronger balance sheet. CSR has a $153.1m net cash position and an investment grade BBB+ rating from S&P. We also favour the maturity profile of its debt facilities with a small amount of debt maturing in 2025.

The strength of the balance sheet gave management the confidence to declare an 8.5 cents per share interim dividend plus a 4 cents per share special dividend in 1HY21. Overall, we like CSR's ample liquidity and shareholder friendly stance despite the challenging economic backdrop.

Early signs of a recovery are mounting

CSR is committed to paring back its cost structure and streamlining its business. Its ongoing cost restructuring programs are expected to lead to significantly lower selling, general and administrative (SG&A) expenses in FY21. We see good potential for a continued recovery in the building products business based on the segment's strong 1HY21. Although revenue was down 6% during the first four weeks of 2HY21 (basically October 2020), recall that operating profits were up in 1HY21 despite lower volumes. As construction activity increases and volumes start to rise, we believe CSR's strengthened margins hold the potential to drive some solid profitability.

Government stimulus measures combined with low mortgage rates are already driving a fast turnaround in residential construction. Federal and state government budgets that include heavy spending on infrastructure projects should also be supportive of a rebound in demand for CSR's building supplies. These external influences, along with CSR's cost control programs, point to a good second half and FY22, in our view.

There is also a decent chance that the aluminium business recovers. Demand for the metal appears to be slowly improving as economies reopen and construction activity picks up. Management is forecasting Aluminium EBIT to be in the $14m to $23m range. We like that CSR has a significant hedge book in place through March 2024 to help offset unfavourable movements in aluminium prices and capitalise on profitable pricing.

The big unknown remains the impact of COVID-19 on the economy, employment and Australians' propensity to build new homes. Barring a pandemic-induced downturn, CSR shares, which tend to be a bellwether for Australian construction activity, are likely to benefit from the residential housing recovery. The company's diversified nature and cost cutting measures should enable it to persevere and build up some nice growth for investors. Four stars from us.

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Share price chart

Source: Tradingview

Leading market position and land bank

Summerset Group's communities serve the needs of New Zealand's older population. It operates independent-living apartments as well as supported living residences, which offer assistance with things like housekeeping and shopping. Summerset's more than 6,000 residents can receive health care through in-home care or access to on-site 24-hour medical care centres. Aside from the range of services, Summerset's status as New Zealand's first certified carbon-zero retirement village operator also appeals to prospective residents.

The company makes money from care fees and the income it receives from various village services. Most of Summerset's revenue comes from fee subsidies that are provided for eligible age-care residents by the New Zealand Ministry of Health.

Summerset holds a dominant position in New Zealand's growing retirement village and aged care facility market. It owns a geographically diverse land bank that is the largest in the sector—5,380 units worth. So, the growth catalyst here is straightforward. Strong demand for retirement village living is expected to lead to more and more construction activity around new senior residences.

COVID-19 grinds sales to a halt

The full year results to December 2019 showed an 8% increase in underlying profit after tax to NZ$106.2m. Net profit was down compared to FY18 largely because the company delivered 100 fewer retirement units (354). It was a tale of two halves in FY19 as Auckland and Christchurch's residential property markets slowed to start the year only to see a lift in activity in the second half. In the end, Summerset opened three new retirement villages during the year and added seven sites to its development pipeline. With 12 villages in development and 10 pieces of land waiting for future development, Summerset stands to more than double its current footprint of 19 villages in the near future.

For the six months to June 2020 underlying profit was down 6% to NZ$45.1m and the group managed a NZ$1m after tax profit. It opened three new retirement villages in Tauranga, Napier and New Plymouth as well as the main building of the new Casebrook village in Christchurch where half of the units sold within the first three months.

As you may have guessed, COVID-19 has had a significant impact on trading conditions. Facilities were forced to close and visitors weren't permitted on site. Lockdown restrictions in the April to May period limited sales and settlement activity. Retirement unit sales dropped to zero in April, which qualified Summerset for the government wage subsidy. But even with these headwinds, the results were pretty good and reflect the strength of the business. And once the lockdown orders were lifted, the group experienced a strong rebound.

Recent guidance confirms a positive outlook

As far as the balance sheet is concerned, Summerset's growing asset base is a positive, in our view. Assets grew 13% to NZ$3.4bn as at 1HY20 due to a combination of growth at existing villages and ongoing development. The value of its properties has moved higher since midyear 2019 and net assets were up 6% to NZ$1.1bn. Although net debt has increased since FY19 to NZ$621.9m due to land settlements and construction progress, the increased 35.8% gearing ratio remains healthy. Absent the impact of COVID-19 on its investment property valuations, gearing would have been around 34.5%. After weighing the uncertainty around the pandemic, management moved forward with a slightly lower 6 cents per share dividend in 1HY20.

On 16 December, management issued guidance for calendar 2020 that points to a better second half performance. Underlying profit for the full year is expected to be in the NZ$96m to NZ$98m range. At the midpoint this would represent a 15% sequential improvement over first half profit and confirms that the business has bounced back nicely from the COVID-19 challenges. Summerset also disclosed its decision to return the NZ$8.6m wage subsidy it received in April. This too should make investors to feel good about the financial stability and growth prospects for the company.

So, while some demographic trends are hard to predict, there is a high degree of certainty that folks in New Zealand will be living longer and grow to represent a bigger part of the population. As the leader in the country's retirement village industry, this should support Summerset's ability to generate reliable growth and makes the share an attractive long-term defensive position, in our view. 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.