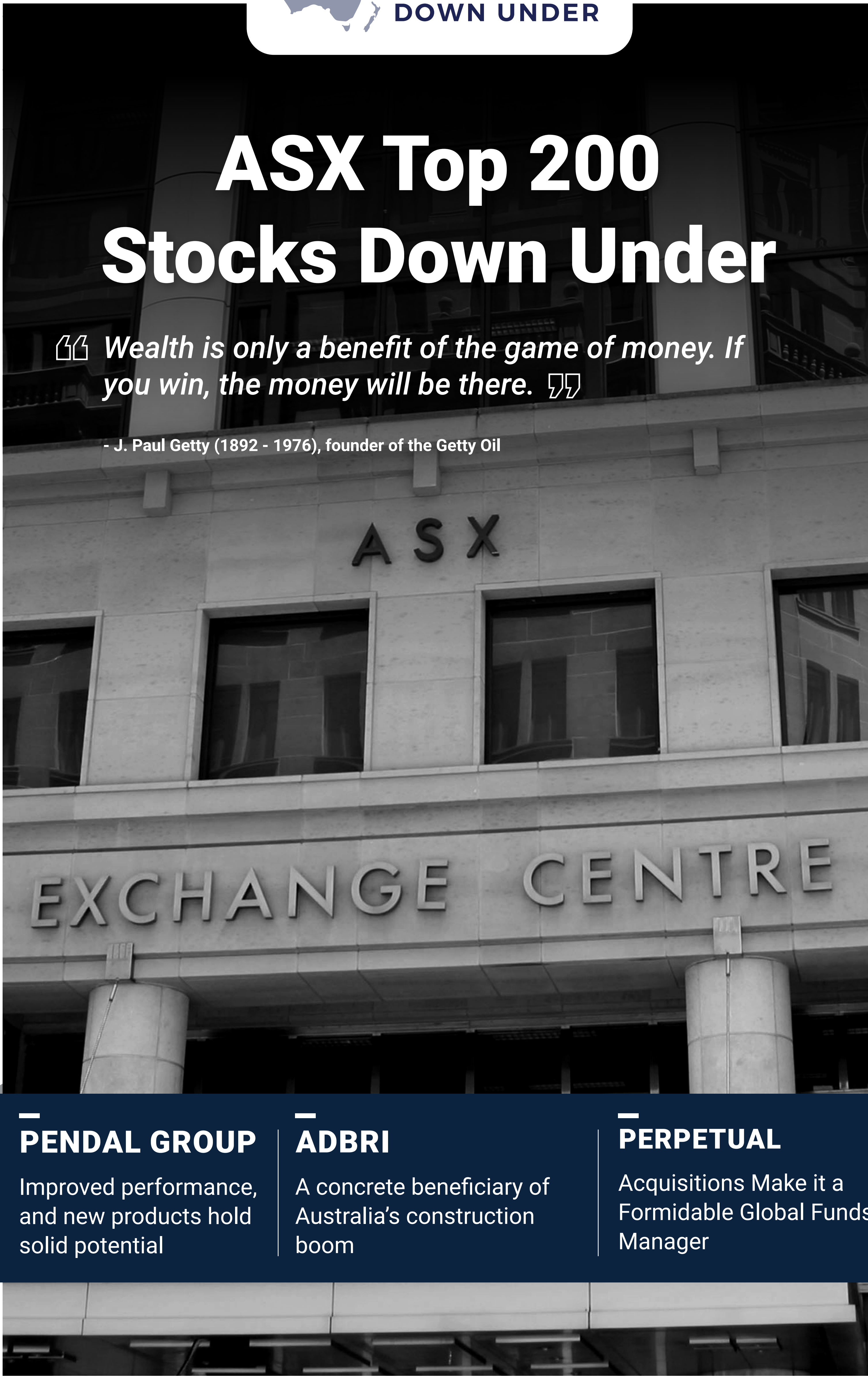
STOCKS
DOWN UNDER

18 JANUARY 2021

ASX Top 200 Stocks Down Under

“Wealth is only a benefit of the game of money. If you win, the money will be there.”

- J. Paul Getty (1892 - 1976), founder of the Getty Oil



PENDAL GROUP

Improved performance, and new products hold solid potential

ADBRI

A concrete beneficiary of Australia’s construction boom

PERPETUAL

Acquisitions Make it a Formidable Global Funds Manager

PENDAL GROUP

Improved performance, and new products hold solid potential

Stocks Down Under rating: ★★★★

ASX: PDL
Market cap: A$ 2.1B
Dividend yield: 5.7%

52-week range: A$3.00 / A$9.33
Share price: A$ 6.48

Based in Sydney, Pendal Group is a global fund management firm that was known as BT Investment Management prior to 2018. Its strong line-up of Australia-based funds hold good upside potential as the domestic economy continues to recover amid support from fiscal stimulus and low interest rates. We also like the strength of the company's international and global funds and see this growth persisting. The group's recent investment performance has been strong, marked by many outperforming funds that drove improved fund flows in the most recent quarter. Meanwhile, a wave of new product launches tailored to client needs, including new Impact fund offerings, bode well for future growth. The share is trading at 17x earnings and comes with a generous 5.6% dividend yield.

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ADBRI

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ASX: ABC
Market cap: A$ 2.2B
Dividend yield: 2.3%

52-week range: A$1.74 / A$3.94
Share price: A$ 3.11

Headquartered in Adelaide, AdBri is a materials supplier for Australia's building, construction, infrastructure and mineral processing industries. Adbri's share price is trading near a 10-year low, but there are favourable demand dynamics developing here. Federal and State government spending and the easing of responsible lending rules are expected to be supportive of infrastructure growth. As the company recovers from the impact of COVID-19, we like the exposure to the growing construction and mining industries. With several big infrastructure projects kicking off across Australia, Adbri is well positioned to grow in conjunction with Australia's economic revival. At a valuation of 10.1x FY21 EV/EBITDA we believe the stock is a solid foundation for a long-term growth portfolio.

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Dividend yield: 4.1%

52-week range: A$19.65 / A$47.47
Share price: A$ 35.52

Sydney-based Perpetual is a funds management group that, true to its name, has been helping Australians invest forever. Founded by Australia's first prime minister (the Honourable Edmund Barton) back in 1885, the company provides a range of financial products and services to both individuals and organisations. We see solid earnings growth prospects at Perpetual based on its recent acquisitions and cost savings execution. Now better equipped to compete on a global level following the additions of Barrow Hanley and Trillium, the funds manager has strengthened its investment capabilities by adding valuable exposure to the fast-growing ESG market. This, along with a growing Corporate Trust business, suggest better times are ahead for Perpetual. The share was down 10% in 2020 and at 20x earnings is an attractive play on recovering capital markets.

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Share price chart

Source: Tradingview

Well diversified funds management platform

An independent investment management firm, Pendal Group has operations in Australia, Asia, Europe and the Americas. It runs a boutique-style fund management business that offers clients a mix of investment strategies. On the equity side of the business, investors can choose from Australian, UK and European, Asian and Emerging Markets as well as Global equities. Pendal also offers cash, fixed income and multi-asset strategies. Through its wholly owned J.O. Hambro Capital Management (JOHCM) business, Pendal Group also manages a range of global and regional investment strategies. Its funds are marketed through institutional and wholesale channels as well as through Sydney-based Westpac Bank.

The group's result for the 12 months through September 2020 were decent considering the impacts of COVID-19. Fund outflows amid volatile market conditions drove net profit after tax (NPAT) lower by 10% to $146.8m. Outflows were particularly heavy within the company's European strategies ($3.3bn), while Westpac's consolidation of its superannuation platform also led to significant redemptions ($2.6bn). Although base management fees were down 5% to $458.1m, we are encouraged by the steady profit margin (48 basis points) associated with this key revenue source. Moreover, performance fees, i.e. revenue generated from investment return incentives, more than doubled to $13.4m.

Pendal's average funds under management (FUM) slipped 4% to $98.4bn in FY20. However, the silver lining is the ongoing strength of the company's FUM outside of Australia. The U.S. Pooled distribution channel posted 15% FUM growth in FY20 whereas all other channels recorded slightly lower FUM. Non-Australia wholesale FUM ($30.2bn) now accounts for more than 40% of the group's core funds. We see the international markets as a key growth opportunity given the increasing interest in Pendal's platform outside of its home country.

Investment performance improving

The latest full year result showed an improvement in investment performance. This underscores the talent of Pendal's portfolio teams. Over the one year period, 72% of FUM outperformed their respective benchmarks and 88% of FUM have delivered above benchmark returns since inception. Thirteen equity strategies beat their respective benchmarks by at least 3% and two fixed income strategies topped their benchmarks by at least 1.5%. The standout performers in FY20 were the JOHCM International Select and Pendal MicroCap strategies, which exceeded their benchmarks by a convincing 24.1% and 23.8% respectively.

Despite the modest net outflows in FY20, the recent performance of the funds drove improved inflows of $1.2bn in the fourth quarter. Strong institutional flows from new and existing mandates led this charge while US Pooled funds saw net inflows for the second straight quarter in 4Q20.

Pendal Group's balance sheet is in very good health. The net cash position rose 38% to $207.5m from FY19 to FY20. In total, more than $200m of seed capital was deployed across 12 funds in the recently completed fiscal year. The strength of the balance sheet supported the firm's ability to pay out 81% of cash NPAT as shareholder dividends. The board revised the group's dividend policy for FY21 to pay out 80% to 95% of underlying profit after tax (UPAT). We find the dividend to be one of the most compelling aspects of an investment in the share.

New product launches in ESG investing

Pendal's investments in new product introductions give us confidence around the firm's ability to innovate and tap into new revenue drivers. In FY20 it launched its first Impact strategies, the Credit Impact Trust and the Global Equity Impact fund. These new products will cater to the growing number of investors interested in having an impact on social and environmental issues through investing.

The funds will be launched globally under the Regnan brand and will focus on environmental, social and governance (ESG) strategies. The goal here is to develop Regnan into a world class ESG/responsible investing (RI) platform. These offerings will build off Pendal's existing ESG platform that includes the well-regarded JOHCM Global Select Strategy (which has attained Morningstar's highest sustainability rating of five stars). We see the expansion into the ESG space as a great way to capitalize on one of the fastest growing segments of the funds management industry.

In November 2020, Pendal announced plans to enter the increasingly popular world of cryptocurrency. The group's head of bond, income and defensive strategies, Vimal Gor, is said to be bullish on the space and especially Bitcoin, which has surged to record highs in recent weeks. We see the foray into Bitcoin as a gutsy way to seek out greater returns from a volatile alternative investment that has a low correlation with traditional asset classes.

So, the recent fund launches along with improving performance and a strong international business point to solid multi-pronged growth potential. We consider an investment in Pendal Group to offer a nice combination of income and upside. Four stars.

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Share price chart

Source: Tradingview

Balance sheet strength underpins resilience

Formerly Adelaide Brighton Ltd, Adbri's roots date back to 1882. The company produces, imports and sells a range of cement, concrete and industrial lime products. It primarily supplies these materials to the Australian construction market and also supports customers in the infrastructure and mineral processing businesses.

Adbri's full year results to December 2019 showed a 7% decrease in revenue to $1.5bn. This was caused by tough conditions in the civil and residential construction markets. Tougher competition in the South Australia and Queensland markets was also a factor. Higher raw material prices, shipping, transport and fuel costs contributed to a 35.6% decline in underlying net profit after tax (NPAT) to $123m.

The half year results for FY20 were okay all things considered. In the six months to June 2020 revenues were down 7% to $700.7m. Business activity slowed a bit at the onset of the COVID-19 pandemic. Weaker demand, weather and bushfire challenges in New South Wales offset strength in Western Australia. It reported a 14% decline in NPAT to $47.6m.

Adbri has a strong balance sheet with $481.7m of available funds. This is due to being fully drawn on its borrowings, which gives it the flexibility and liquidity to manage the current economic environment. Its debt metrics are healthy and well within the board's targets (34.6% gearing). After not issuing a dividend in 1HY19, it declared a fully franked 4.75 cents per share dividend in 1HY20 that represented 65% of underlying earnings. This showcased the company's resilience and commitment to shareholders during a tough time.

The Alcoa termination and COVID-19 impacted the business

COVID-19 has had a moderate impact on Adbri's business. Its mining customers were mostly uninterrupted while construction activity slowed. As with many other companies, however, the pandemic-related uncertainty caused management to withdraw earnings guidance back in April 2020. The cost impact of COVID-19 was estimated to be $4.2m as at 30 June 2020 owing to spending on things like hygiene, safety, training and operational changes.

Today, market conditions appear to be on the upswing in the construction and mining sectors and all Adbri sites are operational. Infrastructure activity is a major source of growth, but so too is mining demand due to a strong production outlook for gold, nickel, iron ore and alumina. Stage 4 restrictions in Victoria in place since August 2020 though, have limited business activity in the state.

Adbri suffered a major blow back in July 2020 when United States aluminium producer Alcoa chose not to renew its $70m per annum contract with Cockburn Cement, an Adbri subsidiary. Cockburn had a 50-year supply relationship with Alcoa, which was one of its largest North American customers. The market punished Adbri shares as a result, sending the stock price more than 30% lower on the headline. Fortunately, news of a four-year contract extension to supply cement and lime to Melbourne-based BHP Group sparked a rally soon thereafter.

Kwinana upgrade should cement cost leadership

On 17 December, Adbri announced that its Kwinana Upgrade Project can move forward after its board made a final investment decision. The company will invest $199m to create a state-of-the-art facility that combines its two existing cement production locations (at Munster and Kwinana) to better serve the Western Australia construction and mining sectors. The modernised site will increase its annual production capacity by 36% to 1.5m tonnes. Adbri estimates that the upgrade will generate a 15% internal rate of return (IRR) that significantly exceeds its cost of capital.

This is a major positive because it will make Adbri better equipped to supply key materials to industries that are expected to grow over the next several years. The Kwinana Project should singlehandedly cement the company's position as a low-cost materials provider in the region and lead to some good growth. We also like that the new facility is expected to lead to $19m of cost savings in year one and have a 20% lower carbon footprint than the existing operations. The completion of the construction and commissioning is slated for mid-2023.

In response to the challenges brought upon by the bushfires and COVID-19, Adbri has recently embarked on a restructuring. Three business units are being transformed into two, Cement & Lime and Concrete, Aggregates & Masonry, while the leadership teams are being redeployed accordingly.

We like the company's new direction and see strong growth opportunities down the road. We believe Government infrastructure spending and a bright mining sector outlook point to better times ahead at Adbri so four stars.

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Share price chart

Source: Tradingview

Well diversified business growing overseas

Perpetual is a diversified financial company that offers investment products and provides financial advice and related services to individuals, advisers and corporations. Its products run the full gamut of the investment spectrum and include superannuation and retirement income funds. The group's core business units are Perpetual Asset Management Australia, Perpetual Asset Management International, Perpetual Private and Perpetual Corporate Trust.

Due to a fast-growing overseas presence, it recently launched the international asset management division to consolidate its businesses in the US, UK and Asia. The Perpetual Corporate Trust unit is a leading provider of securitisation and managed fund services, while the Perpetual Private business caters to high net worth (HNW) clients. These latter two businesses are advisory in nature as opposed to the investment groups which manage funds.

The firm's goal is to build a world-class investment capability with a global distribution platform. To accomplish this, it has a three-part strategy, each of which is people focused. Of course, the client comes first in this business, so forming long-lasting relationships with its customers and helping them build wealth is paramount. Strong products and service are the focus here. To be a trusted financial services leader, Perpetual must also attract and retain talented professionals. This is the second part of its strategy. Finally, it aims to keep its shareholders happy by delivering sustainable growth. This is done by building or buying investment distribution capabilities in growing global markets.

COVID-19 weighed on FY20 result

Perpetual's FY20 results were underwhelming, but on the bright side, this has made the shares more affordable for investors. For the 12 months to 30 June 2020, revenue was down 5% to $489.2m and net profit after tax (NPAT) fell 29% to $82m. Certainly COVID-19 had a major impact on performance. Global equity markets that were moving along nicely in FY20 collapsed in March 2020 and dragged down the value of Perpetual's asset base, and thereby its main fee-based revenue source. The Investments division saw revenue fall 15% due to market movements and outflows while revenue was down slightly at Perpetual Private largely due to lower interest rates.

There were, however, some strong aspects of the FY20 result that caught our attention. Under a new operating model, Perpetual continued to deliver cost savings at the high end of its $18m to $23m target range. Moreover, the group's Net Promoter Score, a measure of client satisfaction, increased from +40 in FY19 to +45. Lastly, the Corporate Trust business remained strong, delivering 16% pre-tax profit growth and was named the Kanga Awards "Trustee of the Year" for the fourth straight time.

Despite the challenging year, we see ongoing strength in Perpetual's balance sheet. It has maintained financial flexibility in keeping its net asset position relatively stable compared to FY19 despite using more than $145m of cash to pay down corporate debt and to fund a major acquisition. We believe the group has ample liquidity to face whatever 2021 may bring and a strong set of assets bolstered by its recent purchases.

Barrow Hanley acquisition adds growth opportunities

On 18 November, Perpetual announced the 75% acquisition of US-based Barrow, Hanley, Mewhinney & Strauss ('Barrow Hanley') for as much as $439m. This will have a major impact on the business because it triples Perpetual's assets under management (AUM) to more than $87bn. After completing the acquisition, management expects to achieve 20%-plus underlying EPS accretion per annum. So, we like the newfound scale and earnings growth potential.

Previously owned by BrightSphere Investment Group, Barrow Hanley manages approximately US$41bn of assets in various equity and fixed income funds. Although Barrow Hanley will continue to operate independently, its presence in the US, London and Hong Kong will expand Perpetual's global distribution footprint.

Now a much bigger firm with improving performance, Perpetual has some strong momentum in its favour. Through FY20, more than 70% of its funds ranked in the first or second quartile based on 10-year performance. Although most Australian equity strategies are still lagging their benchmarks from a five-year perspective, they have outperformed in shorter time periods. Through 30 November 2020, most domestic stock funds beat their benchmark over the one-year period and all outperformed for the three-month period. All global equity, multi-asset and fixed income strategies delivered above benchmark returns for the three-month period. ESG fund performance in the recently acquired US-based Trillium business has also been strong in recent months.

Bottom line, we like the improving fund performance and added muscle provided by the Barrow Hanley acquisition, which together with Trillium's platform gives the group exposure to the fast-growing ESG space. But we advise investors to act quick. At current share price levels, we believe Perpetual's bargain status won't last for an eternity. So four stars from us.

Pitt Street Research Pty Ltd

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