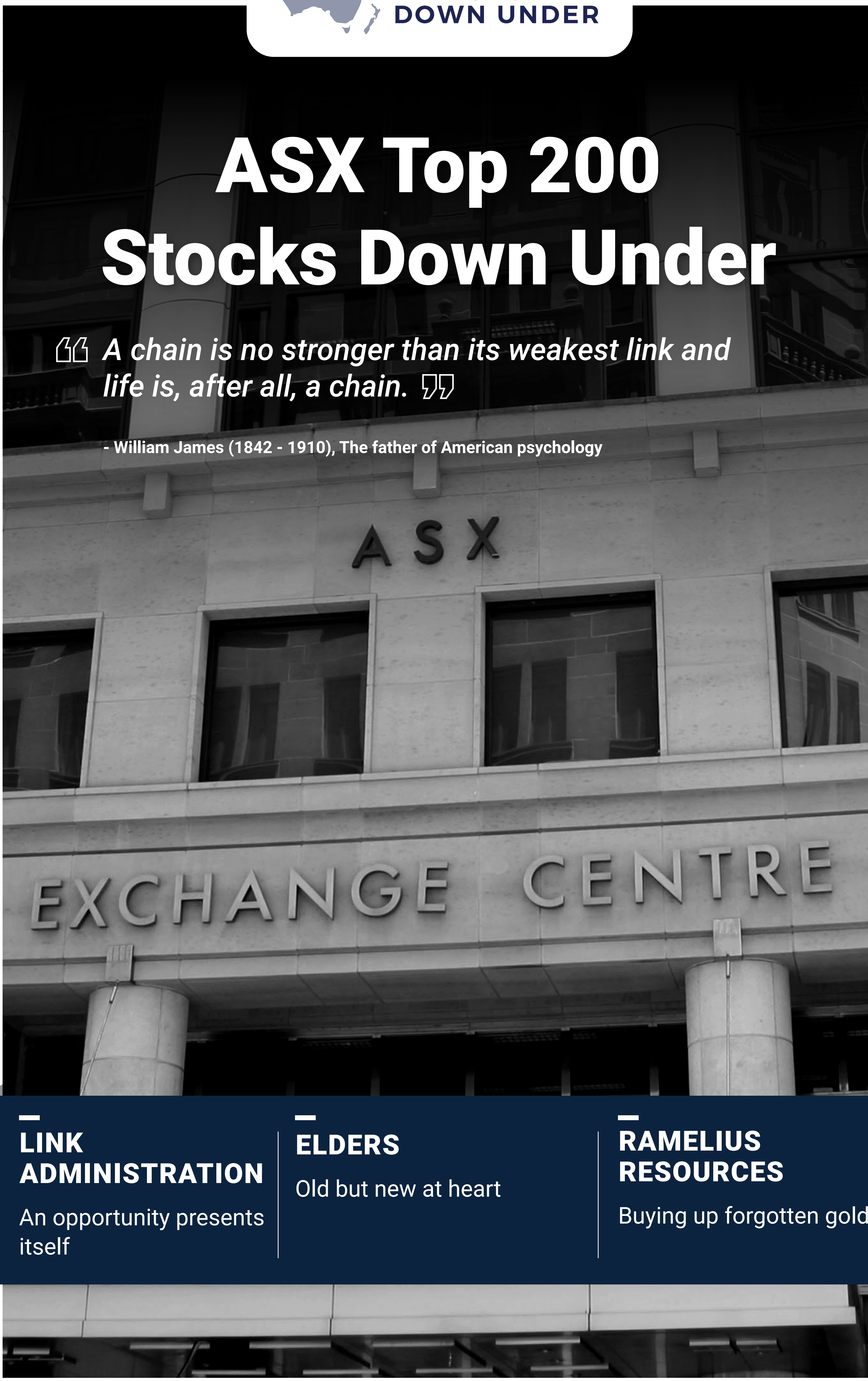
STOCKS DOWN UNDER

1 FEBRUARY 2021



ASX Top 200 Stocks Down Under

> *A chain is no stronger than its weakest link and life is, after all, a chain.*
>
> - William James (1842 - 1910), The father of American psychology

LINK ADMINISTRATION

An opportunity presents itself

ELDERS

Old but new at heart

RAMELIUS RESOURCES

Buying up forgotten gold

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An opportunity presents itself

Stocks Down Under rating: ★★★★

ASX: LNK
Market cap: A$ 2.6BN
Dividend yield: 2.4% (50% Franked)
52-week range: A$2.64 / A$6.98
Share price: A$ 4.78

While this Sydney-based giant's name might be Link Administration, this company is certainly not headed for administration. If you have not heard of Link before, we recommend looking at the share registry of some of your stocks, because chances are it is managed by Link. This is a massive company with operations around the world. Management's rebuff of a recent acquisition offer caused a share price rout and we think this presents an opportunity.

READ MORE

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Market cap: A$ 1.7BN
Dividend yield: 2.2% (100% Franked)
52-week range: A$7.00 / A$12.28
Share price: A$ 10.64

Headquartered in Adelaide, Elders has been at the centre of Australia's farming industry since 1839, providing financing, banking, real estate, wool, grain and livestock trading services. Grain, cattle, sheep and wool, and agricultural exports are where the company has its largest exposure. Unlike many other ASX listed companies with this exposure to the domestic agricultural industry, Elders provides middleman services. We think the company provides investors attractive exposure to this industry without the usual production risk. So long as the price is right, which it probably isn't right now.

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Share price chart

Source: Tradingview

The market is the market of course

Link's market is not just any market, but the market. The global financial market to be precise. Link connects individuals, governments and organisations with their assets, including pensions, equity, debt, alternative assets and property. The company's services include retirement and superannuation solutions, corporate market accounts, fund solutions and banking and credit management all tied together through its data and asset platforms.

Link has a presence in over 18 different jurisdictions with Australia, Europe (including the United Kingdom and Ireland) and India representing its key markets. If this all sounds like a lot that's because it really is. In its retirement and superannuation solutions division alone, it provides services to over 10m account holders globally.

One of Link's advantages as a company is the highly recurring nature of most of its revenue. During FY20, 84% of its $1.2bn in revenue was recurring. That didn't stop FY20 being a down year, however, with total revenue and operating EBITDA declining 3% and 16.7% respectively. It is important to note that we removed the Corporate and Private Client Services division's results from our year-over-year revenue and EBITDA calculations as this division was sold on 28 June 2019, so these are like for like. While revenue declines were mostly attributable to COVID-19 and confusion around BREXIT, continued pressure on fees due to competition also had an impact.

EBITDA declined faster than revenue mostly due to increased investments in technology and COVID-19 related costs, causing operating expenses to increase 3% year-over-year despite the sale of a major division.

We believe Link offers a vital service to the global financial markets. Its incumbent market position in many of its jurisdictions grants the company a relative, although not impenetrable, moat against encroachment by competitors. The company will certainly continue to come under fee pressure as the sector continues to shift towards lower-cost products. Still, we believe Link's historical track record of retaining its clientele will continue into the foreseeable future.

FY22 is where it's all at

We basically view FY20 and FY21 as hunkering down years for Link. The COVID-19 pandemic might not be a massive issue in Australia, but the company's other major markets, like the United Kingdom, are virtually overrun with the virus. Additionally, Link is currently in the process of reorganising, simplifying, and absorbing its current acquisitions. All of these factors will contribute to both the market and Link's expectation that revenue and EBITDA will slightly decline during FY21. The market is currently expecting a revenue and EBITDA decline of 1% and 3% respectively.

FY22, on the other hand, is expected to see most, if not all, of FY20 and FY21's stumbling blocks resolved, allowing revenue and EBITDA growth of 9% and 19% respectively. For this recovery to occur, however, we believe Link needs a couple of things to fall into place.

The first is for the global COVID-19 pandemic to begin rolling back. We believe this is one of the larger risks for FY22 as it is unclear if this will happen during the first half of the year. The second main thing is management's ability to execute Link's simplification plan efficiently. This plan has many aspects, but two of the main ones are the demerger of Link Property and successfully executing the Global Transformation Program. The company's Global Transformation Program is on schedule as of management's last update in December and this program is slated to generate annualised cost savings of $75m per year starting in FY22. The program was initially estimated to generate annualised savings of $50m, but this figure was revised as management repeatedly overshot its goals.

Everybody wants a slice

Link operates in a highly desirable segment of the Australian financial market and other companies are certainly taking notice. On 7 December 2020, the company received an unsolicited buyout offer of $5.56 per share from SS&C Technologies (NASDAQ: SSNC), an US$18.3bn market capitalised, United States-based financial services company. Despite the premium of slightly more than 10%, management quickly and rather bluntly rebuffed the offer stating: "The Link Group Board considers that the SS&C Proposal does not represent compelling value for Link Group shareholders on a control basis."

Management's rebuff did not sit well with SS&C Technology Holdings and on 3 January 2021, the company sent a letter to Link stating it had decided to withdraw its proposal. This announcement caused Link's share price to crash from its post-offer high around $5.60 to slightly over $4.60, rebounding only to around $4.80. In response, on 18 January 2021, management began exploring all options including a trade sale of its property division with on the intention to provide more solid information to shareholders during 2HY21.

What now?

As we mentioned above, we view FY21 as a transition year and a 'wash' in-terms of results. We believe the COVID-19 pandemic combined with the simplification and Global Transformation Programs taking place during FY20 and FY21 mean investors should value Link based on its FY22 results. Link is currently trading at EV/EBITDA multiples of 10.6x and 10.1x for FY22 and FY23 respectively. This is based on an estimated EBITDA growth rate of, respectively, 19% and 4% for both years.

FY22's valuation seems to be on the low side, given an anticipated 19% EBITDA growth, but 4% EBITDA growth during FY23 is not worth 10.1x, in our view. Despite this, we remain bullish on Link for one main reason, the demerger of Link Property.

Even though SS&C Technologies' offer fell through, its 10% premium at the time shows that Link's assets are well placed and valuable. We believe the Property demerger (or trade sale) is likely to unlock enough shareholder value is makeup for the company's FY23 EV/EBITDA valuation. It's four stars from us.

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Share price chart

Source: Tradingview

Elders? Is that an aged care company?

No, Elders is not an aged care company, but rather an all-encompassing operation for all your Australian farmer needs. Do you need to buy seeds, fertiliser, chemicals, animal health products, cattle feed, other rural merchandise or even the services of a specialist to help you find out what you need on your farm? Elders is your one-stop-shop. All right, now that you have your farming supplies, how do you sell your livestock, wool and grain? Look no further than Elders' broker services. The company also owns a 50% interest in AuctionsPlus (livestock auction platform) and 30% of Clear Grain Exchange (online grain trading platform).

Now that I have sold my products, I want to do some expansion and need a loan and while I'm at it I need some insurance. Can Elder's help? Yes they can through the partnership with Rural Bank and StockCo and Elders Insurance for banking, livestock funding products and insurance needs. You know what, farming right now is just to difficult with all this industry disruption, so I want to sell my farm and rural property. Once again, Elders has you covered. The company offers marketing and real estate agent services as well as water and home loan broker services.

Onto the third

FY20 saw the company develop its third Eight Point Plan, which focuses on a massive integration and Systems Modernisation Program. The integration program aims to increase the gross margin of the rural products business by pushing its own branded products line. The Systems Modernisation Program is designed to upgrade the company's core operating systems and applications to increase efficiency and provide an easier way to absorb new acquisitions. This program is set to be finished by around 2023.

We don't usually see companies outline their plan and focal points over the next three years as clearly as Elders does and we are impressed at the transparency. Most importantly, Elders' management has a solid track record of meeting its projections. The second Eight Point Plan fell shy of the 20% underlying Return on Capital (RoC) at 18.7%, but it far exceeded its 5-10% EBIT growth performance goal after it increased EBIT 64% year-over-year to $120.6m during FY20. Sure, this was assisted by the rural supplies wholesaler Australian Independent Rural Retailers, where there was significant outperformance compared to business case projections at the time of purchase. However excluding this acquisition still saw the company exceed its goal of 10% EBIT. Yes, acquisitions are an important part of Elders' growth, but they are not the whole story.

Agricultural exports are the Achilles heel

Elders' direct exposure to agricultural exports is slim and verging on inconsequential at a net loss of $1.2m from Chinese sales during FY20. However, Australian agricultural prices are highly dependent on exports and this is where Elders' international exposure materialises. According to the Australian Department of Agriculture, Water and the Environment, around two-thirds of agricultural products are exported annually, with slightly under 20% being exported to China during FY18. This exposure to China's economic strikes against Australia has caused strong concern throughout the industry and has the potential for a strong impact on prices. This is why we believe agricultural exports are Elders' Achilles heel, not from direct exposure, but from the potential for declining prices, hurting the industry's demand for the company's products and services.

The price is not right

We are certainly a fan of management's high shareholder transparency through its current Eight Point Plan, but we are concerned about Elders' current valuation. FY21 is projected to produce EBITDA growth of 3.7% to $168.4m and an average annual EBITDA growth rate of only 4.4% between FY21 and FY24. Based off this EBITDA projection, Elders' FY21 EV/EBITDA valuation is 11.1x. We are a fan of its business model, but not its current share price, especially with the newly added China risk. Therefore, it's two stars from us at this time.

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Share price chart

Source: Tradingview

Okay, let's start with the trivia… who exactly is this mythical horse that is Ramelius Resources namesake? One of UNESCO's 1,100 or so World Heritage sites is the Mines of Rammelsberg, in the German state of North Saxony. Rammelsberg is part of the famous Harz Mountains that taught the whole world how to do mining back in the Middle Ages. Legend has it that the mineral wealth of Rammelsberg was found when a horse called Ramelius dug at the ground with his hoofs. The mines resulting from this discovery lasted for about a thousand years or so. Ramelius Resources was so named because its founders hoped it would have similar luck. Since Wattle Dam, it has.

It's a long way from Wattle Dam

Ramelius posted a very sound September quarter by exceeding its gold production guidance to 71,344 ounces, with 41,064 ounces coming from its Mt Magnet mine and 30,280 ounces from Mt Edna. The company experienced a record FY20 year with a record production of 230,000 ounces gold at an All-In Sustaining Cost (AISC) of A$1,164 per ounce, up 17% year-on-year. This resulted in A$113.4m in NPAT. Ramelius is now forecasting a production output of 260,000-280,000 ounces at an AISC of A$1,230-1,330 in FY21.

The company recently updated its mineral resource and ore reserve estimates, with total resources up 15% to 90 million tonnes at 1.6 g/t for 4.7 million ounces and ore reserves up 32% to 17 million tonnes at 2.1 g/t for 1.1 million ounces. Unsurprisingly, Ramelius' recent acquisition of the Penny West Gold Project (and Spectrum

Metals with it) has led the increase in grade and reserves. Penny West, only 150 km from the Mt Magnet mine, is one of the highest-grade undeveloped gold mines in the area, fitting easily with its strategy to acquire and develop quality projects near its processing hub.

Risk versus reward

Now in its tenth year of operation in its current form, Ramelius is a source of envy for other WA miners. Part of the success story is the company's attitude towards risk: it took a leap of faith on its high-grade, but highly variable, Wattle Dam mine, 25km of Kambalda, which turned out to be a seven-year 270,000-ounce company-maker, exceeding the original mine plan of just 13,500 ounces. This put Ramelius on the path toward 300,000 ounces and three processing hubs.But that fearless attitude has also cantered around prudent investment decisions, with the company's managing director Mark Zeptner seeing the value of mothballed and under-explored mines, which new technology could unlock. The company is still uncovering new orebodies at the 100-year-old Mt Magnet mine, expanding its eight-year mine life for at least another five.

Buoyed by the strong gold price, the company has outlined its $25m exploration budget in order to get to its 300,000-ounce target. With two processing hubs at Mt Magnet and Mt Edna, the company is looking to establish a third 100,000-ounce hub to make this a reality. As acquisitive as Ramelius is, the company has assigned itself a lot of future work, with some projects not yet in production, including the Tampia Hill, near the WA Wheat Belt town of Narembeen. Tampia Hill was acquired in 2019 in the Explaurum takeover.

For existing projects, numerous expansions are on the drawing board, such asexpansions at Mt Magnet (and Penny West) and the stage 3 open pit study at Mt Edna, which has the potential to switch to an underground operation.

Are there any other miners out there?

Given the growth rate this year alone, we expect Ramelius to remain aggressively acquisitive. In the short term, the ramp-up of the Tampia Hill and Marda operations and the integration of the Penny West Gold Project will add to the company's existing list of potential money-makers. Long-term, the sky appears to be the limit now that cash and gold on hand has risen to $221.9m, with $44m raised during the September quarter.

The main contributors to the company's growth will be stage 2 of the Eridanus open pit and underground scoping at Mt Magnet, as well as further exploration at the Vivien Gold underground (15 km west of Leinster). The company is working towards a June 2021 start to production at Penny West following a positive feasibility study and reduced operating costs, to $87m, and increased metallurgical recoveries.

We believe Ramelius is still too young a horse to be put out to pasture. However, since about September or October, the gold price has been a weight in this horse's saddlebags. That's why we think it's two stars right now. A potential resumption of gold's long term rise would quickly reverse this view to four stars given this company's ability to just keep growing.

Pitt Street Research Pty Ltd

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