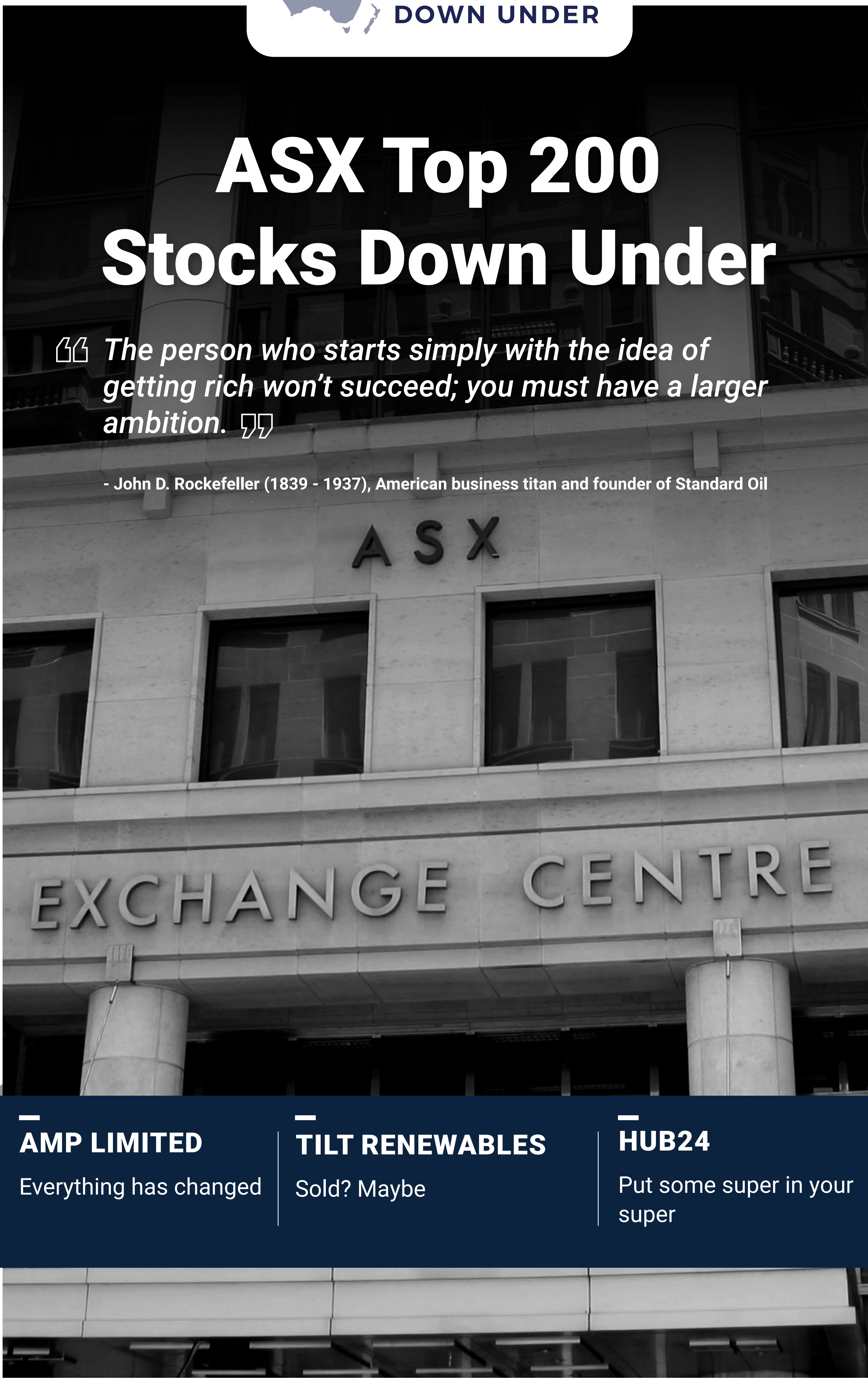
STOCKS DOWN UNDER

15 FEBRUARY 2021

ASX Top 200 Stocks Down Under

"The person who starts simply with the idea of getting rich won't succeed; you must have a larger ambition."

- John D. Rockefeller (1839 - 1937), American business titan and founder of Standard Oil



AMP LIMITED

Everything has changed

TILT RENEWABLES

Sold? Maybe

HUB24

Put some super in your super

AMP LIMITED

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Stocks Down Under rating: ★★

ASX: AMP
Market cap: A$ 5.4BN
Dividend yield: 3.1% (100% Franked)

52-week range: A$1.08 / A$2.09
Share price: A$ 1.32

In what is our third update on the AMP Limited, we are changing our rating from four stars to two. When we first published our four star rating on 4 September 2020, it was directly after the 2 September announcement of an asset review. However, as announced on 11 February 2021, everything changed as the company saw its only suitor, Ares Management, pull its offer. In accordance with this, management is now trying to turn the company around themselves. So, what does this mean for AMP?

READ MORE

TILT RENEWABLES

Sold? Maybe

Stocks Down Under rating: ★★★★

ASX: TLT
Market cap: A$ 2.5BN

52-week range: A$2.65 / A$6.70
Share price: A$ 6.15

Headquartered in Auckland, Tilt Renewables is part of the surging interest in wind and solar farms worldwide. The company currently operates seven farms in Australia and New Zealand. Not content to sit on its assets, management currently has 11 wind and solar farms in development with an additional two already under construction. But right now that's not really the story, because Tilt has received a number of non-binding offers and it seems the company is for sale.

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Share price: A$ 26.48

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Share price chart

Source: Tradingview

A brief history

AMP was a focus of the Hayne Royal Commission and was subsequently labelled as suffering from "widespread misconduct". While this was slightly over two years ago, AMP's problems are far from over. The company has been struggling not just to repair its reputational damage, but also to revive its struggling business. Since the Royal Commission's final report on 1 February 2019, AMP shareholders have seen an approximate 50% destruction in the value of their holdings. This decline has been due to a combination of factors, including a general lack of leadership on the part of management as they have struggled to turnaround the company, which saw $177m in Net Profit After Tax for FY20. While this might not seem so bad, this compares to $848m in Net Profit After Tax during FY17, a decline of 79%.

As if the misconduct unearthed during the Royal Commission was not enough, two major AMP executives were forced out of their position due to improper conduct in 2020. We mentioned this before during our first article on AMP, but it warrants mentioning again. Investors need to remember that often a company is only as good as its image and the AMP brand has been heavily marred by these constant, and clearly avoidable, scandals. Executives who engage in inappropriate and unethical conduct, as well as those who look the other way, are directly hurting the company. And since it's their own actions that are the cause, they can only be labelled as incompetent stewards of shareholder value.

What happened to a buyout?

When we first wrote our 4 September 2020 report on AMP we stated "Buying AMP Limited now is a bet on the break-up of the company, not on the turnaround being attempted by the current CEO. If a break-up does not materialise, or if the board fails to consult investors on any sale, then we believe the company deserves a solid two star rating. However, due to the likelihood of a break-up happening, we are issuing a four star rating at this time."

Unfortunately, the additional suitors that were expected to emerge from the woodwork with an interest in AMP's more salvageable operations never appeared. Despite management's assurances that there was "a lot of interest." Meanwhile, the company has seen its business only decline further causing Ares Management to back out of its proposed purchase of AMP, although Ares is still discussing purchasing the crown jewels, AMP's asset management division.

What happened during FY20?

FY20 was just a continuation of the decline of the company as management struggled to get its arms around its significant problems. During FY20, AMP generated $2.3bn in revenue, a 12.6% decline year-over-year. This decline was due mostly to the continued capital flight from AMP.

During FY20, the company's Australian division saw a decline in Assets Under Management and Administration of $12.7bn, a decline of 8% year-over-year. AMP Capital, the crown jewel of the company, saw an even worse decline of $13.3bn, or 6.5% year-over-year.

We don't expect this to improve anytime soon. Not only is AMP's brand completely tarnished from poor management, scandals and just overall poor performance, but the company is now undertaking a turnaround during an incredibly competitive time for the industry. As we discussed during our Netwealth article on 12 October 2020, a massive shift is occurring from the old and underperforming asset management platforms, like AMP, to new and innovative companies such as Netwealth and HUB24. During this increasingly competitive time, AMP is being forced to respond to significant margin squeezes by a freeze on salaries and a drastic reduction in the bonus pool. AMP is stating that they are heavily committed to cutting fees, but we worry that for shareholders this could be too little, too late to pull the company out of its tailspin.

Where does that leave us?

"The proof is in the pudding" is a common saying and for AMP, we are completely out of pudding. After reporting its terrible FY20 results and due to Ares pulling its takeover offer, the stock dropped more than 11% for the day. We believe this is likely to only be the beginning of the pain AMP shareholders are going to experience. Whenever a Chief Executive Officer is forced to "plea for clemency" from his shareholders, as CEO Francesco De Ferrari did during FY20's report, that should bring up a massive red flag for investors.

Unfortunately, based on the increasingly competitive landscape and, what we view as, a completely trashed brand image, we remain sceptical of AMP's ability to successfully execute its planned turnaround. With no full buyout option in sight for shareholders, we now view this as a two star stock.

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A new type of farmer

How the world generates its electricity worldwide has changed rather rapidly over the last few years. Installation of wind (30% of total capacity) and solar (60% of total capacity) capacity has led this sprint into renewable installation with the International Energy Agency (IEA) now predicting that total power capacity of wind and solar will outstrip natural gas by the end of 2022 and coal by the end of 2023. In its 2020 Renewable report, the IEA also predicts that renewable capacity will increase by 10% year-over-year during 2021, compared to just 4% in 2020. The main driver for this growth, according to the IEA, is the electricity sector. Despite 2020 seeing a net decline in global energy demand of 5%, renewable energy demand actually increased by 1%. This has seen a direct impact on the shares of global wind and solar companies. As of October 2020, shares of solar companies worldwide had more than doubled in value from December 2019. So even COVID-19 could not stop the unstoppable renewable-energy train and showed that the farmer of the future will work on wind and solar farms as soon as 2024. That's good news for Tilt Renewables.

Assets in demand

Tilt currently operates seven wind farms in SA, VIC, NSW and New Zealand with a total installed capacity of 367MW at the end of its 1HY21, which is 30 September 2020. Tilt has an additional two wind farms under construction in VIC and New Zealand and had already installed 336MW and 133MW, respectively, on those farms as of 1HY21. The Victoria farm is slated to be at full production in the first quarter of CY21. This also happens to be when New Zealand construction is to be completed.

Revenue during FY20 (ending 31 March 2020) declined 12% year-over-year, to $168.8m due to fluctuations in energy prices, a risk for all companies in the renewable energy space. This decline in revenue led to a subsequent decline in EBITDA of 13% to $116m. FY21's results are estimated to see a significant further decline to $132m in revenue and $70m in EBITDA.

However, we would remind our readers that for Tilt FY21 will include the majority of COVID-19 as their financial year runs from 1 April through 31 March. The market expects revenue and EBITDA to rebound hard during FY22, to $185m and $107m respectively. This rebound seems well within reason to us and might even be on the low side. Let's face it, the pandemic is more or less over in Australia and New Zealand, and Tilt is slated to bring both of its current construction projects online, which will more than double its current production capacity.

Who is Infratil?

Tilt is in an unusual situation for a publicly listed company as Infratil effectively controls it through its 65% ownership stake. While this would normally constitute a simple footnote, Infratil announced on 7 December 2020, that it was initiating a strategic review of its shareholding in Tilt with an eye to completely divest the company. Since then, Infratil has made it clear that it has received a significant, though undisclosed, amount of offers for Tilt. To be clear, this would constitute a 100% purchase, not just the 65% owned by Infratil. On 4 February 2021, Tilt announced to the market that it had begun due diligence proceedings with a 'number of parties' who had issued non-binding proposals. While far from a certainty, it seems increasingly likely that Tilt will be acquired and taken private. The issue investors are facing at the moment is that the market has not received any guidance as to the valuation these offers put on Tilt. It is important to note that since the 7 December 2020 announcement, Tilt shares have rallied 40%.

Normal valuation metrics do not apply

Tilt is an interesting case study in valuation. The company is currently trading at EV/EBITDA ratios of 37x and 24x for FY21 and FY22, respectively. However, this is based on an expected decline in EBITDA of 41% during FY21 and growth of 53% during FY22. While 53% EBITDA growth might seem rather impressive, we would remind our readers that this is due to FY21 containing the majority of COVID-19's market troubles. Therefore, FY22 is simply a return to normal conditions. After all, FY22's EBITDA is estimated to be 10% below FY20's.

Normally we would state that based on the current valuation, Tilt would be a two star company. However, we believe the potential for a full acquisition changes things quite considerably. The continual and drastic influx of cheap money combined with fervour for all things renewable causes us to believe a considerable premium likely to be paid for Tilt.

The issue is this: It is completely unclear what this multiple would be. We think it is unlikely, although not impossible, that Tilt would be sold for less than current market value. However, we believe there is a good chance that Tilt will be sold at a clearly higher price than what the stock is trading at today.

Tilt is certainly a risky play, but it has some highly desirable assets for investors willing to take the risk. So, four stars from us, although this type of risk may not be for everyone.

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Share price chart

Source: Tradingview

Superannuation, Australia's step ladder

HUB24 taps into two different major ongoing themes, i.e. the expansion of Australia's financial resources due to superannuation and the market punishment currently being enacted on HUB24's industry.

Australia is home to the fourth-largest pension pool of capital in the world due to our superannuation system. Over the last ten years, our total pension assets have seen an average growth rate of 10.2%, one of the world's highests. When considering Australia's ranking as the 55th largest nation by population size, superannuation has truly allowed Australia to punch well above its weight. This capital pool is predicted to grow from the current $1.9tn to $7tn by 2035 and a significant portion of these assets are invested in the Australian capital markets.

Not everybody in the sector is enjoying this capital accumulation. Due to a large number of scandals, poor ethics and straight-up incompetence, many of the largest platform providers are rapidly losing their funds. According to Netwealth's FY20 annual report, the top ten platform providers by market share of Funds Under Administration are Westpac (18.4%), AMP (16%), CBA (15.2%), NAB (13.4%), Macquarie (10.4%), IOOF Group (8.8%), Netwealth (3.8%), Mercer (3%), HUB24 (2.1%) and Xplore Wealth (1.8%). Within this top ten list, only

Netwealth ($9.1bn), HUB24 ($4.9bn), Macquarie ($3.2bn) and Xplore Wealth ($0.7bn) saw positive net fund flows. In fact, the smallest loss of net funds within this top ten was CBA, losing $1.2bn. This trend started with the Royal Commission and we believe this will likely continue over the next couple of years.

Comparing against the competition

We last wrote about HUB24 on 3 March 2020 and on 12 October 2020 we wrote about Netwealth. We mentioned HUB24 in our Netwealth article because we believe Netwealth and HUB24 are two of the higher-quality companies in the financial platform industry at the moment. Therefore, to understand either company, we believe it is best to compare the two. Since we focused on HUB24's FY20 results in our last publication, we will only be discussing FY21's results here.

The most recent update for each company is December's Funds Under Administration update. In 2020, HUB24 saw a 38.7% year-over-year increase in Funds Under Administration to $22bn compared to Netwealth's 14% year-over-year increase to $38.8bn. HUB24 is certainly growing its Funds Under Administration at a much faster rate than Netwealth, but in this business, size does matter and Netwealth has significantly greater Funds Under Administration than HUB24. We believe this gap is likely to be maintained for some time unless Netwealth starts to see net outflows in the next few years, which we find unlikely at this time.

However, from a valuation perspective, we believe HUB24's growth deserves a premium over Netwealth's, despite Netwealth's size advantage. Why? Because HUB24 is growing at one of the fastest rates in the industry due to its lack of scandles during the Royal Commission and runs a platform that has a greater focus on innovation. This growth is coming at the expense of the older, more established platforms.

Margin growth is real

HUB24 has two main EBITDA growth drivers: revenue expansion and EBITDA margin growth. Netwealth is more established and, therefore, has a stable EBITDA margin of 52%. HUB24, on the other hand, is still developing and, therefore, had an EBITDA margin of only 22% during FY20. An EBITDA margin of 22% compared to the margins of its closest peer of 52% is a big difference, yet it is important to remember that HUB24's FY19 EBITDA margin was only 15%. We believe HUB24 will continue its rapid EBITDA margin expansion over the next couple of years and the company will likely manage to match Netwealth's margin eventually. This leaves approximately 30%-points of margin upside, a significant amount, in our view.

The best in the industry

For those investors interested in this industry, we definitely believe you can't go wrong with HUB24. At first glance, the Price/Earnings ratio of 85x for FY21 might seem like a lot, but combining the company's margin and revenue growth equals an expected earnings growth of 81% during FY21 and 86% during FY22. Considering this growth, the current changing of the guard in the industry and taking into account the company's growth potential from a margin perspective alone, we believe HUB24 is the place to be in the superannuation platform space. Four stars.

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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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