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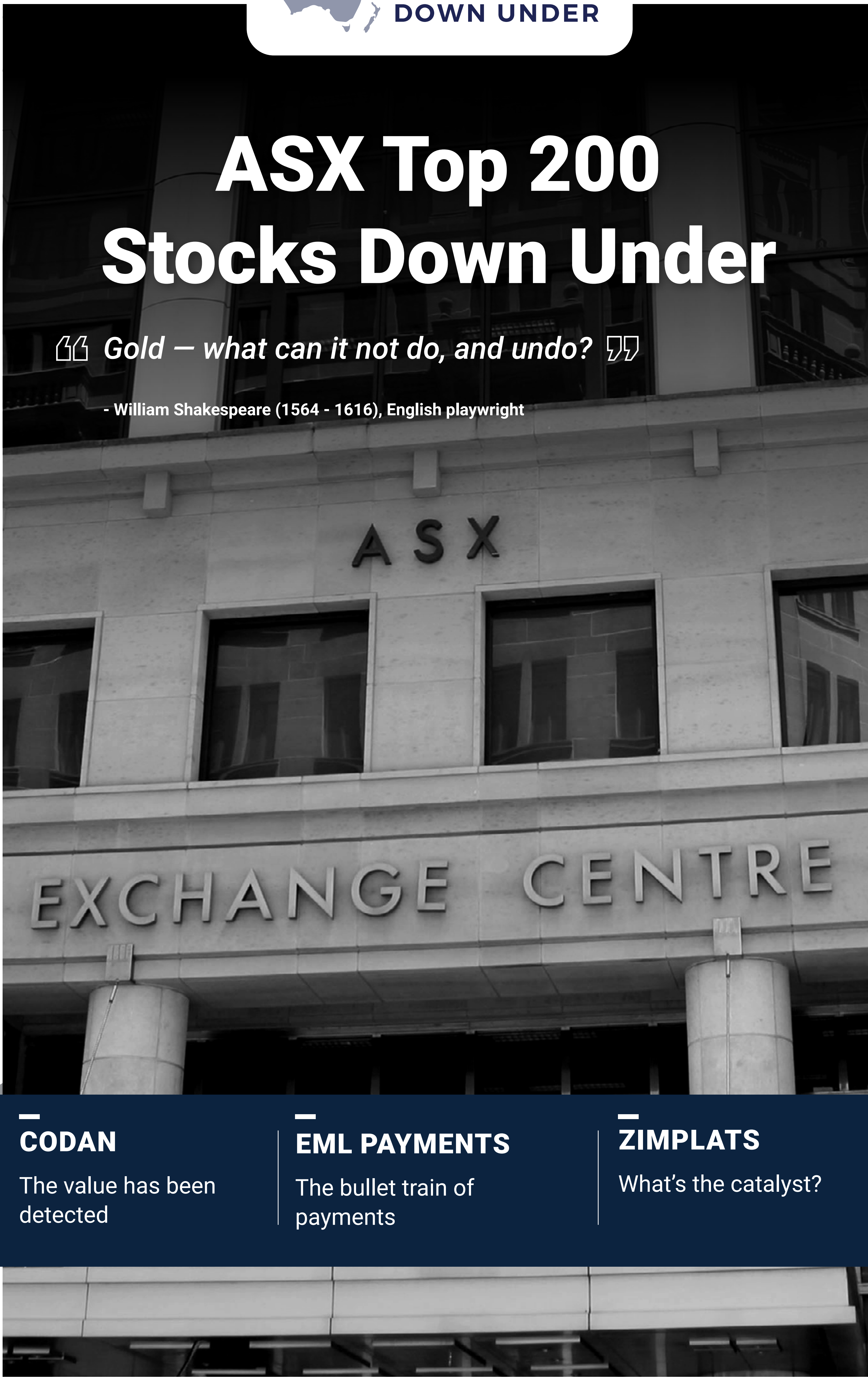

ASX Top 200 Stocks Down Under

> *Gold — what can it not do, and undo?*
>
> \- William Shakespeare (1564 - 1616), English playwright

CODAN

The value has been detected

EML PAYMENTS

The bullet train of payments

ZIMPLATS

What's the catalyst?

CODAN

The value has been detected

Stocks Down Under rating: ★★★

ASX: CDA
Market cap: A$ 2.2BN
Dividend yield: 1% (100% Franked)

52-week range: A$3.90 / A$15.40
Share price: A$ 15.03

Headquartered in Adelaide, Codan is a global software and hardware developer for civilian and military-grade products focusing mostly on communication and metal detection. We believe Codan benefits from two main trends causing a powerful tailwind - the growing instability around the world, and the strength of gold price. While the stock already rallied 51% during 2020, we think the market has realised Codan's power.

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EML PAYMENTS

The bullet train of payments

Stocks Down Under rating: ★★★★

ASX: EML
Market cap: A$ 1.5BN

52-week range: A$1.20 / A$5.37
Share price: A$ 5.08

Headquartered in Brisbane, EML Payments offers customers in 28 different countries a portfolio of payment solutions. A key strength of EML is its principal membership with Mastercard in Australia and Europe, which grants it the ability to issue pre-paid cards like gift cards and general pre-paid cards. EML is protected from BREXIT destroying its business as the company's E-money licence is from the Central Bank of Ireland. Will EML Payments benefit or fall by the wayside with COVID-19 accelerating the transition to a digital-focused economy? We think benefit.

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ZIMPLATS

What's the catalyst?

Stocks Down Under rating: ★★★★

ASX: ZIM
Market cap: A$ 1.3BN
Dividend yield: 9% (100% Franked)

52-week range: A$6.96 / A$15.21
Share price: A$ 12.15

Once the Corona Crash was over in March 2020 the good times returned for the precious metal platinum and other metals in the platinum group complex. Platinum bottomed at under US$600 an ounce back then, but has since been over US$1,100 an ounce. We think 2021 will be a good year for platinum and its cousin palladium as industrial demand for the metal improves. A good proxy for these metals is the ASX-listed Zimplats, owner of a large platinum mine in Zimbabwe.

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Share price chart

Source: Tradingview

Global instability, gold, and the potential for profits

For people who are concerned about investing in a military contractor whose focus is in Asia, Africa, the Middle East, and Latin America, we would point out that Codan is not an arms manufacturer. For military purposes the company only sells communications equipment and landmine detectors, neither of which can be used in a direct offensive capacity. However, the largest portion of Codan's revenue comes from the sale of metal detectors for the purpose of hunting for gold. Gold hunting has become extremely popular since the Global Financial Crisis (GFC) as the price of gold skyrocketed and individuals looked for ways to supplement their income.

The world is becoming a more dangerous place, with almost every region seeing increasing conflict and discord. This has caused military spending across the board to increase sharply, especially in the regions of Codan's focus: Asia, Africa, the Middle East, and Latin America. According to the World Bank, the average increase in military spending as a percentage of GDP in the aforementioned regions was 3% during 2019, year-over-year. As 2020 ony just ended (thank goodness), the official statistics have not yet been calculated and released, however we think that that year will have seen another year of increased GDP being deployed to military purposes. This benefits Codan as one of the most important aspects of a modern military is the ability to stay in constant communication, and Codan just so happens to sell communication equipment.

The heroes and their tiny sidekick

Codan generated $348m in revenue during FY20 with 98% being directly attributable to its two primary divisions: metal detection and communications.

Unless you have been living under a rock (pun intended) for the last few years, you would have noticed that the price of gold has skyrocketed. Like many times in the past when the price of gold has seen record appreciation, interest in hunting for gold has accelerated at an almost identical pace. As the world leader in metal detection technology, this has been the cause of much prosperity at Codan's metal detection division. Since FY16, year-over-year sales have increased over 50% each year from $99.2m back to then to $236.4m in FY20. While this division also includes the company's mine detection equipment, the growth truly comes from individual prospectors hunting for gold. This does mean if the price of gold was to collapse overnight, Codan's sales would likely follow along with it.

We believe the volitility of gold is an important aspect of Codan's annalaysis. Companies with exposure to volatile industries like gold need a more stable division to help smooth over the downtimes, communications is that division for Codan. We mentioned before how we believe the world's instability will provide Codan's communication division with an important growth trend. Between FY16 and FY20, the revenue growth was always north of 25%. This allowed for the division to grow revenue to over $100m and we believe this revenue base can hold up even if the metal detection unit sees revenue stagnation or even decline.

The value has been extracted

The market is currently expecting EBITDA growth of 25% during FY21 and 18% compounding annual growth rate between FY22 and FY24. Based on these projections, we believe the stock's current valuation is truly within its fair value range. From an FY21 EV/EBITDA value basis Codan is currently trading at 18x. From an FY24 EV/EBITDA basis, the valuation is at 11x. We believe there is the potential for the communications sector to surprise the market. However, as most earnings come from the metal detection division, we believe the surprise is unlikely to be significant enough to make a difference. In our opinion, Codan is currently squarely within its fair value range. Three stars from us.

EML PAYMENTS

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Share price chart

Source: Tradingview

The dreaded gift of a pre-loaded card

Whoever thought that it would be a good idea to give people a gift of restricted cash? Well, according to Smithsonian Magazine, it was the long-defunct Blockbuster in 1994. Sure, you may be thinking, there is no way the gift card was invented only in 1994. Well, yes and no. The concept of gift certificates is certainly older than 1994, and the concept of restricting cash onto a piece of plastic was first sold decades ago by Neiman Marcusm but the first time a restricted cash gift card was advertised and displayed as a standalone product bwas when Blockbuster did so in 1994. Since then, the concept has taken off, with Starbucks selling 1,500 every minute in the United States and Canada during 2012, and the concept has kept growing since then. Gift cards are, at their basic level, reusable, pre-loaded debit cards. This means that it is not too far a leap for a company that facilitates the creation and management of gift cards, could also be involved in other card products.

Reusable, pre-loaded debit cards is where EML Payments comes into its own, with thye company having done an impressive job since its 2003 founding in taking a slice out of the worldwide market. As of 1HY21, EML is a truly global organisation, with operations in 28 countries and 486 employees. The company has offices in

Australia, the United States, England, Ireland, Poland, and Sweden to manage $10.2bn in Gross Debt Volume during 1HY21 alone. Compare that with the whole of FY20, where EML issued around 11m gift and incentive cards and 2m general purpose reloadable card, for a Gross Debt Volume was $13.8bn. For EML to facilitate 73% of its FY20 Gross Debt Volume during 1HY21 alone is certainly an outstanding result.

What is Gross Debt Volume, exactly? It's the total debit amounts processed by the company's processing platforms during the period in question. So, the volume of transactions EML processed during 1HY21 was 73% of its total volume processed during all of FY20. This is why EML reported revenue growth of 61%, to $95.3m, during 1HY21 and EBITDA growth of 42%, to $28.1m.

The three divisions

EML operates under three main divisions: General Purpose Reloadable (GPR), Gift and Incentive (G&I), and Virtual Account Numbers (VANS).

General Purpose Reloadable provided the largest source of growth during 1HY21, with $54.4m in revenue represented a more than tripling of the business due to . Say you're a government department and you need to make money available to a programme beneficiary. EML's GPR cards enables you to do so in an easily managed way. This division processed $4.9bn in Gross Debt Volume during 1HY21.

Gift and Incentive, unsurprisingly, saw a slight decline in revenue from $40.1m during 1HY20 to $35m during 1HY21. Seeing as how many around the world have spent their holidays, birthdays, and other important events behind locked and closed doors, people did not have the opportunity to either buy or spend gift cards in stores.

Virtual Account Numbers provides customers with the ability to easily make and manage large commercial payments as well as process Buy Now Pay Later transactions. Before you get too excited about a Buy Now Pay Later approach, this division is a very small part of EML's revenue generation at only $5.8m during 1HY21 representing a small increase of 5.5%, year-over-year.

The bullet train of payments

As we noted above, EML had a very strong 1HY21, and while we are uncertain if management will be able to keep growing at such a significant rate, we do believe the stage is set for a boom during 2HY21 and FY22 as worldwide people begin to come out of lockdown and restrictions. The question is: Does the market already know this and have they already priced this in?

EML certainly surprised analysts with its 1HY21 reporting. Still, with eight different firms currently placing price targets, we believe it is unlikely this will happen to such a degree again as estimates have already been revised. The current consensus places FY21 and FY22's EBITDA growth at 62% and 41%, respectively. Despite these upgrades and the over approximately 17% jump the stock took the day it reported 1HY21's results, we believe the market still undervalues EML. Looking at FY21 and FY22's EV/EBITDA ratios, we find 33.5x and 24x, respectively. Compared this to what we believe is a strong opening up play fuelling significant growth, and we believe the market is still undervaluing EML's shares. Four stars.

ZIMPLATS

What's the catalyst?

Stocks Down Under rating: ★★★★

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Share price chart

Source: Tradingview

Way back in 1998 the emerging Australian gold miner Delta Gold decided to spin out its Zimbabwean platinum assets. The company had been working since 1986 on developing the Harley Platinum Mine only an hour's drive south of Harare, and that mine had been commissioned with BHP as the major joint venture partner in 1997. The Zimplats spinout went well, but then BHP threw in the towel due to a string of geological and metallurgical problems, leading to the suspension of underground mining in 1999. Never mind, said Zimplats, which inherited BHP's stake. It had a better alternative in a new open-cast mine further south called Ngezi. That mine started up in 2002 and the Johannesburg-based Impala Platinum, better known as Implats (JSE: IMP), liked its prospects so much it offered in 2003 to buy the whole of Zimplats at $4.08 per share.

A survivor

Now fast forward a couple of decades. These days Ngezi, which is about 180 km south of Harare by road, is four underground mines and a concentrator, and there's also a concentrator and a smelter at Selous, 80 km to the north. In the year to June 2020 Zimplat's revenue from Ngezi and Selous rose 38%, to US$869m, while NPAT increased 81% to US$261m. That was because the price of platinum was better, as was palladium, rhodium and nickel, all of which are produced from this massive mine. Measures in '6E' terms, where the output of platinum, palladium, rhodium, ruthenium, osmium and gold are converted to a platinum equivalent, Zimplats's output only fell 3% in FY20, to 550,000 ounces. COVID-19 didn't force the mine's closure and everything has operated more or less normally ever since.

We think the fact that Ngezi is still around says a lot about the long-run potential of this huge asset, which may have another 30 years' worth of mine life to run. Zimplats is sufficiently appreciated by the market to afford it billion dollar capitalisation on ASX, and the market is liquid enough despite the free float being only 13%. The stock does, however, labour under one massive sentiment problem – the fact that its mine is in Zimbabwe, which is why the P/E in only about 5x. As we all know, that unfortunate southern African country went to wrack and ruin in 2000 when the government of President Robert Mugabe started violently expropriating white-owned land. What's less appreciated is the fact that since 2000 Zimbabwe has been on a rollercoaster. The economy was busted from 2000 to 2008. However after 2008 there was a pleasing recovery as the government enacted pro-market reforms. Then after 2016 a second and currently ongoing bust set in, one that wasn't fixed by the November 2017 coup d'état that rolled Mugabe in favour of the current President, Emmerson Mnangagwa.

Trading below NTA

Now you know why you can buy Zimplats today at less than Net Tangible Asset Backing, which as at June 2020 was US$11.82, or A$15.31 at the 0.77 exchange rate. We argue, however, that that discount is set to close over time. For one thing, Ngezi has been running for two decades and hasn't come close to being nationalised because the export earnings were too important for the struggling Zimbabwean treasury. For another, the 2008-2016 experience tells you that Zimbabwe is capable of reforms, and we predict that a new round of reforms to help Zimbabwe make it out of the Corornavirus Crisis in one piece will feature the mining sector prominently among them.

Meantime Zimplats has something really important going its way – prices for the platinum group metals. Certainly, COVID-19 badly impacted the complex, but that was only for a little while. At that time platinum dropped from US$1,000 an ounce to more like US$600 while palladium went from around US$2,800 to US$1,700 an ounce. Both, however, recovered smartly since March. Platinum is back over US$1,000 an ounce as we write and palladium is over US$2,300.

Two clean, green metals

And no wonder. The two metals are mainly used its autocatalytic converters to reduce harmful exhaust emissions – platinum for diesel engines and palladium for petrol engines. A renewal of world economic growth in 2021 has got to be good for the automotive sector and therefore for platinum and palladium, particularly given the environmental concerns of the Democrats who won last November's elections in the US. And palladium is particular interesting because before the Coronavirus ruined everything the price of that metal was skyrocketing due to demand being stubbornly ahead of supply.

Zimplats stock has recovered nicely from the $7.01 level of 13 March but with platinum and palladium set to have a good year, and the stock still trading below NTA, there's more where this important platinum proxy can go. Obviously if something really bad happens in Zimbabwe in 2021, sentiment will be impacted. But if the Mnangagwa government bites the bullet and initiates some reforms, Zimplats is an obvious beneficiary. With the political risks in mind, this one is four stars, in our view.

Pitt Street Research Pty Ltd

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