STOCKS DOWN UNDER

16 NOVEMBER 2020

ASX Top 200 Stocks Down Under

Fools say that they learn by experience. I prefer to profit by others' experience

- Otto von Bismarck (1815 - 1898), Founder and Chancellor of the German Empire

ASX

EXCHANGE CENTRE

LYNAS

Digging those Rare Earths

BAPCOR

A false start disqualification

WAYPOINT REIT

In WALE we trust

LYNAS

Digging those Rare Earths

Stocks Down Under rating: ★★★★

ASX: LYC
Market cap: A$2.9BN

52-week range: A$1.02 / A$3.33
Share price: A$3.28

In this article we'd like to introduce you to a major industrial company that is really important to the modern economy, has very few competitors and loyal customers all over the world. And no, we don't mean Apple. We mean the Sydney-based Lynas Corp, which is the world's second largest producer of Rare Earths. With Electric Vehicles and wind turbines, among other 21st century products, requiring a heck of a lot of Rare Earths, we predict a great future for Lynas.

READ MORE

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Market cap: A$2.5BN
Dividend yield: 2.4%

52-week range: A$2.85 / A$8.53
Share price: A$7.34

Headquartered in Melbourne is a leading aftermarket provider of vehicle parts, accessories, equipment and services. The company has about 1,000 locations across Australia, New Zealand and Thailand. While the automotive aftermarket was one of the harder hit industries, the market expects a return to normal during FY21. The issue is a return to normal means a return to less than 10% earnings growth annually, a reality not apparent in the stock.

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Share price: A$2.72

Waypoint REIT is specialising in service stations and convenience properties across Australia. This Australian convenience giant is headquartered in Sydney and recently went through some major changes. Many listed Australian REITs of Waypoint's size have two separate, but related, companies split between management and ownership lines. However, as of 1 October 2020, the trust completed its reorganisation and absorption of its management entity. So, the question must be asked, is the this start of something new or something blue?

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Share price chart

Source: Tradingview

Back in 2013 Lynas Corp. reached an important milestone in its corporate development. In 2001 the company made the decision to try and get into the Rare Earths industry and spent most of the next decade seeking to mine the world's richest Rare Earths deposit at Mt. Weld, 35 km south of Laverton in Western Australia. By late February 2013 Lynas had achieved its goal, with the first Rare Earth Oxide (REO) products from Mt. Weld concentrate rolling off the production line at a plant near the Malaysian city of Kuantan. Lynas stock had risen eightfold since the Global Financial Crisis and was now changing hands at $6.30.

Lucrative non-Chinese supply

Now fast forward seven years or so. Back at the low of the Corona Crash in March 2020 you could buy Lynas Corp for just $1.08 a share. Sure, the stock has re-rated nicely since then, and indeed, it is now up threefold, but it's still not too much higher than the $2.25 level that Wesfarmers (ASX: WES) had indicated in March 2019 was a fair price. Why has Lynas yet to regain its old mojo?

We think the problem is that investors are yet to genuinely appreciate both the importance of Rare Earths to the world of the 2020s and Lynas' near-unique space within it. Most investors who like the resources sector

know about copper, nickel, gold or iron ore. Rare Earths are, by comparison, a little arcane, unless you really paid attention in chemistry class at High School and insisted on your teacher explaining the importance of things like neodymium and praseodymium. Most investors also don't appreciate that 85% of the world's Rare Earth supply come from China, so that when a company like Lynas can offer up Rare Earths that don't come from China, that is a really big deal.

The vitamins of industry

What exactly are Rare Earths? Well, if you take a look at the Periodic Table in your long-neglected chemistry textbook you'll see 15 of them folding out from the single box allocated for elements 57-71 three columns from the left. Throw in scandium (No. 21) and yttrium (No. 39) from the same column and you've got the 17 Rare Earths. They're not actually rare in nature but they're rare in terms of being found in economic quantities such as what you find at Mt. Weld. China is called the Saudi Arabia of Rare Earths because most of the existing economic deposits occur in that country.

Rare Earths are sometimes nicknamed the 'vitamins of industry' because of their use in smart electronic products, wind turbines and sophisticated defence equipment. The rise of the electric car as a 21st century transport option will depend in part on the availability of Rare Earths. Given this rising economic importance and the tendency of China to suddenly turn off supply without warning, users of Rare Earths outside of China just love having non-Chinese sources. And Mt. Weld is about as non-Chinese as it gets in this game,

Working with Uncle Sam

One very important prospective customer is America's Department of Defence, which in July of this year signed a contract with Lynas to design a Rare Earths separation facility. We think users of Rare Earths will increasingly favour Lynas over its Chinese counterparts in order to ensure security of supply. Remember, Lynas can account for where its product comes from and can certify that it has been made in an environmentally-sensitive manner. In the 2020s Lynas' customers are beginning to insist on this kind of accountability. Just to make doubly certain that it is geographically well placed, Lynas is now working on building a new Rare Earths cracking and leaching facility in the WA mining town of Kalgoorlie.

Lynas had a lousy FY20, with revenue down 16% to A$305m and EBITDA down 40% to just A$59.8m. However one can blame that almost solely on the temporary production halts and price weaknesses associated with Covid-19, weaknesses Lynas could cope with because it was holding $101.7m in cash at the end of the year. In a normal year – and Mt. Weld has 25 years' worth of reserves so there's plenty of 'normal' years still to come – Lynas can do much better. Indeed, on consensus numbers EBITDA is expected to increase 68% p.a. between FY20 and FY23 as prices and production recover. Lynas stock, however, is currently trading on an EV/EBITDA multiple of just 21x forecast FY21 earnings. That multiple looks pretty inexpensive to us given the growth opportunity, making Lynas a four star play even after the recent re-rating.

BAPCOR

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An aftermarket after action report

Bapcor had a surprisingly solid year all things considered. The company managed to increase its revenue by 12.8% year-over-year while only seeing a 4.1% and 5.5% decline in EBITDA and Net Profit After Tax. A quick clarification on EBITDA and Net Profit After Tax, though, the 4.1% and 5.5% declines are based off an EBITDA of $138.7m and a Net Profit After Tax of $88.7m. The reported numbers were actually $144.5m and $88.7m, respectively. The discrepancy is due solely to the adoption of AASB16 causing leasing expenses to be moved to the balance sheet and artificially increasing the company's profit. The market expects things will return to normal between FY21 and FY22 as the company finishes filling the pent-up demand from lockdown and resumes mostly normal trading operations. We believe this is highly likely and therefore, agree with the market's assessment of 4% and 6% EBITDA growth after FY21.

Dividing these divisions

Bapcor has four main divisions: Burson Trade, Bapcor NZ, SWG and retail. Burson Trade provides the largest portion of the company's revenue (38.4%) growing at 7.1% during FY20 to $561.7m. While 7.1% revenue growth is impressive during COVID-19, the company did attribute most of this growth to a six month long promotion. This promotion had a temporary negative impact on margins, but was a success overall. Although, it does imply the division's past revenue growth is not an indication of a new period of higher growth.

Bapcor NZ had the most difficult time among the company's divisions with revenue and EBITDA declining 5.2% and 14%, respectively. Fortunately, this division has historically been the lowest provider of both revenue ($156.3m and 10.7%) and EBITDA ($19.6), so the divisions poor operating results did not hurt the company's total performance to a significant degree. Management stated the decline was due to New Zealand's lockdowns having a significant negative impact on demand within the aftermarket automotive industry.

SWG is known as two different titles within the company's reports: SWG and specialist wholesale. Investors should remember that these are the same divisions. SWG stands for Specialist Wholesale Group and historically provided the largest portion of the company's total revenue and EBITDA growth, although FY20 saw mixed results. While the division still increased its revenue 26% to $520.4m, EBITDA only increased 8.7% to $50.3m. The results were actually significantly worse than indicated, however, as acquisitions hid the divisions FY20 decline. Excluding acquisitions this division saw an EBITDA decline of 7.1%. SGW's spectacular growth is often due to acquisitions and investors should keep that in mind when analysing the company's financials.

The retail division consists of Autobarn, AutoPro, Sprint Auto parts and Midas and ABS service workshops. The retail division saw the most impressive organic revenue and EBITDA results, increasing 14.7% to $292.7m and 12.8% to $30.5m, respectively. These results were almost exclusively presented by the division's Autobarn branded stores. During May and June 2020 Autobarn saw same store sales increase 51% year-over-year. While the company has attributed this to changes made in management and increased efficiency and store standards, we believe that the fantastic results were due mostly to pent up demand from lockdowns. We look forward to the retail division's 1HY21 results.

False start, instant disqualification

The market is currently assuming between 4% and 6% annual EBITDA growth for Bapcor between FY21 and FY25. Meanwhile, the stock is currently trading at an estimated FY21 and FY22 EV/EBITDA ratio of 12.1x and 11.4x, respectively. We believe this valuation does not match the company's financial prospects at this point in time.

The key phrase in our valuation statement is "at this point in time." Bapcor is a company that usually does exceedingly well when new car sales shoot up, but for the last couple of years that has not been the case. We don't believe the new car market is likely to change over the next couple of years while the world recovers from COVID-19. However, if and when that situation changes, Bapcor's growth prospects should improve quickly. For now, though, the stock is a two star investment for us.

WAYPOINT REIT

In WALE we trust

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Property = Viva Energy = Shell

Waypoint's property portfolio could easily be considered a surrogate bet on the survival of Viva Energy Group (ASX: VEA) because 97% of the trust's annual rental income is derived from properties leased to Viva. Viva has the exclusive licence to sell Shell fuels and lubricants in Australia. If this exclusive right was to be lost, we believe Viva would be in serious financial trouble. This would pose a serious ongoing concern risk for Waypoint's operations. Luckily, this risk seems to be very small, but we believe it is important enough to mention.

Despite the singular tenant focus of Waypoint's property portfolio, the trust has what we consider to be relatively stable properties. Despite the decline in traffic that many of the company's properties experienced during the height of the lockdowns, the company still managed to retain a 99% rent collection rate. The Weighted Average Lease Expiry (WALE) for the trust's portfolio currently sits at slightly over 11-years. Mostly due to the positive appreciation of the trust's properties, the net asset value per share of the trust increased 3.9% since December 2019 to $2.38.

The interesting thing about Waypoint's rental agreements is that Viva Energy is unlikely to refuse a renewal of the rental agreement. There are two main reasons for this, the first is because of the location-specific nature of petrol stations and convenience stores. Additionally, both companies have close ties as VER Manger's parent company was Viva Energy. VER Manager was the old, now absorbed, property management organisation in charge of Waypoint's property portfolio.

What's the management deal?

On 1 October 2020, the trust announced to the market that it had finished reabsorbing its management operations (VER Manager) back into the organisation. Fortunately, the announcement also made it clear that all of the principle management figures from the old company had agreed to stay on and had already signed new contracts. This leads us to believe the likelihood of any major transition issues will be relatively small.

So, what is the main point here? Waypoint is likely to increase it's overall margins. The trust achieved 3% annual rental increases at the end of 2019 due to the nature of its contracts, driving rental income from investment properties to $79.1m for 1HY20 (January – June), which is a 6.4% increase. You see, the company also expanded its property portfolio outside of its Viva Energy properties, which accounted for the other portion of the company's 6.4% year-over-year rental income increase.

The result of it all

All-in-all, Waypoint is a solid REIT with strong, reliable revenue generation. While the company is highly exposed to the ongoing success of Viva Energy, we view this to be a rather negligible issue at this time. Normal operations for the trust paint an interesting picture, but 1HY20 showed that management has decided to expand Waypoint into a true, independent REIT. Out of the five properties purchased during 1HY20 for a total of $32.5m, only one had Viva Energy as a tenant and all had WALEs of over ten-years.

We believe the trust's acquisition strategy focusing on properties not linked to Viva Energy, but keeping with the trust's long-term WALE portfolio, will provide shareholders with a continually appreciating property portfolio in the future. Additionally, we believe this will allow the company to potentially break the cycle of lacklustre dividend growth.

From a valuation perspective we believe P/B is the best metric to value Waypoint. In our view, Waypoint deserves to be valued in line with to another long-term WALE-focused REIT we looked at in ASX Top 200 Stocks Down Under on 9 November 2020, Charter Hall Long WALE REIT (ASX: CLW). We believe Charter Long WALE's fair value should be a premium of 5% to 7% to its Net Tangible Asset value. However, the trust only has a 1.4% dividend yield compared to Waypoint's 4.8%.

Waypoint is currently trading at 15.5% premium to its 30 June 2020 Net Tangible Asset value per share of $2.38. We believe this is too high a premium to pay at this time, but we do understand why investors have driven up the price of this REIT. With interest rates so low and the current market consensus suggesting that they will stay that way for years to come, REITs that had very little or no exposure to the downsides of COVID-19 have been trading at a premium to their peers. We believe a premium much closer to 10% would be fair value for this company. It's a three star rating from us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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