STOCKS DOWN UNDER

15 MARCH 2021

ASX Top 200 Stocks Down Under

I only understand friendship or scorched earth.

- Roger Ailes (1940 - 2017), Former Chairman and CEO of Fox News

FINEOS CORPORATION

Contract Wins are Piling up for This Software Upstart

UNITED MALT GROUP

Pint Half Full Investors Have a Tasty Opportunity

RESTAURANT BRANDS NEW ZEALAND

Quick Turnaround for Quick Service Food

FINEOS CORPORATION

Contract Wins are Piling up for This Software Upstart

Stocks Down Under rating: ★★★★

ASX: FCL
Market cap: A$ 1.2B

52-week range: A$2.16 / A$5.75
Share price: A$ 4.02

Headquartered in the tech hub of Dublin but listed on the ASX, Fineos Corporation is a web-based software developer for the insurance industry. It serves customers in the general, life, accident, and health insurance fields through offices located in Europe, North America, Australia, and New Zealand. The shares have advanced nearly 10% year-to-date but remain well off their record high set in August 2020. We favour the high margin, recurring nature of the company's revenue streams and see further upside from here. Fineos has opportunities to expand into new markets, other insurance verticals, and upsell new products to its growing customer base.

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Market cap: A$ 1.2B
Dividend yield: 1.0% (0% Franked)

52-week range: A$3.53 / A$5.24
Share price: A$ 4.00

Headquartered in Sydney, United Malt Group is a witch's brew of beer companies with businesses in Australia, New Zealand, Europe, the U.K., and North America. As a provider of bagged malt and other craft beer ingredients to brewers, distillers, and food companies around the world, trading conditions fell flat amid the pandemic. An abrupt pause on the rapid growth in the craft beer market forced the group to go into survival mode. United Malt Group's share price is trading near a 52-week low. This is a reflection of lower on-premise craft beer demand that has outweighed increased at-home consumption during COVID-19. But looking ahead, the company's strong brand portfolio and geographically diverse customer base put it in a good position to stage a turnaround as the pints start flowing.

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Auckland-based Restaurant Brands New Zealand operates Kentucky Fried Chicken (KFC), Pizza Hut, Taco Bell, and Carl's Jr. fast food restaurant chains in New Zealand, Australia, and the USA. In total its nearly 300 stores serve the cravings of a customer base which is spreading as the company expands its global footprint into parts of Australia and the USA. While sales were impacted by government mandated closures in the early going of last year, trading conditions have since improved as people have returned to satisfy their budget-conscious munchies. The shares have bounded back remarkably since dipping below NZ$7 at the onset of the pandemic. Now trading near a 52-week high, Restaurant Brands New Zealand stock is benefitting from the reopening trade and optimism around a growth period ahead.

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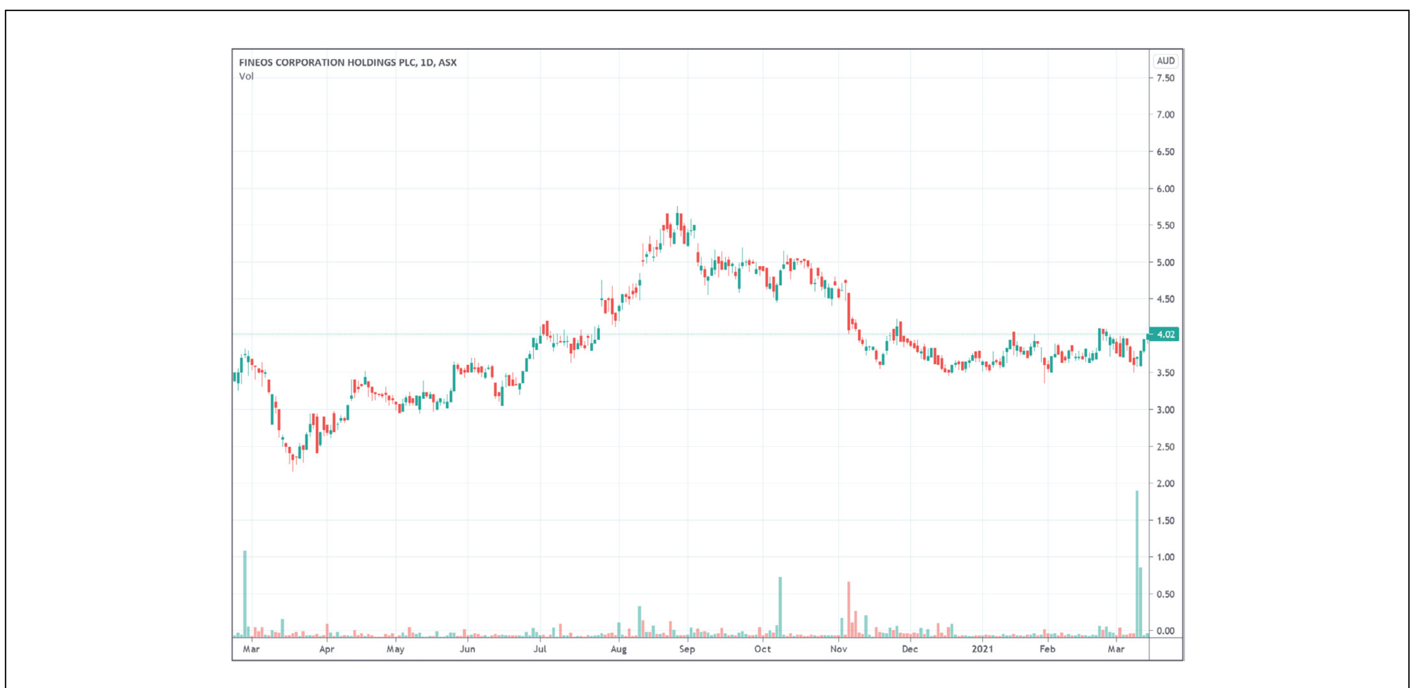

Source: Tradingview

High retention rates, recurring revenues

Fineos Corporation's software-as-a-service (SaaS) solutions help insurance companies administer policies, manage claims, and perform billing. Its customers span the insurance spectrum from life and accident insurers to health insurance firms. The company's AdminSuite includes software that supports a range of insurance functions like billing, claims, payments, and absence. The FINEOS Claims and FINEOS Payments are its core software offerings and the strength of the business. Since most revenues are subscription-based, the Fineos business model is attractive in our view. Investors like us certainly appreciate the revenue visibility.

Like other SaaS companies, Fineos has competitive advantages that are unique to the online software space. Unlike legacy software platforms which require clunky cd's and ongoing product updates, Fineos doesn't have an update cycle. Its software is updated in the cloud meaning customers barely notice and aren't troubled by pesky sales rep visits and productivity delays. Moreover, financial services companies that invest in online software typically stay with the software once it becomes integrated with the enterprise. The cost of making a switch often isn't worth it. As a pioneer in insurance SaaS, Fineos enjoys a significant first mover's advantage. This along with the sticky nature of its client base means it can quickly capture share in its market.

Limelight Health buyout boosts U.S. presence

The FY20 results exceeded management's targets as revenues climbed nearly 40% to €87.8m. Around 30% of revenue was from recurring software subscriptions with the remainder from new and existing client services such as implementations and upgrades.

In August 2020 Fineos announced the acquisition of U.S.-based insurance software provider Limelight Health. The move represented a big step forward in the company's plans to expand in the U.S. and spread the word about its brand.

Earlier in the year Fineos brought on the largest insurance company in the U.S., Prudential Insurance Company of America, as a client which really bolstered its credibility in the $1.3 trillion U.S. insurance market. We view the Limelight Health buyout as yet another significant growth accelerant.

Despite the ongoing challenges of COVID-19 Fineos delivered a solid 1H21 performance. Revenue increased 30% to €52.6m with two-thirds of the growth derived organically and the remainder from acquisitions. Annual recurring revenue accounted for 73% of total revenue compared to 30% in FY20 thanks to new client wins and upgrades. Services revenue slowed to 16% because of a focus on one major implementation project. Although Fineos is still operating at a net loss that was €2.5m in 1H20 due to elevated spending to promote its brand and extend its global reach, profitability is not far off. As the business scales and spending subsides, the bottom-line performance should soon turn from red to black.

For FY21 management is forecasting top line growth of 20% led by a 30% increase in subscription-based revenues. After 30% overall growth (including 35% organic subscription growth) in the interim period, this guidance may be conservative and primed for a beat. In addition, the forecast does not include the contribution from the newly acquired Limelight Health business which could be at least €4m. Nevertheless, it's good to see the subscription part of the business leading the charge.

We also favour the clean balance sheet. Despite the recent acquisition activity, the cash balance is robust at €30.7m. The debt balance has been reduced by 24% since 30 June to €8.6m.

Impressive client profile

Fineos has built a nice client portfolio that consists of some top-tier insurance customers. Six of Australia's top 10 life and health insurance providers are Fineos clients. So too are seven of the top ten life and health insurers in the U.S. Across the pond in New Zealand, 100% of accident claims are processed using Fineos software.

Building off its recent momentum, Fineos announced a new contract win in February 2021. New Zealand's Partners Life selected the Fineos platform as its solution for life insurance and medical claims after considering multiple options. Although the term of the initial SaaS contract was rather modest at 5-years, given the company's retention rate, there's a good chance this gets extended. More importantly, the new customer will strengthen Fineos's dominant position in New Zealand.

So, we like the company's positioning in the growing insurance software market and its increasing level of annual recurring revenues (ARRs). With market share gains likely in the future, we consider Fineos a favourite mid-cap growth share.

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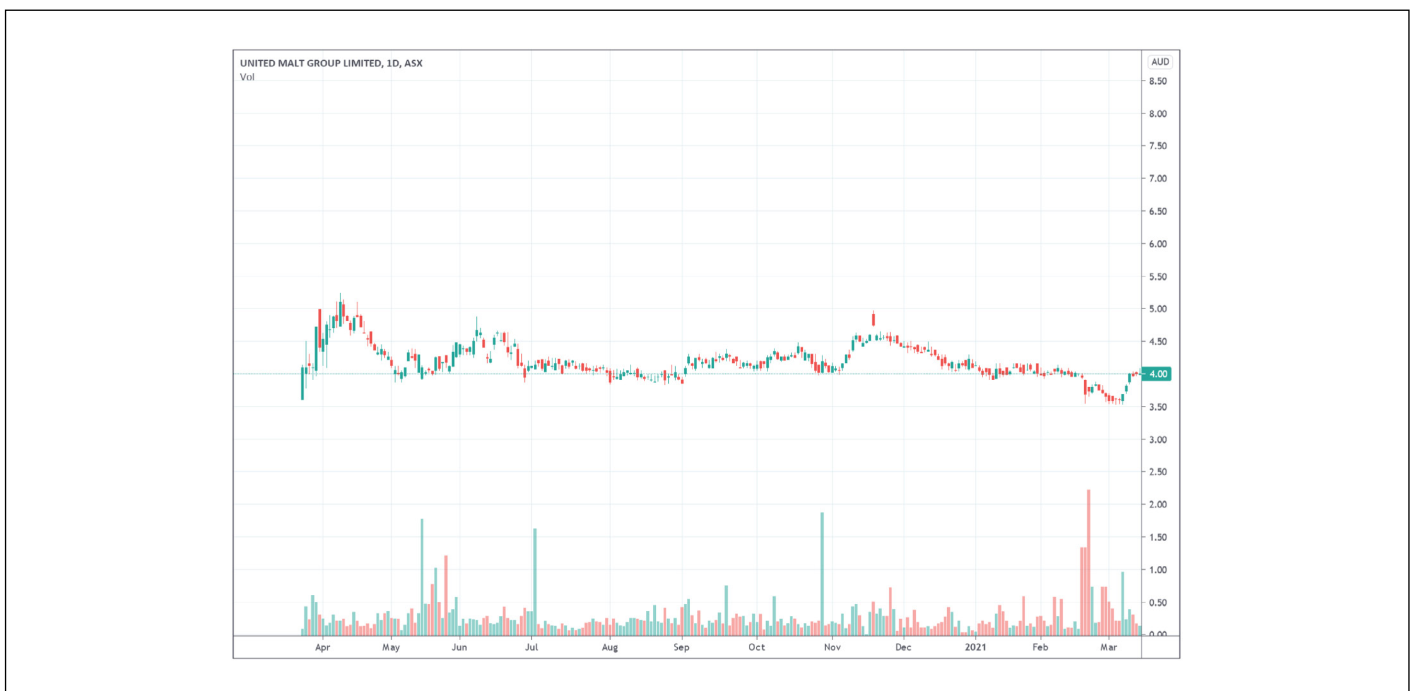

Source: Tradingview

Pub closures put a halt to malt

As one of the world's largest commercial maltsers, United Malt Group is less than a year removed from its spinoff from Sydney-based GrainCorp Ltd. It was indeed a rough timing for the separation. The newly independent company was immediately slowed out of the gates by restrictions on on-premise alcohol consumption. With many restaurants and bars closed, beer volumes sank industrywide meaning little demand for malt inputs. This led to some financial results that were hard for the market to swallow.

However, all things considered the FY20 performance wasn't all that bad. Revenue slipped just 2% to $1.3bn with the second half numbers dragging down a solid interim period. Net profit after tax (NPAT) fell 3% to $57.4m. An unfavourable product mix and higher insurance premiums after the spinoff impacted the bottom line.

The results exceeded market expectations, but the bears were quick to point to the impact of government funding and temporary COVID-19 cost reductions. Although not sustainable, we don't think these factors

diminish the underlying strength in the business and the craft beer market as a whole. Once large group events like concerts and sports resume, consumers' taste for craft beer will pick up where it left off and create some thirsty pent-up demand for the industry.

Buying another round

On the bright side, having endured such an unprecedented year, United Malt Group will likely emerge stronger. Although COVID-19 uncertainty remains, things seemingly can only get bitter, uh better, from here. We view this to be a great opportunity for shareholders to buy another round of United Malt Group stock.

Heading into 2021 United Malt Group's markets have largely reopened. The company noted an absence of significant craft brewery closures and the resiliency of on-premise sales as pubs have reopened their doors. In the long run the pandemic may actually create new growth opportunities for brewers. Many have enhanced their technological capabilities by offering digital ordering, pickup, and delivery services. Outdoor seating areas are being built to attract customers. This may expand capacity and increase malt demand as conditions normalize. Many brewers are branching out into new products such as hard seltzer which should ultimately bring greater sales opportunities for United Malt Group.

While United Malt Group has taken steps forward in some countries it has taken steps back in others. On 8 February it announced the closure of its Grantham facility in the U.K. effective March 2021. Malt production will be shifted to both the Witham and Arbroath facilities in an effort to improve asset utilisation and lower costs (including energy, waste, and water costs).

Meanwhile the company is moving forward with plans to expand in neighbouring Scotland where it has made investment to add 79k metric tonnes of capacity across a pair of sites. Construction at the new malting plant in Inverness originally scheduled to be completed by the end of this year has been pushed forward to May 2022 due to government restrictions on worker counts and social distancing. Yet Scotland remains an attractive growth market for United Malt Group because distillers there are a source of strong demand stemming from the rising popularity of aged whiskey.

The group's expansion into Mexico represents another interesting growth channel. United Malt recently inked a deal with its existing Mexican distributor to increase its presence in the country's fast growing craft beer market. Move over Corona, there's a new malt in town.

Cyclical recovery favours value shares

United Malt Group's balance sheet is moving in the right direction. The net debt balance of $261.7m is less than half what it was at as 31 March 2020. The proceeds of the company's $170.6m secondary equity offering were partly used to reduce debt with the remainder being deployed for growth opportunities. No long-term debt repayments are due until November 2022 which should give management some breathing room to pursue growth.

With a P/E of 22x the share offers good value. We also like the group's plan to increase its dividend payout ratio to around 60% of NPAT as trading conditions improve. As vaccine distribution progresses and restrictions ease consumers will return to their favourite pubs, dining rooms, and festivals. In the process, we expect United Malt Group's financial performance to begin bubbling.

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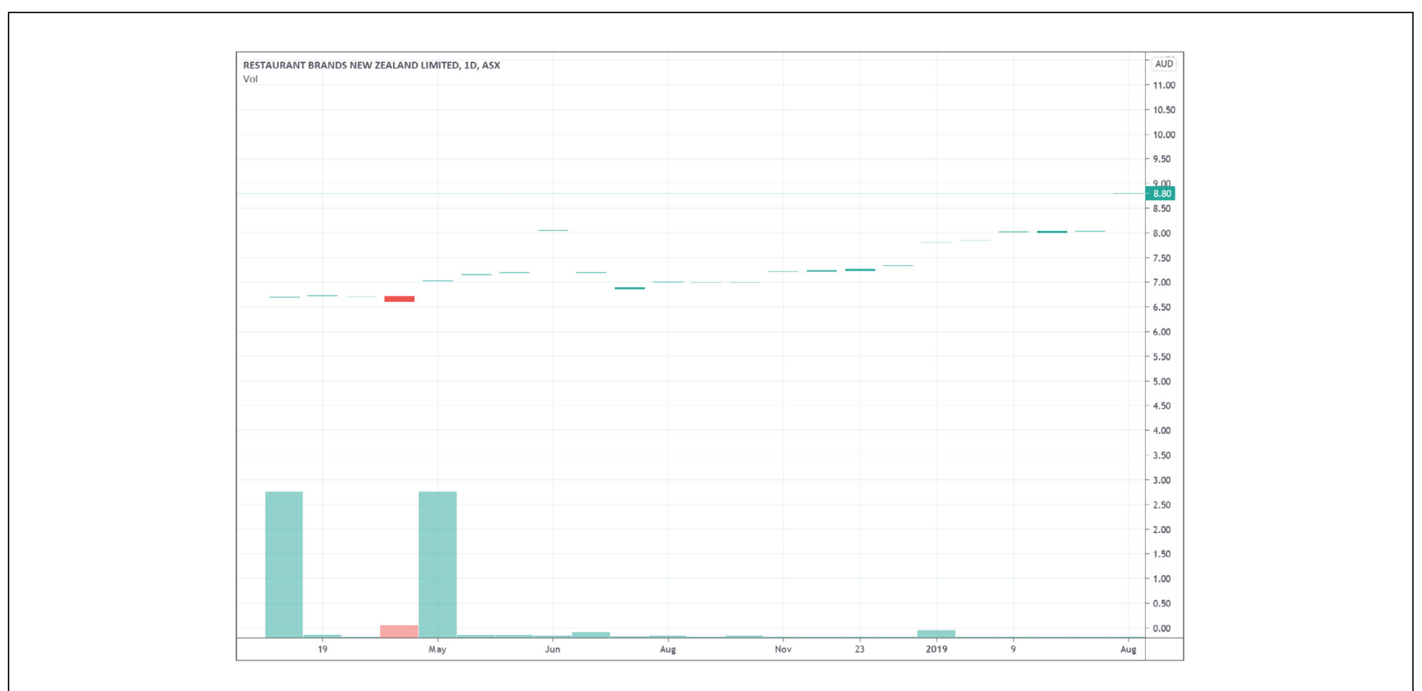

Source: Tradingview

COVID-19 slows fast food

As we expected Restaurant Brands New Zealand's second quarter results were severely impacted by COVID-19. All of its fast-food locations in New Zealand were closed for about a month through 28 April. For the next couple of weeks thereafter only drive-through and delivery was available. Meanwhile, dining rooms at its stand-alone stores in Australia were closed for the entire quarter and 10 mall locations were closed during half the quarter. This led to an 11% sales decline to NZ$183.3m for the quarter ended 30 June.

The inevitably weak second quarter pulled down first half results. Total group sales were down 13% to NZ$383.4m mostly due to the pandemic but also because the reporting period was two weeks shorter than the prior year period. Net profit after tax (NPAT) plunged 43% to NZ$11.4m. Despite this there were pockets of surprising strength such as a profit increase in the U.S. market driven by a hearty appetite for Pizza Hut among homebound Americans.

USA expansion bodes well for growth

The company is moving beyond the ANZ region to find complementary growth. In September 2020 it completed its previously announced acquisition of 69 KFC and Taco Bell locations in Southern California, USA. The company funded the $80.7m purchase from existing credit facilities but given the strength of the balanced sheet we are less concerned about the increased debt balance. Most of the acquired stores are KFC with the remainder being the combo meal variety of multi-branded KFC/Taco Bell establishments. We applaud the expansion into the U.S. market where the company also has assets in Hawaii and see further opportunity to diversify in North America.

As Restaurant Brands enters its next phase of growth, we expect its financial performance to reflect not just a healthier global economy but its expanded market presence. This has certainly been the case in recent quarters. Third quarter sales increased 13% to NZ$239.8m in part due to the addition of the California business, but also due to strong sales at existing stores as ex-California sales advanced 6.5%. This performance was particularly impressive because all divisions recorded growth including New Zealand where locations were closed for the first month of the quarter. Somebody was supersizing their order!

The momentum carried into the fourth quarter. Apparently, a lot of holiday shoppers made a pit stop for fast food because Q4 sales increased 7.4% excluding California and 20% including the new territory. In Australia, same store sales increased 3.6% and 10.8% overall when tossing in the group's eight additional Aussie locations. The strong rally to the 2020 finish line helped calendar year sales increase 2.1% (and 8.4% including California). This was no small feat given the economic backdrop.

Stock should be on investors' menu

Of course, sales growth is one thing but what about the bottom line? Well, despite COVID related safety expenses and higher wages, profits have been growing too. On 25 February, Restaurant Brands New Zealand provided full year results (through December 2020) that showed 27% and 3% increases in sales and NPAT, respectively. Part of this gain was due to a shift in the company's reporting timeline, but irrespective, profits were still up.

The stock's 29x trailing P/E ratio is far from cheap, but this valuation includes the results during the early stage of the pandemic, so not normal operating conditions. To the company's credit, its business model has proven to be resilient thanks to its globally recognised brands and geographic diversification. For fiscal 2020, management expects that less than half of sales will be derived from the New Zealand market with 21% coming from Australia and 36% the USA. We like this balanced revenue model and exposure to three strong fast-food markets.

Looking ahead to Restaurant Brands long-term earnings prospects there are several growth levers. The Taco Bell brand was launched a little over a year ago in ANZ so there is more growth yet to come there. Plans to open 100 new stores by 2025 is at the core of the company's strategy as is expansion in the USA. Along the way the group should reach its sales target of NZ$1bn in short order—and so, we would place an order for some shares in anticipation of a steady growth trajectory.

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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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