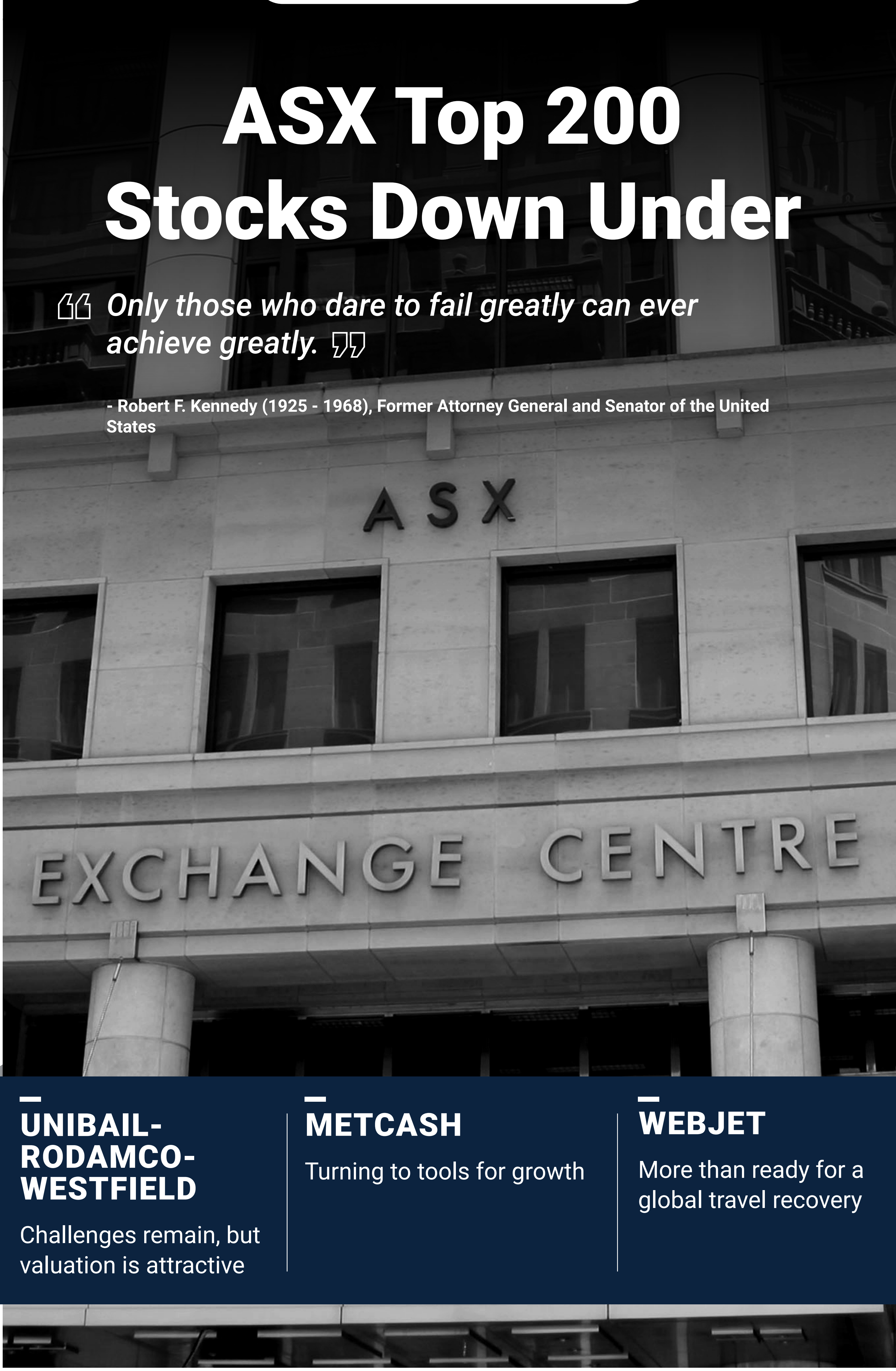
ASX Top 200 Stocks Down Under

> *Only those who dare to fail greatly can ever achieve greatly.*

- Robert F. Kennedy (1925 - 1968), Former Attorney General and Senator of the United States



UNIBAIL-RODAMCO-WESTFIELD

Challenges remain, but valuation is attractive

METCASH

Turning to tools for growth

WEBJET

More than ready for a global travel recovery

UNIBAIL-RODAMCO-WESTFIELD

Challenges remain, but valuation is attractive

Stocks Down Under rating: ★★★★

ASX: URW
Market cap: A$ 1.2BN
Dividend yield: 1.6%

52-week range: A$2.41 / A$5.79
Share price: A$ 5.34

Unibail-Rodamco-Westfield (Unibail) owns and operates commercial properties in the UK, Europe and the United States. Due to its heavy exposure to shopping centres, COVID-19 has had a crippling effect on the business. Since some centres have reopened, however, customer traffic and sales have trended toward pre-pandemic levels. This suggests that despite the popularity of online shopping, people are still willing to return to their favourite stores. Despite progress in the recovery, risks remain including an accelerating shift to online retail and ongoing pandemic uncertainty. Also, Unibail's results are in Euros, so this is a source of currency risk for Australian shareholders. Nevertheless, the CDI is trading at a significant discount to net tangible assets and is therefore an inexpensive way to gain exposure to a global retail recovery.

READ MORE

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Market cap: A$ 3.5BN
Dividend yield: 5%

52-week range: A$2.25 / A$3.67
Share price: A$ 3.47

As Australia's leading wholesale distribution and marketing company, Sydney-based Metcash has a strong presence in food, liquor and hardware retailing. It is not only a leading food wholesaler and Australia's largest liquor retail supplier, but an emerging supplier to some of the country's largest hardware stores. This unique combination makes for some well diversified revenue streams that are good to have in today's retail environment. After a challenging FY20 in which Metcash was impacted by the bushfires and COVID-19, the company now faces heightened competition from online retailers in addition to ongoing pandemic restrictions. Its focus on the more profitable hardware business should help amid elevated trade tool demand from DIYers. The stock is trading near its 52-week high, but may have limited upside from here, in our view. At the end of the day, Metcash predominantly operates in a low margin, low growth industry. This doesn't compel us to put any of its shares in our shopping cart.

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Share price chart

Source: Tradingview

Shopping centres for sale

As Europe's largest commercial real estate company, Unibail derives net rental income from three property groups—shopping centres, office and other, and convention and exhibit. Since shopping centres account for 95% of net rental income, COVID-19 lockdowns and restrictions had a crippling impact on 2020 performance. On average, Unibail properties were closed for 93 days and operated under normal conditions for just 70 days during the year.

This led to a 26% decline in like-for-like net rental income to €1.79bn as rent relief and doubtful debts weighed heavily. This was mostly driven by a 24% like-for-like net rental income decline in shopping centres, but also a 94% plunge in the convention and exhibition net rental income. On the bright side though, whenever the centres were open, performance was strong. This was especially the case in the food and beverage segment with consumers loading up their carts. By 3Q20, sales had rebounded to 86% of their 2019 level and foot traffic was back up to 77%.

As you'd expect, management has had to take some drastic survival measures in response to COVID-19. It cancelled the dividend, deferred non-capital expenditures, disposed of several shopping centres and pared back its development pipeline to enhance liquidity and strengthen the balance sheet. Last year €2.3bn of assets were sold, including the SHiFT, three Les Villages office buildings and five shopping centres in France, Unibail's largest European market. The asset disposals were part of a larger plan to dump €4bn of properties over the next couple years for the purpose of deleveraging.

Reeling in retail innovators

Although Unibail's leasing activity slumped 36% last year (1,528 new leases were signed), it picked up in 2HY20. The company is trying to lure emerging retail concepts, such as those in the automotive, entertainment and digitally native, vertically integrated brands, or DNVB, sectors. DNVBs are a new type of eCommerce innovators that sell their own products through their websites. They sell directly to consumers rather than relying on the Amazons of the world, which gives them a price advantage over competitors. Once the brand is established, they branch into traditional retail to generate more growth. In our view, Unibail's ability to attract DNVBs to their properties will help it stay relevant in an increasingly e-commerce driven world.

In the meantime, Unibail will continue to face pandemic-related challenges. As at the beginning of February 2021, all countries in which the group operates had some level of restrictions in place that impact Unibail. Through 10 February 2021, approximately 52% of Unibail shopping centres were restricted from trading with only essential stores allowed to be open. With large group gatherings still prohibited across Europe, the UK and the United States, the convention, exhibit and airport businesses won't be able to contribute much either.

Financially fit to survive

In terms of solvency, Unibail has sufficient liquidity to handle any further COVID-19 setbacks. Management recently estimated it can cover its financing needs for the next 24 months. At year end it had €11.4bn in cash and available credit facilities. This was lower than the €12.7bn of liquidity it had at 30 June 2020, but it is still a healthy amount for a company this size. Plus, as the asset disposal plan progresses, the cash position should further strengthen.

The dividend is a main attraction of property shares. However, Unibail's dividend remains suspended through FY22. This may seem like a deterrent to some investors. In the long-run, though, shareholders should be better off. Unibail's high level of capital reserves will allow it to reduce debt and pursue growth opportunities. Once it completes its deleveraging program it will emerge a stronger company that likely returns to a pattern of dividend growth. Operating from a position of financial strength will also allow the company to pounce on any attractive properties deals without denting liquidity too much.

As at 31 December, EPRA net tangible assets (NTA) per share was €128.10. Unibail's ASX-listed shares represent a 20-to-1 chess depository interest (CDI). A CDI is a unique financial product that entitles holders to the ownership benefits of an ordinary share, or in this case 0.05 shares of Unibail. Based on the current EUR/AUD exchange rate, one CDI is valued at AU$9.93, which implies a discount approximately 45%.

We continue to favour Unibail's balance sheet strength and see limited risk of shareholder dilution. Earnings should continue to see improvement as vaccine distribution progresses, restrictions are lifted and shoppers venture back into their favourite destinations. So, our customer satisfaction rating for Unibail is four-stars.

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Local matters

Headquartered in Macquarie Park, Sydney, Metcash has come a long way since its 1927 roots as David's corner store. Today, it supports more than 1,600 independently owned grocery stores, including IGA and Foodland as well as convenience stores though its Campbell's Cash & Carry and C-Store Distribution brands. It washes this business down with a liquor store network of nearly 2,800 locations that consists of brands like Big Bargain, Cellarbrations, Duncan's, Porter's Liquor, The Bottle-O and Thirsty Camel.

Although not advisable for consumers to make purchases in this order, the last part of the Metcash shopping spree is hardware supply. It supports over 700 stores owned by leading hardware retailers Hardings, Home Timber & Hardware, Mitre 10, Thrifty-Link Hardware and True Value Hardware. In each case, Metcash focuses on independent, family-owned businesses that hire and source products locally. Management has recently noted a "significant change in shopping behaviours" with more people shopping 'local' these days.

Given the disruptions in the business caused by the bushfires and COVID-19, the FY20 result was beyond respectable. Sales were down only 1.8% and EBIT was up 1.8%.

Strong start to 2HY21

The half year results were also decent as Metcash continued to adapt to the pandemic economy. The combination of elevated customer demand, supply chain constraints and COVID-19 safety requirements (i.e. higher expenses) is no easy juggling act. Yet all distribution centres were fully operational during the interim period and contactless receiving and dispatching was successfully implemented. Metcash introduced an online retail option for food and liquor and provided financial support to retailers hurt by trading restrictions. It also launched a Click & Deliver service for its DIY hardware customers in metro Melbourne.

When the six months ended 31 October 2020 were all said and done, revenue was up 12.2% to $7.1bn and EBIT rose 30.4% to $203m. This was the result of higher foot traffic and an increased average basket size in the food business, while liquor also saw heightened demand from pandemic-weary Australians. For the first five weeks of 2HY21 food and liquor sales were up 2.4% and 16.9%, respectively. Demand was also sharp in the tool trade as people continued to devote time to home improvement projects. Hardware sales, excluding Total Tools, were up 19.3% for the first five weeks of 2HY21.

Meanwhile, Metcash is hoping its recent acquisition of Total Tools can drill some growth into the business. Metcash paid roughly $57m for a 70% stake in Australia's largest trade tool supplier. Total Tools' network of 86 stores offers globally recognized brands, like Milwaukee and Makita. Noteworthy here is the fact that the Hardware segment accounts for just 16% of revenue but 31% of EBIT. So, the addition of a higher margin hardware division, if integrated properly, stands to have a favourable impact on the bottom line. The Kollaras private label business also holds growth potential.

Low growth dividend play

The balance sheet is improving, but not spectacularly. The $188.4m gross debt balance is now off the books, but at the expense of a lowered cash position of $172.5m compared to $275.1m at the end of FY20. Net assets and equity didn't change much since 30 April 2020 at $1.37bn, but look good compared to $1.03bn as at 31 October 2019. The company paid an interim dividend of 8 cents in 1HY21 and should be able to maintain its 60% dividend payout target.

Metcash is a steady, fully franked dividend play ($0.145 dividend in 2020) that probably won't lose you a ton of money, but isn't likely to send you to an earlier retirement either. The valuation is typical of a grocery wholesaler at 15.7x earnings — fairly valued if not a bit expensive following the solid run over the last 12 months.

From FY16 to FY20, sales and EBIT grew 2.1% and 2.5%, on average, respectively. A similar result is likely in the cards for FY21. In fact, you could take a nap for a couple of years and would probably wake up to see Metcash delivering the same kind of slow growth performances. It's a solid and essential business, but absent any major growth catalysts we'd hit the snooze button…it's two stars from us.

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Bed banking business a source of cash

In Boston Consulting Group's COVID-19 consumer sentiment surveys, leisure travel has consistently been listed as the #1 thing people have missed most during the pandemic. From Generation Zers to Millennials to Baby Boomers, more than 90% of global travellers have said they plan to return to airplanes and hotels. This is a very good omen for Webjet.

Webjet's consumer travel agency business should certainly benefit from an uplift in domestic and international travel given the strength of its namesake and Online Republic brands. Webjet is the leading online travel agency (OTA) in Australian and New Zealand while Online Republic specialises in online car, motorhome and cruise bookings. Yet it's the WebBeds part of the business that investors should still be most excited about. This is the online B2B hotel supplier to the travel trade that has a fast-growing presence in the European, APAC and AMEA regions. The business has been around for nearly a decade now, but its scaling has really taken off lately.

Once a small side business to complement Webjet's, the WebBeds business has grown into the company's main source of EBITDA. It is the world's second largest B2B accommodations player after Spain's Hotelbeds. As the lowest cost B2B provider it has more than 44,000 customers globally, including retail travel agents, wholesalers, online travel agents, corporate travel agents and tour operators. This mix gives it strong exposure to the leisure travel market. With the domestic and leisure markets among the first to open up, Webjet's expanded domestic inventory should give it a nice boost out of the recovery gate.

Travel recovery underway

As expected, the FY20 result was dragged down by a weak second half performance as reservations were cancelled left and right. But this doesn't mean we should forget about Webjet's strong 1HY20 performance. Strength in the WebBeds business drove record EBITDA of $86.3m in the interim period. This is more of a reflection of how the company can perform under normal circumstances. In our view, we are much closer to normal than we were a year ago.

Things started looking up in the back half of last year. The Webjet OTA returned to profitability and took market share as the Australian and New Zealand leisure markets opened their doors to domestic travellers. The WebBeds business also showed improvement, but was still impacted by lockdowns and travel restrictions. Once WebBeds gets to full strength we favour management's strategy of reducing its cost base to drive efficiency gains of at least 20%.

On the surface, Webjet's 1HY21 result was understandably ugly given its limited chances for revenue. But as we touched on the last time we wrote about the company, back in May 2020, out of crisis can arise great opportunity. Management's efforts to cut expenses companywide should ultimately place it in an advantageous spot when international travel resumes. Although 1HY21 revenue was a fraction of what it was in 1HY20, expenses were trimmed by more than 50%. Granted some expenses, like staffing, will rise as business volumes return, but certain savings are likely sustainable once trading conditions normalize.

Strong financials, inexpensive valuation

WebJet's strong capital position has proven to be a mark of resilience and placed it in a position to build off its #2 B2B accommodations ranking. The monthly cash burn has come down substantially and with an increased $283m cash balance, it is in a good position to opportunistically deploy capital as its markets rebound.

Although the dividend has been deferred, prior to that the dividend had been raised in each of the last four years. Management plans to review the dividend policy following the 1HY22 result and we expect a return to dividend growth as operating conditions continue to improve.

At EV/EBITDA multiples of 27.7x and 13x for FY22 and FY23 respectively, we believe Webjet remains a good deal among digital companies with a history of delivering solid growth. Specifically because we're expecting to see a recovery in EBITDA from $63m negative for the current financial year to $76m positive in FY22. On top of that EBITDA is expected to roughly double in FY23 to $154m.

We like the diverse nature of the Webjet and WebBeds customer bases and anticipate this will support a broad-based recovery in both businesses. Eventually our beloved travel industry will return and in anticipation of this, we like the idea of reserving some Webjet shares.

Pitt Street Research Pty Ltd

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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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