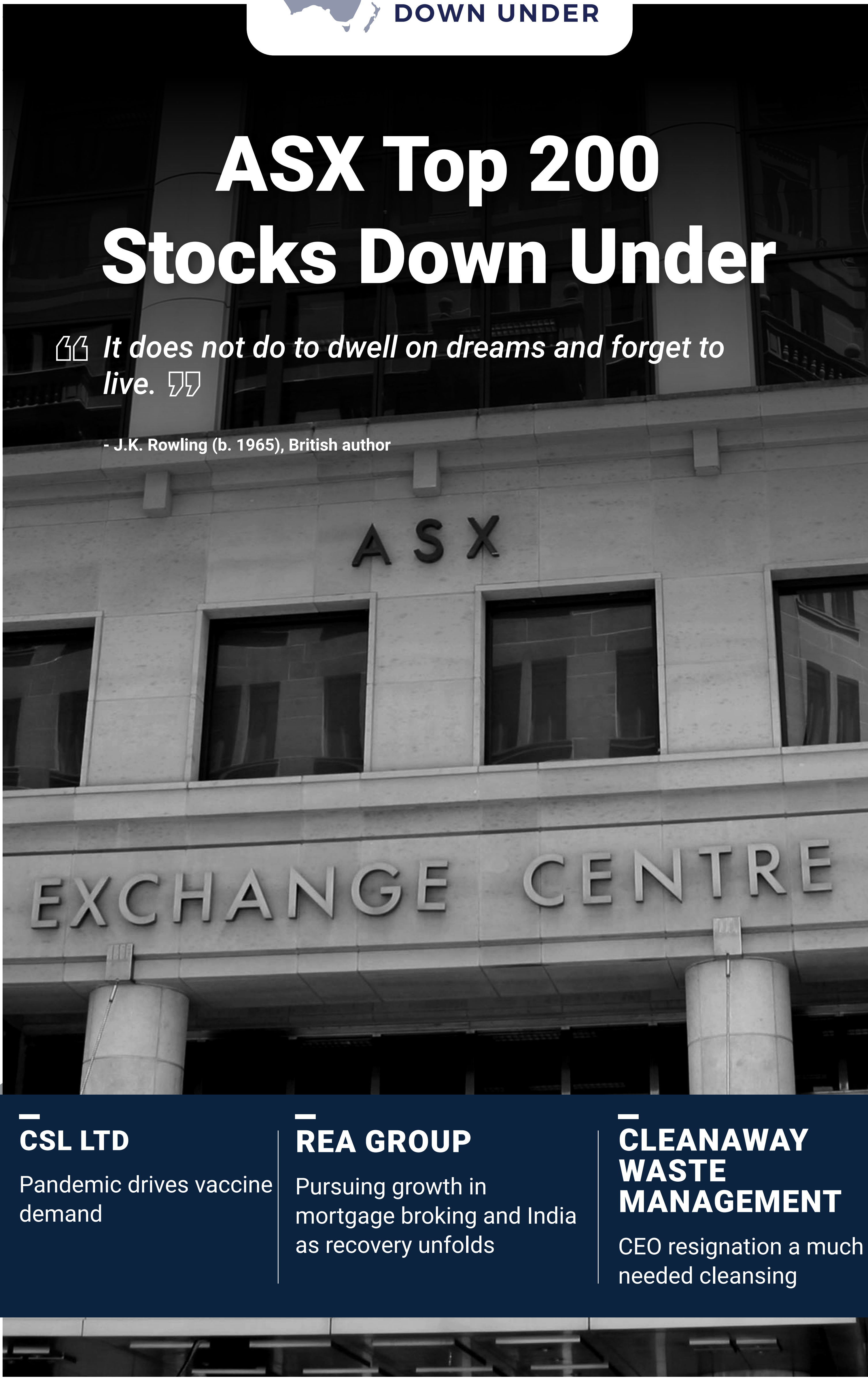
STOCKS DOWN UNDER

24 MAY 2021

ASX Top 200 Stocks Down Under

It does not do to dwell on dreams and forget to live.

- J.K. Rowling (b. 1965), British author



CSL LTD

Pandemic drives vaccine demand

REA GROUP

Pursuing growth in mortgage broking and India as recovery unfolds

CLEANAWAY WASTE MANAGEMENT

CEO resignation a much needed cleansing

CSL LTD

Pandemic drives vaccine demand

Stocks Down Under rating: ★★★★

ASX: CSL
Market cap: A$ 127BN
Dividend yield: 1% (0% Franked)

52-week range: A$242.00 / A$320.42
Share price: A$ 284.30

We continue to see Melbourne-based CSL as a strong, defensive anchor for an investment portfolio. As the world's top blood product supplier, CSL has a track record of delivering consistent growth stemming from steady demand for intravenous immunoglobin and albumin. The favourable demographics of the global health care sector, including the aging population and treatment advancements, should support healthy growth for many years to come.

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Pursuing growth in mortgage broking and India as recovery unfolds

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ASX: REA
Market cap: A$ 20BN
Dividend yield: 0.8% (100% Franked)

52-week range: A$96.10 / A$163.75
Share price: A$ 152.81

Based in Melbourne, REA Group operates property search websites that had been growing nicely prior to COVID-19. When we last wrote about the company on 11 May 2020, we liked the business model, but were getting concerned about the impact of the pandemic. With those fears diminished and the real estate market recovering, we feel more comfortable with the stock. It has climbed 81% over the past 12 months, but with overseas growth opportunities ahead as well as in complementary businesses, we believe REA still has significant upside.

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Share price chart

Source: Tradingview

Performing under pressure

Since we last wrote about CSL in March 2020, much has changed in the world, especially in the health care sector. A coronavirus outbreak that once appeared contained in China spread into a pandemic—and even more so thrust CSL onto the front lines. The maker of blood-based therapies and influenza vaccines has done quite well in the spotlight, supplying hospitals with the things they need to help fight the coronavirus and other medical conditions. It also partnered with the University of Queensland to develop a COVID-19 vaccine.

With manufacturing facilities across six countries and operations in more than 60 countries, CSL had to navigate the challenges of the pandemic on a global scale. This meant maintaining the safety of its staff and donors and delivering critical medicines for patients. At a time of elevated plasma demand, donors had to be carefully screened for COVID symptoms and, in many cases, were redirected to CSL's sister donation centres. Given the life-saving nature of its products, running out of stock wasn't an option. Thankfully, CSL's supply chain went largely uninterrupted.

Not surprisingly, through it all the company maintained its strong capital position and was in a rare group of companies that not only offered, but maintained profit guidance.

High influenza vaccine demand

Despite the challenging second half environment, CSL's full year 2020 results showcased resilience. Revenue increased 9% to approximately $9.2bn with several immunoglobin, albumin and haemophilia products recording double-digit growth. The Specialty Product division also did well, contributing 10% top line growth. The Seqirus side of the business, i.e. influenza vaccines, also performed well thanks to a 21% jump in seasonal influenza vaccine sales. Revenue advanced 16% in CSL's largest geographic region of North America, which accounted for more than half of total revenue. Net profit after tax (NPAT) increased 10% year-over-year to $2.1bn.

An important development during FY20 was CSL's successful transition to having its own distribution model in China. We view this added flexibility and efficiency to be extremely important given China's position as a major drug market. With the new Good Supply Practices (GSP) license in place, CSL will now be able to reach more hospitals in China's smaller cities.

The 1HY21 result showed continued strength. Revenue climbed 15% to $4.9bn and NPAT increased 45% to $1.8bn. Management cautioned investors to expect the FY21 result to be "heavily skewed to the first half." Nevertheless, we found the results to be impressive given the company's new focus on COVID-19 vaccine manufacturing. The pandemic environment boosted the performance of the Seqirus business while the blood products division grew at a more modest 11%.

It wasn't Seqirus that impressed us in this half so much as albumin – for this product's revenue for the half nearly doubled, thanks to a normalising of Chinese sales following the GSP transition. Seqirus, however, was no slouch either - people wary of contracting any infection, COVID-19 or otherwise, were quick to sign up for flu shots, driving a 44% surge in seasonal influenza vaccines. CSL also announced plans to construct a next generation influenza vaccine manufacturing facility in Australia.

Strong R&D pipeline

Looking ahead to CSL's growth prospects, the company continues to look for growth in the United States where it added 40 new plasma collection centres in FY20 to bring its US total to 261 (and the global total to 277). CSL plans to open 20-30 more centres worldwide in FY21. COVID-19 induced demand for influenza vaccines should also support Seqirus volumes in the US and other key markets.

CSL is the world's leading supplier of plasma therapies and the second largest provider of influenza vaccines. Combined, these markets represent a $36 billion opportunity. Given increased disease awareness and the heightened importance of vaccine development in the wake of COVID-19, demand will likely remain robust for some time in our view. At the same time, CSL's strong R&D capabilities are likely to keep churning out new products in immunology, hematology, cardiovascular and respiratory health to support further growth.

The company has several promising product candidates in late-stage trials, including a potential blockbuster in CSL-112. This is the company's formulation of apolipoprotein A1, a naturally occurring protein that has demonstrated an ability to remove cholesterol from the arteries. If approved, CSL-112 could bring in up to US$5 billion in annual revenue, which is more than half of what CSL posted in FY20.

Four stars, but not for value investors

After reaching a record high of $329 in April 2020, CSL's share price has come down by more than 26% in March 2021 amid general market weakness. It has since bounced back to $284, which we still view as a great chance to buy into one of Australia's most financially fit companies.

However, be aware that CSL's valuation is pretty steep with EV/EBITDA multiples of 28.1x and 24.4x for FY22 and FY23. Especially when we look at the consensus EBITDA-growth expectation of just 1% for FY22, which follows a bumper FY21. For FY23, the market is expecting 15% EBITDA-growth, which is still well below the 24.4x EV/EBITDA multiple for that year. In other words, we're looking at an EV/EBITDA-to-EBITDA growth ratio of 1.63, which very high.

Now, the CSL bulls will argue that this is the premium investors will need to pay to get their hands on shares of one of Australia's most successful companies ever. The bears will say that this valuation is too frothy. We tend to agree with the bulls on this one although we want to flag the risk of potentially disappointing earnings down the line. At this valuation, the market will be quick to punish CSL if anything goes wrong. So, it's four stars from us, but with a "frothy valuation" warning for the value investors among our readers.

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Share price chart

Source: Tradingview

Opening doors to more visitors

Once a small start-up focused on Australia's housing market, REA Group now operates real estate websites and apps in Asia, Europe and the US. The self-proclaimed global real estate advertising company offers online information and tools that help homebuyers and sellers make informed decisions. It is best known for residential property, but it also has sites dedicated to commercial, shared and co-working properties. The business model is straightforward here, with 90% of revenue coming from the Property and Online Advertising segment and the remainder from Financial Services.

The early months of the COVID-19 pandemic dampened Australians' interest in buying and selling homes. Even though people were spending more time online, shopping for real estate wasn't a popular activity. Amid international travel restrictions and economic uncertainty, traffic on the realestate.com.au site slowed considerably. As we anticipated, visitors have since returned to the site in conjunction with improved consumer confidence and economic activity. This has supported increased demand for digital advertising and some upward trending results at REA Group.

The FY20 result reflected the impact of COVID on residential listings as revenue declined 6% to $820.3m, while EBITDA fell 5% to $492.1m. Despite the inevitable trickle effect on advertising revenue, the websites turned in some record performances that demonstrated strong underlying interest. Average monthly visits were up 18% to 90m, with May and June 2020 the strongest months of the year. And with 60% of Australia's adult population frequenting the website, traffic was bound to return.

Elara and Mortgage Choice increase scale

The trend in audience metrics and listings continued to improve in 1HY21. Although commercial listings continued to lag, national residential listings increased 4% including 19% in the key Sydney market. Meanwhile, record low interest rates brought more buyers back to the table as average monthly visits jumped 36% to 115m. The 1HY21 financial results also improved. Revenue slipped 2% to $430.4m, but EBITDA increased 9% to $290m. We anticipate a strong second half result supported by the ongoing recovery in residential and commercial listings and increased project development activity.

REA Group's performance in FY22 and beyond should also be supported by its latest acquisitions. On 29 October 2020, it announced the intention to acquire a controlling interest in India's Elara Technologies. This will add India's fastest growing digital real estate platform to REA's portfolio and bolster its position in the world's fastest-growing economy. India is seeing increasing internet use, yet it still has approximately 500m people waiting in the wings to come online. REA Group now owns a 54.3% stake in Elara and has an outstanding offer to acquire an additional 6.7% minority interest.

More recently, on 29 March 2021, the group announced the proposed acquisition of Sydney-based Mortgage Choice Australia. Under the terms of the deal, REA would acquire 100% of Mortgage Choice shares for an estimated $244m. Mortgage Choice is one of the country's largest mortgage broking businesses with a $54bn loan book, $11bn worth of settlements and it is operating at a net profit.

We see this as a natural extension of REA's core property search business. As homebuyers browse for their next dream home, securing a mortgage is a major step in the process. REA Group already has a small broker business, called Smartline, so the move will expand its brokerage capabilities and keep more customers within the group's property network. It could also make it more attractive to advertisers due to the expanded national audience. Mortgage Choice is expected to be immediately accretive to earnings and holds the potential for significant cost and revenue synergies.

Strong financial position

As the property markets continue to recover, we believe REA Group is in a great position to leverage growth opportunities. It has a growing base of assets that are diversified geographically and supported by well-known website brands. We think it will be hard for competitors to grab market share given the roots REA Group has planted.

The core EBITDA margin is a healthy 67%, and trending higher, and the balance sheet is getting healthier. The current $104m net debt position is expected to turn into a $106m net cash position by FY22. It also has $169m of undrawn debt facilities giving it ample liquidity.

REA Group shares are trading less than 7% below their February 2021 all-time high of $163.75. However, this shouldn't deter investors, nor should the valuation. The EV/EBITDA multiple for FY22 looks discouraging at 30.1x, but things get better when considering the FY23 EV/EBITDA ratios of 26x.

After nearly 12% growth in FY21, FY22 EBITDA is forecast to grow 22%, followed by 16% growth in FY23. It is growth worth paying for, in our view, given the group's dominant position in Australia's online real estate market and growing presence in promising overseas markets. So, it's four stars from us.

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Share price chart

Source: Tradingview

Cleaning house

Back on 21 September 2020, Cleanaway issued a short-winded response to an ASX trading query surrounding the investigation into CEO Vik Bansal's conduct and his 31 August 2020 sale of nearly $10m worth of Cleanaway shares at an average price of $2.50. It stated that the investigation and subsequent report were "not matters that a reasonable person would expect to have a material impact on the price or value of the Company's securities". Apparently, they were mistaken as a month later Cleanaway's share price was down to around $2.00. In our view, both the conduct report and the reason behind Mr. Bansal's fire sale were indeed information that shareholders ought to know.

Nevertheless, Cleanaway's legal team managed to skirt around the issues and its lack of candour deepened the scar caused by its CEO's abusive behaviour towards his subordinates. Exactly four months after Cleanaway responded to the ASX query, it brought the leadership issue to a predictable conclusion in announcing the resignation of Mr. Bansal. The search for a new CEO is underway and the transition is expected to start in the first half of this year. Although the reputational damage will remain, it's a positive that Cleanaway can move forward without the overhang of its disgraced CEO. With this said, from a financial performance perspective, the new CEO has big shoes to fill, considering earnings per share grew 22% per annum during Mr. Bansal's five-year tenure.

Second best is still a win

Getting back to the business itself, Mr. Bansal had one final swan song on 19 February 2021 when he delivered Cleanaway's 1HY21 result. Interestingly, the first two slides in the presentation were all about Cleanaway's employees and culture — damage control at its finest. As far as the financials were concerned, underlying NPAT increased 6.5% to $79m. Sales were flat at $1.07bn largely because of COVID-19 effects, but cost-cutting initiatives and improved operating leverage drove profit margins higher. It was the fifth straight interim result that showed an expanding NPAT margin, a healthy 7.4%.

Soon after the 1HY21 report, Cleanaway was back in the headlines. Media speculation around the potential purchase of France-based Suez SA's Australian business prompted a trading halt in Cleanaway shares. Cleanaway was said to be in advanced talks with Suez to buy the waste treatment assets for EUR2bn. Cleanaway acknowledged interest in the assets, but said there is no guarantee the talks would lead to a deal.

A month later, on 6 April 2021, Cleanaway put the speculation to rest by announcing an agreement to acquire Suez Recycling and Recovery (Suez R&R Australia) for $2.52bn. There are a lot of moving parts to this deal. Firstly, because Suez SA received a takeover offer from France's Veolia Environment SA on 8 February 2021 and secondly, there is the possibility that another suitor for the Suez R&R Australia business comes along and outbids Cleanaway. Lastly, even if the Cleanaway-Suez deal falls through, the two companies agreed to a consolation deal involving the sale of two Suez landfills and five transfer stations located in Sydney for $501m.

The latest update came on 27 April 2021 and it was not the best news, unfortunately. It turns out that the Veolia, Suez deal looks like it's going to close, which has led to the official termination of Cleanaway's deal to acquire all of Suez's Australian recycling and recovery businesses. But there is still a very valuable consolation prize, the Sydney Assets. This agreement is moving forward and expected to finalise during 2Q22, assuming the ACCC approves. However, all hope is not yet lost for the rest of the Australian assets. If Veolia does not proceed with its Suez acquisition by 31 December 2022, Cleanaway gets another shot, but this seems unlikely.

Recurring revenue due to long contract lengths

Given expected EBITDA growth of 8% and 9% for FY22 and FY23, Cleanaway shares are trading at a reasonable FY22 EV/EBITDA multiple of 11.7x. The stock also comes with a small dividend that has risen in each of the last five years.

While much of the attention has been around the CEO change and the Suez M&A activity, Cleanaway's core business is doing quite well. While these other side shows are important, at the end of the day, investors should be most concerned with the performance and prospects of the waste management business. In contrast to the outgoing CEO, both have been squeaky clean.

Cleanaway's revenues are mostly derived from long-term contracts in all three segments — Solid Waste Services, Industrial & Waste Services and Liquid Waste & Health Services. The contracts are the longest duration in the main Solid Waste business, where the company's more than 100 municipal customers typically sign 7 to 10-year contracts. Other customers, like hospitals, resources groups and industrial companies, also engage in multi-year contracts. We like this diversification and that the contract length stabilises the revenue base making Cleanaway somewhat of a defensive share. So, we recycle our four-star rating.

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