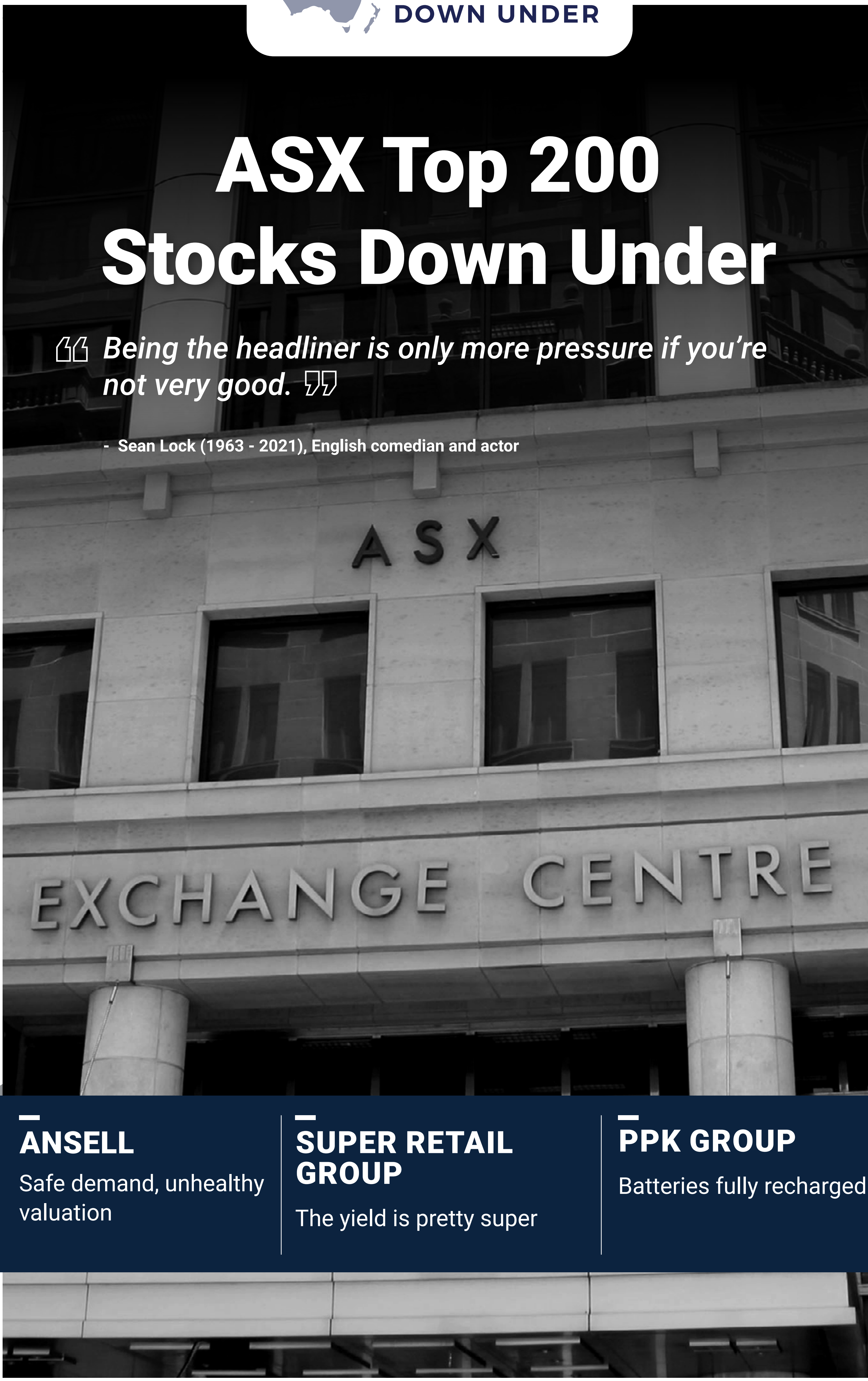
STOCKS DOWN UNDER

23 AUGUST 2021

ASX Top 200 Stocks Down Under

Being the headliner is only more pressure if you're not very good.

- Sean Lock (1963 - 2021), English comedian and actor



ANSELL

Safe demand, unhealthy valuation

SUPER RETAIL GROUP

The yield is pretty super

PPK GROUP

Batteries fully recharged

ANSELL

Safe demand, unhealthy valuation

Stocks Down Under rating: ★★★

ASX: ANN
Market cap: A$ 5BN
Dividend yield: 2.0% (0% Franked)

52-week range: A$33.23 / A$44.07
Share price: A$ 40.70

We suggested a hands-off approach to Melbourne-based industrial and medical glove maker Ansell on 27 February 2020. Although we liked the company, weaker Chinese demand for industrial gloves during what appeared to be an epidemic was reason for pause. Once COVID-19 reached pandemic proportions, things changed, including hyper demand for medical gloves and other PPE. With global vaccination rates progressing, we expect Ansell to revert to its usual steady, but uninspiring growth and see the current valuation as stretched.

READ MORE

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Stocks Down Under rating: ★★★★

ASX: SUL
Market cap: A$ 3BN
Dividend yield: 6.7% (100% Franked)

52-week range: A$9.53 / A$13.73
Share price: A$ 12.77

Brisbane-based Super Retail Group was experiencing less than super demand at the time of our 25 February 2020 report due to the impact of the bushfires and a second staff underpayment scandal. Today, the auto parts and sporting goods specialist is facing another daunting challenge in the form of online competition that has intensified during the pandemic. However, the FY21 results showed they are more than up to the task.

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ASX: PPK
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52-week range: A$3.26 / A$18.02
Share price: A$ 17.76

Yes, we admit it. We got PPK Group wrong. When we wrote about this exciting Brisbane based technology developer back on 29 May 2020 the share price was $4.03 and we rated it two stars. The last year or so has shown the market to be more generous to technology-oriented stocks than we suspected would be possible at the time. And the various technologies within PPK have also developed nicely. Particularly those that are currently being floated as Li-S Energy where the aim of the game is the much-anticipated lithium-sulphide battery.

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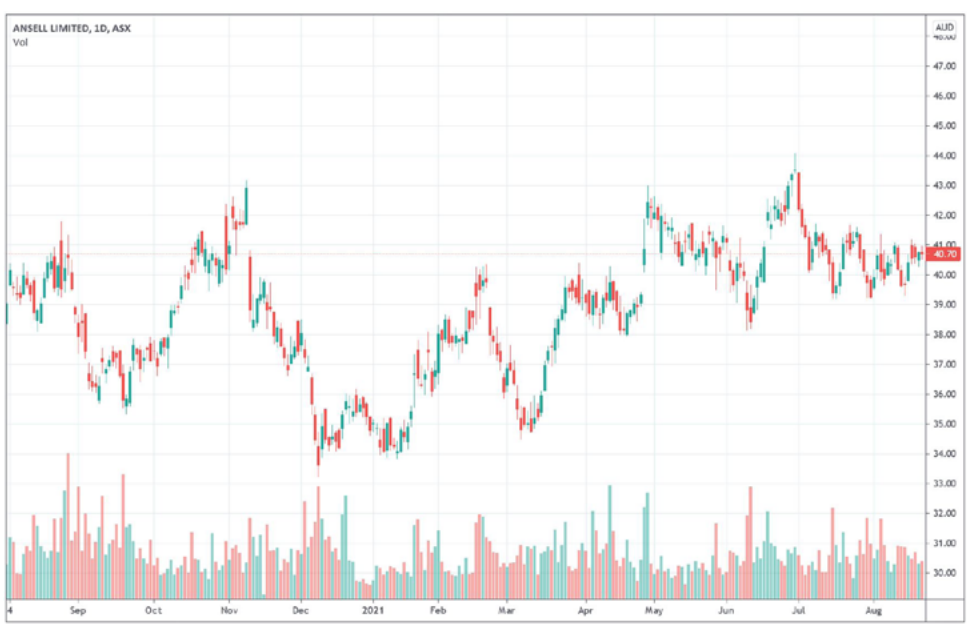
Share price chart



Source: Tradingview

All hands on deck

Although it started out as a condom manufacturer nearly a century ago, today Ansell supplies industrial and medical gloves and other body protection products to customers in more than 100 countries. Its products protect over 10 million people daily. In the healthcare market its key brands include Gammex surgical gloves, Microflex, examination gloves, and AlphaTec hand and body protection products. HyFlex, complete with fingertip sensors, is the world's top selling industrial glove and the lead brand on the industrial side of the business. Customers value the products because they protect their employees from injury and illness, reduce related downtime costs and lower insurance premiums.

The pandemic spurred unprecedented global demand for gloves, face masks, goggles and protective suits in the medical community. Demand was particularly strong for Ansell's Alpha Tech products as they are certified to protect from infective agents. Exam and surgical gloves were also in high demand. On the flipside, with many manufacturing plants temporarily shut down and export restrictions in place, demand for HyFlex and other industrial products was limited. It's worth noting too that Ansell donated protective suits, masks, gloves and goggles to various organizations around the world.

In the end, the healthcare segment recorded 13% sales growth in FY20 while sales were up just 1% in the industrial business. North America, Ansell's largest geographic segment, achieved 9% top-line growth in FY20. This was surpassed only by 18% growth in the Asia Pacific region, but unfortunately, the impact on overall results was minimal because this is where Ansell has the smallest presence. Overall sales were up 8% to US$1.6bn and earnings per share (EPS) jumped 48% to US$1.22.

FY21 guidance raised twice

As COVID-19 wore on, people around the world increasingly wore gloves and suits amid a greater focus on PPE and hygiene. This worked to Ansell's advantage because its larger customers and distributors sought long-term agreements to lock in supply. In 1HY21 sales were up 25% to US$937.8m and EPS soared 66% to US$0.83. Growth in the healthcare business strengthened to 37% and the industrial business recorded 7% growth thanks to higher demand for protective clothing from chemical manufacturers.

The balance sheet looks good. As at 31 December, the net debt position was US$237m and leverage, as measured by net debt/EBITDA, was a conservative 0.7x. With approximately US$560m of cash and undrawn bank facilities, we believe Ansell has the flexibility to pursue expansion and investment opportunities.

For the second half of FY21, management expects sales growth to remain strong despite the tough comparison to the prior year. It thinks second half growth will exceed that of 1HY21 and full-year EPS is expected to be US$1.92 to US$2.02. FY21 guidance has been upgraded twice now, which we find to be curious considering demand is likely to have slowed over the last 6 months as vaccines became available and COVID-19 cases slowed.

Unfortunately, this won't be last pandemic the world encounters. This means that COVID-19 only reinforced the importance of having a healthy inventory of gloves and other protective equipment. So, while order volumes may slow as the current pandemic subsides, we believe the world will remain attentive to the need to stay stocked up on Ansell products.

New CEO

The pandemic also impacted Ansell's leadership plans. It had previously planned to find a successor to the CEO position in July 2021, but pushed this timeline back to December 2021. Current CEO Magnus Nicolin agreed to postpone his retirement accordingly to allow the board to evaluate candidates as international travel restrictions ease. But apparently, Mr Nicolin was anxious to sail off into the sunset. On 8 June 2021, Ansell appointed Neil Salmon as CEO effective 1 September 2021. Mr Salmon has been with Ansell since 2013 as CFO and President of the industrial business. Ansell has announced that it will be releasing its FY21 results on 24 August 2021.

Ansell shares have climbed 2.8% over the last 12 months and set a new all-time-high around $44 in June. The stock is valued at an EV/EBITDA ratio of around 10.2x for FY22 and 10.4x for FY23. However, EBITDA is expected to drop almost 5% in FY22 and 2% in FY23. Until there is a significant downturn in the share price or the consensus earnings forecasts get a big upgrade, we'd prefer to sit on our properly sanitised hands.

They say slow and steady wins the race. It's hard to deny that Ansell is a global safety leader and that its products are a source of steady demand, especially with the COVID's Delta variant wreaking havoc at the moment. However, we think there are more attractive business models to invest in, so it's three stars from us.

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Share price chart

Source: Tradingview

Armageddon demand

Super Retail Group operates a retail network of more than 670 stores across Australia and New Zealand under three main categories. The BCF and Macpac outdoor recreation brands sell camping, boating, fishing and other outdoor equipment, while Rebel is a retailer of sports and fitness equipment, bicycles and athletic apparel. And Supercheap Auto offers auto parts and accessories. Approximately 60% of revenue is derived from the sports and outdoor segments with the remainder from Supercheap Auto.

COVID-19 had a significant impact on Australia's retail industry. Non-essential businesses were forced to close and operate under restrictions for the better part of last year. Fortunately, for Super Retail Group many of its auto products are considered essential and many of its outdoor products fall under self-sufficiency. This meant that Supercheap Auto and BCF stores saw increased demand for things like batteries, camping stoves, generators, portable gas, portable toilets, refrigeration equipment, solar energy panels, water filters and of course sanitisers and wipes. At Rebel stores, apparel sales fell, but demand for personal fitness and gym equipment soared after gyms were closed.

And since over 80% of its retail locations are in homemaker centres or are standalones, sharply lower foot traffic at large shopping malls was less of an issue. The Supercheap Auto and Macpac stores in New Zealand did, however, close for seven weeks, but these stores accounted for less than 7% of group revenue at the time. Overall, a strong second half led to a decent FY20 result. Sales were up 4.2% to $2.83bn, EBITDA increased 4.3% to $328m, and net profit after taxes (NPAT) was up 1% to $154m.

Super Retail learned some new tricks

A powerful economic trend that was only accelerated by the pandemic was the consumer shift to online shopping. Whether due to store closures or perceived safety, Australians have become more comfortable buying online over the past year — and there is expected to be some level of permanence to the increased interest in online shopping across all of retail. This is bad news for Super Retail.

E-commerce is an area where the group is still playing catch-up and not gaining much ground. Approximately 10% of group sales came from online channels in FY20. Investments in online home delivery and the Click & Collect pick-up platforms have helped make online a bigger part of the revenue mix, but it remains a predominantly bricks and mortar business. This will make it hard for Super Retail to compete with brands that have a greater e-commerce presence as well as the emerging crop of online-only competitors.

However, in the last 12 months, things have changed markedly. In FY21 sales were up 22% to $3.5bn, EBITDA was up 70% to $776.2m and NPAT climbed 100% to $306.8m, all like-for-like. Online sales broke records during FY21 and have continued this trend between 1 July 2021 and 18 August 2021, growing 62%, while Click & Collect grew 137%. Clearly, the strong results we saw online during the first half of FY21 were more than just an aberration. The company has managed to pivot hard towards online sales and as lockdowns continue to be implemented across the country due to the Delta variant, it seems people have taken up fixing their car, going for walks and many other activities that are leading them to return to Super Retail's brands time and time again.

We're in it for the dividend

To strengthen its financial position during the pandemic, Super Retail secured a new $100m debt facility with ANZ Bank and completed a $203m equity raise at $7.19 per share. Like many companies, Super Retail also suspended its dividend to preserve cash. However, this has now been reversed, with Super Retail offering a $0.55 final dividend for FY21. Right now, the balance sheet is healthy with $417m in cash, no net bank debt and the flexibility to pursue growth opportunities. So, in the course of FY21, the company has proven that it can build and expand on online presence, which bodes well for the future, especially in the near term with the lockdowns we're seeing across Australia.

Super Retail Group shares are trading around 5.8x EV/EBITDA for both FY22 and FY23, which isn't very high. However, consensus estimates imply a drop in EBITDA of about 18% in FY22 and essentially flat EBITDA the year after. It's not until FY24 that the market expects a pick up in EBITDA growth for Super Retail. So, this is not your typical growth stock. However, with a 6% dividend yield and COVID-19 unlikely to go away during FY22, we believe Super Retail has proven that it can handle the pandemic's heat and earned its place in the kitchen. If you're a yield junkie, it's four stars from us.

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Share price chart

Source: Tradingview

Crossing the chasm to being a technology company

Back in October 2018, PPK Group was a lowly maker of load haul dump machines for the underground coal mining industry. How boring! It did around $35m a year in revenue, but was loss-making. Then PPK got smart, transitioning to being a technology developer, and hasn't looked back. First came the October 2018 acquisition of part of BNNT Technology, a venture that was commercialising technology from Deakin University in Geelong for making Boron Nitride Nanotubes. Then in October 2019, PPK invested in Craig International Ballistics, a supplier of body armour to defence and police forces. In June 2020 came the initial fund raising for Li-S Energy, another Deakin-originated venture, developing a lithium-sulphide battery, with the help of BNNT knowhow. The PPK Mining Equipment business was retained and managed to get into the black, but it's fair to say that by mid-2020 PPK was a completely different company.

In May 2020 we thought the market was overvaluing the potential of BNNT. What we hadn't reckoned with was the speed with which the technologies under PPK's control would create something revolutionary, namely, a workable lithium-sulphur battery. You've doubtless read about how the lithium-ion battery is changing the world. Well, the lithium-sulphur battery is better and the white coats at Deakin reckon that their BNNTs can overcome the last of the technical hurdles that can make such a battery a reality. That story has developed to the point that Li-S Energy is now being spun out of PPK.

A technology the battery world has been waiting for

In the early 1990s, the breakthrough lithium brought to rechargeable batteries was 'energy density', where a lot of power could be packed into a relatively small mass. But there's a limit to this energy density, at about 300 Wh/kg. A well-known theoretical alternative is the lithium-sulphur battery, where the anode is lithium and the cathode is made out of carbon and sulphur. That combination is known to be able to boost the energy density five-or-six-fold. The problem is the reactivity between the lithium and the sulphur. Every time you recharge such a battery you get these mossy, needle-like deposits called 'dendrites' forming on the anode, which quickly breaks down the electrolyte that shuttles lithium-ions back and forth. Not only does the lithium end up trapped so that it can't deliver the promised power, but the reaction can also cause the battery to short-circuit, or worse, catch fire.

The PPK/Deakin Dream Team reckon they've solved that problem with BNNT. Boron nitride nanotubes are a wonder material in terms of strength, flexibility, thermal conductivity and the ability to withstand extreme temperatures. PPK and Deakin can make large amounts of high purity BNNT at reasonable cost. And it turns out that such nanotubes are great at stabilising lithium-sulphur battery components. Coat BNNTs on the lithium anode and you inhibit the dendrite growth and cut the heat dissipation from the anode. The result is a lithium-sulphur battery that works more or less like a lithium-ion battery, only with productivity improvements that would leave the Energiser Bunny breathless.

All eyes on 30 August

Now, it's still early days for Li-S Energy and its lithium-sulphur batteries. The company is going to have to perfect its own batteries, then go out and convince the players in the battery space that it has the Right Stuff. And that will likely take years. However, working in its favour is the fact that the Electric Vehicle as a key user of lithium-ion batteries is now mainstreaming in the automotive space and the players in that industry, Elon included, are all ears when they hear about technologies that can improve energy density as robustly as Li-S Energy can.

Li-S Energy has raised $34m at $0.85 a share in order to be able to deliver that Right Stuff. At that price the new company will have a market capitalisation of $544m. All going well, Li-S Energy stock is expected to start trading on ASX on Monday 30 August under the ticker code LIS, with PPK to retain about 45%. Is half a billion dollars or so a reasonable valuation for a pre-revenue company that is being built around a concept? Well, the concept is revolutionary and the battery market is very receptive. And Novonix (ASX: NVX | see 18 June 2020 report) with its new materials for battery anodes and cathodes is currently capitalised at over A$1.5bn. So, there's a good chance the market is going to respond well when Li-S Energy stock hits the secondary market.

We think the rapid evolution of Li-S Energy over less than 18 months says a lot about the speed with which the post-2018 PPK under Executive Chairman Robin Levison can create shareholder value. It also points to the huge upside that PPK can create from BNNT Technology across a range of applications, such as in 3D printing, better polymers and ceramics, and so on. Consequently, we're switching our rating on this company from two stars to four. Power on!

Pitt Street Research Pty Ltd

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