STOCKS DOWN UNDER

30 AUGUST 2021

ASX Top 200 Stocks Down Under

"Never confuse a single defeat with a final defeat."

- F. Scott Fitzgerald (1896 - 1940), American author

WISETECH GLOBAL

Short covering has made WTC too expensive

TREASURY WINE ESTATES

A glass half-full even without China

FLIGHT CENTRE TRAVEL GROUP

Gearing up for a strong recovery

WISETECH GLOBAL

Short covering has made WTC too expensive

Stocks Down Under rating: ★★

ASX: WTC
Market cap: A$ 15BN
Dividend yield: 0.1% (100% Franked)

52-week range: A$25.00/ A$57.31
Share price: A$ 46.35

Back on 27 February 2020, Sydney-based logistics software company WiseTech Global was trading near a 52-week low. To some, the polarising share was best left untouched given its valuation and disdain among short-sellers. Yours truly at Stocks Down Under felt it was a good buy opportunity. WiseTech is up more than 80% since then and is trading near a 52-week high. We can't deny the valuation is now quite rich, but feel it is warranted given the growth ahead as the logistics industry goes digital.

READ MORE

TREASURY WINE ESTATES

A glass half-full even without China

Stocks Down Under rating: ★★★★

ASX: TWE
Market cap: A$ 9BN
Dividend yield: 2.2% (100% Franked)

52-week range: A$7.87 / A$13.34
Share price: A$ 12.45

When we last wrote about Melbourne-based winemaker Treasury Wine Estates on 10 March 2020, the stock was getting clobbered from a short seller attack and weak US performance. Making matters worse, the coronavirus and later poor Australia-China trade relations kept pressure on the share price. We think the worst is likely over for Treasury, which will benefit from a pivot to other growth markets and the eventual reopening on international trade borders.

READ MORE

FLIGHT CENTRE TRAVEL GROUP

Gearing up for a strong recovery

Stocks Down Under rating: ★★★★

ASX: FLT
Market cap: A$ 3BN

52-week range: A$11.18 / A$20.16
Share price: A$ 16.89

Our 6 March 2020 article on Brisbane-based Flight Centre came at a time when travel and leisure companies were getting hit hard as the coronavirus began to spread around the world. With Australia's largest travel agency also dealing with a price gouging scandal, the share soon plunged to a record low under $10. Travel conditions have since improved as has the stock price, but we think there is near-term turbulence ahead as international corporate and leisure travel slowly get off the ground.

READ MORE

WISETECH GLOBAL

Short covering has made WTC too expensive

Stocks Down Under rating: ★ ★

ASX: WTC
Market cap: A$ 15BN
Dividend yield: 0.1% (100% Franked)

52-week range: A$25.00/ A$57.31
Share price: A$ 46.35

Back on 27 February 2020, Sydney-based logistics software company WiseTech Global was trading near a 52-week low. To some, the polarising share was best left untouched given its valuation and disdain among short-sellers. Yours truly at Stocks Down Under felt it was a good buy opportunity. WiseTech is up more than 80% since then and is trading near a 52-week high. We can't deny the valuation is now quite rich, but feel it is warranted given the growth ahead as the logistics industry goes digital.

Share price chart

Source: Tradingview

Driving the logistics tech revolution

WiseTech Global is a provider of cloud-based software for the Australian and international transportation and logistics industries. Its flagship product is CargoWise One, an end-to-end logistics platform used by freight forwarders to manage their transactions. The solution appeals to customers because it is subscription-based and doesn't require a significant upfront investment. The fact that it affords them the flexibility to choose only the modules that apply to their respective businesses, whether that be customs, warehousing, geo-compliance, or e-commerce, does not hurt either. In addition to CargoWise, WiseTech offers the Xtrade messaging solution that lets suppliers and customers share information as well as transport management solutions for truckload (LTL) shippers.

It is very much a global operation. Over 12,000 logistics organisations across 150 countries rely on WiseTech software to facilitate the movement and storage of all types of goods. And since many customers are multinationals, CargoWise's ability to support cross-border offices and languages is also a big selling point. We like the company's well-balanced geographic diversification. Roughly one-third of revenues come from the EMEA, Asia Pacific and Americas regions, respectively.

Just as customers like the subscription model, we too like WiseTech's software-as-a-service (SaaS) model because it generates a high level of recurring revenue and is highly scalable. In FY20 nearly 90% of revenue was derived from recurring on-demand or license maintenance services.

Demand on the comeback trail

As we touched on in our last report, WiseTech lowered its FY20 revenue and EBITDA guidance, citing the coronavirus impact on global supply chains. We felt the market was nearsighted in punishing the share and that the long-term growth potential was intact. In the end, the company delivered revenue of $429m, which was up 23% and in line with its revised guidance. EBITDA came in near the upper end of the updated guidance and up 17% to $127m. It stands to reason that the financial results would be temporarily weakened in a COVID-19 environment where global manufacturing activity and logistics movements fell sharply.

As lockdown restrictions eased and economic activity picked up, demand for goods movement came back to life with a vengeance. We anticipated this catch-up effect and it started to shine through in the FY21 result. Revenue was up 24% to $507.5m and EBITDA soared 63% to $206.7m. As COVID-19 mobility restrictions eased and global trade resumed, demand for WiseTech's solutions improved.

An interesting development late last year was the announcement of a strategic alliance with Sydney online payment services provider OFX Group. OFX is now WiseTech's preferred provider of international payments. This is good news for WiseTech customers that execute international transactions and need currency exchange services. We think the integration strengthens WiseTech's existing customer relationships and opens doors to winning new business from global freight forwarders. A full launch is expected in 3Q22.

A bad day to be a short seller

The balance sheet still looks strong. As at 30 June 2021, the company had $315m in cash, $225 in undrawn debt facilities and no debt. It was able to support a $0.038 per share fully franked interim dividend. The yield isn't much, but we reckon it's not too shabby as far as high growth software companies go. The FY21 numbers were very well-received by the market last week and led to a short squeeze, pushing the shares up more than 50% intraday on the day of the announcement. We believe the days of J Capital messing with WiseTech are now permanently behind us. J Capital is the firm that wrote a few scathing research reports on WiseTech in 2019 in support of its own short position in the stock.

High growth expectations

Since their March 2020 bottom, WiseTech shares have risen 349%, so the natural reaction may be to take a cautious stance. In fact, we believe WTC is now well overpriced. Following the share price spike last week, the stock is now valued at an EV/EBITDA multiple of 52.9x for FY22 and that goes down to 42.7x for FY23. With EBITDA growth expected of around 34% in FY22, which just started, and 24% in FY23, we believe the recent short covering has made WTC stock too expensive for now.

Additionally, the recent flurry of on-market sell transactions by founder and CEO Richard White are cause for concern. Over the last two months, Mr. White has executed nine separate sell orders worth more than $50 million. Granted, he is still by far the largest shareholder with a 40% stake in WiseTech and we understand the need to diversify, but these sorts of founder divestments are never a good look.

Although the pandemic accelerated an underlying shift towards digitisation in the logistics industry that bodes well for long-term growth at WiseTech, we think the stock is just too expensive right now. We'll wait for a pull-back. Until then, it's two stars from us.

TREASURY WINE ESTATES

A glass half-full even without China

Stocks Down Under rating: ★★★★

ASX: TWE
Market cap: A$ 9BN
Dividend yield: 2.2% (100% Franked)

52-week range: A$7.87 / A$13.34
Share price: A$ 12.45

When we last wrote about Melbourne-based winemaker Treasury Wine Estates on 10 March 2020, the stock was getting clobbered from a short seller attack and weak US performance. Making matters worse, the coronavirus and later poor Australia-China trade relations kept pressure on the share price. We think the worst is likely over for Treasury, which will benefit from a pivot to other growth markets and the eventual reopening on international trade borders.

Share price chart

Source: Tradingview

Lockdown wine is fine

Grow and source grapes. Produce, market and sell wine using locally owned distribution. This is the simple, yet potent business model at global winemaker Treasury Wine Estates, the former wine division of Foster's Group. The company owns a variety of popular wine brands in the commercial, masstige and luxury categories that are conceived at its 13,000-plus hectares of vineyards. More than 70% of revenue comes from the premium wine market, which includes luxury and masstige price points.

Down Under, Coldstream Hills, Lindemans, Penfolds, Pepperjack, Rawson's Retreat, Seppelt, Wolf Blass, Wynns and YellowGlen and 19 Crimes (of Snoop Dog fame) are some of the labels. Then there is Acacia Vineyard, Beringer and Blossom Hills in the United States. It also owns the Matua and Squealing Pig brands in New Zealand, Rosemount in the UK, Maison de Grand Esprit in France and Cavaliere d'Oro in Italy. Treasury also operates a small beer and cider distribution business in New Zealand.

COVID-19 had some extraordinary impacts on the winemaking industry. With bars and restaurants closed and restricted, in-home consumption increased dramatically alongside e-commerce purchases. Fortunately for Treasury it did not experience major supply chain disruptions and its 2020 Australian vintage was completed as planned despite the challenging health & safety protocols.

However, with out-of-home consumption and social gatherings way down, the pandemic weighed on the FY20 result. Revenue declined 6% to $2.65bn and EBIT fell 22% to $533.5m. The FY21 results were understandably weak as well, but signs of demand improvement started to show, as revenue ended the period effectively flat, up less than 1%. The bricks & mortar retail and e-commerce channels were strong, but on-premise and travel

retail businesses were still severely limited. For FY21, revenue came to $2.7bn and EBIT decreased less than 1% to $510.3m.

Want cheese with that whine?

China has long been considered a huge growth opportunity for Treasury given the increasing consumer palate for wine in China over the last few years. We still think it is, but the timetable has clearly been altered with China choosing to throw around its weight in global trade matters.

In August 2020 the Chinese Ministry of Commerce (MOFCOM) launched anti-dumping and countervailing duty investigations of Australia wine exports into China. This was followed by the Chinese Alcoholic Drinks Association requesting that Australian wine imports in two litres or less containers be subject to retrospective tariffs. Of course, the spat with China has involved much more than wine and came with speculation of a broad embargo of Australian exports into China.

In November 2020 MOFCOM moved to apply a 169.3% tariff to Australian wine through 28 August 2021 at the latest. This was later revised to a final determination of 175.6% as at 28 March 2021, a duty that will supposedly remain in place for at least five years.

With Chinese demand expected to be minimal as a result, Treasury began to make several moves. It relocated wine earmarked for China to other luxury markets, including non-China Asian markets, Australia, the U.S. and Europe. It increased investment in those markets and reallocated luxury grape sourcing to other premium Australian brands.

Treasury acknowledged that 2HY21 EBIT will be below that of 1HY21 with a minimal contribution from China. Looking further down the road, we expect Treasury to strengthen its presence in non-China markets and will be a more powerful global brand once China demand returns.

Other places drink wine. Treasury does have exposure to China, but we believe the market reaction has been overblown. The Asia segment accounted for 23% of revenue last year and that includes non-China countries, the Middle East and Africa. More importantly, we favour the decisive pivot to other wine drinking nations, which is pretty much the rest of the world.

Treasury's foray into the highly competitive North American market has been the source of much criticism over the years. In the US market it has faced weakness due to a shift towards low-priced private label wines. Still, with the Americas accounting for 40% of sales, it's a market that Treasury has to get right.

With the number two spot in the US luxury wine market, we think Treasury has a strong foundation to grow from. It took a good step in reaching a deal with US-based The Wine Group (TWC) in March 2021. The long-term agreement will allow TWC to source and sell several of Treasury's US commercial brands. Aside from generating $100m for the sale of the brands, Treasury will move further away from the commercial market and closer to its goal of focusing on the higher margin, luxury end of the market.

2020 leadership vintage

We note that the vintage of the leadership team is rather recent. Tim Ford took over as CEO and Matthew Young stepped into the CFO role last year. Their debut couldn't have come at a more challenging time. Fortunately, they inherited a company in good financial health and have thus far done a respectable job managing the pandemic and China challenges. Treasury's balance sheet is in good shape as entering the pandemic with a strong liquidity positioned helped. It contains a $48.1m cash position and a decreasing net debt balance. To the company's credit, it was able to continue dividend distributions in FY20 ($0.28) and offer a FY21 interim dividend ($0.15).

Much like some of the commercial wine brands, we believe Treasury's valuation is rather inexpensive. The consensus EV/EBITDA multiple is 14.6x for FY22 and 12.9x for FY23. We've considered the share to be a contrarian play for some time now and see further upside ahead. Remember, flat results despite the massive attacks from China show the resilience of the company's operations and the skill of its management. FY22 could still be considered a transition year with EBITDA expected to fall by about 8%. However, FY23 is looking strong with an expected 13% EBITDA growth.

Bottom line, Treasury has a strong brand portfolio that is rapidly shifting towards the premium space. The company's other major shift, i.e. moving away from its reliance on China, should also serve investors well over the long-term. We drink to that, it's four stars.

FLIGHT CENTRE TRAVEL GROUP

Gearing up for a strong recovery

Stocks Down Under rating: ★★★★

ASX: FLT
Market cap: A$ 3BN

52-week range: A$11.18 / A$20.16
Share price: A$ 16.89

Our 6 March 2020 article on Brisbane-based Flight Centre came at a time when travel and leisure companies were getting hit hard as the coronavirus began to spread around the world. With Australia's largest travel agency also dealing with a price gouging scandal, the share soon plunged to a record low under $10. Travel conditions have since improved as has the stock price, but we think there is near-term turbulence ahead as international corporate and leisure travel slowly get off the ground.

Share price chart

Source: Tradingview

Travel to nowhere

Flight Centre is one of the world's largest travel agencies in both the leisure and corporate sectors. The group offers a one-stop travel booking experience where customers can reserve flights, accommodations and transport online or at retail locations. It operates under many brands — AVMIN, Corporate Traveller, FCM Travel Solutions, Topdeck, Travel Managers Group, Travel Money Oz, The Infinity Group, Travelsmart, StudentUniverse, Universal Traveller and 99 Bikes.

Most revenue comes from traditional travel agency services, but it also brings in money from its own tour and hotel businesses. With operations in 23 countries and a corporate travel management network that spans almost 100 countries, approximately 54% of sales were derived from outside Australia and New Zealand in FY20. Flight Centre gets most of its overseas revenue from North America and Europe. It is this international side of the business that holds the key to long-term growth because transaction volumes and margins tend to be higher. We realise the company has reported FY21's results, but we believe FY20 is a more important indicator of the company's future revenue split.

Just as the travel industry was seeing clearer skies after Brexit, Hong Kong unrest and headwinds from the US-China trade war, the coronavirus presented an unprecedented challenge. With government restrictions in place across the globe, travel demand was minimal for much of 2020. More than half of Flight Centre's retail

outlets were temporarily closed, senior staff's pay was cut in half and about 6,000 sales and support jobs were lost. The company also paused non-essential capex projects and marketing spend, completed a $700m equity raise, took on $200m in additional debt funding and secured another $400m from a convertible note offer.

Skies far from friendly

Despite efforts to reduce costs and improve liquidity, there was only so much Flight Centre could do to combat the lack of revenue. Total Transaction Volume (TTV), a key stat in the travel agency business, fell 75.2% to $4bn and it suffered a $433.5m Net Loss After Tax.

There were some signs of improvement late in CY20. Although travel was still restricted to domestic-only and essential overseas trips, revenue rose to its highest post-pandemic level in the month of December 2020. Still, there is no sugar coating the fact that with the Delta strain running rampant, the situation is unlikely to improve before the end of 2021. And with lower margin domestic and corporate travel accounting for most of the limited volume, income margins were also well below normal at 10.3%.

Unfortunately, we don't see an improvement in travel demand anytime soon. There is considerable risk that domestic travel will be mostly on lockdown for the rest of 2021 in Australia and there is a near-zero chance that international travel will resume at scale before Christmas. And as Qantas recently indicated, ramping up international travel will likely take most of 2022.

Latent travel demand to erupt after reopening

Thanks to all the capital raising and cash preservation measures, Travel Centre is in decent financial health all things considered. As at 30 June 2021 it had $1.4bn in cash, $941m in liquidity, the company is currently burning between $30m and $40m per month. This should give it the flexibility to spread its wings overseas and potentially acquire complementary businesses as these growth opportunities arise.

Prior to COVID, an appealing attribute of a Flight Centre investment was the generous dividend payments. Including a special $1.49 payout, shareholders received $3.07 of dividend in 2019. But with the distribution suspended since last year, the income component of the share is no longer there, at least for now.

Flight Centre is not expected to return to net profitability until at least FY23. At the EBITDA level, consensus forecasts imply an EV/EBITDA multiple of 20.3x for FY22 and 8.9x for FY23. Now, FY22 can already be considered a lost year, with large parts of Australia in lockdown so far in 1HY22. But if and when we start to open up again, beginning when Australia hits the magic 70% vaccination rate threshold expected in November, we believe FY23 could turn out to be a bumper year. We would expect many people will want to travel again and won't mind splurging on overseas trips.

The current consensus EBITDA growth expectation for FY23 is 129%! And the EV/EBITDA for that year is only 8.9x. Sure, there will be a catch-up effect in FY23, but growth is expected to be around 37% the year after. In other words, we believe Flight Centre should be on investors' radar screens again. Four stars from us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

You are receiving this email because you subscribed to our Stocks Down Under newsletter.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document