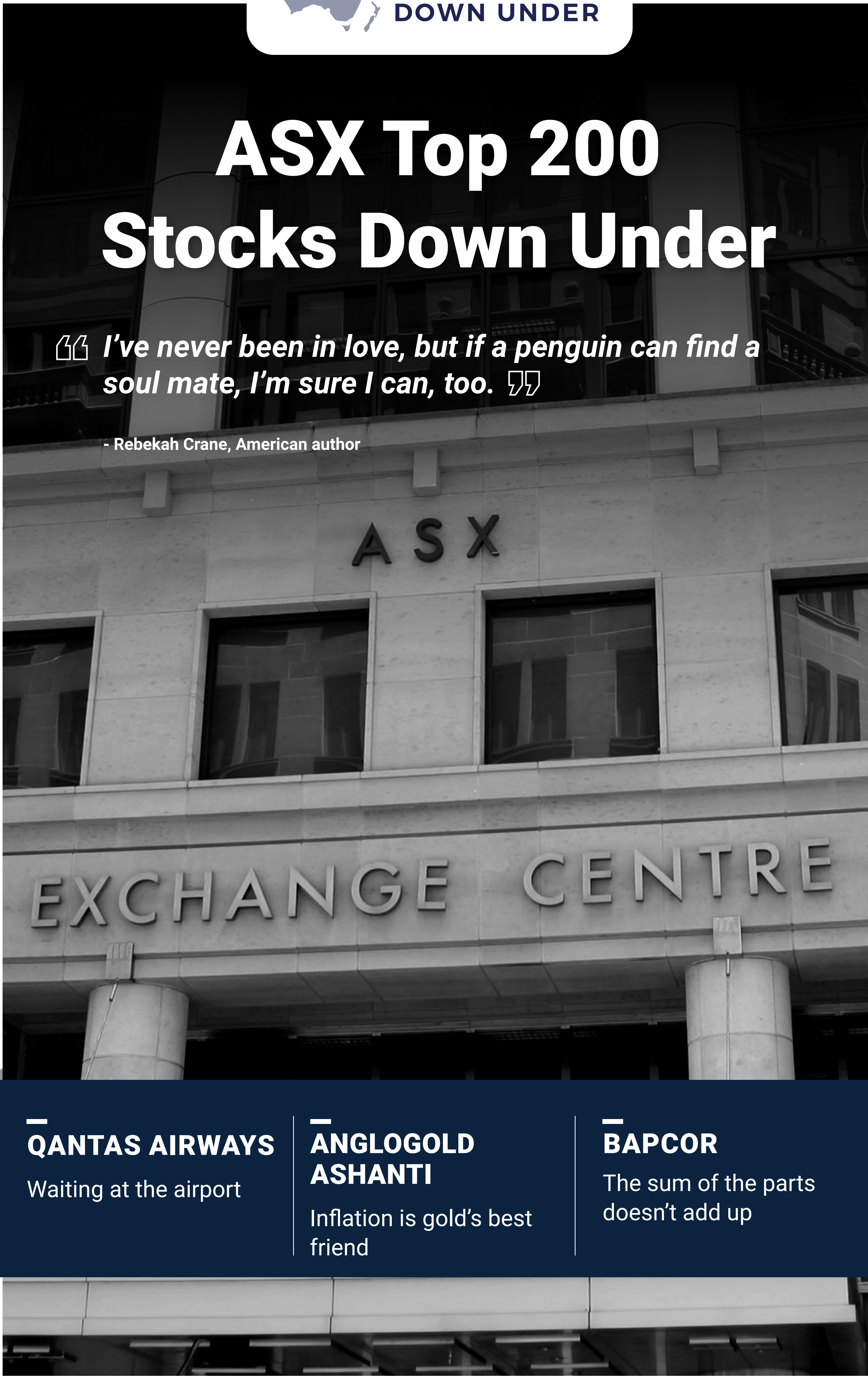
STOCKS DOWN UNDER

1 NOVEMBER 2021

ASX Top 200 Stocks Down Under



I've never been in love, but if a penguin can find a soul mate, I'm sure I can, too.

- Rebekah Crane, American author

QANTAS AIRWAYS

Waiting at the airport

ANGLOGOLD ASHANTI

Inflation is gold's best friend

BAPCOR

The sum of the parts doesn't add up

QANTAS AIRWAYS

Waiting at the airport

Stocks Down Under rating: ★★★★

ASX: QAN
Market cap: A$10.3BN

52-week range: A$4.18 / A$5.97
Share price: A$5.35

When we last covered the Sydney-based airline Qantas Airways in April 2020, we stated there was a lot more upside in the stock. This was after the shares had gained 66% from their low of $2.14 and were trading at $3.56. Fast forward almost eighteen months and the stock is trading at $5.37. With the pandemic showing signs of slowing and Australia opening up, now is a good time to take another look at Qantas. Spoiler alert: we think QAN stock will be flying a lot higher this time next year.

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ASX: AGG
Market cap: A$9.7BN
Dividend yield: 2.1% (0% Franked)

52-week range: A$3.95 / A$7.70
Share price: A$4.90

Anglogold Ashanti was one of the few companies that was doing well during the first few weeks of the pandemic. After we last covered the company in April 2020, the share price shot up from around $6 to over $10. However, as fears of a long recession with high inflation didn't materialise and with lower gold prices, the company began to perform poorly. Trading $4.90 currently and with the US Dollar finally beginning to experience inflationary pressures, Anglogold might just be a company worth looking at.

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Bapcor is an aftermarket dealer of car parts, accessories and services. Based in Melbourne, the company has over 1,000 locations in Australia, New Zealand and Thailand. As the world recovers from the pandemic and people start driving again, Bapcor should be in a good position to benefit. The share price has largely recovered from the COVID setback and has been trading in a range of roughly $7.00 to $8.50 since August last year. What will it take to break free?

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Share price chart

Source: Tradingview

COVID-19 becomes COVID-21

In our previous forecast, we believed that the company would be able to replicate its FY19 performance in FY22. This was based on the assumption that the lockdowns would have long been lifted and the world would have returned to normal sooner. Well, here we are, well into FY22, and it seems like COVID will be with us for a while longer.

The problem is not just Australia. Relative to the rest of the world, Australia has dealt with the pandemic reasonably well, although being locked up in your own country for 18 months didn't feel so good. The issue is that international flights represent a vast portion of Qantas' business. As long as the pandemic does not subside in countries like the US and Japan, Qantas may not be able to return to its old ways of steady profits and regular dividends for two reasons. Firstly, the company cannot operate flights to areas that have suspended air travel. Secondly, a significant percentage of people is afraid to travel due to the risks posed by COVID overseas. However, we believe the green shoots are coming through, starting with the return of international travel today!

In order to stay afloat, Qantas has had to resort to extreme cost-cutting in the last 18 months. In November 2020, the company announced that it would axe 2000 jobs. Still, no airline can cut costs enough to break even during period of extremely limited flying. As such, the company has received a substantial amount of aid during the course of the pandemic; over $2bn in total by the end of this year.

Coming out at the other end of the tunnel

Despite its financial troubles, bankruptcy has never been on the cards for Qantas. Other companies have suffered a lot worse, including Virgin Australia, one of its biggest competitors, which went into administration less than a week after we published on the two airlines in Stocks Down Under.

It is no surprise that Qantas balance sheet has taken a hit. Total debt, which stood at $5.3bn in April 2020, has ballooned to more than $8.2bn, with more being piled on every day. In June 2020, the company raised $1.36bn through an institutional placement at $3.65 per share. Due to its massive size, the company also had access to the unsecured bond markets, even during the pandemic. In September, the company secured a 10-year $500 bond at 5.25%, which replaced $400m of previous debt at 7.5%.

Our initial thesis for the company still stands. Due to its size, reputation and affinity with the Australian public, the company has survived the pandemic and is now coming out at the other end. Once vaccination reaches levels of 90%+ and air travel returns to 2019 levels, the company should be able to perform at pre-pandemic levels.

The balance sheet has deteriorated with net debt of $6bn at the end of FY21, compared to around $4.7bn before COVID-19 hit. However, we believe it's manageable for QAN.

The stock is very cheap on FY23 and FY24 numbers

Consensus estimates put FY22's EBITDA at $1,281m (compared to just $397m in FY21), while EBITDA in FY23 is expected to reach $3,313m. And in FY24 the market is forecasting EBITDA of $4,049m. Disregarding the first "catch-up" year FY22, these numbers imply EBITDA growth of 159% for FY23 and 22% for FY24.

Now combine that with Qantas' EV/EBITDA valuation of just 4.9x and 4x for those years and we believe you're looking at an extremely cheap company that is at the start of the runway and about to take off.

Of course, we understand that there are risks associated with travel stocks at the moment, including the risks of new lockdowns and new travel restrictions. And in the case of Qantas an additional capital raise to reduce its net debt level can't be ruled out either. But we think the company's valuation is very compelling.

More importantly, we believe the increasing global vaccination rates and the fact that the medical industry is now on top of the virus means we will slowly start to put COVID-19 behind us. Therefore, we believe QAN will be able to gain more altitude in the next 12 to 18 months. Four stars from us.

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Inflate the bubble

Back in April 2020, the advent of inflation and the loss of trust in fiat currencies seemed inevitable. However, something very different happened. Governments worldwide continued to stimulate their economies and asset prices across the world skyrocketed. However, one asset class that did not receive the same treatment as the others was precious metals. Gold, a metal that had already been on a long bull run since late 2015, rose until August 2020 and then fell off a cliff. At its high, the price of an ounce of gold was slightly above US$2,036. Currently, it is trading around US$1,800. While a fall of around 12% in little more than a year may not justify the 'falling off a cliff' statement for any other asset, we believe it definitely does for something considered the primary store of wealth across the world.

Gold has traditionally been considered a hedge to the stock market. When the market rises, gold falls and vice versa. While this is not always true, it was true during the pandemic. Gold mining companies have suffered as a result. Newmont (NYSE: MEM), one of Anglogold's major competitors, has fallen about 21% in the last fourteen months, while Barrick Gold has fallen 36% in fourteen months.

So while the fall in Anglogold's share price is quite apparent, it seems that the tide is finally beginning to turn, with COVID-induced inflation increasing around the world, including in the US. And since the US market is by far the largest, it has the most impact on gold prices.

We believe gold is headed up

The future of Anglogold depends on the performance of the stock market and the economy in general. Michael Burry, who successfully predicted the 2008 housing crisis (and who is best known from the movie The Big Short), has recently taken a US$280m short position in US treasury bills, indicating that he expects rising interest rates due to inflation. Bond yields have already started to go up in most developed economies and we should expect gold prices to rise on the back of that. This will allow companies such as Anglogold to benefit from these higher gold prices.

One of Anglogold's significant advantages from an investment point of view has been its willingness to divest out of unprofitable ventures and quickly move to areas where mining costs are lower. We expect the company to take advantage of the increase in prices by prioritising profit margins above all else.

FY21 has been problematic for Anglogold, with underground operations at the Obuasi mine suspended after the death of a miner in May. Moreover, the actual cost of mining has exceeded the predicted cost (US$1,234 an ounce actual against US$1,000 an ounce predicted). For FY20 in total, the company's All-In Sustaining Cost of Production (AISC) was US$1,059, compared to US$998 in FY19. For FY21, the company's expected AISC is US$1,130-1,230, which will impact margins.

It's a steal

The company has been busy in recent months, finalising the sale of its assets in South Africa and Morila Limited, which owns 80% of the Morila mines in Mali. It has also acquired Corvus Gold, a company in which Anglogold already owned a 19.5% stake. Management is not afraid to take big decisions and Anglogold should be able to perform exceptionally well if gold prices rise.

Dividend for FY21 is expected to be US$0.30, with an increase to US$0.35 in FY22 and US$0.47 in FY23. This increase can be attributed to the consideration received for the sale of assets and the company's expected performance in FY22 and FY23.

Despite the bleak near term outlook, what makes Anglogold so enticing is what it can do in FY22, which starts on 1 January. According to consensus estimates, EBITDA is expected to fall to US$1,805m in FY21, down from US$2,340m in FY20, before rising to US$2,387m in FY22 (up 32%) and US$2,459m in FY23 (up 3%). This values the company at just 5.1x and 3.8x EV/EBITDA for FY22 and FY23, making it an even bigger steal than when we covered it back in 2020.

Taking everything into account, we think that Anglogold Ashanti is still a four-star investment.

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Share price chart

Source: Tradingview

Australian car sales are in full swing

When we covered Bapcor previously in November 2020 with a two-star rating, we mentioned two crucial facts. The first one was that the prospects of the company failed to justify its valuation. The second one was the caveat that Bapcor could be highly profitable during years of increased car sales. The vehicle industry is highly cyclical and aftermarket parts dealers' profits usually move with total car sales.

After a pandemic-stricken 2020, Australian car sales in 2021 seem to be a lot better. By the end of August 2021, total car sales in the country amounted to 732,828. This was the highest number since 2018 and a lot better than the 575,906 sold by that time last year. The August number represented growth of 33.1% year-on-year and was up from 16.1% growth in July. If this strong growth trend continues, we could see sales figures similar to those of 2016-17, when over 1.15m cars were sold annually.

Combating uncertainty with geographical expansion

Two things make forecasting Bapcor's numbers tricky. Firstly, the rate of opening up. In other words, when will Australia go back to the office again en masse. And secondly, the current chip shortage. A modern car may have as many as 1,400 chips and vehicle manufacturers compete for silicon with computer and cell phone makers, crypto miners, gamers and appliance manufacturers. As such, the current supply has slowed down car sales globally and car imports into Australia have declined this year. According to Intel and IBM CEOs, the chip shortage is expected to last for another couple of years, although we believe the worst of it will be over by this time next year.

These two problems are something that Bapcor cannot control. However, the company is trying to diversify its exposure to COVID by expanding geographically. This way, the risk of lockdowns in one area could be hedged by continuing operations in other areas.

In March 2021, the company announced an agreement to acquire a 25% stake in Tye Soon for SG$12.5m. Based in Singapore, Tye Soon claims to be the most prominent aftermarket car parts distributor in Southeast Asia. Apart from Australia and Thailand, Tye Soon operates in Singapore, Malaysia, South Korea and Hong Kong. With annual revenue of over SG$200, we believe this company provides the perfect kind of diversification to Bapcor (keeping the pandemic in mind).

In June 2021, Bapcor updated its five-year strategic targets, with further expansion in Asia playing a key part. Bapcor can increase its Tye Soon stake in the future and may find synergies in the supply chain, research and distribution. The company is also currently optimising its supply chain by acquiring state-of-the-art technology and consolidating its distribution centres to reduce operational expenditures. Aiming to differentiate itself by being the only 'specialist' focused parts distributor in the Asia Pacific, the company generally has a positive outlook for the next five years (barring massive supply shocks).

Limited growth at a fairly high price

FY21 has been a terrific year for Bapcor. Revenues surged from $1.46bn to $1.76bn, with net profit increasing from $78.5m to $118.5m. EBITDA amounted to $279.5m, up from $62.5m the year before… not too shabby indeed.

However, following a strong FY21 and looking at the next few years, we can see that the market is forecasting a much more moderate growth rate for Bapcor. Specifically, consensus estimates put EBITDA growth at just 4% for the current financial year and 8% for FY23. Overlaying that with the company's EV/EBITDA multiples of 10.7x for FY22 and 9.8x for FY23, we believe there is no hurry to get into the stock. With this valuation it may be a while before the stock breaks out of that $7.00-$8.50 trading range we mentioned at the beginning.

As an opening up play in this space, we prefer the AMA Group, which we put on Marc & Stuart's Top Pick list two weeks ago. In addition to its parts business, AMA should benefit much more from increasing traffic numbers because of its smash repair business. For now, Bapcor is a three-star stock in our book.

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