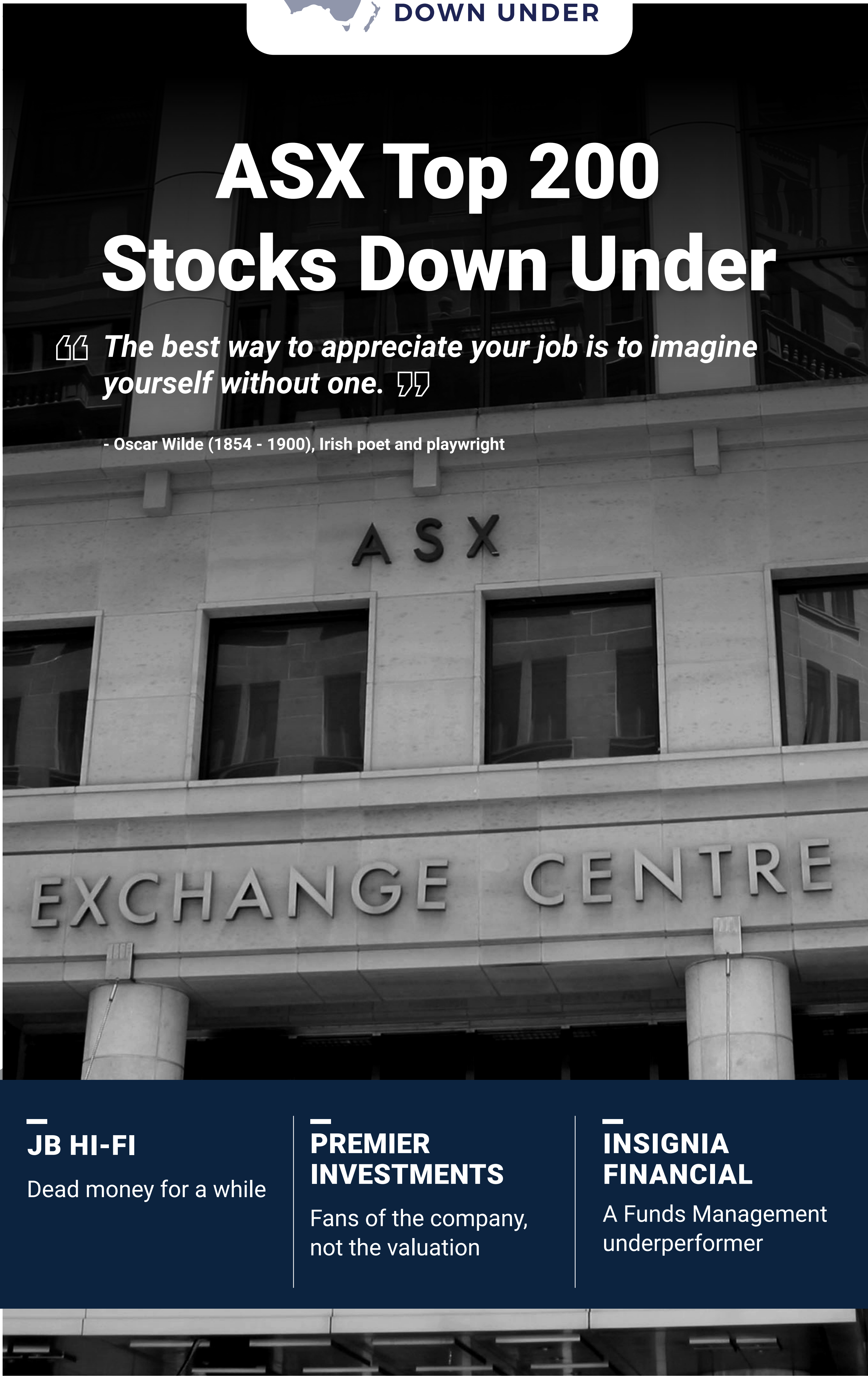
STOCKS DOWN UNDER

20 DECEMBER 2021

ASX Top 200 Stocks Down Under



> *"The best way to appreciate your job is to imagine yourself without one."*
>
> **- Oscar Wilde (1854 - 1900), Irish poet and playwright**

JB HI-FI

Dead money for a while

PREMIER INVESTMENTS

Fans of the company, not the valuation

INSIGNIA FINANCIAL

A Funds Management underperformer

JB HI-FI

Dead money for a while

Stocks Down Under rating: ★★★

ASX: JBH
Market cap: A$5.4BN
Dividend yield: 6.1% (100% Franked)

52-week range: A$43.12 / A$55.25
Share price: A$47.65

We last reported on Melbourne-based JB Hi-Fi on 5 June 2020, rating the stock two stars and illustrating the dangerous of investing at the same time, the unknown. The market had been expecting a decline in EBITDA of 6% year-over-year and while we were confident that JB Hi-Fi was standing strong against COVID-19 and selling well online, we were not confident enough to go against the consensus of 14 analysts. Well, an announcement released four business days later, on 11 June 2020, smashed the market's expectations and proved to us we should have trusted our gut. The announcement sent the stock on a serious upward trajectory. But now things are beginning to normalise and its unreasonable to expect FY22 will surprise to the upside, but looking forward to FY23 and things are controversial, but bright.

READ MORE

PREMIER INVESTMENTS

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Stocks Down Under rating: ★★

ASX: PMV
Market cap: A$4.9BN
Dividend yield: 2.6% (100% Franked)

52-week range: A$20.84 / A$32.62
Share price: A$30.11

Headquartered in Melbourne, Premier Investments is really just an investment in the Just Group with extras. Don't get us wrong, this company is certainly 'premier'. In fact, this was one of our best post-Corona Crash calls, with our 2 June 2020 four-star rating having generated nearly a 100% return. If you are not familiar with the Just Group, you likely know at least one of its brands: Smiggle, Peter Alexander, Just Jeans, Jay Jays, Portmans, Jacqui E and Dotti. While online sales did not make up a large portion of Premier's sales during FY19, it was already a fast-growing segment before we went through the forced transition online. And this is why we believe the company is well prepared to keep its online growth going, while transitioning back towards retail traffic.

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ASX: IFL
Market cap: A$2.3BN
Dividend yield: 6.4% (100% Franked)

52-week range: A$3.05 / A$5.39
Share price: A$3.60

We last wrote about Melbourne-based Insignia Financial (formally known as IOOF Holdings) on 4 June 2020, rating the stock four stars at the worst of its Corona crash at $4.92 per share. Clearly, we were wrong, but if you had been an avid reader of Stocks Down Under reports, you would have seen that we have since done a full 180 on our thinking on this stock and its main competitor, the AMP Group (ASX: AMP | see 15 February 2021 report). Insignia Financial made a massive acquisition earlier in 2021, but the company is still in decline and in a seemingly constant fight with ASIC over a stream of alleged regulatory breaches. Insignia Financial is no AMP, but we would still steer clear.

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Share price chart

Source: Tradingview

In this case the past is not really prologue

If you live in Australia you will have seen JB Hi-Fi everywhere. This major entertainment and electronics retailer is a combination of US-based Best Buy (NYSE: BBY) with the modernisation and online footprint of US-based Target (NYSE: TGT) (Australian Target is owned by Wesfarmers). JB Hi-Fi also has a sizable presence in New Zealand, but compared to Australia it is far less profitable. So, it's probably a good thing that New Zealand makes up less than 10% of JB Hi-Fi Australia's sales. When you look at FY21's total sales of $8.9bn, it shows how irrelevant the New Zealand division is, with its NZ$261.6m in sales (17.4% year-over-year growth) accounting for less than 3% of total sales.

Outside of its original operations, JB Hi-Fi also owns the Good Guys, an Australian home electronics and appliance retailer. Don't worry, the Good Guys does not really have any crossover to JB Hi-Fi's product offerings and the acquisition has proven to be extremely profitable for shareholders. In FY21, the Good Guys grew revenue 13.7% to $2.7bn, accounting for a whopping 30.3% of total revenue, not bad for an acquisition.

Despite the outstanding success shown by JB Hi-Fi during FY20 and FY21, FY22 and FY23 will likely be completely different ball games. What was originally a gradual shift to online shopping before COVID has drastically accelerated since COVID. But it's highly uncertain just how much of the shift to online is going to be permanent. Additionally, as a mostly electronics-focussed retailer, JB Hi-Fi saw a massive boost in sales during 2HY20 and FY21's work from home shopping spree. So, we can say with relative certainty that FY22 will see a decline in revenue and profits compared to FY21. Therefore, we believe the only proper way to value JB Hi-Fi is by looking forward to FY23, which starts in about 6 months. JB Hi-Fi has made a lot of strategic changes that we believe will propel it past current market expectations for FY23, so let's dive into the two main divisions, JB Hi-Fi Australia and the Good Guys to understand why.

JB Hi-Fi dominating online

We have to admit, it's a good thing JB Hi-Fi has been so successful at moving its operations online, because it would be ironic if a retailer that specialises in electronics and home entertainment could not handle the transition into the digital age. In FY21, JB Hi-Fi's three divisions managed to increase online sales rather considerably. The main division, JB Hi-Fi Australia, saw online sales grow 93% to $780m (13.1% of total sales). The New Zealand division generated online sales of NZ$27.6m or 10.6% of total New Zealand sales. The Good Guys division saw online sales increase 48.5% to $258.3m, or 9.5% of its total sales.

These are impressive growth statistics and in our view, it proves that JB Hi-Fi is able to adapt to changing times. And if there is another lockdown (a situation we believe will be unlikely) the company already has the infrastructure in place to accommodate its customers accordingly.

Dead money for a while

The market currently expects FY22 EBITDA to decline 15.9% to $808.4m, which shouldn't be a surprise due to the massive demand for electronics during the lockdowns in the initial stages of COVID in 2020. Unfortunately, the market does not currently believe JB Hi-Fi will return to EBITDA growth until FY24, when EBITDA is expected to hit $785m, i.e. 1% EBITDA growth. FY22 is certainly going to experience an EBITDA decline due to the massive demand caused by FY21's lockdowns as well as the store closures during part of FY22 (without the lockdown demand). However, from FY23 onwards, we believe it is unlikely there will be store closures due to lockdowns anymore and we believe all the work done to improve the online presence will pay dividends going forward, albeit that revenue growth will likely be lower than before.

Given that FY23 is expected to see a nearly 4% decline in EBITDA, while consensus estimates for FY24 are calling for EBITDA growth of just 1%, we believe the stock is going to be dead money for a while. Most likely direction? Sideways. So, it's three stars from us.

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Source: Tradingview

Strong FY21 recovery

Premier Investments is comprised of the wholly owned Just Group (Smiggle, Peter Alexander, Just Jeans, Jay Jays, Portmans, Jacqui E and Dotti), a 28.1% interest in the publicly traded Breville Group (ASX: BRG | see 16 August 2021 report) and a greater than 15.77% stake in Myer Holdings (ASX: MYR | see 9 March 2020 report). It is important to note here, that we currently have a two-star rating on the Breville Group. However, while these investments have performed well for Premier in the past, the bulk of the company is its ownership of the Just Group, making up its main operating segment 'Premier Retail'. This is what we will focus on.

In FY21, the Premier Retail division saw sales increase 18.7% year-over-year to $1.4bn, while Net Profit After Tax (NPAT) for the whole company jumped 97.3% to $271.8m. We mention NPAT's record result here because it was due almost entirely to the Premier Retail division. Unlike many of its competitors, Premier Investments did not have a terrible FY20 In fact, FY20 saw growth across all operating segments when compared to FY19 and FY18.

Online was already ready for COVID-19

In FY21, online sales reached $300.7m, up 36.4% year-over-year, accounting for 20.8% of total sales. What's so interesting about the growth in online sales was that it was across all categories, not just one. We believe this indicates that the company has established a stable, long-term online presence, rather than a short-term burst.

The valuation is premium

Among the 13 analysts that are currently covering Premier Investments, the consensus is that FY22 will experience a 15.3% decline in EBITDA year-over-year, to $458m. However, Premier Investments is also expected to return to growth in FY23 with EBITDA growth of 3.5%, to $474.4m, which is still 12.3% below FY21's EBITDA of $540.9m.

COVID-19 saw an explosion in demand and it is unreasonable to assume that Premier Investments would be able to keep growing after having experienced highly unusual market circumstances, like lockdowns. However, going forward we believe that the company's systems, developed to address COVID demand, will prove to be a significant boon to it's competitive edge.

However, we also believe that Premier Investments is likely overvalued at this time, even taking into account expected growth in FY23. Using the market's consensus estimates, we arrive at FY22 and FY23 EV/EBITDA multiples of 10.1x and 9.8x, respectively. At an expected EBITDA growth of just 3.5% in FY23, we can only conclude that Premier's valuation is premium. So, it's two stars for now.

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Share price chart

Source: Tradingview

A brief explanation of Insignia Financial

Before we dive in, it's important to have an overview of what exactly Insignia Financial does. Insignia Financial's principal operations can be split into three divisions: financial advice, portfolio and estate administration, and investment management.

The financial advice division is where Australian clients go to receive guidance around their investments. This includes making a financial plan, providing direct suggestions and putting clients into various financial products. During FY21, this division generated $20.1m in Profit After Tax (PAT), a decline of 58.5% year-over-year due mostly to a combination of integrating MLC's advisors and the loss of a major contact. This indicates to us that while the contract loss caused a decline in operating revenue of 13.6%, the greater decline in PAT is not a small blimp that will be fixed once the MLC integration is complete.

The portfolio and estate administration division is where superannuation and other investments come to roost. This division generated $200m in net operating revenue during FY21, a decline of 5.3% year-over-year. Due to the decline in revenue and increase in administration and licensing fees, PAT declined 22.2% year-over-year to $45.1m. We expect this margin pressure will be a long-term trend and as we will discuss later on, we are bearish on this division in particular. We do not expect positive results out of this division in the near future, which is a major issue for Insignia Financial as it is currently the largest source of PAT.

The investment management division looks at global single and multi-manager funds and attempts to combine them in a way that offers the best returns for its clients. Some of these financial products include Insignia Financial MultiMix, MultiSeries, OptiMix and OnePath Diversified. From a financial point of view, this division was by far the best performer during FY21, only seeing a 2.9% decline in revenue ($64.5m) and an 8.2% decline in PAT ($34.5m). Like the other divisions, we don't expect the margin here to improve as the majority of its decline was due to the implementation of an Office of the Responsible Entity, which is a section of the business we don't expect to be allowed to be downsized anytime soon. But more on that later.

What's worse than one declining business?

The answer: two declining businesses. Insignia Financial's massive ($1.4bn) acquisition of NAB's wealth management business was made with a lot of fanfare when it was first announced back in 2020. The main point management wanted investors focused on was that it made the company the largest Australian wealth manager by FUMA (Funds Under Management and Administration), number one in the number of advisors and number two in superannuation provider by Funds Under Administration (FUAdmin).

Sure, the companies offered a lot of synergies as well, at the time an estimated pre-tax synergy of $150m by the third full year of ownership (we are currently in year two) and this seems to be on track. But here's the problem, Insignia Financial and MLC are poorly performing, declining operations. According to Stockspot's annual ranking of Australian Superannuation Funds by poor performance and high fees, Insignia Financial's OnePath superannuation funds were the worst in all of Australia, knocking off AMP's. The recently acquired MLC was only tied for third place along with Zurich and EISS. Here's another fun fact, Insignia Financial has been included in every list of poorly performing Super Funds since it was started in 2013.

Excluding the MLC acquisition, Funds Under Management, Administration and Advice (FUMA) increased 5.4% year-over-year to $213.3bn. But wait Stocks Down Under, didn't you say Insignia Financial is in decline? Yes, we did, and yes Insignia Financial is. You see, the only statistic that really matters for a company like Insignia Financial when it comes to FUMA is the net capital flows. For FY21, Insignia Financial had net outflows of $8.6bn, pension payments of $2bn and combined one-off movements of $4.5bn net outflows. During FY21, the market was on a tear and this is the only reason Insignia Financial's FUMA increased year-over-year, but for all intents and purposes, Insignia Financial's FUMA declined. This trend continued during 1Q22, when the company saw net outflows of $0.9bn for Funds Under Administration (FUA), although this was once again compensated for by positive market movements of $3.4bn. Regarding Funds Under Management (FUM) for 1Q22, this also saw net outflows of $1.4bn, also offset by $2bn in market gains. In summary, so far, FY22 has seen a lot of the same, slow decline for Insignia Financial.

Not worth the risk

In our view, it's not worth getting involved with a company in decline, like Insignia Financial, especially since the decline seems to be part of an overall trend. It is true that the market believes Insignia Financial will experience EBITDA growth in FY23 (10%) and FY24 (11.3%), and the stock is currently valued at 5.8x and 5.2x, respectively. Still, even at the current discount (0.96x P/B), we don't believe it's worth the risk, although it seems unlikely to us that the stock will fall much further, so three stars.

Pitt Street Research Pty Ltd

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Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and is founded on more than 40 years of combined experience researching companies in a range of different sectors.