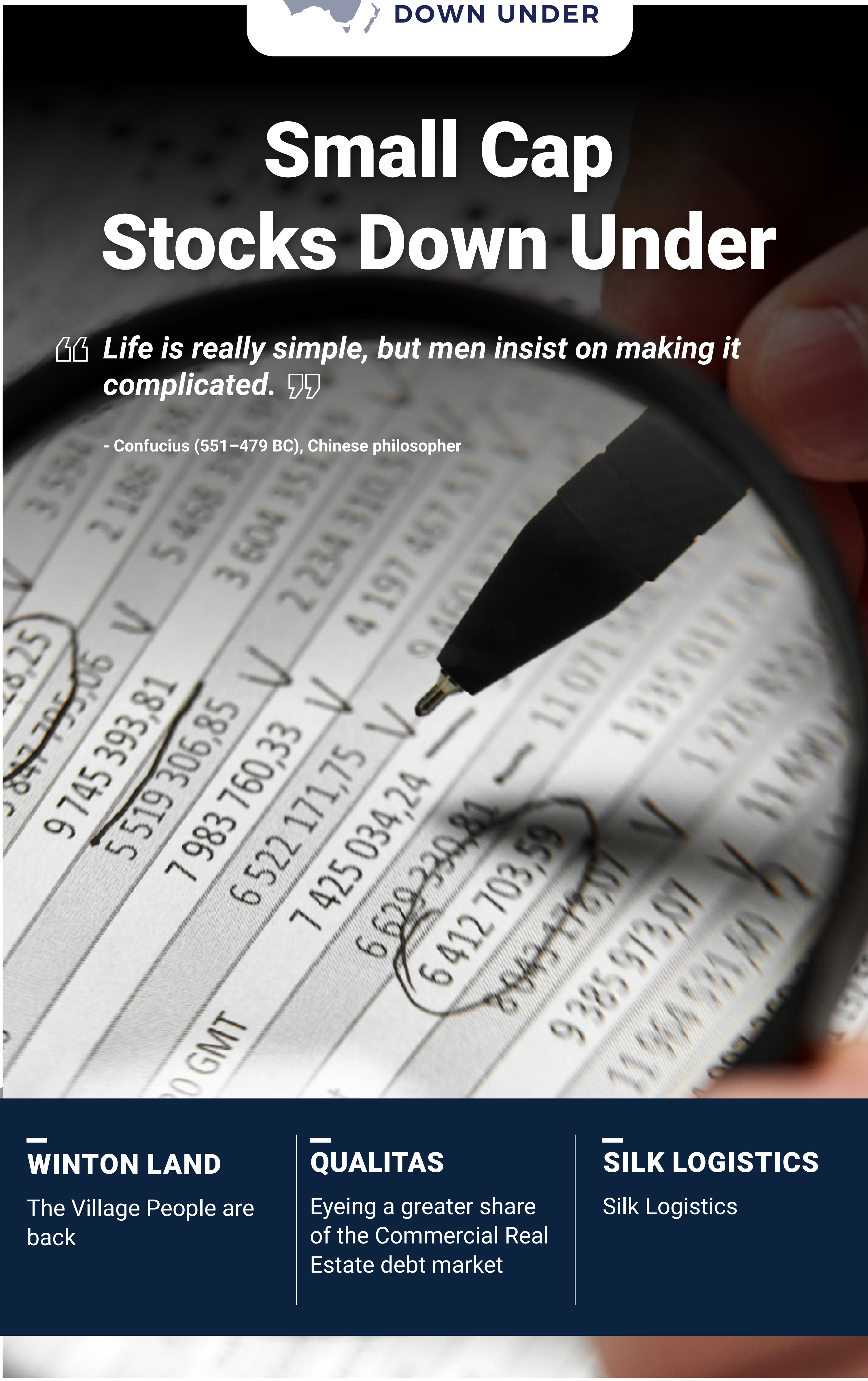
STOCKS DOWN UNDER

4 FEBRUARY 2022

# Small Cap Stocks Down Under



*Life is really simple, but men insist on making it complicated.*

- Confucius (551–479 BC), Chinese philosopher

## WINTON LAND

The Village People are back

## QUALITAS

Eyeing a greater share of the Commercial Real Estate debt market

## SILK LOGISTICS

Silk Logistics

# WINTON LAND

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Stocks Down Under rating: ★★★★

**ASX: WTN**
**Market cap: A$1.1BN**
**Dividend yield: 2.5%**

**52-week range: A$3.66 / A$3.76**
**Share price: A$3.70**

Winton Land is a Kiwi property developer, which only just listed in December 2021. It specialises in planned communities, but is hoping to expand into retirement villages in the coming years. While Australian investors may not think of the New Zealand housing and retirement village markets as investment destinations, the market dynamics and the success of other companies in this field - particularly Summerset (ASX: SNZ) - mean Winton Land isn't a stock to be snuffed at.

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# QUALITAS

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Stocks Down Under rating: ★★★★

**ASX: QAL**
**Market cap: A$694m**
**Dividend yield: 3% (100% franked)**

**52-week range: A$2.17 / A$2.65**
**Share price: A$2.22**

Qualitas (ASX: QAL) is one of the ASX's newer property companies, having only listed in December last year. While most other listed property players directly invest in properties, or develop those properties, Qualitas is a property financier with a focus on Commercial Real Estate (CRE). Australia's major banks currently provide over 90% of funds for the CRE debt market, but Qualitas is hoping to gain a greater share in the years ahead.

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**Market cap: A$160M**
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Logistics have been a nightmare for most, if not all, industries since COVID-19 took off. While this has led to significant complications for many logistics companies, it has also created overwhelming demand. Melbourne-based Silk Logistics does exactly what its name sounds like; the company helps ensure that its customers' logistics experience is as smooth as possible. We believe that Silk Logistics' use of technology and strong management team have put the company in a strong position.

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### Share price chart


*Source: Tradingview*

### Mastering the master-planned community

Winton was founded in 2009 and dual-listed on the ASX and NZX just prior to Christmas last year, having raised NZ$350m at NZ$3.89 per share.  It is headed by New Zealand property magnate Chris Meehan.

Winton's two areas of focus are master planned communities and retirement villages. You probably know what a retirement village is and doubtless you've seen a master planned community before. These are new, comprehensively designed neighbourhoods that encompass new homes and commercial properties. The company not only sells residential lots and dwellings, but designs and builds the civil infrastructure – the roads, street lights, shopping centres, childcare facilities…and even the pubs.

Winton has 29 projects across 13 master-planned communities, predominantly in New Zealand. As of 15 November 2021, it had pre-sold NZ$703m in properties and the company expects to yield a combined total of 7,442 lots. By the end of FY25 it expects to have received $171m in settlements - $20m of which has already been received. While it is relatively early days, we believe investors can be optimistic about this company. On average it has made a gross margin of over 40% and achieves an Internal Rate of Return of over 45% on its completed projects.

Winton has a heavy focus on growth corridors across New Zealand, but it is Auckland-centric, Auckland being the nation's largest city. 78% of lots are up there and Winton will likely do well given the expectation that Auckland can grow its population by an average of 1.1% annually until about the middle of the century.

### New Zealand or Australia, guess who has more kids?

While New Zealand has a population of just over 5 million, it is experiencing faster population growth than Australia. According to the World Bank, New Zealand's population has grown faster than Australia's every year since 2014. Population growth slowed in both countries in the last 12 months due to border closures, but Australia was still outshone by its Kiwi neighbours, growing by just 0.14% in the 12 months to 31 March 2021, while New Zealand grew by 0.6% in the 12 months to 30 June 2021.

But population growth has caused a substantial housing shortage – estimated by Westpac, ANZ and Kiwibank to be 65,000-75,000 dwellings. Record low interest rates and government schemes, such as grants and the ability for first home buyers to contribute their KiwiSaver funds, have further increased demand for housing.

The lack of new residential lots has also contributed to the problem with sales remaining below levels seen in the early 2000s. In the past three decades, only 740,000 building consents were issued, but New Zealand's population grew by 1.63 million. While Winton Land may not be able to eliminate the problem, it can help to ease the squeeze.

### The new Village People

Although Winton will not complete its first retirement properties until 2024, we think patience will pay off for investors who wait. Demand for retirement villages is expected to rise in the years ahead because of New Zealand's aging population. The number of New Zealanders over 75 is expected to rise from 332,000 in 2020 to 833,000 by 2048. Winton is aiming to capitalise on this demand. This new business unit, named Northbrook, is targeting to complete and ultimately operate 917 retirement village units - comprising of 731 independent living units and 186 care suites over five villages between FY24-27.

While the bulk of its master-planned communities are in Auckland, Winton's proposed retirement living developments are more evenly spread across the country, with two in Auckland and one each in the three South Island towns of Christchurch, Arrowtown and Wanaka.

### Could Winton emulate Summerset?

One other Kiwi company in the retirement village space is Summerset (ASX: SNZ | Stocks Down Under 11 January 2021). This company first listed on the NZX in November 2011 with a market capitalisation of ~$300m and dual listed on the ASX in July 2013 without raising capital. Summerset has grown nearly tenfold since listing thanks to successful expansion and Winton evidently wants to emulate that success. For evidence, look no further than Winton's hiring of ex-Summerset CEO Julian Cook to head its retirement living strategy.

Investors in Winton will have to wait a few years to realise these ambitions. But if the success of Summerset and the demand for new properties and retirement villages are any indicators, a significant payoff could come for Winton shareholders. And in the interim, investors won't be left wanting with ~$150m in settlements due as well as other developments coming into the pipeline in future years.

Winton Land achieved revenue of NZ$177m and EBITDA of NZ$69m in FY21. Although it is expecting revenue and EBITDA to retreat to NZ$158m and NZ$49m respectively in FY22, it is also tipping these to rebound substantially in FY23 to NZ$344.7m and NZ$137.5m respectively. That big jump is attributable to the significant number of developments that will complete in FY23. With a market capitalisation of just under $1.1bn, it makes the stock's EV/EBITDA ratio for FY23 of just 8x look very modest considering Summerset's ratio of 14.7x. Four stars from us.

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### Share price chart


*Source: Tradingview*

### Ever wanted to be a bank? Here's your chance

Qualitas is a real estate management firm that provides finance for property developers. It has a total of $4.2bn in Funds Under Management (FUM) across 13 active funds and achieved 36% Compound Average Growth in FUM since it was founded in 2008. It obtains the money from investors who receive regular distributions, making an investment in Qualitas as close as you can get to being a bank without having a bank license.

The Group already has a fund listed on the ASX, having taken public the Qualitas Real Estate Income Fund (ASX: QRI) back in 2018, but it opted to list itself in December last year. It raised $335m as part of its IPO and hopes the proceeds will provide capacity for acquisition opportunities.

CRE (Commercial Real Estate) finance has become popular with investors in recent years. This is not just because low interest rates have made property investment more appealing, but because CRE finance has one of the lowest impairment rates of all asset classes, at less than 1% since 2014. This is because borrowers are typically property developers, corporations or High Net Worth Individuals who take on finance to develop property to make a profit or refinance debt.

## Real estate private credit is a $410bn opportunity

Qualitas estimates that the Australian private credit market for real estate was worth $410bn in 2021. Traditional bank lenders make up approximately 90% of the market, while alternative lenders make up just 10%. But the company is betting that alternative lenders, who fund lending activities through investor equity as opposed to deposits and wholesale funding, will grab a larger share of the pie as they have in overseas markets. For instance, in the US, private capital providers hold a market share of 53%, while in Europe they hold 60%. Non-bank lenders are taking share in those jurisdictions because they can provide greater flexibility, leverage and speed to market than traditional lenders.

Qualitas told prospective investors in its IPO roadshow that if just 1% of Australia's $3.3 trillion in superannuation assets went towards alternative assets, it would represent a $33bn opportunity, implying a significant addressable market. But Qualitas is also hoping to grow its own share of the pie among alternative lenders. Qualitas holds a ~10% share of the $41bn held by alternative lenders.

It is hoping to stand out from its peers because of its historical results and institutional relationships. In FY21, it generated a net revenue of $55.8m and an NPAT of $10.6m. In FY22, it has guided to $72.1m in revenue and a $16.0m NPAT. If achieved, these figures would be 29% and 51% higher respectively. It has also guided to a pro-forma annualised dividend yield of 3% for FY22.

Qualitas also boasts significant institutional investor support thanks to the returns it has made in the past. As of 31 October 2021, 66% of committed funds under management held by Qualitas belonged to institutions. Of these, 64% are sovereign wealth funds and 38% are private banks, with pension funds and fund managers making up the balance.

## Changing macroeconomic headwinds could be a threat

One catalyst for the strong performance of the property finance space has been solid macroeconomic conditions in Australia. In the industry's favour has been stable population growth, lower bond yields, stable inflation and the near-uninterrupted economic growth of the last 30 years – and a quick recovery after every disruption, including the initial onset of COVID-19.

With Australia moving into a 'living with COVID' phase, it remains to be seen how the economy will be impacted and what impact it will have on demand for commercial finance. In recent months, there has been significant disruption in the property development space due to COVID outbreaks and supply chain bottlenecks. While these will not be reflected in the Australia's economic statistics until later this year, property developers are feeling the pinch and we think it is unlikely the property finance market will run as hot in 2022 as it has in 2021.

## Will Qualitas grab a larger market share?

We think it is unlikely Qualitas will grab as large a share of the market as alternative lenders have in other jurisdictions, given the size and scale of Australia's largest lenders. It also remains to be seen what impact predicted interest rate hikes – and changing macroeconomic conditions – will have on the lending market.

Nevertheless, there is potential for Qualitas – along with other CRE debt providers – to grab a higher market share in Australia than the current 10% share they hold. If Qualitas achieves its guided profit figures, we believe there is scope for the share price to improve. It's four stars from us.

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### The weakest link

While the market has only been actively aware of supply chain issues since COVID-19 began, the crisis was long in the making. Much like a finely tuned machine, a few grains of sand can cause massive disruptions that take a long time to resolve. The first grain of sand was introduced during Former American President Donald Trump's administration. The cause was his administration's policy that focused on renegotiating trade deals with Europe and China. No matter your opinion on the policy itself and whether it succeeded, one of the consequences was supply chains beginning to grind. Many industries saw declines in stock and tightening in the availability of products. Still, it was far from catastrophic and likely would have recovered if not for COVID-19.

COVID-19 caused massive disruptions across all sectors of the supply chain. Bottlenecks are present in the container market, shipping routes, ports, air cargo, trucking lines, railways, warehouses and even labour. This has created shortages of manufacturing components, long order backlogs, delivery delays and a spike in transportation costs and consumer prices. Unfortunately, most predictions and industry commentary forecast this situation will last for at least another year. But what has been a loss for most of the world has been a gain for the logistics industry, even if operations have become a headache.

## Physical, meet technological

Silk Logistics has more than 700 permanent employees and approximately 1,200 staff in total. The company provides what it calls a fully 'integrated port-to-door service' across all mainland Australian states. Basically, Silk's business model combines technological efficiency with logistics capability and believes its technological edge sets it apart.

The company operates two primary divisions that offer distinct services: port logistics and contract logistics. The main focus of the port logistics division is 'wharf cartage'. For those not previously aware of the term, wharf cartage is the transportation of deliveries and containers once they reach port. The contract logistics division completes the logistics offering through its all-encompassing warehousing and distribution services.

## Still some silk left on the roll

FY21's revenue growth was 29%, bringing the total to $323m and resulting in a seven year Compounding Annual Growth Rate (CAGR) of almost 20%. New customers were a large part of that, generating $46 million in new annualised revenue, although only two thirds of this impacted FY21, the rest will be accounted for in FY22. The important thing is that FY21 was a strong year and EBIT, cash generation and Return on Capital (RoC) all beat management's Prospectus forecasts given at the time of Silk's ASX listing on 9 July 2021.

These results make it clear that Silk provides a strong combination of technology and physical transportation capability. We believe the company's business model both increases efficiency and lowers costs, while its growth indicates that it likely provides a better service. The market currently expects Silk to generate 10% EBITDA growth in FY23 and 8.6% in FY24. This, in turn, values the company at FY22 and FY23 EV/EBITDA multiples of 8.2x and 7.4x, respectively.

We believe these forecasts are conservative, especially since Silk Logistics is not a widely covered stock. We believe the company has strong potential to win new contracts over the next few years. Therefore, when we combine Silk's strong operations with its valuation discount, it's clear to us that this is a four star stock - especially given the conservative earnings forecasts.

**Pitt Street Research Pty Ltd**

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