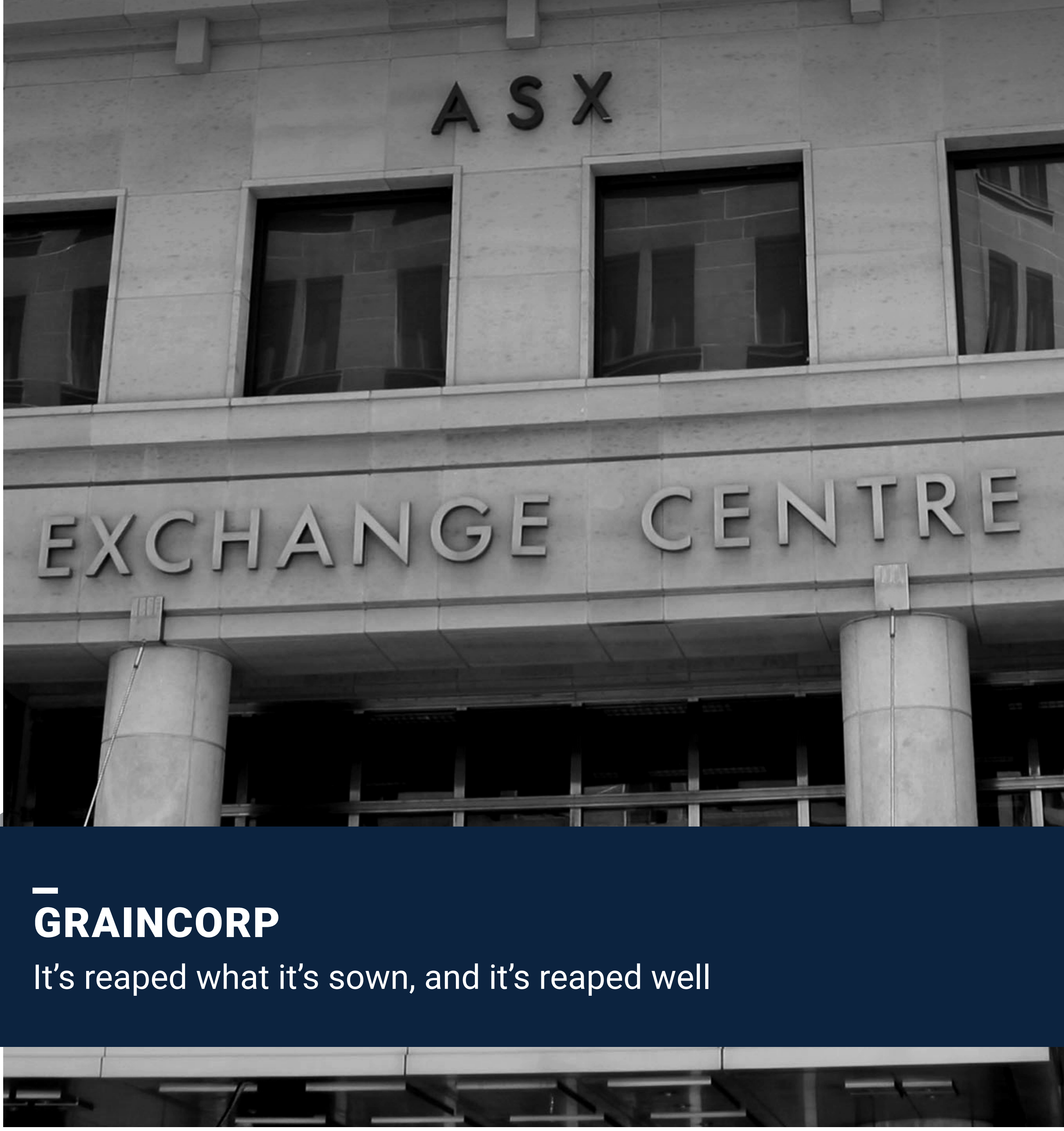
ASX Top 200 Stocks Down Under

> *If agriculture goes wrong, nothing else will have a chance to go right.*
>
> - M.S. Swaminathan (b. 1925), Indian agronomist



GRAINCORP

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Stocks Down Under rating: ★★★★

ASX: GNC
Market cap: A$2.3BN

52-week range: A$4.76 / A$10.86
Share price: A$10.01

One of the few spaces resilient to the market downturn is the agriculture sector. Despite Australia's trade relations having seen better days, the past couple of years have been strong for the sector – weather conditions have been solid (facilitating bumper crops and strong breeding seasons), and commodity prices are high. And many companies have outperformed the index, including GrainCorp which is up 21% this year when the ASX is down more than 5%. GrainCorp isn't the most diversified stock by any means, but it's proven resilient and we think there's more growth to come.

Share price chart

Source: Tradingview

A grain all-rounder

GrainCorp began in 1917 as a government-owned company tasked to collect and transport grains from all over New South Wales by rail. Today it is one of the world's leading grain traders, accounting for over 50% of export trades. As its name implies, it specialises in grains; it collects, transports, processes, stores and trades them.

Grains are edible seeds of various grasses that are foods for people and animals but are also ingredients for other foods and beverages. Wheat for instance, the world's largest grain, goes into flour for bread, paste, breakfast cereals and noodles. Others are rice, corn, oats and malt. The latter is important for beer brewing, but GrainCorp demerged its malt business into a new company: United Malt Group (ASX: UMG) which we covered in March this year.

It's a good time to be in agriculture

People always need food, irrespective of the weather or the state of the economy. But periods of drought or excessive rain affect grain harvests and hence transportation and storage volumes, which affects GrainCorp's revenues and ultimately the bottom line. The start of the pandemic marked the end of a long drought on

Australia's East Coast that has led to bumper harvest seasons for the company. And in demerging UMG, it did itself a favour because malt was arguably most exposed to the pandemic restrictions with the entity reliant on pubs, which were closed. And UMG's share price has been shaky ever since it listed – a sharp contrast to GrainCorp's performance.

In FY21 (the 12 months to 30 September 2021), GrainCorp recorded EBITDA of $331m (up from $108m in FY20) and an NPAT of $139m (up from a $16m loss in FY20 excluding the UMG demerger). It made an 11.1% Return on Invested Capital (ROIC), and it paid a dividend of 18c per share.

In its 1HY22 results, which were only announced on 11 May 2022, the company generated EBITDA of $427m (up from $140m in the prior corresponding period) and an NPAT of $246m (up from $51m). Although the Russo-Ukraine conflict has wreaked havoc on global markets, it has actually been a positive for GrainCorp with the pair making up a third of global wheat exports and other nations looking for alternative sources. Global wheat futures briefly hit a record high of around US$13 a bushel in February.

GrainCorp confirmed previously issued guidance for FY22 of EBITDA between $590m and $670m and an NPAT of $310m to $370m on an underlying basis. The midway points would represent 90% EBITDA growth and 144% NPAT growth. The company expects this result to be buoyed by demand for grains and oilseeds along with strong supply chain margins. As of 31 March 2022, it had a core cash balance of $129m. The company's performance was so strong it paid out an interim special dividend of 12c a share in addition to its ordinary dividend, which was also 12c a share, up from 8c per share in the prior corresponding period.

It has outperformed the market, but can it still outperform?

GrainCorp's share price had stagnated between 2014 and 2020, but since the Corona Crash it has performed well, rising from $2.95 in March 2020 to over $10 today and holding firm, even in spite of dour equity market conditions. And it is still trading at reasonable multiples – 6.9x EV/EBITDA and 6.4x P/E for FY22, while for FY23 (which begins on 1 October 2022) it is valued at 11.1x EV/EBITDA and 12.1x P/E. Consensus estimates for FY23 do predict a 'normalisation from FY22 to $5.8bn in revenue and $410.1m EBITDA, which would imply declines of 38% and 20% respectively from FY22. But compared to FY21's revenue and EBITDA, FY23 would still be 6% and 25% higher respectively.

We also observe that GrainCorp's results generally are contingent on many factors outside the company's control, including the seasonal crop, global trade disruptions and export volumes. However, the company has reiterated or upgraded its FY22 guidance several times, giving confidence that it will be delivered. By the same token, if it misses there will be greater punishment than if it had only issued guidance once.

As long as it doesn't miss its guidance, this stock deserves four stars, in our view. Nevertheless, with consensus estimates for FY23 set to be lower, we may reconsider our rating on GrainCorp after its FY22 results in November dependant on what guidance the company's management issues.

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