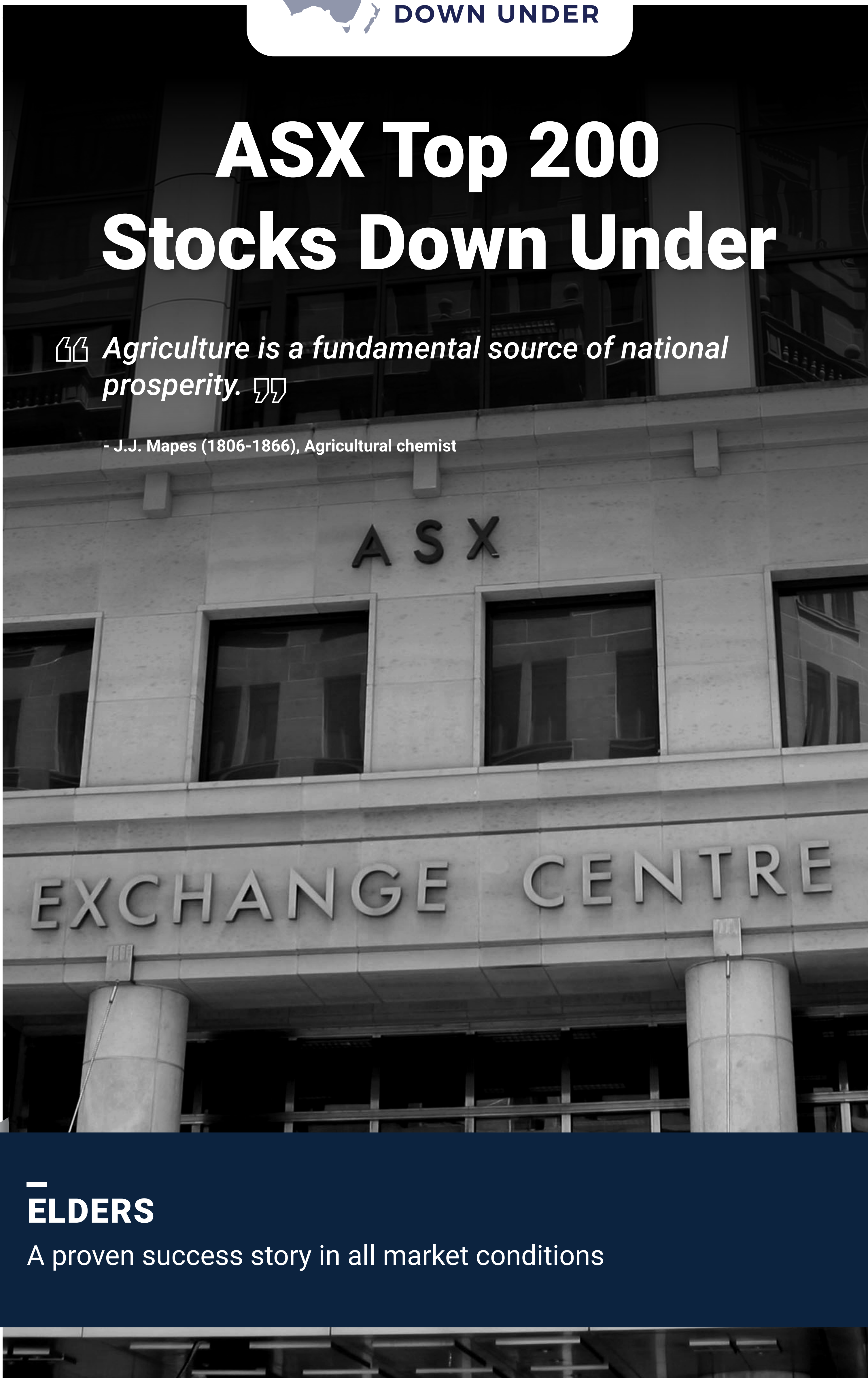
STOCKS DOWN UNDER

11 JULY 2022

ASX Top 200 Stocks Down Under

“Agriculture is a fundamental source of national prosperity.”

- J.J. Mapes (1806-1866), Agricultural chemist



ELDERS

A proven success story in all market conditions

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Stocks Down Under rating: ★★★★

ASX: ELD
Market cap: A$2.0BN

52-week range: A$10.73 / A$15.32
Share price: A$12.59

As we observed in mid-May, when we covered GrainCorp (ASX: GNC), agriculture has been a resilient sector this year. This thesis still holds true, particularly in respect of Elders (ASX: ELD), which is up nearly 2% this year, over 11% in the last 12 months, and up 147% in the last five years. As a business that traces its origins back to 1839, we shouldn't be surprised that it can thrive in adverse market conditions. Elders' history has not been perfect – it nearly went bust during the GFC. But it has had success in the past couple of years due to solid agricultural conditions and how the business spent the bad times (preparing itself for better ones).

Share price chart

Source: Tradingview

An agricultural 'all rounder'

Elders literally is an 'all-rounder' acting as a one-stop-shop for agricultural services. It provides financing, banking, real estate, wool, grain and livestock trading – in all cases providing middleman services. As a consequence, it does not have the usual production risk that comes with companies that directly sell agricultural produce into the domestic and export markets.

As we mentioned above, Elders has a long history that almost came to an end during the GFC. Until that point, previous management tried to diversify the company into non-agricultural areas in light of the very long drought during the 2000s, doing so with debt. Current CEO Mark Allison took the job in 2014 and undertook a share consolidation and asset sale that took it back to what it had always been good at.

Exposed to agriculture prices, but good times right now

Despite being a 'middleman', Elders is still exposed to agricultural prices and these prices are dependent on two things – agricultural conditions and export markets. Agricultural businesses suffered from the drought of

2017 to 2019, along with the bushfires in late 2019. This meant less livestock could be bred, less grain could be grown and those that could were of lower quality than otherwise would be the case.

Since COVID-19, the rains have returned and, despite some flooding events, conditions have been better for agriculture and prices have followed suit. Russia's invasion in Ukraine has also had an impact, particularly in the grain market.

Turning to export markets, these account for two-thirds of consumers for our agricultural products annually. China historically made up a significant proportion of these exports, with close to 20% of agricultural products exported to China in FY18. Although the agricultural industry isn't quite in the same boat as the infant formula industry that had put literally all its eggs in the China basket, many companies took a hit from trade tensions between Australia and China.

Ultimately, for 2022-23, the Australian Department of Agriculture, Fisheries and Forestry forecasts the gross value of agricultural production to be $80.4bn and the total value of the agriculture, fisheries and forestry sectors to amount to $86.2bn. Food prices are at the highest levels in a decade and are not expected to ease during 2022 or much of 2023. This all flows through to Elders' bottom line. More production means more business for Elders and high prices (combined with the essential nature of many agricultural outputs) means higher profit margins. On a side note, we also observe this is translating into higher prices for fertilisers and crop chemicals, and Elders is benefiting because it provides these supplies.

There's reason for optimism, even if tough times come

When we last covered Elders (ASX: ELD), on 1 February 2021, we gave it two stars on the basis of the China risk and Elders' lower EBITDA growth relative to other businesses. But as we mentioned above, even though China was a significant market, it was not the only market for the agricultural sector. And equity markets were in a different environment at the time, preferring higher growth businesses. Nearly 18 months on, the tide has turned as inflation and interest rates spiral higher. Many of those higher growth companies are slowing or declining as investors flee to value stocks. And we think investors did not appreciate back then how quickly agricultural conditions were improving compared to the last decade.

Consensus estimates for FY22 suggest $3.2bn in revenue and $273.1m in EBITDA, up 24% and 31% from FY21. FY23 consensus estimates suggest a dip to $3bn in revenue and $262.4m in EBITDA - down 13% and 4% respectively. Nevertheless, we think Elders deserves four stars for these five reasons.

First, this company's financial year is 1 October to 30 September, so it will ride the wave of momentum in FY22 for longer. Second, if replicated, FY23 revenue and EBITDA would still be up 18% and 27% from FY21. Third, we don't think investors should underestimate what this company can achieve considering its long-term track record. Fourth, you can get this stock at FY23 multiples of just 9x EV/EBITDA and 13.2x P/E. And fifth, unlike GrainCorp (ASX: GNC), Elders is expected to slightly increase its earnings in FY24. Although it is by a wafer thin 0.1% from $262.4m to $262.8m, we note this would be higher than FY21. For comparison's sake, GrainCorp's EBITDA is expected to drop by another 36% in FY24 and be 18% lower than FY21.

Nevertheless, there are three things that could cause us to reconsider our rating. First, if Elders provides FY23 guidance that is below the current consensus estimates. This would gloom investors for the entire financial year. And second, if drought conditions of the late 2010s make an unwelcome comeback. This too could cause investor pessimism and also affect the company's operations. Third, above average rainfall continues to occur – this has been challenging in certain areas.

Nevertheless, it has not affected the total agricultural production figure at this stage. Ultimately, we think Elders' management has learnt its lesson from the 2000s that it is best to just stick to what the company does best.

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