STOCKS DOWN UNDER

14 NOV 2022

ASX Top 200 Stocks Down Under

Investing favours the dispassionate. Markets efficiently separate emotional investors from their money.

- Naval Ravinkant (b. 1974), founder of AngelList

SOUL PATTINSON

Ageing gracefully

SOUL PATTINSON

Ageing gracefully

Stocks Down Under rating: ★★★★

ASX: SOL
Market cap: A$10.4BN

52-week range: A$22.52 / A$32.90
Share price: A$28.81

When you've been in business for over a century, you must be doing something right. Today, we're looking at Washington H. Soul Pattinson and Co (ASX:SOL), a company that has been publicly listed for nearly 120 years. It is an investment house that has stakes in several businesses, most notably Brickworks (ASX: BKW). It claims to have outperformed the market, both in the long and short terms and has lived up to its word.

Share price chart

Source: Tradingview

Still beating the market

Soul Pattinson had humble ancestry as a pharmacy store in the 1870s, but the modern company was founded in 1902 when Lewy Pattinson bought out father & son founders Caleb & Washington Soul. It was listed on the Sydney Stock Exchange a year later and claims to be the second oldest company on the bourse.

As we mentioned, it is an investment company owning stakes in several businesses, most notably Brickworks (ASX: BKW) with a stake of over 40%. Other assets include a 12.6% stake in TPG (ASX: TPG), a 25.4% stake in Tuas (ASX: TUA) and a 40% stake in coal miner New Hope (ASX: NHC). It also has a significant portfolio of private assets which you may hear media reports about from time to time. Last month it participated in a $12m private funding round for body composition scanning business Evolt360. A few weeks earlier, it participated in a seed round for Pillar Performance -a sports supplement business run by former Waratahs player Damien Fitzpatrick. A more prominent example is Milton Corporation which Soul Pattinson already part-owned and acquired outright in the middle of last year.

Is it really beating the market?

Over the last 20 years, Soul Pattinson claims to have delivered a Total Shareholder Return of 12.2% per annum and to be the only All Ords company to have increased its dividend every single year for the last two decades. It gets even better if you look longer term. Over 40 years it has delivered 14.9% growth annually, meaning a $1,000 investment back then would be worth $256,434 now. Even in the last 12 months, it boasts of good returns. It claims to have beaten the market by 20%.

OK, WSP's share price has hardly 'beaten the market' lately, losing 16% in the last 12 months while the ASX 200 is only down 6%. But in FY22 (the 12 months to July 31 2022), it grew its Pre-tax Net Asset Value (NAV) by 13.8%, 20.2% ahead of the All Ords which lost 6.4%. On a post-tax basis, its NAV grew by 28.5% which implied a 34.9% outperformance of the market. It also delivered a $834.6m operational post-tax profit (up 154%) and $347.9m in net cashflows from investments (up 93%). It paid a special dividend of 15cps in addition to an ordinary dividend of 72cps, up 16.1% and representing a yield of 3.3%.

Consensus estimates expect a retreat in FY23

Comparisons of revenue and EBITDA are complicated because the group is consistently buying and selling new assets. However, both are expected to fall in FY23, revenue by 37% to $1.8bn and EBITDA by 53% to $865m. EPS is expected to fall too from $2.80 a share on a normalised basis to $1.15. For FY24, revenue and EBITDA are expected to rebound by 6% and 7% respectively to $1.9bn and $920m. EPS, however, is expected to fall again to $0.93 a share.

The EV/EBITDA and P/E multiples are 11.1x and 24.4x respectively for FY23 but there are arguments that neither are useful for financial companies as earnings can fluctuate from year to year. One preferred metric is the Price to Book Value (reflecting the Net Assets of the company to the market value for those assets). For most non-financial companies, Book Value will not be useful because assets on the balance sheet are at historical cost minus a certain extent of depreciation that is up to the company's accountants. But for financial firms, assets are periodically marked to market, so these really are the underlying value of the assets.

With a share price of $28.81 yesterday and a Book Value Per share of $23.42, Soul Pattinson is trading at 1.2x. In other words, the market is valuing the company 20% higher than its book value. Value investors may not like any company with a P/BV greater than 1x, taking it as a sign that the company is overvalued. But we would note three things. First, Soul Pattison's isn't excessive by any means. Second, you might argue it deserves a premium given its solid history. And third, in the unlikely event that it went bankrupt immediately, it indicates there would be assets left over - at least theoretically.

It's not a good time now, but better days will return

The harsh reality is, 2022 is a tough time to be a listed money manager. Soul Pattinson hasn't done as bad as companies such as Magellan and GQG. But all fund management companies have been sold off in 2022 from those with internal dramas and lost mandates such as Magellan to even companies like GQG that have done nothing wrong. You see, we are exiting a decade during which Australian investors paid a hefty premium for listed fund managers relative to other markets. This led to a never-ending gold rush of investors heading to the sector and for some companies like Pendal & Perpetual to use highly valued scrip to head offshore and buy fund managers, leading to investors overlooking internal issues. But rising interest rates and poor performance in recent months have bought these issues to the surface.

Turning our attention back to Soul Pattinson. We think the share price might lull until the broader sector recovers. And some of its major investments face challenges of their own, particularly Brickworks (you can read about Brickworks and its headwinds in last Monday's edition) and New Hope (which is under pressure to divest from coal). But this company has a long-term record that is second to none and we have every reason that it can continue to deliver. We accept this may not be reflected in the share price immediately but for investors willing to wait for others to take notice, this one is four stars.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content is financial advice but is not (and cannot be construed or relied upon as) personal financial advice. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Please make sure that investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of unpredictable market and economic factors.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research/ Stocks Down Under unless otherwise noted.

Stocks Down Under/Pitt Street Research directors and staff may own shares in the companies mentioned in our articles, videos, reports and analyses.

You are receiving this email because you subscribed to our newsletter.