STOCKS DOWN UNDER

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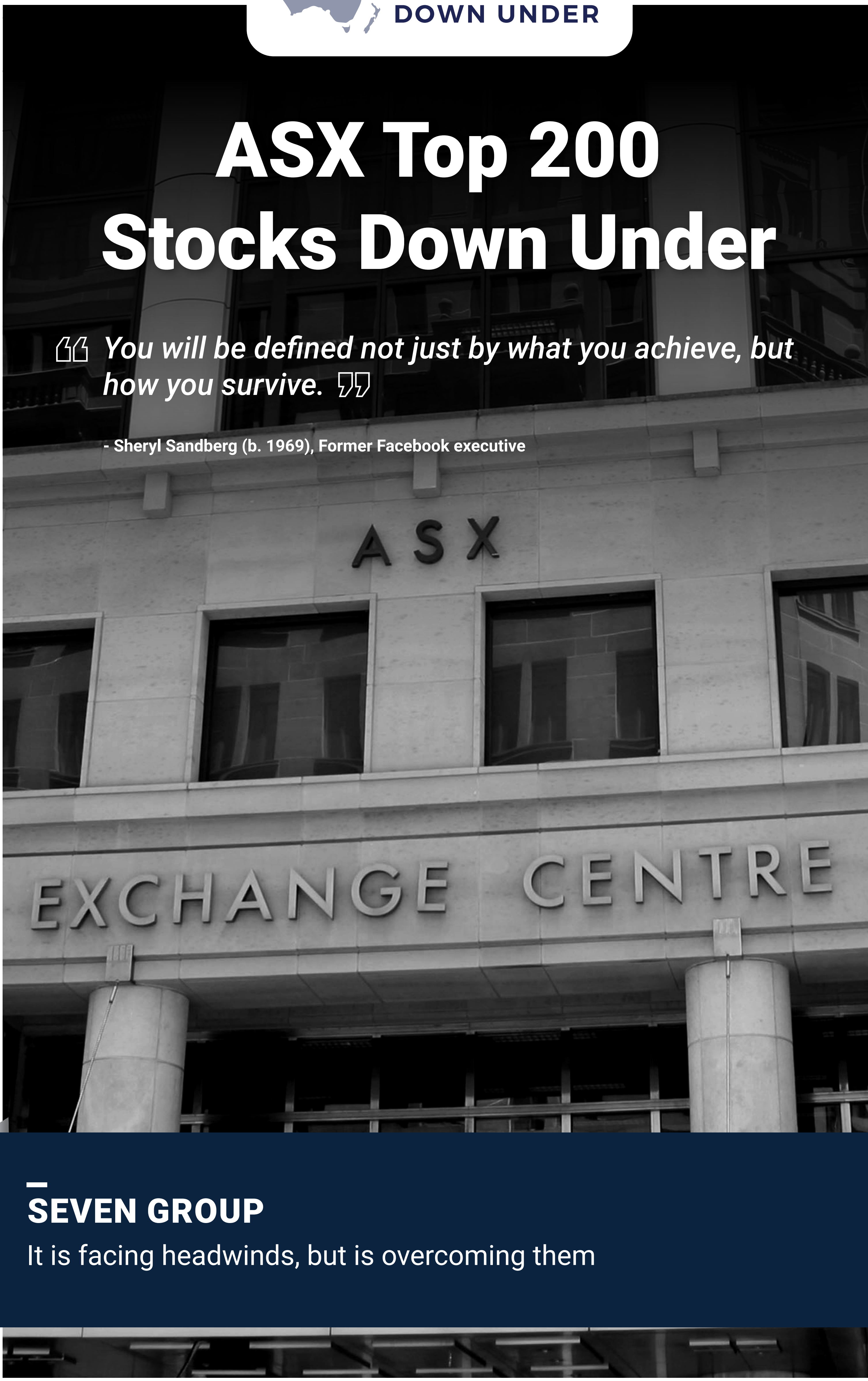
ASX Top 200 Stocks Down Under



> *You will be defined not just by what you achieve, but how you survive.*

- Sheryl Sandberg (b. 1969), Former Facebook executive

SEVEN GROUP

It is facing headwinds, but is overcoming them

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Stocks Down Under rating: ★★★★

ASX: SVW
Market cap: A$7.5BN

52-week range: A$15.82 / A$23.28
Share price: A$20.65

Today we turn our attention to Seven Group (ASX:SVW). Seven Group is not the media company Seven West Media (ASX:SWM) - which is easy to confuse given both are ASX listed. The company we're looking at today is an investment company, headed by the Stokes family (initially by Kerry and now by his son Ryan). Seven Group does have a major stake in Seven West Media, but it is one of several assets owned by the group. The portfolio also includes a 30% stake in Beach Energy, a 72.6% stake in Boral as well as ownership of WesTrac, Coates, Allright and Sykes. As you can see, the portfolio skews towards the construction and industrial space, not the best to be in right now.

Share price chart

Source: Tradingview

Exposed to industrial headwinds

At the recent AGM, Chairman Terry Davis told shareholders that Seven invests in businesses that have underlying sector momentum in market leading positions with competitive advantages, where value add opportunities exist. But, as you might have observed above, the bulk of the company's portfolio is the industrial services sector.

Seven's two biggest holdings are WesTrac and Boral. WesTrac is an industrial equipment provider, particularly of Caterpillar products, which Seven owns 100% of. Boral sells construction materials, such as cement, concrete, gravel, asphalt and sand, and Seven has a 70% stake. Seven was a minority holder in Boral before it made an unsuccessful takeover bid for the whole company.

Both companies benefited from the infrastructure stimulus during the pandemic, but have been feeling the pinch in the last 18 months with construction shutdowns (due to lockdowns and bad weather), higher energy prices and supply chain issues. Boral's FY22 profit took a $136m hit, more than offsetting promised synergy benefits. Boral anticipates revenues for FY23 to be higher having made the largest price increases in five years. But it may not be able to offset an impact on the bottom line.

Media & energy

Let's address the other two elephants in the room, Seven Media and Beach Energy (ASX:BPT). Seven Media is in a cut-throat industry, facing significant competition and changing consumption habits. However, it has coped well all things considered. In FY22, it recorded the strongest results in a decade with $1.5bn in revenue, $342m in EBITDA and a $211m profit. While its share of TV advertising is just 9% in the metropolitan market, it has 47% in the Video On Demand (streaming) market.

It has the rights to several key events, including the Olympics, the AFL, the Ashes and Bathurst 1000 and it recently signed a content deal with NBCUniversal, to stream its own content on its 7plus platform. Seven also owns Perth newspaper the West Australian and as a monopoly, it is in a strong position out West – recording its best financial result since FY17.

As for Beach, it owns oil and gas infrastructure assets as well as offshore and onshore development projects. It is set to benefit from the gas shortage on the East Coast in the shorter-term, with higher prices, and, in the longer-term, with Stage 2 production at Waitsia (one of the largest gas fields ever discovered onshore in Australia) set to come online in 2024. Last month, Beach made its first takeover bid in five years, putting up its hand for Warrego Energy (ASX:WGO). It was competing with bids from Warrego's Joint Venture Partner Strike Energy (ASX:STX) and Gina Rinehart, but withdrew from the bidding race last week.

Despite a promising outlook and positive results, Beach has been let down by multiple production downgrades, plus the unexplained exit of its CEO and hot-seat vacancy for some months afterwards.

A good FY22, but what does FY23 hold?

Ultimately, there was more good than bad in Seven's portfolio during FY22 and it was reflected in its results. Revenue grew by 66% to $8bn, underlying EBITDA grew 39% to $1.5bn and underlying NPAT rose 14% to $577m. But Seven's statutory NPAT of $607.4m was down 4% from FY21, due to impairments and transaction costs at Boral.

In FY23, Seven expects 'low double-digit Group EBIT growth relative to FY22, subject to no material change to market conditions'. Consensus estimates expect $8.7bn in revenue, $1.7bn in EBITDA and a $1.78 EPS – up 8%, 13% and 17% respectively. These estimates give us an EV/EBITDA multiple of 8.3x, a P/E multiple of 11.7x and a PEG ratio of 1.6x. The mean share price target among the 8 analysts that cover Seven is $22.99 which would represent 10% growth considering Friday's closing share price of $20.65.

Industrial headwinds will be key

Despite the group's diversified portfolio, the performance of its industrial assets will be key. We are encouraged by the company's price increases, the largest in five years, as well as its belief that its clients will pass on the increases to their customers. But as we noted above, it may not be able to eliminate impacts completely.

We think a far bigger risk is the industrial's business big exposure to coal. Rather than trying to reduce it, Seven appears to be gambling that coal will remain part of the energy mix for a long time. Back in August, Ryan Stokes himself said that he expects this to be the case, judging by the fact that WesTrac's coal clients are investing in new fleets. Be that as it may, it will be of little use if barriers to approving new coal mines remain high. Whether you're an ardent ESG investor or an ardent coal lover, you can't disagree with that. WesTrac also has exposure to iron ore and after a boom during the pandemic, prices have fallen from all-time highs and are expected to stagnate for a few years now, although coal has been performing well in recent weeks on the back of China potentially opening up faster than expected.

One other risk we note is rising interest rates and their impact on construction activity. You might argue that interest rate rises to date have had a modest impact at best on activity. But ultimately, the company appears to be shrugging off these concerns, something that cannot be said of all companies in the industrial sector.

Based on trading in FY23 to date, Seven Group reiterated the guidance of low-teen underlying EBIT growth at WesTrac, expects 'stronger' revenues in FY23 at Boral and at a group level it expects high single-digit to low double-digit underlying EBIT growth. Assuming the company can achieve those results, this one is four stars.

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