PROMISING THEMES

From currency to computers

These stocks offer investors the chance to profit from strong business growth

This month we've split our column into two lists. The first represents companies of varying sizes, with global growth opportunities and the second shows companies exposed to the booming demand for software and data.

Exposure to companies growing overseas makes sense. Over the long run, fast growth rates and long runways, particularly off a low base, can help to produce returns which defy the economic and business cycles that plague many mature businesses.

In the short term, Australia's economy is beset by imbalances that are generating speculative misallocations of capital at one end and pressure on sales and margins at the other.

Finally, there's a benefit that stems from having exposure to multiple geographies and currencies.

Software and data will remain a growth area for many years. From manufacturing and design to sales and marketing, there is almost no aspect of commerce that doesn't produce it, need to store or use it.

Data, it seems, is akin to an oil discovery. And of course, software is the essential transmission mechanism for that data to communicate an intention.

The following companies are all growing their overseas businesses, ensuring Australian investors benefit from a growing global economy and currency diversification. Keep in mind, however, that getting the theme right is only half the battle. Investors must also ensure a reasonable price is paid rather than a high one.

GLOBAL GROWERS

There's debate about whether the Australian dollar will rise or fall against the US dollar, but one thing is certain: it makes almost no sense to have all your wealth tied to one currency.

As well as the companies below, other global growers include CSL (ASX: CSL, hold), Costa Group (CGC, hold) and Starpharma (SPL, speculative buy).

TECHNOLOGY AND SOFTWARE

Software is currently the sexiest place to put their money for many professional investors thanks to what is being referred to as the "digitisation of the economy" tailwind. Companies such as Afterpay, Seek, IDP Education, WiseTech Global, Jumbo Interactive and NextDC are all beneficiaries of the popularity in software.

But while the tailwind may be helping to drive revenue growth, in many cases there is limited if any profit. It's too easy to say NextDC will continue to roll out new data centres to take advantage of the growth in data and communications, but investors must also remember that competitors will emerge and unit prices will decline.

Low interest rates and steady economic growth, however, are allowing investors to defer the date that profit is delivered but eventually returns on capital need to be positive.

Apart from these companies below, another consideration is WiseTech Global (WTC, hold).

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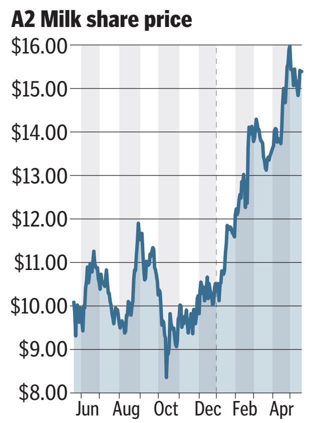

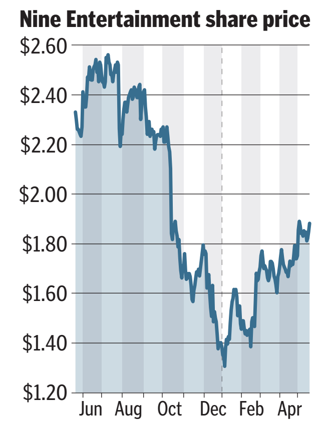

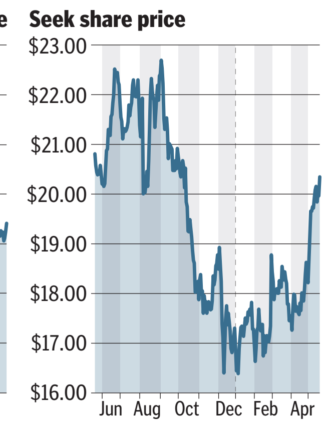

1 A2 Milk

ASX code A2M
Price $15.39
52wk ▲ $16.08
52wk ▼ $8.14
Mkt cap $11.3bn
Dividend -
Dividend yield -
PE ratio 48
HOLD

A strong third-quarter trading update from the infant milk formula marketer revealed a 44% lift in revenue. However, it announced no material changes to its full-year 2019 or 2020 outlook and this is partly due to pulling forward some fourth-quarter orders. In China, market share now sits at 6%, up from 5.4% at December 2018. In the US, A2 has added 300 stores to its distribution network, which includes a new Costco geography. After announcing its coffee creamer product for the US market, the company announced its Smart Nutrition fortified nutritional milk powder for kids aged four to 12, initially in Australia and China. Recent share price strength implies expectations of greater than 40% revenue growth and an EBITDA margin of more than 30%.

2 Macquarie Group

ASX code MQG
Price $119.93
52wk ▲ $136.84
52wk ▼ $103.30
Mkt cap $40.8bn
Dividend $5.75
Dividend yield 4.8%
PE ratio 14
BUY

The strong full-year result in May was driven by more volatile gains on sale and performance fees. The international businesses now account for two-thirds of Macquarie's income. Equity capital market volumes disappointed, as did foreign exchange turnover. But the company reported higher assets under management – reaching a record $500 billion – and merger and acquisition activity. Coming off strong prior numbers might mean the near-term growth outlook is more challenging and management has forecast a lower profit for 2020. But what we have learnt is that at this early stage of the year management's guidance is typically conservative because it's difficult to predict revenue when so much is based on market conditions.

3 ARB Corp

ASX code ARB
Price $18.27
52wk ▲ $23.94
52wk ▼ $14.55
Mkt cap $1.5bn
Dividend 38¢
Dividend yield 2.1%
PE ratio 26
HOLD

The 4WD accessory maker's trading update for the third quarter of 2019 revealed 2.2% growth in Australian aftermarket sales, which make up 63% of total sales. This was lower than the growth reported for the first half, which was up 4.1%. Particularly slow were Queensland and NSW. Unlike domestic sales, export sales, which represent 29% of total sales, were up 9.2% year on year, compared with the 6.9% growth reported in the first half of 2019. Export sales strength was attributed to the weaker Australian dollar. ARB remains one of the higher-quality companies on the ASX and management reiterated its desire to act conservatively when it comes to using the strong balance sheet for acquisitions.

Prices as at close of business, 17-5-19.

1 IDP Education

ASX code IEL
Price $16.72
52wk ▲ $16.09
52wk ▼ $8.38
Mkt cap $4.3bn
Dividend 18.5¢
Dividend yield 1.1%
PE ratio 68
HOLD

IDP Education is benefiting from the increasing mobility of international students. Through the 2017 acquisition of Hotcourses, IDP is leveraging a platform to deliver leads, penetrate new markets and introduce its value-added services, ultimately increasing revenue. Through digitisation, such as the rollout of its computer-based International English Language Testing System, IDP's already impressive economics and margins are expected to improve. As with many companies benefiting from software tailwinds, the share price appears fully valued. In the absence of disappointment or an exogenous event, continued top-line growth should remain supportive.

2 Nine Entertainment

ASX code NEC
Price $1.88
52wk ▲ $2.60
52wk ▼ $1.30
Mkt cap $3.2bn
Dividend 10¢
Dividend yield 5.3%
PE ratio 9
BUY

I have previously written about the structurally shrinking audiences and profits suffered by free-to-air-television networks. Nine, however, is transforming itself with Stan, 9Now and Domain as part of an integrated monetisation platform. Some analysts now describe Nine as an attractive growth story. The streaming service Stan is on an annualised revenue run rate of about $200 million and continues to grow subscribers. Stan is now also profitable and is projected to incrementally add about $30 million to EBITDA in 2020. Revenue at 9Now grew 75% – admittedly off a low base – and Domain is being held up as a beneficiary of a major cross-selling program within the group. Nine also recently sold its Australian Community Media and Printing business.

3 Seek

ASX code SEK
Price $20.34
52wk ▲ $22.94
52wk ▼ $16.27
Mkt cap $7bn
Dividend 46¢
Dividend yield 2.3%
PE ratio 141
HOLD

Seek is still seen by many analysts as being tied to Australian employment cycles, and while much of its profits are derived from Australia, revenue from overseas businesses is already greater. Seek is reinvesting heavily overseas, which means that, at the profit level, it looks dependent on Australia. The reality is, however, vastly different and Seek continues to articulate a very long runway for growth. Price increases locally are also a strong possibility and the company believes revenue growth of circa 20% out to 2025 is not unrealistic.