

Wealth Weekly

Healthcare Sector Check-up

WEALTH MANAGEMENT RESEARCH

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The rebound from a one-day rout on 11 June carried over into early last week, but faded towards the end of the week – constrained by concerns over renewed increases in COVID-19 case numbers in parts of the US and uncertainty around the pace of recovery in reopening economies. The technology and healthcare sectors continued to do particularly well, while more cyclical sectors lagged.

Healthcare still offering ok value after strong rebound

Healthcare stocks have rebounded from March lows faster than the broader market as investors looked to sectors with defensive attributes. The S&P 500 Healthcare index is only -3% short of the the peak level it reached prior to COVID-19. We believe **the long-term investment case for the healthcare sector remains underpinned by attractive fundamentals, supported by ageing populations, innovation, and increasing wealth in emerging economies**. In addition, we think the COVID-19 pandemic has increased the perceived value of healthcare services and infrastructure, and may have lessened the probability of significant changes to US policy on drug prices. We have reviewed a number of leading global healthcare companies. As a group their valuations still appear attractive given their growth prospects.

Our preferred global healthcare stocks are **AstraZeneca, Baxter International, Gilead Sciences, Medtronic, Merck & Co, Sanofi, and Takeda Pharmaceutical**. For investors who prefer to invest in a more diversified, actively managed portfolio of healthcare stocks, we currently favour **Worldwide Healthcare Trust** and **Biotech Growth Trust**.

Themes of the week

We re-initiated coverage on Skellerup Holdings last week with an OUTPERFORM rating. SKL is a New Zealand based industrial manufacturer with large industry exposures to the dairy, potable and waste water, and infrastructure sectors around the world. We see upside to margins and growth in SKL's Industrial division as it targets original equipment manufacturers as customers, improves pricing and increases efficiency. SKL's Agri division is facing headwinds in domestic markets. We see some downside risk to earnings, but SKL's conservative balance sheet offers some flexibility. The stock is trading at a discount to the market and offers an attractive dividend yield.

Many companies have raised equity or increased their bank funding facilities to get them through the financial impact of COVID-19, but they are yet to lock in some long-term funding at attractive rates through issuance of listed bonds. Two issuers (The Warehouse Group and Rabobank) have recently disappeared from the NZDX as their bonds matured and SKYCITY will likely join them in September following an early redemption. The loss of these issuers is a blow for the NZDX and for investors looking for diversification. **We may have to wait until after the reporting season in August before we see much new bond issuance.**

Looking ahead

In a speech on Monday, Reserve Bank of Australia Governor, Rob Lowe, predicted that interest rates will remain low for years, accompanying deflationary pressures, increased savings and large shortfalls in potential economic activity. The Reserve Bank of New Zealand will release its Official Cash Rate decision on Wednesday. Stride Property Group will report its FY20 result on Tuesday.

Reviewing Preferred Healthcare Stocks

Expanding our sector exposure

Despite the healthcare sector staging a strong recovery from March lows, our selection of leading healthcare companies (Figure 1) as a group continues to offer double digit medium-term earnings growth prospects while trading on undemanding multiples, with a median PE of 16x (looking through the COVID-19 impact on earnings in the current year).

We have selected a basket of seven international healthcare equities that, in combination, offer attractive value-for-risk at current prices and exposure to a broad range of long-term growth thematic. Our preferred exposures are: **AstraZeneca** (AZN.L), **Baxter International** (BAX.N), **Gilead Sciences** (GILD.O), **Medtronic** (MDT.N), **Merck & Co** (MRK.N), **Sanofi** (SASY.PA), and **Takeda Pharmaceutical** (4502.T).

We are also reviewing **Abbott Laboratories** (ABT.N) and **Bristol-Myers Squibb** (BMY.N) for inclusion in the International Model Portfolio and Forsyth Barr Global Equities Fund.

For investors seeking diversified healthcare exposure through an investment trust, our current preferences are the **Worldwide Healthcare Trust** (WWH.L) and **Biotech Growth Trust** (BIOGW.L) (page 3).

Figure 1. Healthcare company fundamentals

Company Name	Code	Mkt Cap (Local bn)	Price (local)	12-mth Chg	Fcst 1 PE	Fcst 2 PE	PEG	ROE	Div yld	EPS 3yr CAGR
Abbott Laboratories **	ABT	159.7	90.28	+8.2%	31.9x	24.5x	1.9x	14%	1.7%	+17.1%
AbbVie	ABBV	169.6	96.23	+23.0%	9.3x	9.4x	-4.4x	n/a	5.1%	-2.1%
Amgen	AMGN	135.5	230.32	+26.8%	14.8x	13.6x	1.8x	77%	2.8%	+8.2%
AstraZeneca **	AZN	110.2	84.00	+31.0%	26.5x	21.3x	1.1x	23%	3.4%	+24.4%
Baxter International *	BAX	42.5	83.85	+4.1%	25.3x	21.9x	2.0x	21%	1.0%	+12.6%
Bristol-Myers Squibb **	BMY	126.6	55.97	+17.1%	9.0x	7.5x	0.8x	17%	3.3%	+11.8%
Eli Lilly and Co	LLY	154.1	161.07	+40.5%	23.6x	20.2x	2.1x	207%	1.9%	+11.4%
Gilead Sciences *	GILD	92.9	74.04	+8.6%	11.7x	11.5x	3.4x	31%	3.7%	+3.5%
Illumina *	ILMN	53.3	362.92	+4.3%	60.6x	47.5x	2.7x	22%	0.0%	+22.4%
Intuitive Surgical	ISRG	68.3	585.54	+13.2%	66.5x	45.0x	2.3x	17%	0.0%	+28.7%
Johnson & Johnson	JNJ	377.8	143.41	+2.3%	18.7x	16.0x	1.9x	29%	2.8%	+9.7%
Medtronic *	MDT	126.6	94.43	-3.6%	26.1x	16.8x	1.1x	9%	2.4%	+24.2%
Merck & Co *	MRK	192.4	76.22	-9.8%	14.3x	12.8x	1.6x	52%	3.2%	+9.2%
Pfizer	PFE	184.6	33.24	-22.8%	11.9x	11.1x	1.7x	21%	4.6%	+6.9%
Roche Holding ^	ROG	290.6	337.45	+21.0%	16.4x	15.4x	2.4x	59%	2.8%	+6.8%
Sanofi **	SASY	116.0	92.32	+19.2%	15.0x	13.8x	2.2x	9%	3.6%	+6.8%
Takeda Pharma **	4502	6292.9	3992.00	+4.4%	9.2x	8.3x	1.1x	5%	4.5%	+8.5%
Thermo Fisher Scientific	TMO	137.2	347.44	+20.1%	28.0x	24.1x	2.0x	13%	0.2%	+14.1%
Zoetis	ZTS	65.3	137.40	+21.2%	40.9x	33.5x	2.6x	68%	0.6%	+15.5%
Median				+13.2%	18.7x	16.0x	1.9x	22%	2.8%	+11.4%

Source: Forsyth Barr analysis

Note: * current member of the International Model Portfolio and/or the Forsyth Barr Global Equities Fund. ** new ideas being considered for addition to the International Model Portfolio and/or the Forsyth Barr Global Equities Fund. ^ companies with primary listings outside of the US.

Healthcare sector investment trusts

Worldwide Healthcare Trust (WWH.L)

Worldwide Healthcare (WWH.L) is a UK-listed, closed-end fund that invests in healthcare stocks globally, but with a heavy weighting to the United States. **WWH invests in big pharma, specialty pharma, generics, big biotech, emerging biotech, medical devices, life science tools, healthcare services and emerging market healthcare companies.** The biotech and devices sub-sectors, which WWH is overweight, are going through a period of unprecedented innovation with scientific advancements leading to new drug targets and new drug approvals that are changing the standard of care and in some cases delivering cures.

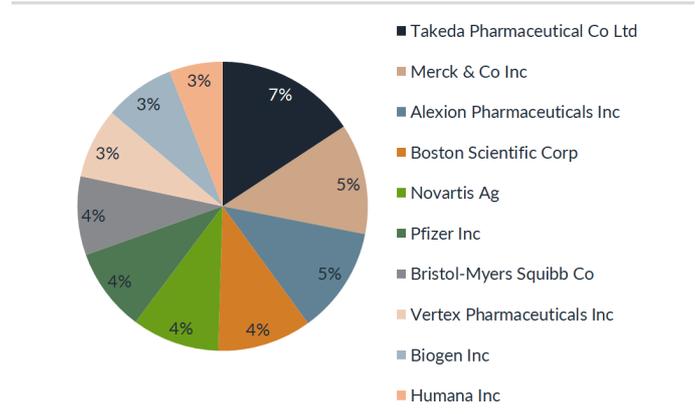
The fund has comfortably outperformed its benchmark this year. WWH's managers retain a positive view on the sector in the long-term. But they have tactically reduced the trust's usually modest gearing to the low end of its historical range as they noted that investor sentiment on COVID-19, the possibility of a second wave of infections, and the increase in retail investor involvement in the market have created frothy market conditions – which could set the stage for near-term volatility.

Figure 2. WWH top 10 holdings

	Weight	P/E	EPS growth	PEG	ROE
Takeda Pharmaceutical	6.6%	9.9x	+13%	0.7x	5%
Merck & Co	5.2%	14.3x	+12%	1.2x	52%
Alexion Pharmaceuticals	5.0%	10.7x	+7%	1.5x	20%
Boston Scientific	4.4%	38.5x	+45%	0.9x	13%
Novartis	4.1%	16.0x	+9%	1.9x	19%
Pfizer	3.9%	11.8x	+7%	1.7x	21%
Bristol-Myers Squibb	3.7%	9.0x	+14%	0.7x	17%
Vertex Pharmaceuticals	3.3%	32.0x	+21%	1.5x	26%
Biogen	3.3%	7.9x	-2%	-ve	47%
Humana	2.5%	20.4x	+16%	1.3x	20%
Total/median	42.0%	13.1x	+13%	1.0x	20%

Source: Forsyth Barr analysis

Figure 3. WWH top 10 holdings



Source: Forsyth Barr analysis

Biotech Growth Trust (BIOGW.L)

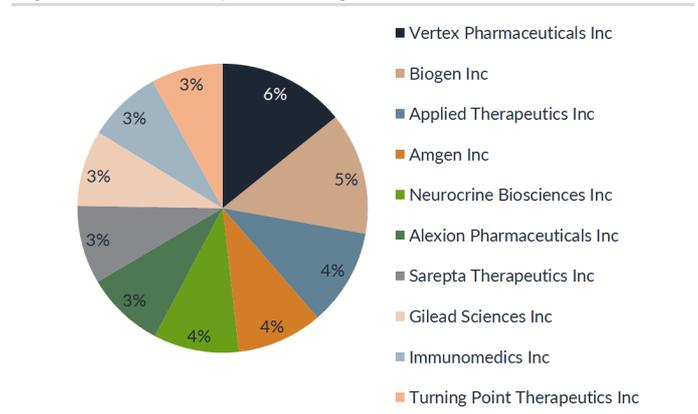
Biotech Growth Trust (BIOGW.L) invests in biotechnology stocks, predominantly in the United States. Its distinctive performance track record reflects the biotechnology cycle of rising and falling innovation and valuations, as well as the varying fortunes of the large cap and emerging biotech sub-sectors. After several years of weakness, BIOGW has enjoyed an exceptionally strong run of performance in late 2019 and early 2020. The innovation cycle is currently running at full strength, which bodes well for growth. Diminishing fears of US drug price reforms have helped the sector's performance. BIOGW's managers have noted increased investor appetite for biotech company IPOs, which have continued steadily through the pandemic.

Figure 4. BIOGW top 10 holdings

	Weight	P/E	EPS growth	PEG	ROE
Vertex Pharmaceuticals	5.5%	32.0x	+21%	1.5x	26%
Biogen	5.3%	7.9x	-2%	-ve	47%
Applied Therapeutics	4.2%	-ve	+18%	n.a.	n.a.
Amgen	3.7%	14.8x	+9%	1.7x	77%
Neurocrine Biosciences	3.7%	33.9x	+38%	0.9x	44%
Alexion Pharmaceuticals	3.4%	10.7x	+7%	1.5x	20%
Sarepta Therapeutics	3.4%	-ve	n.a.	n.a.	-39%
Gilead Sciences	3.3%	11.7x	+3%	3.7x	31%
Immunomedics	3.2%	-ve	-49%	n.a.	-99%
Turning Point Therapeutics	3.1%	-ve	-5%	n.a.	n.a.
Total/median	38.8%	13.2x	+7%	1.5x	29%

Source: Forsyth Barr analysis

Figure 5. BIOGW top 10 holdings



Source: Forsyth Barr analysis

Themes of the Week

Equities

Skellerup (SKL.NZ) – Rubber Meets the Road – Re-initiate as OUTPERFORM

Last week we re-initiated coverage on Skellerup with an OUTPERFORM rating and an NZ\$2.40 target price. **SKL develops, manufactures and distributes technical rubber products and vacuum pump systems for the dairy, potable and waste water, and infrastructure sectors.** It sells products globally under a number of key brands.

Targeting growth through OEM contract wins and margin expansion

SKL has two key operating segments:

- The **Agri division designs and produces a range of essential dairy consumables** including liners, tubing, and filters. Agri includes SKL's footwear business, which produces Red Band gumboots and a range of specialist safety boots. The Agri division is facing headwinds in domestic markets, which it aims to offset through growth into lower margin international markets.
- The **Industrial division develops and manufactures specialist products and components, and vacuum pump systems.** Products are generally critical components used in a broad range of applications. Water & waste, and Roofing, make up more than half of Industrial revenue. The Industrial division offers medium-term upside as it targets (1) increased sales to original equipment manufacturers (OEMs), and (2) EBIT margin expansion through improved pricing and operational efficiencies. SKL plans to use its technical expertise in polymer compounds and manufacturing to solve specific component production challenges for OEM customers. Growing sales to OEMs requires relatively little capital. By their nature OEM sales tend to lock in customers to a degree, which could improve the stability of SKL's earnings.

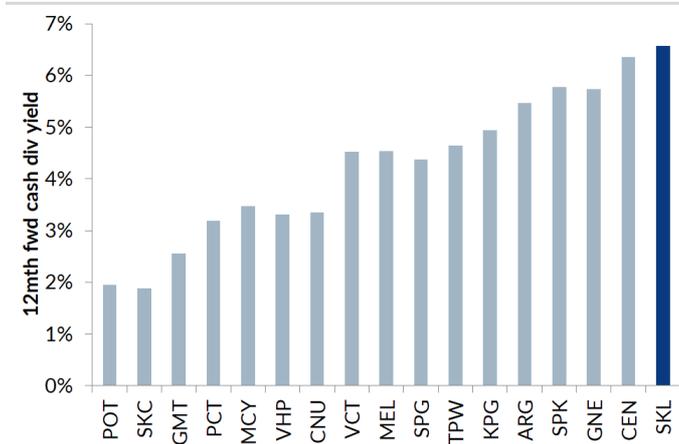
Earnings exposure more resilient than in the past

The economic fallout from COVID-19 adds uncertainty to SKL's outlook. **We see downward risks to margins and earnings in the near-term due to the downturn. However, the company's earnings exposure is more defensive to a recessionary environment than it has been in the past, in our view.** SKL has reduced its exposure to commodity markets. We suspect the portion of its Agri business earnings that is driven by discretionary capital projects (such as dairy conversions) is now lower. In addition, the bulk of SKL's Agri business is in essential consumable products for use in the global dairy industry, which should be more resilient to cuts in discretionary spending by farms and businesses. SKL might benefit from increased fiscal stimulus targeted at aged water infrastructure, partially offsetting a downturn in other sectors.

A conservative balance sheet and low capex provide some flexibility during periods of short-term turbulence.

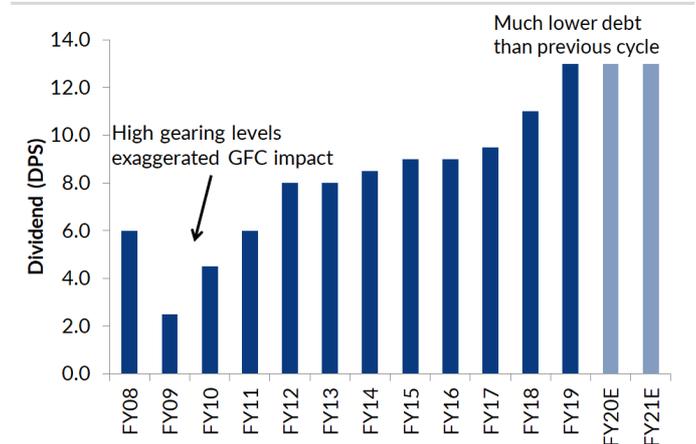
SKL is trading at a discount to the market (14x 12 month forward PE multiple) and offers investors an attractive dividend yield (Figure 6 & 7), backed by a strong balance sheet.

Figure 6. 12-month forward cash dividend yield (FB)



Source: Bloomberg, Forsyth Barr analysis

Figure 7. SKL's strong track record of growing dividends



Source: Bloomberg, Forsyth Barr analysis

Fixed Interest

Some issuance please

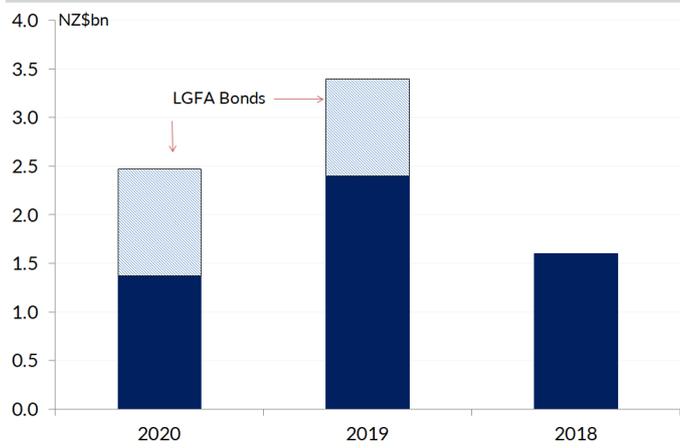
The financial impact of COVID-19 has led many New Zealand companies to either raise equity or increase funding facilities via existing banking arrangements. **What New Zealand companies have not done is utilise the New Zealand debt market and issue bonds.** This may well change in the coming months as both banks and borrowers look to lock in some long-term funding. However, with corporates likely to be more financially conservative than previously, the appetite for additional debt may be small.

The NZDX has lost a couple of issuers lately as the only remaining NZDX issues from The Warehouse Group (WHS) and Rabobank both matured. SKYCITY (SKC) will follow in September when it redeems its only debt issue, SKC040, early. The maturity or early redemption of these senior bonds means the issuers would in future have to go through the process of producing a (Simplified) Product Disclosure Statement, adding costs to listing a new security on the NZDX.

Losing three issuers is a blow for the NZDX and for investors looking for some diversification. There have only been four issues so far in 2020 from New Zealand issuers: BNZ, Westpac, Housing NZ and the Local Government Funding Agency, whose issue of NZ\$1.1bn makes up 44% of all of the new issuance in 2020. **Redemptions are easily outweighing issuance year-to-date, which is well behind issuance in Australia and the over US\$1.2tn worth of corporate bond issued in the US in 2020.**

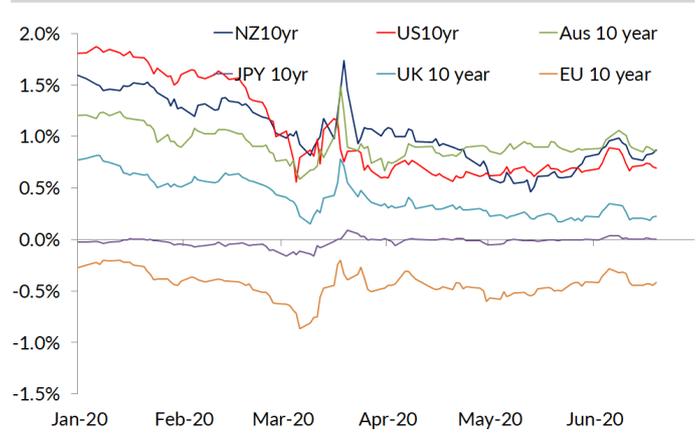
With most corporates having a 30 June balance date **it is unlikely that we will see much in the way of new issuance until at least reporting season, which begins in August.**

Figure 8. New Issuance



Source: Forsyth Barr analysis

Figure 9. 10yr Government bond yields



Source: Forsyth Barr analysis, Thomson Reuters

Research Worth Reading

New Zealand

Air New Zealand (AIR) – NAVigating to FY20

Just 11 days before the end of the current financial year AIR provided earnings guidance. It was a bit better than our expectations, which lifts our asset value assessment at year-end, but not enough to change our view that the share price is currently way over-valued. UNDERPERFORM. (Published by Forsyth Barr)

Z Energy (ZEL) – Coming Out of Lockdown

Following ZEL's NZ\$347.5m equity raise, our coverage of ZEL comes out of lockdown (restricted coverage) with an OUTPERFORM rating and an NZ\$4.20 target price. Trading in recent weeks has been encouraging, aided by New Zealand moving to Alert Level 1 earlier than we (or ZEL) had expected. In addition, ZEL's structural cost-out plans are greater than we had previously envisaged, boosting the longer-term outlook, ZEL's competitive position with the discounters and confidence that ZEL can produce the earnings to deliver a NZ28cps dividend in FY22. OUTPERFORM. (Published by Forsyth Barr)

Equity Strategy – Recovery Heat Map; Progress Slowing

Our high frequency data heat map shows that New Zealand's economic recovery has slowed as consumer behaviour closes in on pre-COVID levels. Real time data points show that activity so far in Alert Level 1 appears similar to late in Alert Level 2. Credit card data indicates spending is running ahead of the same week a year ago (despite negative sentiment), and heavy vehicle traffic is also above year-ago levels. Consumption trends are supportive to domestic retailers such as Kathmandu (OUTPERFORM) and Briscoe (no rating). SKYCITY (OUTPERFORM) mentioned last week that its visitation numbers are tracking above expectations. Air New Zealand's (UNDERPERFORM) domestic services have benefited from greater load factors as it is no longer keeping middle seats empty.

Australia

Afterpay (APT.AX) – A Market Leader, Maintain BUY

Ord Minnett maintains a BUY rating on APT with a revised target price of \$64.70ps. On Ords' revised estimates, APT should reach around 9.8m active customers by 30 June 2020. Fast forward 2 years, and Ords expects APT to exceed 20m active customers. Strategic interest in the Buy Now Pay Later sector has been recently highlighted by Heights Capital's investment in Zip Co, further adding to the sector's appeal following Tencent's acquisition of a 5% stake in APT. BUY. (Published by Ord Minnett)

Aristocrat Leisure (ALL.AX) – UBS Evidence Lab inside: Digital app revenue trends – June 2020

UBS Evidence Lab tracks revenue share data for social gaming and social casino apps in the iOS and Google Play store. The data suggests a significant increase to 2H20 social casino revenue driven by continued social distancing restrictions. UBS estimates that ALL experienced +40-50% growth year-on-year (y/y) over April and May 2020, driven by strong market growth (market share was broadly flat y/y). BUY. (Published by UBS)

Brambles (BXB.AX) – US Cost Monitor – Lower Inflation Sets Path for Margins

Despite considerable disruptions to global supply chains from COVID-19, a number of key cost indicators continue to show favourable trends for BXB. Lumber prices have stabilised, but transport costs have continued to fall through May 2020. Retailer inventories are broadly steady on the same time last year, as is pallet pricing as measured by the Wood Pallet Producer Price Index. BUY. (Published by Citi)

Seek (SEK.AX) – Upgrading earnings, Upgrade to Buy

Four factors lead UBS to upgrade its earnings estimates for SEK: 1) weekly trackers (and ABS payroll data) show a sustained week-on-week improvement in job volumes, 2) dynamic pricing will recommence for recruiters/corporates from 1 July, 3) SEK's last update suggested cuts to contractor/marketing costs, and 4) UBS's economics team has upgraded its job forecasts. UBS has largely reversed the EPS estimate cuts that it implemented on 27 March, leading to +30-60% EPS upgrades. UBS's rating moves from NEUTRAL to BUY. (Published by UBS)

Viva Energy Group (VEA.AX) – Trading update

VEA provided a first-half-CY20 trading update that was better than Ord Minnett's forecasts, as expansion of retail fuel margins drove higher retail operating earnings (EBITDA). Costs and capital expenditure were managed better than expected. The Geelong Energy Hub provides optionality, and Ord Minnett is more positive on the stock due to retail fuel margins, capital expenditure and cost management, capital management and valuation support. ACCUMULATE. (Published by Ord Minnett)

International**Apple (AAPL.O) – Five Reasons Apple Stock Can Trade Higher**

Citi increased its target price on AAPL from \$310 to \$400 and believes shares could trade higher for five reasons: 1) Apple will likely have a strong 5G product offering in time for Christmas 2020; 2) positive data points from Apple's supply chain suggest iPhone sales are unlikely to disappoint in the short term relative to low expectations; 3) if Huawei has to halt phone shipments due to restrictions on use of US chip technology, this could drive market share increases for Apple, and there is growth potential for Apple in India; 4) search trends indicate that growth should return in the wearables category in the September quarter; 5) Apple Services continues to accelerate. Despite AAPL's recent stock price gains, Citi sees further upside and reiterates its BUY rating. (Published by Citi)

ING Group (INGA.NA) – Mr Steven van Rijswijk to take over as CEO

Last week ING announced that Steven van Rijswijk will take over as CEO of ING. Mr van Rijswijk has served as Chief Risk Officer of ING Group since 2017. He has been with ING since 1995 with a background in the Wholesale Banking unit. BUY. (Published by UBS)

Lululemon Athletica (LULU.O) – UBS Evidence Lab inside: Survey Shows LULU Has Big Growth Potential

UBS Evidence Lab's latest Global Athletic Wear Survey reveals LULU has a very large growth opportunity ahead of it, which could easily justify the market's current valuation. Even though LULU has reached \$4b in sales, only 13% of global athletic wear consumers have even heard of the brand vs. 96% and 93% for Adidas and Nike, respectively. NEUTRAL. (Published by UBS)

Nike (NKE.N) – UBS Evidence Lab inside: Nike Preserves Its Title as Athletic Wear's Strongest Brand

UBS believes NKE's ongoing momentum should drive a sustainable P/E premium. UBS Evidence Lab's 6th annual Global Athletic Wear survey confirmed NKE resonates with consumers more than any other brand. Despite its already strong position, the data from the survey revealed improvements in perception. This strong customer engagement should allow the company to endure COVID-19 headwinds and expand market share. BUY. (Published by UBS)

PayPal (PYPL.O) – Buy PYPL – Updating Model for Recent Updates, Checks

Citi sees the following factors as positive for PYPL: Intra-quarter comments from PYPL, data-points from Visa and Mastercard, evidence of the sustainability of changes in consumer behaviour, and PYPL's ability to access very attractive debt-based funding if needed. Citi continues to view PYPL as a disruptor that is benefitting from an accelerated shift to digital commerce, which supports its long-term growth. While the stock price has risen, Citi still sees valuation upside at current levels. BUY. (Published by Citi)

Starbucks (SBUX.O) – Minding Our Ks and Qs: Our Read of SBUX's Fiscal 2Q20 10-Q

Citi lowered its EPS estimates for SBUX in 2020, 2021 and 2022 as a result of SBUX's recently issued guidance for fiscal 3Q, 4Q and 2020. Citi's new, lower, target price is \$87. Despite the near-term pressures that SBUX is facing as a result of COVID-19, over the longer term, Citi expects SBUX to grow its top and bottom lines faster than many of its consumer staples peers and consequently deserves to trade at a premium valuation multiple. BUY. (Published by Citi)

Investment trusts**Monks (MNKS.L) – Final Results: Continued strong performance, increases healthcare exposure**

During the financial year to 30 April, MNKS's managers added to holdings in Illumina (gene sequencing) and Abiomed (miniature heart pumps), and initiated positions in SoftBank (telecommunications & venture capital), Denali Therapeutics (neurodegenerative disease treatments), Ubisoft and SEA (both gaming). Numis continues to back the management of MNKS, believing that a diversified portfolio of Baillie Gifford's best-ideas is an attractive vehicle for investors seeking exposure to long-term growth stocks. (Published by Numis)

Calendar

Figure 10. Calendar

Date	New Zealand	Australia	International
22-Jun	Credit Card Spending	RBA Governor Lowe Speaks Transurban 4Q20 Metcash FY20	
23-Jun	Stride Property Group FY20	Manufacturing PMI Services PMI	US: Existing Home Sales (May) UK: Composite/Services/Manufacturing PMI EU: German Manufacturing PMI (Jun)
24-Jun	RBNZ Rate Statement RBNZ Interest Rate Decision	CSR AGM	US: New Home Sales (May) EU: Herman ifo Business Climate Index
25-Jun	Exports/Imports (May) Trade Balance (May)		US: Crude Oil Inventories
26-Jun			US: Core Durable Goods Orders (May) US: GDP (Q1) US: Initial Jobless Claims
27-Jun	CFTC NZD Speculative Net Positions		

Source: Forsyth Barr analysis

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