

Wealth Weekly

Markets Shake Corona Concerns

WEALTH MANAGEMENT RESEARCH

wmr@forsythbarr.co.nz

+64 4 499 7464

Equity markets climbed higher last week as investors shrugged off coronavirus fears, instead focusing on stronger than expected corporate earnings, and Friday's encouraging US jobs report.

International reporting season continues

Last week we had results from some of our International Model Portfolio companies. For the most part results met expectations, with Walt Disney reporting strong uptake of its new subscription streaming service, Disney+. Meanwhile, Alphabet's Cloud business showed good momentum with revenue growth accelerating, while Siemens result was weighed on by costs associated with de-conglomeration as the company looks to spin-off assets.

Themes of the week

News flow in coming weeks is likely to be dominated by Wuhan coronavirus headlines, with official numbers indicating over 40,000 have been infected, while the death toll stands at 910. It is still too early to quantify the economic impact from the virus, but research from our affiliates suggest the virus will likely be worse than SARS for China, and globally.

From a New Zealand perspective, near term earnings risk exists for a wide variety of companies across the travel, tourism, freight, export and manufacturing industries. Tourism Holdings has already pointed to a softer earnings outlook as a result of the virus. Conversely, Kathmandu has shown resilience, and its positive trading update at its Investor Day was well received by the market. In our view, the coronavirus is unlikely to have a lasting impact on trade and consumer mobility, and therefore we see limited impact on long term intrinsic valuations of the companies exposed.

We retain a positive view on Aristocrat Leisure and Nike, with recently updated research from our international partners supporting the investment thesis for both. Industry data points continue to indicate strength in both ALL's digital and land based slot machine segments. While Nike's investments in product innovation, supply chain, and eCommerce, appear to be underappreciated by the market.

On Wednesday, the Reserve Bank of New Zealand (RBNZ) will make an Official Cash Rate and Monetary Policy Statement announcement. While there seems little appetite that the OCR could move either up or down in the foreseeable future, risks are skewed more to the negative (a cut on the OCR) side of the ledger, in our view.

Looking ahead

This week reporting season ramps up, especially in Australia and New Zealand. Companies we follow that are expected to deliver results, include;

- Australia: CSL (CSL), James Hardie (JHX), South32 (S32), Goodman Group (GMG)
- New Zealand: Contact Energy (CEN), Sky TV (SKT), SkyCity (SKC), Skellerup (SKL), NZX (NZX)
- International: Applied Materials (AMAT), Alibaba (BABA), AstraZeneca (AZN)

International reporting season continues

Alphabet (GOOGL) reported its 4Q19 result, which came in slightly behind expectations at the revenue line, while EPS beat expectations due to an extremely low tax rate. Total revenue growth slowed versus the prior quarter, and management pointed to continued FX revenue headwinds for 1Q20 and slightly higher headcount growth vs. 2019. On a more positive note GOOGL's Cloud business, which makes up 20% of revenue, showed good momentum with strong growth in customer demand, and revenue growth accelerating. GOOGL provided improved revenue disclosure for Youtube and Google Cloud, which, while positive, did not provide a segmental breakdown at the profit line which would provide a better understanding of what the company is spending on cloud user acquisition as it tries to catch up with the likes of Amazon and Microsoft.

Siemens (SIE) delivered a somewhat mixed 1Q20, as cost associated with de-conglomeration weighed on company profitability. Retained guidance suggests a stronger 2H20, pointing to early signs of an economic recovery in China and strong orders in some longer cycle markets like Mobility. However, SIE's Digital Industries segment continues to face headwinds in key end markets like automotive and machine building, but software orders were strong. The pending spin-off of Siemens Energy, due in September 2020, is the next major catalyst, although there are other stage posts before then, including an update on Mobility (rail) due next quarter. We continue to see portfolio simplification as a catalyst for lower costs, increased agility, and a higher valuation.

Walt Disney (DIS) reported a strong start to 2020, delivering 1Q20 results above market expectations. Revenue grew +36% while EPS was understandably down -17% yoy due to ongoing investment in DIS's new streaming service, Disney+. DIS's Studio and Media Networks segments were particularly strong, but investors' key focus was on customer acquisition for DIS's subscription offerings. DIS impressed in this respect, announcing that Disney+ had 28.6m subscribers, a phenomenal number for a service that is less than three months old, while Hulu had 30.7 million subscribers, and ESPN+ had 7.6 million subscribers. Management announced plans to launch Disney+ in India and Europe in late March. 2Q19 guidance accounted for headwinds from the closure of Shanghai and Hong Kong Disneyland, assuming a two month closure across both properties during the quarter. There was no change to guidance for Disney+, which DIS expects to breakeven in 2024, with a targeted 60–90 million subscribers.

Other international companies that reported last week included; Gilead Sciences, ING Groep, Merck & Co, and Takeda Pharmaceuticals. Please refer to Research Worth Reading on pages 5–6 for result summaries on these companies.

Themes of the week

Macro Snapshot

Coronavirus update

The latest virus to scare the world (after SARS in 2003, MERS in 2012, Ebola in 2014–16, and Zika in 2015) seems extraordinarily concentrated in one region of one country (Wuhan in central China). The infection and death toll is concentrated in one specific area and questions are now being asked about the initial reports suggesting the virus is infectious even in asymptomatic sufferers.

SARS, MERS and Ebola were contained before they had a significant impact on the global economy or financial markets. In fact, since 1981 there have been 13 world viral epidemics, with almost no impact on the global equity market performance over time. The short-term post viral outbreak average performance was +0.4%, followed by three and six month gains of +3.1% and +8.5% respectively (All-Country World MSCI index). The current virus seems to be following a similar pattern with rapid initial infection rate, which should taper off as the winter months (in China) give way to spring. If so, expect a rebound in travel from Q2 and a resumption in consumer spending (plus pent-up demand), which could set the scene for a resurgence in growth in H2.

Note the recovery rate of the virus (3,298) is accelerating faster than the latest death rate (910) according to the WHO official database.

Equities

Odds are in Aristocrat's favour

Aristocrat Leisure (ALL.AX) has made a strong start to 2020, with industry data points indicating strength for both ALL's digital and land based slot machine segments.

Within ALL's land based slot machine segment;

- It had the top two and five of the top seven most anticipated premium leased games
- It continued market share gains vs its major competitors IGT and SciGames
- It maintains a sizable lead in forward looking slot machine order expectations
- It maintains its position as likely to have the highest floor share amongst new casinos openings/expansions.

Within ALL's digital segment, its hit online role play game *Raid: Shadow Legend* continues to see revenue acceleration, and the game ranks as either a #1 or top 3 grossing role playing game in Google Play and iPhone across a number of key markets.

ALL continues to trade at a material discount to ASX listed growth peers, and we continue to like it as an Australian Model Portfolio stock.

Just Do It — Nike recommendation and target price upgrade

Nike (NKE): Our international research affiliate has upgraded NKE from Neutral to Buy, with a new Target price of US\$136.00. NKE trades at a PE discount to other top global consumer discretionary stocks, despite its sector leading Return on Invested Capital. Our affiliates have upgraded their revenue and EPS growth forecasts to reflect NKE's investments in product innovation, supply chain, and eCommerce, which they believe supports a higher PE multiple of 37x.

Last week, Nike released a statement saying, "In the short term, we expect the coronavirus situation to have a material impact on our operations in Greater China". At the same time, the company noted its business momentum is robust in all other geographies and the long-term strategy is firmly on track. The coronavirus is not expected to impact NKE significantly over the long-term, and the athleisure trend appears to have legs. We continue to hold NKE in our International Model Portfolio.

Fixed Interest

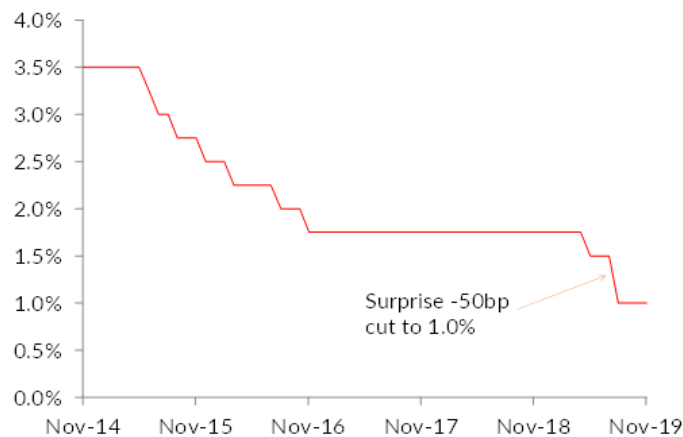
RBNZ with a tough call to make

The Reserve Bank of New Zealand (RBNZ) will deliver its first Monetary Policy Statement for 2020 this week. According to market pricing, the Central Bank is expected to keep the Official Cash Rate (OCR) at its current 1.0% level. However, global risks have escalated in recent times and quantifying the impact of issues such as the coronavirus is difficult. The RBNZ is likely to highlight a number of areas that could be impacted such as tourism, education and New Zealand's export sector.

The current easing cycle began in June 2015 and while there seems little appetite that the OCR could move either up or down in the foreseeable future, risks are skewed more to the negative (a cut on the OCR) side of the ledger. Unforeseen risks to economic growth such as the Coronavirus take time to play out and may turn out to be temporary, and the RBNZ could decide to ride that one out.

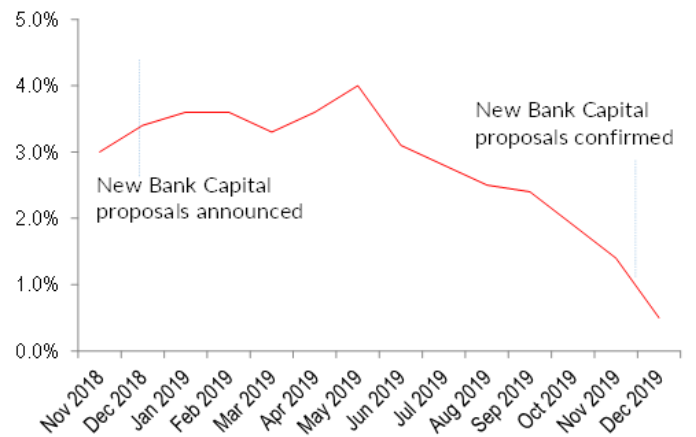
Are there risks closer to home where the RBNZ should be directing its attention?

Figure 1. Official cash rate



Source: Forsyth Barr analysis, RBNZ

Figure 2. Annual credit growth



Source: Forsyth Barr analysis, RBNZ

The consequences of the capital review

If any evidence was required that the new Bank Capital rules (finalised in December 2019) would have an impact, we look no further than the rural lending statistics released by the Reserve Bank of New Zealand (RBNZ). Since the RBNZ announced its new capital proposals in December 2018, nearly all experts / commentators had stated that the rural sector would be the most impacted. This is because a bank must hold more capital against these types of loans, making the return on capital low and not attractive when compared to a less risky asset like a residential home. It is just as easy for a bank to withdraw and/or reduce their exposure to this sector. If this trend continues it will become a serious issue (if not already) for the sector and then it may become an issue for the New Zealand economy.

Meanwhile, there are no such difficulties for prospective home owners with the continual housing shortage and removal of capital gains fuelling an already hot housing market. The RBNZ will no doubt be watching this closely.

Research Worth Reading

New Zealand

Equity Strategy: Coronavirus - Impacts and Consequences

The coronavirus outbreak continues to gain momentum with the number of new cases growing daily. It is nigh impossible to predict (1) the length of time it will take to contain the spread of the virus, and (2) future containment measures. Therefore, it is also very difficult to forecast the ultimate financial impact on companies with direct or secondary exposure to it. Tourism Holdings (THL) is the only company thus far to downgrade near term earnings as a result of the coronavirus (as well as several other issues). However, other companies are exposed and may see some impact on their near term outlooks. These include Auckland Airport (AIA), Air New Zealand (AIR), Comvita (CVT), Fonterra (FSF), Mainfreight (MFT), Napier Port (NPH), Port of Tauranga (POT), Sanford (SAN), Scales (SCL), Skellerup (SKL), Skycity (SKC), Synlait (SML), and The a2 Milk Company (ATM).

Kathmandu Holdings (KMD.NZ): Torquay Tour

Kathmandu Holdings (KMD) provided investors with an encouraging 1H20E trading update and greater detail on its new group strategy following the acquisition of Rip Curl. Whilst there is scope for some limited cost synergies, we believe the key benefit Rip Curl offers KMD is the opportunity to accelerate its international expansion plans through leveraging expertise and existing relationships in the wholesale channel, namely in North America and Europe. We currently see the risk/reward as balanced and retain a NEUTRAL rating.

Tourism Holdings (THL.NZ): Beaten Up, Bouncing Back, But Stuck in Neutral

Tourism Holdings (THL) has provided first time explicit earnings guidance for FY20, which further lowers market expectations, but perhaps not as much as the share price was previously expecting, hence the relief rally. Earnings should ultimately recover. However, the timeframe and magnitude is unclear and we cannot discount the potential for further downgrades over the coming months. Therefore despite relative valuation attractions, we retain a NEUTRAL rating.

Australia

Treasury Wine Estates (TWE.AX): The US Datapoint Investors Should Focus On

In the most recent half, Treasury has faced price declines of -10% in the \$11+ per bottle category. The challenge for Treasury in our view is that the company has 43% of its wines sold on promotion, versus the industry at 38%. Treasury has promoted its premium wines, which has resulted in a positive mix shift over the past three years, but the effectiveness may be falling. One solution is to wind back on promotions, but that usually results in a costly drop in volume. We remain cautious on the stock. Neutral. (Published by Citi)

Xero Limited (XRO.AX): Xero-ing in on 2H20 Google trends

Based on Google search trends, Xero's momentum appears to have continued into 2H20E in Australia, NZ and the UK, though trends are negative in the USA and Canada. Management is executing and we remain fully supportive of Xero's strategy. However, we think Xero's current share price potentially factors success without compensating investors for the risks involved with a very long-dated investment thesis. Sell. (Published by UBS)

International

Alphabet (GOOGL) — Revenue Miss; YouTube Disclosure Below Expectation

Alphabet's 4Q19 result was slightly behind expectations at the revenue line, but ahead on EPS thanks to a very low tax rate. The company highlighted that FX headwinds will remain for 1Q20, and to expect slightly higher head count growth vs 2019. GOOGL's cloud business showed good momentum thanks to strong growth in customer demand. Nothing in these results was thesis changing. We continue to recommend Alphabet as our favourite large cap Internet stock. Buy. (Published by Citi)

Gilead Sciences (GILD): In Vitro data from Wuhan institute suggest effectiveness of Remdesivir against coronavirus

Researchers from the Wuhan institute have published some in-vitro data indicating Remdesivir's activity against the 2019 strain of coronavirus. We think that this is a positive sign, suggesting that the activity of Remdesivir may be real, as we previously saw with one treated US patient. We think that it is hard to quantify the revenue opportunity at this point, as the focus seems to be to get a drug to the patients. However, there could be a long-term opportunity with future stockpiling of this drug, as governments tend to stockpile against future outbreaks. Buy. (Published by Citi)

Gilead Sciences (GILD): Guidance not as bad as it appears. Expense increase should not be a surprise

GILD's 4Q revenues were ahead of expectations but EPS was below, primarily because of inventory write-down. While some investors may not like the commentary around deals as the company appears to focus on small bolt-on deals, we continue to think this is the right strategy as we see it difficult to create value with large late stage deals. We do note that it is hard to see growth at this point and lack of clarity could keep the stock range-bound in near term. Buy. (Published by Citi)

ING Groep (INGA): Key 4Q19 Call Takes — Decent Execution Given the Circumstances

We see no meaningful revisions to 2020 consensus core net profit estimates on the back of 4Q19 results and the call. The ING story is about operating leverage and cost control in the face of macro and industry challenges — while the costs story has been partly 'delayed' by a year, ING is delivering on resilient NII/margins and starting to deliver on fee growth. Buy. (Published by Citi)

Merck & Co (MRK): Doubling down on innovation strategy

Merck delivered a mixed 4Q19 result, with key drugs Keytruda and Gardasil missing revenue expectations. We see the misses as near-term hiccups with limited read-through to underlying demand. We continue to forecast higher than consensus revenues over 2021–2025, driven by non-Keytruda assets: Lynparza, Lenvima, and Gardasil. Buy. (Published by USB)

Nike (NKE): Forget Victoria's Secret; Nike Is Redefining Sexy

We attended the 2020 Nike Forum, which reminded us of the Victoria's Secret (VS) Fashion Show. While we used to watch the VS fashion show and think it was also one of a kind, we have a hard time saying the same these days. "Sexy" these days is about function, fashion and inclusivity. In our view Nike gets it. We believe their brand positioning and product innovation will help drive sales globally for years to come. Buy. (Published by Citi)

Takeda Pharmaceuticals (4502): Q3 in line, revised estimates could find market favour

Q3 results were largely in line with market expectations. Takeda lifted its operating profit estimates, on the back of growth in mainstay products and cost controls. The result underlined the steady progress Takeda is making, and there do not look to have been any surprises. At the individual drug level, we sense that Entyvio, Takhzyro, and immunoglobulins are performing solidly. Buy. (Published by Citi)

Walt Disney (DIS): Results: A Solid Start to Fiscal 2020

Disney reported a strong start to 2020, delivering 1Q20 results above market expectations. As of February 3, 2020, Disney+ had 28.6 million subscribers, Hulu had 30.7 million subscribers, and ESPN+ had 7.6 million subscribers. Disney announced plans to launch Disney+ in India on March 29, 2020. Management also discussed the potential for an international launch of Hulu in 2021. Buy. (Published by Citi)

Figure 3. Calendar

	New Zealand	Australia	International
10-Feb	Contact Energy 1H20 result	Aurizon Holdings 1H20 result GPT Group FY19 result JB Hi-Fi 1H20 result	CN: CPI Jan-20 JP: Balance of Payments Dec-19
11-Feb		AU: Home Loans Dec-19 Beach Energy 1H20 result Challenger 1H20 result Suncorp 1H20 result Transurban 1H20 result	UK: GDP data 4Q19 UK: Trade Balance Dec-19
12-Feb	Electronic Card Transaction data Jan-20 RBNZ Interest Rate Announcement and MPS Sky TV 1H20 result	Ancor 1H20 result CBA 1H20 result Computershare 1H20 result CSL 1H20 result Downer EDI 1H20 result Evolution Mining 1H20 result Insurance Australia Group 1H20 result James Hardie Industries 3Q20 result Northern Star Resources 1H20 result Orora 1H20 result	EU: Industrial Production Dec-19 Visa Investor Day
13-Feb	Skellerup 1H20 result SKYCITY 1H20 result	AGL Energy 1H20 result AMP FY19 result ASX 1H20 result Goodman Group 1H20 result Magellan Financial Group 1H20 result Newcrest Mining 1H20 result South32 1H20 result Telstra 1H20 result Treasury Wine Estates 1H20 result Woodside Petroleum FY19 result	US: CPI Jan-20 Applied Materials 1Q20 result
14-Feb	Food Prices Jan-20 NZX FY19 result Tower AGM		EU: Trade Balance Dec-19 EU: GDP data 4Q19 US: Retail Sales Jan-20 US: Industrial Production Jan-20 Bayer AG R&D Investor Day Alibaba 3Q20 result NVIDIA FY20 result
15-Feb			AstraZeneca FY19 result

Black – company news, Red – economic news

Source: Forsyth Barr analysis

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