

Wealth Weekly

Solid Results Amid Pandemic

WEALTH MANAGEMENT RESEARCH

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A combination of declining COVID-19 cases and reduced restrictions in developed economies, economic data that was no worse than expected, and solid corporate earnings announcements helped equity markets climb further last week. Only rising political tensions between the US and China, and widespread protests in the US, threatened to spoil the party. The NZX50 rose +3.3% in May (broadly in line with international markets) and is now down just -5.3% year to date, having bounced +28% higher from its 23 March low.

NZ company results season

The reporting season continued last week, with Arvida and Mainfreight reporting robust results, while Infratil's and Sanford's earnings were more mixed. Arvida's result featured impressive new sales gains, reflecting strong product demand. Mainfreight's outlook is challenged by the economic downturn, but the longer-term growth potential remains attractive. Infratil's result included stronger than expected numbers from Vodafone NZ and rapid growth at CDC Data Centres, along with more subdued results from Trustpower and Tilt Renewables. At Sanford, strength in Aquaculture was offset by weather-related weakness in Wild Catch. We retained OUTPERFORM ratings on Arvida, Mainfreight and Sanford, but downgraded Infratil to NEUTRAL after its share price performed strongly over recent weeks (it remains in our model portfolio).

Themes of the week

Last week we had results from some of our preferred international companies. **Quarterly earnings from Alibaba, Medtronic, Nvidia and Palo Alto Networks were largely in line, or better than expected,** with companies exposed to technology and internet themes proving relatively defensive amidst the COVID-19 pandemic.

Companies in the consumer discretionary sector have felt the brunt of the pandemic, as retailers closed shop doors throughout the world, and consumers and employees stayed home. Some companies fared better than others, with the likes of Amazon and Alibaba benefiting from accelerating ecommerce and internet trends. We continue to like Amazon and Alibaba as portfolio holdings; however, **we are seeing attractive value-for-risk in consumer names like Adidas, Nike, Estee Lauder, Kering, LVMH, McDonald's and Starbucks.** These companies delivered strong growth prior to COVID-19, and although they may continue to experience disruption over the next 12–18 months, we are of the view that growth will resume sooner than expected, and at current prices we think near-term risks are sufficiently priced in.

The Reserve Bank of New Zealand's (RBNZ) bi-annual Financial Stability Report last week largely confirmed that the retail banks have enough capital and liquidity to cope with all but the most severe circumstances. This follows the RBNZ's recent deferral of plans to force banks to increase how much capital they hold in order to withstand a one-in-200 year event. The RBNZ expects NZ's 2020 economic output to decline by the most in 160-years, but says this constitutes only about a one-in-30 year event as far as the resilience of banks is concerned. Life insurers, non-bank lenders like finance companies, and heavily indebted farmers apparently look more vulnerable than the banks.

Looking ahead

Investore Property will report its FY20 result on Wednesday. The Reserve Bank of Australia will announce its interest rate decision on Wednesday, and the European Central Bank late on Thursday.

NZ Company Results Review

Arvida Group (ARV.NZ)

Arvida's recent development activity and sales volume have continued with a strong full year result, highlighted by impressive new sales gains, reflecting strong product demand. Supporting ARV's strong product demand is its significant development pipeline of ~1,700 units and care suites at various development stages.

The impacts of COVID-19 will create short-term headwinds for the company, particularly if we see disruption to supply chains, a slowing residential housing market or additional COVID-19 shutdowns. However, ARV's strong needs-based offering represents a defensive earnings profile relative to other names in the sector, which should in part help offset the impacts of COVID-19.

We remain attracted to ARV as a long term growth opportunity given its defensive earnings profile, significant development pipeline and positive long-term industry demographics.

Infratil (IFT.NZ)

Infratil's FY20 result contained a couple of positive surprises, with Vodafone's contribution slightly better than expected and Infratil deciding to maintain its final dividend at 11cps (having previously indicated it was likely to trim the dividend). CDC Data Centres continues to be Infratil's growth engine, with its operating earnings up +59% on FY19. Both the Trustpower and Tilt Renewables results were down on last year due to lower hydro generation volumes for Trustpower and the sale of a large wind farm for Tilt.

COVID-19 had little impact on the Infratil FY20 result, with only Wellington Airport having a slight negative (-2%) hit to earnings. Looking forward, Wellington Airport is the most impacted business and given the uncertainty Infratil has decided not to provide any group-wide FY21 earnings or dividend guidance (although there is earnings guidance for Trustpower, Tilt Renewables and CDC Data Centres as these businesses are not greatly impacted by COVID-19).

We are NEUTRAL on Infratil, having downgraded our rating following the FY20 result. Dividend growth is unlikely in the near-term (and a dividend cut is possible in our view) and we believe asset value growth will be harder to achieve in the near-term, particularly with the growth in CDC Data Centres FY21 earnings guidance disappointing. That said, the majority of Infratil's investments will perform well during the COVID-19 economic downturn and the low interest rate environment will provide a tailwind.

Mainfreight (MFT.NZ)

Mainfreight's strong momentum has continued with a robust full year result, however, its outlook is challenged by COVID-19 disruption and the global economic downturn. Its quality and sales focus should at least partially mitigate the earnings impact.

It tends to never miss an opportunity to strengthen its competitive position and continues to have a significant opportunity to grow internationally. The company's strong culture and moral code are epitomised by its decision to repay the government wage subsidy it received, despite qualifying for it.

The valuation is not cheap, but we are attracted to MFT's longer term growth potential and management's strong track record.

Sanford (SAN.NZ)

Sanford reported a choppy 1H20 result, with weak Wild Catch earnings offsetting growth in Aquaculture. Although a disappointing result, the key drivers of the earnings miss were largely one-off in nature. COVID-19 and the collapse of the foodservice channel were unprecedented, while the light toothfish catch was largely impacted by weather rather than an underlying change to the fish stock. Encouragingly, SAN's aquaculture operations maintained positive momentum, with both firmer prices and higher volumes delivering profit growth. We expect Aquaculture operations will be the key drivers of earnings growth going forward.

In addition to the result, SAN announced it had lodged resource consent applications for a series of significant open ocean salmon farms, called Project South, which at full capacity would produce 25,000 green weight tonnes per annum across five sites. Open ocean farming represents a significant opportunity for SAN, and is backed by the Government's strategy to grow the sector to an NZ\$3bn industry by 2035 (2019 ~NZ\$620m). However, at this stage it represents long-term option value rather than forecastable cash flows.

Whilst the near-term outlook remains uncertain, we continue to view SAN as offering attractive medium-term growth at undemanding multiples (14x forward PE).

Themes of the Week

Global equities results wrap-up

Alibaba (BABA) delivered better than expected 4Q20 results with revenue up +22%, while quarter to date trends highlighted a healthy rebound in consumer activity as lockdowns eased. Management provided FY21 revenue guidance for +28% growth, in line with expectations. However, at the same time, management noted ongoing uncertainty due to COVID-19 and pointed to US/China tensions adding additional uncertainty beyond the pandemic.

Medtronic's (MDT) 4Q20 result was largely in line with its previously provided COVID-19 impact update in April, with 4Q revenue declining -26% yoy. The company suspended guidance but provided insight into how it sees a recovery across its businesses and geographies, noting it expects 1Q21 to be worse than 4Q20 given the 4Q only included 6 weeks of impact from the virus. However, this may prove conservative as the first few weeks of May have shown a gradual sequential improvement in MDT's three biggest regions (US, Western Europe and China). Based on recent comments from MDT's CEO, the company may look for tuck-in acquisitions, given it has US\$11bn of cash, no debt maturing until early 2021, and an untapped US\$3.5bn credit facility.

Nvidia (NVDA) reported impressive 1Q21 results, with revenue and EPS ahead of consensus estimates, as strong growth in its Data Centre segment and improved gaming demand trends offset a sharp decline in Auto. Overall sales were up +39% yoy. NVDA continues to see strong demand for its training and inference platforms, thanks to broad adoption by cloud/hyperscalers and large enterprise customers for AI services in cloud computing. In regard to gaming, NVDA pointed to stay-at-home mandates driving a >50% increase in hours played on GeForce gaming platforms. 2Q revenue and gross margin guidance was slightly ahead of expectations, as was opex guidance, as NVDA continues to invest in deep learning and artificial intelligence.

Palo Alto (PANW) posted strong 3Q20 results, assisted by surging demand for firewall capacity as employees around the world shifted to working remotely. Revenue growth re-accelerated to +20% yoy, and billings to +24% yoy. Notably, product revenue showed signs of stabilisation, growing +1% yoy, a significant improvement on -9% in 2Q20. PANW provided 4Q20 guidance for billings and revenue that was largely in line with consensus expectations. However, management pulled its long-term growth targets to deliver US \$5.0bn in revenue by FY22 and +20% average annual growth from FY19, highlighting uncertainty in the macro environment, and stated "we expect a bumpy ride the next few quarters".

Global consumer sector equities

After reviewing the global consumer sector we are broadening our exposure to five industries:

Luxury – Kering (PRTP.PA) and LVMH (LVMH.PA)

Within the luxury space we are partnering Kering with LVMH. In combination, these two companies own some of the world's largest and best known luxury brands; including Kering's Gucci, Yves Saint Laurent, Balenciaga, Alexander McQueen, Bottega, and LVMH's Louis Vuitton, champagne producer Moët & Chandon, and cognac producer Hennessy.

Active Wear – Adidas (ADSGn.DE) and Nike (NKE.N)

We are pairing Adidas, the second largest sportswear manufacturer in the world with the world's largest, Nike. Both are well positioned in growing markets with structural tailwinds such as growing sports participation and health and well being awareness.

Ecommerce – Alibaba (BABA.K) and Amazon (AMZN.O)

We are sticking with Alibaba and Amazon for best in class exposure to accelerating Ecommerce and Internet trends.

Restaurants – Starbucks (SBUX.O) and McDonald's (MCD.N)

Starbucks and McDonald's should prove relatively resilient if economic conditions worsen, as consumers who are time-poor will look for affordable, fast, and tasty dining options.

Cosmetics – Estée Lauder (EL.N)

We are adding Estée Lauder for exposure to premium-end skin care, makeup, fragrance, and hair care products.

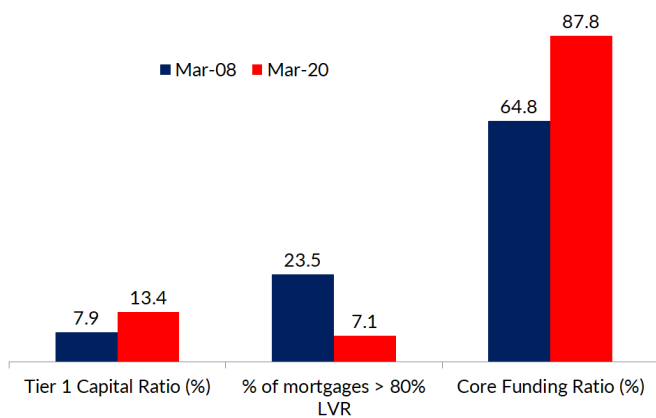
Fixed Interest

More capital or enough capital?

The Reserve Bank of New Zealand (RBNZ) released its bi-annual Financial Stability Report (FSR) last week. These reports tend to be quite useful for a number of reasons. First, the release is used to comment on the strength of the financial system, something all of us should be concerned about; a weak banking system can send an economy to its knees. Second, this is usually the report where increases or reductions in policies such as the loan-to-value restrictions are usually announced.

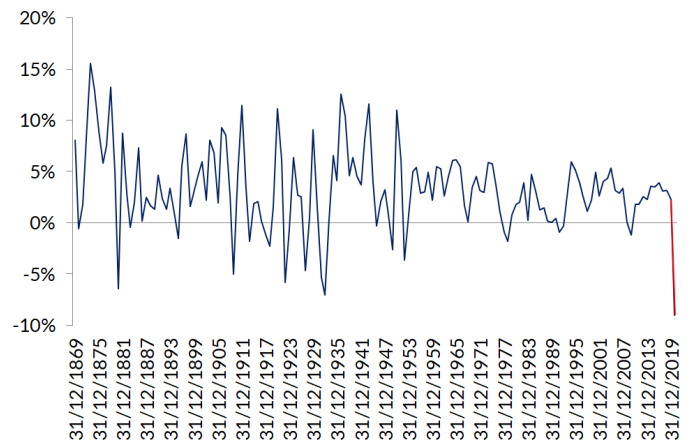
The FSR last week was particularly important for the central bank to outline its confidence (or not) in the New Zealand banking system as it responds to COVID-19. The RBNZ stated the New Zealand economy is facing its biggest decline in annual GDP in at least 160 years. Despite that threat, the RBNZ largely gave the banking system the thumbs up, which may seem a touch ironic given it has spent the last two and bit years telling the banking sector it needs to double its capital to survive an event like COVID-19 – a process which has since been delayed due to COVID-19. That suggests the banks' current capital positions (i.e. the buffer or shareholders funds') was sufficient to begin with. Figure 1 below illustrates the better position New Zealand banks are in compared to the Global Financial Crisis (GFC). Banks have more capital, less leveraged borrowers and more longer term funding.

Figure 1. Capital ratios



Source: Forsyth Barr analysis, RBNZ FSR May2020

Figure 2. Annual GDP



Source: Forsyth Barr analysis

Job losses mounting

The number of workers being laid off will be of concern to the RBNZ, which has an employment mandate alongside its price stability target. Figure 2 shows the challenge in front of the RBNZ as growth forecasts are set to fall sharply. Going forward, the ability to promote growth, inflation and maximum sustainable employment from the current set of numbers will be a great challenge.

Research Worth Reading

New Zealand

Air New Zealand (AIR) – Commencing the Journey to Safety

AIR's liquidity and earnings update (1) highlighted the dramatic changes to its business as a result of COVID-19, (2) confirmed it will be loss making in FY20, and (3) provided some insight into the impending impact to its net tangible assets (NTA) at year end FY20. Ongoing cash burn and flagged impairment charges will have a material impact on NTA as at 30 June 2020, in our opinion. With its recovery profile very uncertain and NTA in decline we retain our UNDERPERFORM rating. (Published by Forsyth Barr)

Arvida Group (ARV) – Ahead of the Curve

ARV has reported a strong FY20 result that highlighted a sharp lift in development activity and sales volumes, the successful integration of large-scale acquisitions and a well performing care operation in the face of considerable challenges with COVID-19. ARV has not provided FY21 guidance given the near-term uncertainties but it is targeting to build a similar number of units in FY21/22 as the 210 units in 2020. We have not made material changes to our already re-based forecasts, however, the environment is recovering faster than assumed. OUTPERFORM. (Published by Forsyth Barr)

Goodman Property Trust (GMT) – FY20 Result – Great Expectations

GMT reported a steady FY20 result, in-line with expectations. While GMT's portfolio proved resilient over lockdown (90% rent collection over April/May) it will still be impacted by the broader economic slowdown. Lower tenant demand will increase vacancy, pressure rents, and reduce development-led earnings growth. As such we believe GMT's stock is trading on lofty valuation metrics especially when compared to the NZ LPV sector. We believe this valuation disparity leaves little room for further outperformance vs. the LPV sector and we downgrade our rating to UNDERPERFORM. (Published by Forsyth Barr)

Infratil (IFT) – Stretching Data Centre Growth – FY20 Result

Whilst IFT's FY20 result had two minor positive surprises, recent strong share price performance and a weaker than expected CDC Data Centre outlook has resulted in us pulling back our rating to NEUTRAL from OUTPERFORM. The positive surprises in the result were Vodafone's FY20 EBITDA being closer to the top of its guidance range than the bottom, and the decision to maintain the 2H20 dividend at 11cps. We have trimmed our target price -NZ10cps to NZ\$4.80. NEUTRAL. (Published by Forsyth Barr)

Kiwi Property Group (KPG) – In the Waiting Room

KPG provided few surprises in its FY20 result. Operationally FY20 was solid, but negative revaluations to KPG's highly retail-concentrated portfolio and increased earnings uncertainty have complicated its ongoing transition into a diversified mixed-use portfolio. Despite trading at a discount to its net tangible asset (NTA) value, we believe risks are skewed to the downside given KPG's leverage to the uncertain economic backdrop. UNDERPERFORM. (Published by Forsyth Barr)

Napier Port – 1H20 – Sitting on the Sea Wall

NPH's first half result reflected favourable pre COVID-19 trade volumes, although the company has refrained from paying an interim dividend. Underlying NPAT was up +7% against the prior year on a similar level of revenue growth. EBITDA margin pressure was a key feature, despite strong pricing gains across containers, bulk and cruise, given labour/capability investment pre-IPO. Investor income is impacted near term by dividend cancellation/uncertainty, but we think the risk/reward for NPH is fair and therefore retain a NEUTRAL rating. (Published by Forsyth Barr)

Sanford (SAN) – 1H20 – Looking Beyond Choppy Waters

SAN reported a disappointing 1H20 with soft toothfish volume and COVID-19 related market impacts weighing on performance. Encouragingly, Aquaculture operations maintained positive momentum, delivering both volume and pricing growth. We have made negative earnings revisions, reflecting the COVID-19 related disruptions and weak toothfish season, and as a result we have cut our target price -NZ\$0.25 to NZ\$7.45. Whilst the near-term outlook remains uncertain, we continue to view SAN as offering attractive medium-term growth at undemanding multiples (14x forward PE). OUTPERFORM. (Published by Forsyth Barr)

Australia

CSL (CSLAX) – On the COVID-19 vaccine sidelines, but could play a greater role

In this report, Citi lists vaccine candidates in development, the approaches used, and the expected timelines for availability. At this stage the financial implications for CSL are limited given it is not directly involved in the development of COVID-19 vaccines. There is a possibility that it could get involved in the manufacturing of a successful vaccine over time, assuming that it matches CSL's technical capabilities. Citi upgraded to BUY given the stock has underperformed the ASX 200 by -19% in the last month. BUY. (Published by Citi)

Ramsay Health Care Limited (RHC.AX) – Assessing the drivers of CY19 volume growth and the longer term outlook

UBS has analysed the drivers of Australian private hospital volume (admissions) growth over CY19 (+0.1%), and evaluated the sector's outlook in a COVID-19 affected world. Population growth/ageing contributed +2% to growth but this was offset by a decline in private health insurance participation (detracting -0.5% from growth) and lower utilisation (detracting -1.3% from growth). For RHC, UBS has increased its Australian volume growth assumptions to +2.5% p.a. (from +2%) in FY23 and beyond. UBS's price target increases to A\$71.20 (from A\$63.20). NEUTRAL. (Published by UBS)

Sonic Healthcare (SHL.AX) – Return of routine but it's more than in the price

Based on recent share price performance (1 month total return of +18% vs the ASX 200's +10%) the market already appears to be pricing in a more favourable recovery in SHL's routine pathology work and/or additional funding from COVID-19 related testing. SELL. (Published by UBS)

Telstra (TLS.AX) – Optus takeaways: will consumers pay more for 5G?

Optus' weak financial performance highlights its need to repair profitability – potentially through higher mobile prices. We think this will give TLS hope it can still monetise 5G through higher mobile pricing, suggesting a near-term DPS cut may be unlikely. Longer-term, however, we remain of the view that the FY21 earnings trough is deeper than what the market expects, which means greater execution risk around TLS' ability to grow into earnings sufficient to support a 16cps dividend by FY23. BUY. (Published by UBS)

Treasury Wine Estates (TWE.AX) – US May Nielsen off-premise wine sales +32% y/y... TWE still losing share

The near term outlook for TWE remains uncertain, and UBS sees risks to estimates for 2H20/1H21. That said, UBS does not foresee TWE having balance sheet challenges even in an environment where EBITDAS missed UBS estimates by more than 30%. UBS also sees potential catalysts via the re-structure of the Americas commercial business and potential demerger of Penfolds. With signs of a faster China recovery as the key near-term catalyst, UBS retains its BUY rating. (Published by UBS)

International

Facebook (FB.O) – Shop Apt to Benefit Long-Term Growth

Facebook announced the launch of Shop. With Shop, Facebook is enabling consumers to purchase items directly within the Facebook or Instagram app. Facebook will likely generate revenue in two ways from Shop. First, retailers will be more likely to advertise on Facebook as ecommerce functionality is built into the firm's social media platform. Second, retailers will typically pay a 5% fee on retail sales conducted through Shop. Citi remains bullish on Facebook's equity and has raised its estimates and target price. BUY. (Published by Citi)

Siemens (SIEGn.DE) – Initial thoughts on the Energy spin report

Siemens published the spin-out report for Siemens Energy. An extraordinary general meeting will be held in July to approve the spin-out, and the transaction should take effect on 28 September 2020. The confirmation that Siemens will further reduce its stake following the initial spin-out is a positive. Citi expects more forward-looking data in the prospectus (which is due in September). Citi continues to see a re-rating of the remaining company as a key reason to own Siemens. BUY. (Published by Citi)

Calendar

Figure 3. Description

Date	New Zealand	Australia	International
1-Jun	Queen's Birthday	AIG Manufacturing Index	CN: Caixin Manufacturing PMI (May) DE: German Manufacturing PMI (May) UK: Manufacturing PMI (May)
2-Jun	Stats NZ Building Consents (April) Terms of Trade (Q1)	Current Account (Q1) RBA Interest Rate Decision	US: Manufacturing PMI (May)
3-Jun	GlobalDairyTrade Price Index Investore Property FY20 result	HIA New Home Sales RBA Assistant Governor Bullock speaks Building Approvals (April) GDP (Q1)	DE: Unemployment (May) UK: Composite PMI (May) UK: Services PMI (May)
4-Jun	ANZ Commodity Price Index	Retail Sales (April) Trade Balance (April)	US: ADP Nonfarm Employment Change (May) US: ISM Non-Manufacturing PMI (May) US: Crude Oil Inventories UK: Construction PMI (May) EZ: ECB Monetary Policy Statement Remy Cointreau FY20 result
5-Jun			US: Initial Jobless claims
6-Jun			US: Nonfarm Payrolls (May) US: Unemployment Rate (May)

Source: Forsyth Barr analysis

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