FORSYTH BARR

WEALTH MANAGEMENT RESEARCH

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Wealth Weekly
Strong Finish to Earnings Season

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Last week we saw positive earnings reports from several major NZ companies. Fisher & Paykel Healthcare surprised with an even better than expected profit as COVID-19 tailwinds continue — although how long for is the big question on investors' minds. Results from Arvida and two of our preferred NZ property stocks, Argosy and Stride, also included positive signals.

Strong results from key NZ companies

F&P Healthcare's exceptional 1H21 result was unsurprisingly dominated by the pandemic, which remains an extraordinary tailwind as FPH's products continue to be used as a therapy for COVID-19. The key question remains — what does F&P Healthcare's earnings path look like beyond COVID-19? For now demand is still strong, but there is significant monthly volatility in growth. **F&P Healthcare is a high quality growth company, however, the high price reflects elevated market expectations for continued growth**. We expect growth to become difficult as the pandemic and related hospital equipment sales fade. Progress with vaccines and the possibility of a low flu season could also drag on the stock. **We see better value growth stocks in both the NZ market and globally**.

On balance **we were broadly encouraged by the 1H21 result of retirement home operator Arvida**. The company's annuity earnings decreased compared to the same period last year, driven by lower than expected deferred management fees. But this was outweighed by strong cash generation, confident development guidance and cost discipline. Our impression from the result was that management's focus over the last six months has understandably been on managing the pandemic impact on residents and staff. Looking ahead, **we believe the success of the care Occupational Right Agreement (ORA) model will be crucial for the investment case of Arvida**. We have retained our NEUTRAL rating.

Argosy Property's 1H21 result was underpinned by underlying distributable profit growth of +5–7%. Revaluation gains of +4.3% led to +8.5% growth in net tangible assets, driven by solid rental growth and lower capitalisation rates. With ARG trading on undemanding metrics versus peers, we lifted our rating to OUTPERFORM.

Better than expected rent abatements as well as recurring and one-off management fees helped Stride Property report a strong 1H21 result. The big news though was the announcement of an NZ$220m capital raising to fund property acquisitions (including a prime Wellington office tower announced last week) for Stride's planned office property fund. We expect Stride's asset management business to generate attractive growth in management fees, and we have maintained our OUTPERFORM rating.

Themes of the week

This week we have made numerous tweaks to our lists of most preferred stocks, adding: NZ aged care company **Oceania Healthcare**; **Stride Property**; Australian property companies **Mirvac**, **Charter Hall Long WALE REIT**, and **Centuria Industrial REIT**; confectionery giant **Mondelez International**; and French building electronics manufacturer **Schneider Electric**. We have removed Origin Energy, Treasury Wine Estates, Viva Energy and Starbucks from our Australian and International most preferred lists.

With hot house prices raising tempers across the land, the government last week asked the Reserve Bank of New Zealand (RBNZ) to consider house prices when it evaluates monetary policy. The RBNZ replied that it already does (stoking the wealth effect was one of its objectives in lowering interest rates) but that it'll look into it. **Wholesale interest rates and the NZ dollar rose as the market interpreted the Finance Minister's enquiry as lowering the chance of negative interest rates**.

Looking ahead

Earnings season has come to an end, but there are a couple more AGMs this week, including Heartland Group's yesterday and Microsoft's early on Thursday. The Reserve Bank of Australia will publish its interest rate decision today, and US Federal Reserve Chair Jerome Powell will testify before Senate and House committees early on Wednesday and Thursday.

NZ Company Results

From solid to exceptional

We had results last week from Arvida Group, Fisher & Paykel Healthcare, Argosy Property and Stride Property. They ranged from solid to exceptional.

F&P Healthcare (FPH.NZ) — 1H21 Result — The Final Wave?

FPH evidently managed the sharp spike in demand for its products amid the COVID-19 pandemic well; its 1H21 result was exceptional. Revenue grew +61% in constant currencies, and despite a big increase in freight costs crimping gross margins, net profit soared +87% as gross profit growth still dwarfed revenue growth. Hospital revenue was unsurprisingly the highlight, while Homecare held up well despite some slowing in diagnosis of new patients with sleep apnoea.

FPH once again upgraded its FY21 guidance, which came as no surprise given the recent resurgence of COVID-19 hospitalisations globally. The new guidance is for net profit of NZ$400–415m, backed by assumptions including that Hospital hardware sales normalise from January 2021 and utilisation levels normalise across 2H21. We view FPH's guidance as conservative but note that the situation is very volatile and difficult to forecast. We lifted our FY21 forecasts to above guidance. The path beyond FY21 remains uncertain. We assume COVID-19 tailwinds continue into 1Q22, but our upgrades are more modest from FY22.

Our valuation assumes that COVID-19 proves to be an enduring catalyst for higher adoption rates of FPH's products, however, the extent of the uplift remains up for debate. **There is potential for disappointment if consumables revenue cannot replace the pandemic-induced spike in hardware sales when it wanes**. Our rating remains UNDERPERFORM.

Arvida Group (ARV.NZ) — 1H21 Result — Care-Full Management

In a refreshing deviation from recent trends at other aged care companies, **ARV reported net debt that was ~NZ$30m lower than our expectations, driven by a combination of lower capital expenditure, higher new sales cash flow and strong working capital management**.

Deferred management fees were substantially weaker than our estimates as a result of a change in valuer assumptions around expected tenure in existing villages in 1Q21. We do not believe this adjustment alone to be material to the investment case, but **should this become a recurring phenomenon it could indicate that resident tenure is longer and therefore turnover and profitability lower** within ARV's new, higher quality, village stock. We have reduced our underlying earnings and annuity EBITDA estimates by +2–6% for FY21–FY23.

ARV firmed up its previous FY21 development guidance, and we have increased our medium-term development forecasts to reflect the strong pipeline. ARV commented that it was "very pleased" with internal village demand for care suites to date, and 2H21 will mark the delivery of the first meaningful group of care suites (Copper Crest and Aria Bay) targeted to be sold under the Occupation Rights Agreement (ORA) model. **We believe the success of the ORA model will be critical for the investment case**. If ARV achieves its target of c. 80% sold under ORA, it could potentially run a cash neutral development business for the next few years.

Argosy (ARG.NZ) — 1H21 Result — Smooth Sailing

ARG's result was slightly messy due to a number of one-off items. **We estimate underlying distributable profit growth was +5–7%**, underpinned by +5.2% like-for-like rent growth as well as the government's reintroduction of tax deductions for depreciation on building structures. **The portfolio maintained its strong metrics**, with building occupancy lifting +60bps to 99.4% while weighted average lease term shortened by 0.4 years to 5.7 years.

Desktop valuations performed by Colliers boosted ARG's portfolio value by +4.3%, and its net tangible assets by +8.5% (helped by gearing, which we estimate at 35%) to $1.41 per share. The revaluation gains were broad-based, with industrial increasing +5.7%, large format retail +5.3% and office +2.7%. These increases were based on a combination of rent increases and lower capitalisation rates.

We upgraded our rating to OUTPERFORM. While ARG's dividend growth will be minimal, we believe it offers relative value in an expensive sector, as it has traded at a lower premium to its net tangible assets than the sector average and offers a higher gross yield.

Stride Property (SPG.NZ) — 1H21 Result — Funding the Flagship

SPG reported a tidy 1H21 operating result. **Better than expected COVID-19-related rent relief outcomes resulted in an upgrade to guidance**. SPG has negotiated lease extensions as part of most deferral/abatement deals. These extensions, alongside recent acquisitions, have resulted in an improvement in SPG's portfolio metrics, with occupancy rising to 96.7% and the weighted average lease term to 5.8 years.

SPG's result was boosted by the inclusion of establishment fees and management fees from its new Industre property fund, which was established in July. The next fund slated for establishment is SPG's office fund which has taken form much faster than expected, with SPG recently announcing NZ$312.5m of acquisitions. SPG will also have c.NZ$300m of retail assets on its balance sheet, which will be the seed for a retail, town centre fund.

We revised up our earnings forecasts to account for recent acquisitions, adjustments to our assumptions for the Industre property fund, and tax adjustments, partially offset by the dilution from the capital raising. Our target price increased as we removed conservative asset devaluation assumptions across the portfolio from our NAV. Our rating remains OUTPERFORM.

Themes of the Week

Equities — Changes to preference list

We have refreshed our lists of most preferred stocks. Below we highlight the key additions (Oceania, Stride, Mirvac, Charter Hall Long WALE REIT, Centuria Industrial REIT, Mondelez International and Schneider Electric) and removals (GPT Group, Origin Energy, Treasury Wine Estates, Viva Energy and Starbucks).

New Zealand equities

Oceania Healthcare (OCA.NZ) — We believe OCA's higher average charges and focus on care suites over traditional care makes it a key beneficiary of the current buoyant market environment for residential homes and high demand for care. We believe OCA to be at an inflection point, with its transition from being a traditional care operator towards a premium operator that charges through deferred management fees (DMF) and re-sale gains. We expect OCA to almost double annuity earnings over the coming three years and deliver the highest cash recovery of new capex in the sector. Should OCA deliver on our expectations and should the buoyant housing market continue, we see substantial further upside medium term. OUTPERFORM.

NZ & AU Property equities

Stride Property (SPG.NZ) reported a strong 1H21 result, underpinned by better than expected rent abatements as well as recurring and one-off management fees. SPG's post-offer (NZ$220m capital raise) pro-forma gearing of 30.4% provides it with capacity for further acquisitions, with management signalling its intention to remain active. We maintain our OUTPERFORM rating, given the attractive growth and operating leverage that we expect SPG's asset management vehicle to generate.

Mirvac Group (MGR.AX) is a fully integrated property company with internalised management. It holds a high-quality diversified investment portfolio of predominantly office & industrial (48%) and retail (15%) assets. Its business is supplemented by medium & high density house & land and apartment development business (37%) in addition to undertaking commercial development. MGR operates in four key cities: Sydney, Melbourne, Brisbane and Perth. MGR's high-level of residential pre-sales provides downside support and greater earnings visibility.

Charter Hall Long WALE REIT (CLW.AX) is a property trust that is externally managed by Charter Hall Group (CHC.AX, which also owns 20% of CLW). CLW has an attractive portfolio of diversified property assets that are highly resilient to the impacts of COVID-19. It owns interests across office, industrial and retail property, with long Weighted Average Lease Expiry (WALE - lease terms), leased to corporate and government tenants.

Centuria Industrial REIT (CIP.AX) is a pure play on Australian industrial property exposure which is highly leveraged to valuation upside from compressing cap rates. The portfolio comprises of c.55 industrial distribution centers, including a number of infill sites that have development potential not reflected in their independent valuations. CIP has increased its portfolio WALE to 10.2 years.

GPT Group (GPT.AX) has been removed from our preferred list. Virus-related income and asset value impacts are likely to be significantly negative for retail and somewhat negative for office and combined these two make up >80% of GPT's portfolio. GPT owns, develops, and manages a core portfolio of retail, office, and industrial properties across Australia.

Australia

Origin Energy (ORG.AX), **Treasury Wine Estates** (TWE.AX) and **Viva Energy** (VEA.AX) have been removed from our preferred list.

ORG faces increasing risk of dislocations in the Australian electricity market as a result of overbuilding.

TWE's earnings will be significantly impacted by China's interim decision to apply tariffs of 107–212% (169% for TWE) to Australian wine imported into China. We see China's tariff decision as having much more to do with geopolitics than with genuine dumping concerns, but the rationale for the decision is unfortunately irrelevant; the impact on TWE is the same.

VEA has been removed in favour of OUTPERFORM-rated **Z Energy** (ZEL).

International

Mondelez International (MDLZ.O) is a global snacking company, founded out of a spin-off from Kraft Foods in 2012. Its key brands include Cadbury, Oreo, Toblerone, Milka and Green & Black's. As c.70% of the company's revenue is generated outside of the US, it is well-positioned to benefit from the growth of global snacking. MDLZ is currently striking a good balance of investment and growth.

Ecommerce sales were up +78% in 3Q20, and the company has indicated it is investing in ecommerce-specific pack sizes and products, along with digital marketing to better target this high growth channel.

Schneider Electric (SCHN.PA) is a French multinational company providing energy and automation digital solutions for efficiency and sustainability. It addresses homes, buildings, data centers, infrastructure and other industries, by combining energy technologies, real-time automation, software and services. The company remains positive on its +3–6% through-cycle growth target. SCHN estimates c. 80% of its exposures to be neutral or positively impacted in a post COVID-19 world, particularly in areas such as smart buildings, internet of things driven by 5G, reshoring of manufacturing footprints, accelerating automation, and government stimulus targeting long-term sustainability.

Starbucks (SBUX.O) has been removed from our preferred list. SBUX's share price has recovered +75% from COVID-19 lows and is up +12% YTD. Incremental store closures in the US and in Canada are expected to weigh on FY21 growth, and a recovery in margins is unlikely until FY22. Following SBUX's strong performance, the shares no longer offer an attractive risk/return, in our view.

Fixed Interest

RBNZ Governor hits the ball straight back over the net to Finance Minister

In response to the seemingly daily coverage of rising house prices, **the government has been forced to act and hence has requested the Reserve Bank of New Zealand (RBNZ) to consider house prices when it evaluates monetary policy**. The move was largely symbolic as the central bank's response pointed out the RBNZ already takes such things into account.

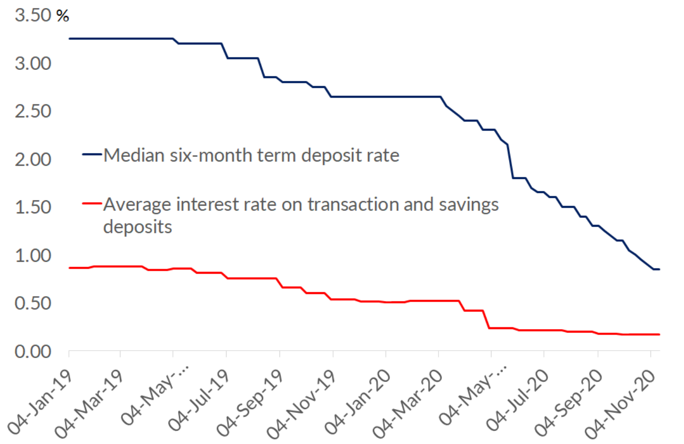
Where to from here?

There does not appear too much the Central Bank can do, with much of the heavy lifting needing to be done by the government (points the RBNZ Governor pointed out publicly such as land supply, tax etc). The unintended consequences of the government getting involved is already apparent, with negative interest rates almost completely ruled out by the market. This is not likely to please the Governor, who had been using such a threat to help lower interest rates. Wholesale interest rates rose +10bp on the news the government had asked the RBNZ to consider house prices. The NZD also strengthened, which again will not please the Governor. However, **the RBNZ has agreed to look further into what tools it may be able to invent or use to help out**.

The RBNZ released its bi-annual Financial Stability Report (FSR) last week indicating **whilst New Zealand has done extremely well, we are not out of danger just yet** with much of the world still experiencing serious COVID-19 restrictions.

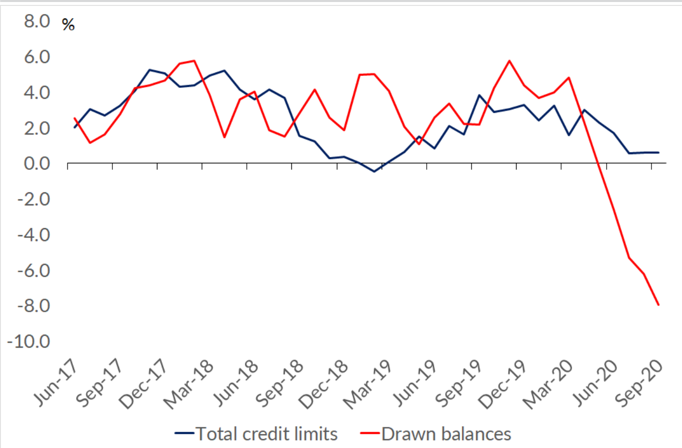
It appears **the Funding for Lending Programme is set to be launched soon, which could be the final nail in the coffin for meaningful term deposit rates**.

Figure 1. Deposit rate for the big 5 banks



Source: Forsyth Barr analysis, RBNZ No FSR

Figure 2. Business sector credit limits and drawdown balances



Source: Forsyth Barr analysis, RBNZ Nov FSR

Research Worth Reading

New Zealand

Freightways (FRE) — Posting a Better Margin Outlook

FRE has a key opportunity to lift profitability in its core parcels operations in light of a more rational competitive backdrop, in our opinion. The latest annual report of its biggest competitor, NZ Post provides several key statements that indicate a strategic desire to lift profitability significantly from current levels. This points towards a continuation of the current positive pricing environment. supporting an expanding industry profit pool. We believe this will allow FRE's 'pricing for effort' strategy to make further pricing gains in the lower margin but higher growth business-to-consumer (B2C) channel. OUTPERFORM. (Published by Forsyth Barr)

Genesis Energy (GNE) — Kupe Strategic Review a Positive

GNE has announced it is undertaking a strategic review of its 46% interest in the Kupe oil and gas field. The review will determine whether GNE retains or sells its stake in the field. The review outcome is expected to be announced in mid 2021, and we consider a sale is the most likely outcome of the review as the strategic need for GNE to own Kupe will diminish over time. We view the decision to undertake a strategic review as a positive. OUTPERFORM. (Published by Forsyth Barr)

Kathmandu Holdings (KMD) — Rip Curl Swells into Southern Summer

KMD's 1Q21 trading update contained more positives than negatives, with the seasonally important Rip Curl delivering strong sales growth, offsetting weakness at KMD. Heading into the Christmas quarter, we expect category exposure to continue to benefit Rip Curl, with a re-allocation of international travel spend likely to favour outdoors and surf. In addition, wholesale order books have recovered, which is supportive of positive trading momentum into 2H21, led by the Northern Hemisphere summer. OUTPERFORM. (Published by Forsyth Barr)

Vital Healthcare (VHP) – In Good Health — Reinstate as OUTPERFORM

VHP's completed capital raising and planned divestments will fully fund its c.NZ$430m pipeline of tenant-led projects. These projects amount to c.22% of the value of its stabilised assets and have an attractive average yield on cost of 6.2%. Completion of this pipeline will drive strong earnings and distribution growth over the next 3 years; we forecast +3.3% annualised growth in dividend per share from FY20–23, which compares favourably to modest expectations for sector peers. We also see potential for growth in net tangible assets, driven by development and revaluation gains, underpinned by strong investor demand for assets with long lease terms and resilient tenants. We note that VHP's committed gearing is high compared to peers, and further portfolio activity may require additional equity. Reinstate OUTPERFORM. (Published by Forsyth Barr)

Australia

Lendlease Group (LLC.AX) — AGM update

LLC held its AGM. Management stayed on message with continued emphasis on simplification, recovery in development work-in-progress, and further growth in the development backlog in the US, where LLC is underweight and there is a sizable addressable market. HOLD. (Published by Ord Minnett)

Ramsay Health Care Ltd (RHC.AX) — What happens after the pandemic?

Citi has analysed Australian hospital data from the last 10 years to help forecast the post-pandemic demand over the next decade. Citi concludes that the aging population will continue to contribute to the strong surgical demand although slightly less than previously, and that annualised volume growth of ~3% is expected in the private system. Combined with 2% annualised growth for price and service mix, Citi forecasts +5% pa Australian revenue growth for RHC Australia from 2023–2030. While the data outlined in the report supports Citi's view that the sector is in reasonable shape, there are several challenges which will require an industry-wide response. NEUTRAL. (Published by Citi)

Treasury Wine Estates (TWE.AX) — Tariffs Make for a Tough Time

The Chinese Ministry of Commerce has imposed antidumping tariffs of 169% on TWE and onerous tariffs on all Australian wine exporters. This will impact TWE's earnings significantly near-term and reduce future growth prospects. The company has outlined a range of responses to the tariffs imposed. It will be difficult to maintain any presence in China, in Citi's view and the company's turnaround in the Americas will become the key share price driver. Citi has lowered its TWE target price and downgraded its rating from BUY to SELL. (Published by Citi)

International

AstraZeneca (AZN.L) — Opening Positive Catalyst Watch

Citi has opened a positive catalyst watch following AZN's underperformance due to the disclosure of equivocal top-line data from its COVID-19 vaccine. The negative reaction of the share price is inconsistent with AZN's agreement with Oxford to supply the vaccine at cost during the pandemic period. Citi also believes negative sentiment over dosing subgroups and comparative efficacy versus mRNA vaccines will be reduced once phase III results are published in the Lancet. Citi anticipates rapid licensing of the vaccine and roll out in the UK followed by EU and less developed countries. Citi also anticipates FDA approval of the adjuvant indication for Tagrisso in 1Q21, and positive phase III data for Farxiga in HFpEF heart failure. BUY. (Published by Citi)

Medtronic (MDT.N) — Despite a Pandemic, Pipeline Momentum

During a pandemic, with an impact on elective procedures, MDT delivered FY2Q21 results that exceeded consensus as procedures rebounded faster than expected and its pipeline product launches are beginning to gain traction. The US$7.65b in revenue (down -1.5% organicically) surpassed consensus estimates of US$7.08b. Citi thinks the recovery across geographies and franchises bodes well for the coming quarters. Citi highlights: 1) transcatheter aortic valve replacement (TAVR) has tailwinds ahead, including an expanded US sales force, and the discontinuation of a competitor's program; 2) Spine is benefitting from expanded capabilities of the Mazor X robotic surgery system; and 3) a comprehensive FDA submission of MiniMed 780G and Zeus constant glucose monitor (CGM) is expected this quarter. BUY. (Published by Citi)

Takeda Pharmaceutical (4502.T) — Taking full control of domestic PDT subsidiary—price looks fair

Takeda has announced that it is taking full ownership of Nihon Pharmaceutical, a subsidiary that is a major player in the Japanese plasma derived therapies (PDT) market, via an equity swap. The aim of the move is to speed up management decision making. Citi thinks the firm will also look to launch new immunoglobulin products in the future. Takeda will issue 1.46m shares (¥5.3bn / NZD73m) and exchange these for 12.7% of Nihon Pharmaceutical's shares. BUY. (Published by Citi)

Tencent Holdings (700.HK) — Management meeting highlights mobile games and ads opportunities

UBS came away from its investor meeting with James Mitchell, Tencent's Chief Strategy Officer, more positive on mobile games and ads, and less concerned about recent regulatory news. While the mega trend of more regulation is clear, Tencent still sees plenty of opportunities for value creation in China Internet. The new anti-trust guidelines are also more focussed on transactional platforms. And while online media regulation may tighten in 1H21, Tencent believes any risks around gaming look manageable. On fintech regulation, Tencent noted that its business is mostly focused on payments, followed by wealth management, and its consumer lending is done through WeBank, which is already a licensed bank in China. BUY. (Published by UBS)

Calendar

Figure 3. Calendar

Date	New Zealand	Australia	International
30-Nov	ANZ Business Confidence (Nov) NBNZ Own Activity (Nov) Heartland Group AGM	Producer Price Index (3Q) Private Sector Credit (Oct) Housing Credit (Oct) Business Inventories (3Q) Company Gross Operating Profits (3Q) Private House Approvals (Oct)	CN: Manufacturing PMI (Nov) EU: ECB President Lagarde Speaks
1-Dec		RBA Interest Rate Decision (Dec) Building Approvals (Oct) Current Account (3Q)	US: Pending Home Sales (Oct) UK: Manufacturing PMI (Nov) EU: Consumer Price Index (Nov) EU: German Manufacturing PMI (Nov) EU: German Unemployment Change (Nov) CN: Caixin Manufacturing PMI (Nov)
2-Dec	GlobalDairyTrade Price Index Terms of Trade Index (3Q)	RBA Governor Lowe Speaks RBA Chart Pack Release AIG Manufacturing Index GDP (3Q) ANZ Job Advertisements	US: Fed Chair Powell Testifies US: ISM Manufacturing PMI (Nov)
3-Dec	Building Consents (Oct) ANZ Commodity Price Index Scott Technology AGM	AIG Construction Index (Nov) Services PMI Trade Balance Home Loans	US: Crude Oil Inventories US: ADP Nonfarm Employment Change (Nov) UK: Composite PMI (Nov) UK: Services PMI (Nov) Microsoft AGM
4-Dec		AIG Construction Index (Oct) Retail Sales (Oct)	US: Initial Jobless Claims US: ISM Non-Manufacturing PMI (Nov) UK: Construction PMI (Nov)
5-Dec		AIG Services Index	US: Nonfarm Payrolls (Nov) US: Unemployment Rate (Nov)

Source: Forsyth Barr analysis

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