

Wealth Weekly

Australia — The Land of Opportunity

WEALTH MANAGEMENT RESEARCH

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As we near the tail end of the earnings reporting season in the US and Europe, things are set to pick up closer to home. Australian reporting season has kicked off and over the next month many companies on our watch list will deliver results. Inside we've highlighted our eight top picks among Aussie equities currently.

Aussie favourites

The backdrop for Australian equities remains buoyant following the Reserve Bank of Australia's (RBA) announcement that it will extend its quantitative easing (government bond-buying) programme by a further A\$100b. This continuation of loose monetary policy, despite the economy and corporate profits suggesting less might be needed, bodes well for Australian equities.

On page 2 we profile eight quality ASX-listed companies that, in our view, offer good value at current prices: Amcor, APA Group, Coles, CSL, Lendlease, Qube, Ramsay Healthcare and Telstra.

Themes of the week

In New Zealand, 39 of the companies we cover are expected to announce earnings over the next two months. We are forecasting that on average they will report subdued revenue and earnings growth (and flat dividends), although we see upside risk to near-term estimates for a handful of the companies.

This week we raised our earnings estimates and target price for Mainfreight. The freight forwarding company is a high quality growth story with an enviable track record and a significant opportunity to expand its presence further in global freight and logistics markets given its competitive advantage. These attractive features aren't missed by the market. It has enjoyed strong share price performance over an extended period of time, driven by a combination of a rising valuation and earnings growth. But at a price of ~33x one year forward earnings, Mainfreight is trading ahead of its key global freight peers and is now broadly on par with the (expensive) domestic market. As a result, **the pace of share price momentum may slow down, and further price upside is likely to rely more on earnings growth**, in our opinion. Mainfreight's forward looking earnings growth rate is more attractive than that of the domestic market.

Macroeconomic policy settings are in the news this week, with the Finance Minister saying the government deficit is on a healthier path than expected, according to Treasury estimates. We'll have to wait and see what that means for policy. He indicated there would be funding and policies to promote housebuilding while reducing the speculative fervour in the housing market. The Reserve Bank (RBNZ) also on Tuesday reinstated some limits on the volume of bank lending to borrowers with high loan-to-value ratios (LVR) from March. **The RBNZ's next policy statement on 24 February will be keenly awaited** as market participants look for signs the central bank might be starting to think about raising the official cash rate. For now most commentators expect the OCR to remain very low for a while yet as central banks the world over remain more focussed on battling economic risks from the pandemic than on fighting the potential for consumer price inflation.

Looking ahead

Australian companies reporting results this week include James Hardie, Commonwealth Bank, AGL Energy, Telstra and Transurban. Further afield, it'll be worth looking out for announcements from Fiserv, Coca-Cola, L'Oréal, AstraZeneca, Schneider Electric, Walt Disney and ING Group. In China the Spring Festival gets underway with a week long public holiday starting on Thursday, while Hong Kong will be closed on Friday and next Monday (as will the US next Monday for Washington's Birthday).

Australian Equities

Top Australian Stock Ideas Pre Reporting

Below we outline the investment cases for our current eight top Australian stock ideas. This group of eight stocks has underperformed the SPDR S&P/ASX 50 fund by -4.5% since 30 November 2020. We think the major financial sector companies, which dominate the ASX 50 index, still face headwinds in the future, and we believe these eight stocks ideas should outperform over the long-term.

Amcor (AMC.AX) is a global packaging company which develops and produces flexible packaging, rigid containers, specialty cartons and closures for a range of end markets. We are attracted to the relatively defensive nature of AMC's business and end markets. Should the company deliver on its targets for modest organic volume growth, cost synergies from the integration of Bemis, and accretive stock buybacks, we expect a c.+6% pa earnings growth rate and a sustainable c.4.5% dividend yield over the next three years.

APA Group (APA.AX) owns and operates gas transmission, storage and generation infrastructure across Australia. APA offers an attractive mix of growth (driven by +5% pa increases in gas volumes) and defensive income (backed by contracts with large companies and by regulation) which support its high level of net debt. APA also has a strong track record of growing distributions and has not cut its dividend since listing in 2000. We also think APA can realise interest savings when it refinances some debt over the next three years.

Coles (COL.AX), the supermarket operator, is a relatively defensive and highly cash-generative business. The outlook is positive for supermarkets going forward, and expectation is for COL to exit COVID-19 in a structurally stronger position, with lockdowns accelerating the move to online shopping. COL has partnered with UK supermarket robotics specialist Ocado to automate its fulfillment. Cost-out, elevated demand and a gradual reversal of COVID-19 costs underpin a high single-digit rate of growth in COL's earnings.

CSL (CSL.AX), which harvests and processes plasma from donors and produces vaccines, continues to experience strong demand for its immunoglobulin (IG) products globally and particularly in the US, where prices are high, and CSL continues to take market share as competitors remain supply constrained. China and Asia also buy high volumes of CSL's lower grade products, a segment that CSL aims to grow further. Favourable news flow around CSL112 and plasma collections returning to pre COVID-19 levels could act as re-rating catalysts for the shares. CSL has historically delivered consistent double-digit EPS growth.

Lendlease (LLC.AX) designs, develops and manages property in the gateway cities of Australia, Asia, Europe and America. LLC plans to simplify its operations and focus on core competencies and recurring earnings. The company targets opportunities underpinned by urbanisation, funds growth, ageing populations, sustainability and technology. We believe LLC's growing urban regeneration pipeline and the funds management business should drive earnings growth and increase earnings visibility over the medium-term.

Qube (QUB.AX) is Australia's largest vertically integrated provider of import and export logistics services, covering port-side operations to long-haul logistics services. QUB has a strategic position in New South Wales following the Patrick Terminal purchase in 2016 and the more recently acquired 99-year lease at Moorebank (which may be monetised via a strategic partnership). While management expects generally weaker conditions through FY21, recent data points have been ahead of expectations, and QUB is well positioned in key markets for when volumes do recover.

Ramsay Health Care (RHC.AX) operates health care facilities across Australia, France, the United Kingdom, Sweden, Norway, Denmark, Germany, Italy, Malaysia, Indonesia and Hong Kong. COVID-19 has resulted in a backlog of elective surgeries. As a result, higher hospital utilisation over the coming 12 months should boost RHC's profitability. We also expect there to be some medium-term gains from hospital consolidation and productivity benefits.

Telstra (TLS.AX), the incumbent telecommunications service provider, has endured several years of stagnant revenue due to intense competition in the mobile market and margin pressure as customers switched to cheaper services following the launch of the National Broadband Network (NBN). We expect to see TLS's mobile earnings improve over the coming year as there are signs that competitors are behaving rationally and increasing mobile plan prices, and TLS's new 5G mobile network should eventually help generate higher revenue from increased data usage. We expect a positive step-change in profit growth by FY23. The potential privatisation of NBN could help to unlock value in TLS's InfraCo assets.

Themes of the Week

NZ Equities

Reporting Season

As the earnings reporting season in the US and Europe slowly winds down things are set to pick up closer to home, with **39 of the New Zealand companies we cover expected to announce results by the end of March**, most of them for the first half of fiscal-2021. Contact Energy will kick off with its report on Monday 15 February.

On average for these companies our analysts are forecasting just +1.1% median growth in revenue and operating earnings, and +1.5% earnings per share growth, while dividends are expected to be flat. However, our analysts expect the risk to near term forecast earnings is leaning more to the upside than the downside.

We have canvassed our analysts for their qualitative view on the risk to forecast earnings and the potential that near term estimates are upgraded or downgraded. **Companies for which the analysts signalled a positive bias include: Briscoe Group (BGP), Freightways (FRE), Michael Hill Intl (MHJ) and The Warehouse Group (WHS)**, with Fletcher Building (FBU) and Steel & Tube (STU) signalled as slightly positive.

In contrast, **our analysts have signalled a negative bias for near term estimates for NZ King Salmon (NZK)**, and slightly negative for Auckland Airport (AIA) and Air New Zealand (AIR).

Mainfreight (MFT.NZ) – 100 Year Company En Route to NZ\$100

We made minor changes to our earnings forecasts for MFT to reflect a stronger NZ dollar and higher constant currency sales growth in key markets. Our target price has increased from NZ\$62 to \$70 (the stock is trading around \$68).

MFT's strategic drive to increase the proportion of its business that is exposed to "everyday freight" provides numerous operational and financial benefits, including lower earnings volatility than more cyclical peers. That has in turn led to the stock being less volatile relative to the market than its larger international freight and logistics competitors — most of which were negatively impacted by government restrictions while MFT, helped by geographic diversification, maintained its earnings growth momentum.

At its current price:earnings (P/E) multiple of ~33x next year's earnings, MFT's valuation has more than doubled from around 15x over the past four years. We believe its re-rating has been driven by a number of factors:

- An increasingly consistent earnings growth track record
- Consensus earnings upgrades
- More apparent defensive characteristics
- A falling cost of capital
- A scarcity premium.

Management has a history of setting itself challenging targets, as outlined in each MFT annual report. A share price of NZ\$100 may have been considered challenging several years ago, but now it's within the realms of possibilities. Assuming historical average EPS growth (+12% pa) can be maintained, and MFT is able to sustain its current forward P/E multiple, then a share price of NZ\$100 is possible within the next 3–4 years, on our calculations.

Fixed Interest

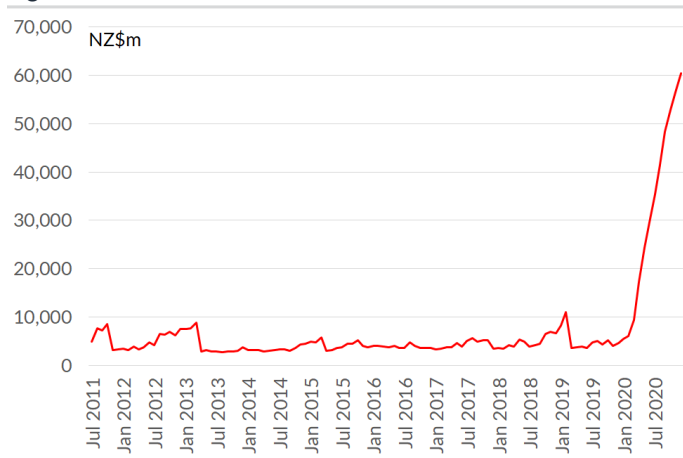
QE and the markets linked forever?

The local market quietly awaits the Reserve Bank of New Zealand's first Monetary Policy Statement on 24 February after digesting a number of other key central bank announcements. Notably our friends across the ditch, the Reserve Bank of Australia (RBA), added a further A\$100b of stimulus to begin when the current bond-buying programme runs out. The RBA will buy around A\$5b of government bonds per week, indicating the concerns that the RBA harbours about the Australian economy. The RBA also said that its current 0.10% Cash Rate would be pinned to the floor until 2024.

Those in New Zealand who believe there is a chance the Official Cash Rate (OCR) could rise are certainly outliers, although the Bank of England (BOE) stated that inflation could well be back within target before too long and it could be time to start thinking about how unwinding quantitative easing (QE) would look. The BOE's QE programme is a mammoth £895b!

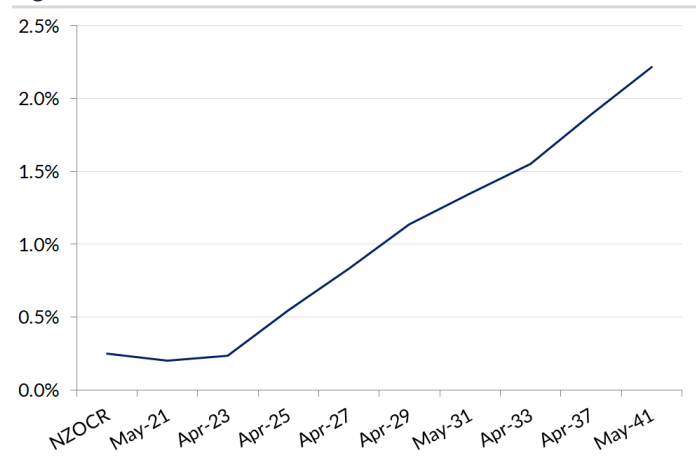
Unwinding QE will be an extremely delicate process. Whilst signaling the end of any QE programme is good news (meaning the economy no longer requires help), the markets – which are now fully addicted to cheap money – will need to be weaned off slowly.

Figure 1. RBNZ balance sheet



Source: Forsyth Barr analysis, total local currency financial assets

Figure 2. New Zealand Government bond curve



Source: Forsyth Barr analysis, Refinitiv

Research Worth Reading

New Zealand

Fixed Income Monthly – Central Banks to Play a Big Part Again in 2021

In 2020 central banks around the globe kicked into action to try and offset the economic woes caused by COVID-19. After a decade of trying to create inflation, there is a chance that as a result of central bank policies over the last year, inflation may actually have been created. If so, this will make central bank decisions even more difficult given the reluctance to raise interest rates. But the ongoing pandemic and the removal of supportive schemes, such as wage subsidies, is likely to see central banks continue to play a pivotal part in economies in 2021. New Zealand fixed income investors face an interesting year, with a new regime around bank capital securities coming into force from 1 July, which will incentivise banks to redeem existing securities (ANBHB, KCFHA, ABB050 and BNZ090) if the Reserve Bank permits. Will we see new issuance to help absorb the proceeds? Or will it (in the absence of worthwhile term deposit rates) result in upward price pressure on an already expensive NZ bond market? (Published by Forsyth Barr)

Power Points – Volatile Start to 2021 – February 2021

2021 has started with a bang, with huge ETF-induced share price movements, Rio Tinto (RIO.AX) announcing NZAS will stay open for longer, the Climate Change Commission (CCC) releasing its draft report, a flurry of quarterly reports and hydro conditions starting to tighten. 2021 is set to be an eventful year, with ETF influence likely to continue and the CCC finalising its report in May 2021 before the politicians have their say at the end of the year. And who knows what will happen with hydrology. We continue to prefer Genesis Energy (GNE) as it offers good value, a good dividend yield and we believe its decarbonisation strategy will pay off in time. At the other end of the spectrum, Mercury (MCY) and Meridian (MEL) remain expensive. (Published by Forsyth Barr)

Australia

Amtor (AMC.AX) – Rinse, repeat, upgrade to Buy

AMC has delivered a solid 1H21 result with constant currency EPS growth of +16%. The EPS growth was largely underpinned by organic growth (+8%), Bemis merger synergies (+6%), lower interest (+5%) and share buy-back accretion (+4%), offset by higher corporate/tax costs (-5%) and raw material inflation (-2%). The organic growth was achieved on volume growth of +3%, with Flexibles up +2% and Rigids up +6%, with North American Beverage volumes up +9% on a very strong hot-fill performance. UBS is attracted to AMC's leading position across key global consumer packaging markets. The defensive nature of these markets is clearly supporting AMC's earnings base and cash flows despite COVID-19 related uncertainty. UBS thinks this earnings resiliency and growth outlook, combined with a solid dividend yield of c.4% should support the stock. BUY. (Published by UBS)

Charter Hall Long WALE REIT (CLW.AX) – 1H21 Results: Secure income with guidance/asset value upside

CLW's 1H21 EPS came in at A14.5c, +1.4% ahead of Citi and consensus. Despite the 1H beat and recent accretive transaction activity, FY21 guidance was left unchanged at "no less than A29.1c", but Citi still sees upside. Key takeaways – (1) limited Covid impact; (2) asset values rise with potential for further upside; (3) upside to guidance. Citi remains Buy-rated on CLW given a c.6.5% FY22E dividend yield (the highest among Citi's real estate investment trusts coverage), low risk and predictable earnings, and upside to guidance/asset values. With a relatively unique portfolio, read-throughs for the rest of the sector are limited. However, the strength in asset values should support growth in funds under management. BUY. (Published by Citi)

CSL (CSL.AX) – Argenx trial update a potential risk for IG suppliers

Netherlands biotech company Argenx has announced it will continue to expand its ADHERE trial evaluating subcutaneous efgartigimod in CIDP (chronic inflammatory demyelinating polyneuropathy). This is positive for Argenx, and potentially negative for the current immunoglobulin suppliers. It is likely that Argenx's approach will work for myasthenia gravis, which will have a small impact on CSL if it occurs. Success in CIDP would have a larger impact of potentially displacing up to 3-9% of CSL's revenue, although at this stage this is not Citi's base case but it warrants further attention over the next 18 months. Argenx has indicated it will update the market with its quarterly results as the trial progresses. Citi made no change to its CSL earnings forecast. BUY. (Published by Citi)

International

Alibaba Group Holdings (BABA.K) – Invest to Grow TAM & Create Value for Consumers & Customers

BABA reported a solid FY3Q21 result with +37% growth in total revenues and +25% growth in net income. Management is committed to invest to grow bigger addressable markets and create value for its customers. The CEO reiterated three growth engines as consumption, technology capabilities and globalisation. Looking into FY2022, investment is likely to step up as the company is seeing good returns so far in new business initiatives. BABA noted Taobao Grocery will be unique and sees initial good results in selected pilot testing cities. BUY. (Published by Citi)

Alphabet (GOOGL.O) – 4Q Results Beat; Negative Cloud Margins Highlight Operating Leverage Opportunity

GOOGL reported 4Q20 revenues of US\$56.9 billion, +7% above Citi and consensus estimates. EBIT margins were 27.5%, well above Citi's 21.8% estimate and consensus at 22.4%. Google Cloud margins were -32% in 4Q20, an improvement from -35% in 3Q20. This represents a significant discount to Amazon's AWS margins of ~30%, and highlights the potential operating leverage in the business as Cloud continues to scale up. This is Citi's central thesis on GOOGL and why it is the analyst's favourite stock. BUY. (Published by Citi)

Amazon.com (AMZN.O) – 4Q Beat; 1Q Guide Above Street; Mr. Jassy New CEO

AMZN's revenues of US\$125.6b beat consensus by +5% and was above the high-end of the US\$112-\$121b guidance range. Operating income of US\$6.9b beat the consensus estimate of US\$4.7b, and was also above the high-end of the US\$1-\$4.5b guidance range. Starting in 3Q21, AMZN founder Jeff Bezos will transition to the role of Executive Chair, while Andrew Jassy will become CEO. BUY. (Published by Citi)

PayPal (PYPL.O) – Buy PYPL – “Power to the PYPL” Continues

4Q20 was the first quarter in which the annualised run rate of PayPal's quarterly Total Payment Volume (TPV) crossed US\$1 trillion. On top of this, the TPV growth outlook for FY21 is for "high-20%". Going into the quarter, Citi worried about the likelihood of muted margin growth – PYPL is looking for modest margin growth, the benefit of which was offset by the higher tax rate expected. PYPL is operating a big flywheel, with robust net new additions (for accounts) expected, as is greater engagement due to the flurry of product launches, and the secular growth tailwinds continue (i.e. digital commerce growth). So Citi again says “Power to the PYPL”. BUY. (Published by Citi)

Qualcomm (QCOM.O) – Bulk of 5G Upside Is Likely Over as Margin Guidance Misses. Downgrading to Neutral as We Expect More Bumps in the Road

QCOM posted variable results and guidance. Margin guidance was below consensus due to the product mix. Citi believes the 5G upside is over and is downgrading QCOM to Neutral and lowering its price target from US\$194 to \$165, as Citi expects more instances of downside as the year progresses. NEUTRAL. (Published by Citi)

Unilever (ULVR.L) – Step-up in BMI in H2 drives 3% EBIT miss

ULVR's Q4 underlying sales growth of +3.5% was bang in-line with consensus. Within this, volume growth of +3.3% was slightly ahead of consensus of +2.9%, whilst pricing came in at +0.2% vs. consensus of +0.6%. FY20 underlying EPS of €2.48 was broadly in-line with consensus as lower net finance costs and tax rate mitigated the lower than expected operating profit. Whilst ULVR did not provide formal 2021 guidance, it unveiled a new multi-year financial framework (which UBS believes will apply to 2021) and indicated that it "begin[s] the year in good shape". SELL. (Published by UBS)

Calendar

Figure 3. Calendar

| Date | New Zealand | Australia | International |
|--------|---|--|---|
| 8-Feb | Waitangi Day | | |
| 9-Feb | | NAB Business Confidence (Jan) Inflation Expectations James Hardie Group 3Q21 Suncorp 1H21 Challenger 1H21 Boral 1H21 | UK: BoE Gov Bailey Speaks EU: ECB President Lagarde Speaks |
| 10-Feb | Credit Card Spending | Westpac Consumer Sentiment (Feb) HIA New Home Sales Building Approvals Commonwealth Bank 1H21 Insurance Australia Group 1H21 | US: EIA Short-Term Energy Outlook US: JOLTs Job Openings (Dec) Cisco Systems 2Q21 Fiserv 4Q20 Heineken FY20 |
| 11-Feb | Electronic Card Retail Sales (Jan) | Westpac Consumer Sentiment MI Inflation Expectations AGL Energy 1H21 AMP FY20 Telstra 1H21 Magellan Group 1H21 Transurban 1H21 Newcrest Mining 1H21 | CN: Spring Festival JP: National Day US: Core CPI (Jan) US: Crude Oil Inventories US: Federal Budget Coca-Cola 4Q20 CME Group 4Q20 IQVIA Holdings 4Q20 L'Oreal FY20 AstraZeneca 4Q20 Schneider Electric FY20 |
| 12-Feb | Business NZ PMI (Jan) Food Price Inflation (Jan) | | HK: Chinese New Year CN: Spring Festival US: Initial Jobless Claims US: Fed Monetary Policy Report UK: GDP (4Q) UK: Manufacturing Production (Dec) UK: Monthly GDP 3M/3M Change Walt Disney 1Q21 PepsiCo 4Q20 ING Groep 4Q20 |
| 13-Feb | CFTC NZD Speculative Net Positions | CFTC AUD Speculative Net Positions | |

Source: Forsyth Barr analysis

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