

Wealth Weekly

Vaccine, Stimulus, Earnings - What's Not to Like?

WEALTH MANAGEMENT RESEARCH

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Equity markets around the world continued to grind higher last week, supported by two weeks of falling COVID-19 case numbers, vaccine optimism, still low (but gently rising) interest rates, and hopes for even more fiscal stimulus in the US. Earnings season should have helped too, as 80% of major US companies and 74% of European firms that have reported quarterly results so far in this earnings season beat expectations – although in practice the share price responses on the day to beats and misses didn't always square with the direction of the earnings and guidance surprises.

Six international equity ideas

As international reporting season winds down, **we highlight six companies that have reported encouraging results and offer attractive valuations at current prices:**

- **Alibaba**, the Chinese ecommerce giant, delivered a solid 3Q21 result with total revenues ahead of expectations, and its cloud segment delivering positive operating earnings for the first time.
- **Amazon** posted strong 4Q20 results, with revenues and operating income well above consensus and the high-end of guidance.
- **Baxter International**, a maker of medical supplies, delivered a respectable 4Q20 result given pandemic headwinds to the number of elective medical procedures being undertaken.
- **Boston Scientific**, a medical device supplier which faced similar pandemic headwinds as Baxter, provided guidance for a return to healthy sales growth in 2021.
- **Ping An Insurance**, a Chinese insurance conglomerate, reported 4Q20 results that were largely in-line with market expectations and gave upbeat guidance.
- **Takeda Pharmaceuticals**, the largest pharmaceutical company in Asia and a significant player in the immunoglobulin market alongside Australia's CSL, reported a healthy profit increase despite lower sales.

Themes of the week

Over the last quarter of 2020, Meridian Energy and Contact Energy stocks significantly outperformed. We attributed this to rising demand for two exchange traded funds (ETFs) which track the S&P Global Clean Energy Index. The rising flow of cash into these ETFs led to the funds buying more Meridian and Contact shares. Their valuations rose, and we downgraded Meridian to UNDERPERFORM in November and Contact to NEUTRAL in January. Meridian's stock price has already lost -40% and Contact's -33% from their respective peaks in early January. **S&P Global, the index provider, on Friday confirmed changes to the index methodology, which we expect will result in the ETFs selling Meridian and Contact shares** in volumes equating to c.49–57 days of normal trading. Contact yesterday reported a solid result, and also announced a \$400m capital raising to pay for its Tauhara geothermal development – a shot across the bow of competitors who may be tempted to go ahead with their own developments. **Contact (which we upgraded to OUTPERFORM today) now offers good fundamental upside, although in the short-term the index change may provide more buying opportunities.** Genesis Energy is also one of our preferred stocks in the sector. We continue to regard Meridian as expensive.

The last 12 months have been challenging for The a2 Milk Company, with recent earnings pressure surprising investors and denting confidence. Findings from our second survey of infant formula customers in China provide confidence that **the a2 brand continues to rank well with Chinese consumers** and reinforced the runway of opportunity still available to a2.

Looking ahead

The focus will again be on company earnings this week, with **EBOS, NZX, Skellerup** and **SKYCITY** the ones to watch on this side of the Tasman and **BHP, Coles, Rio Tinto, Treasury Wine Estates, Westpac, ANZ, CSL, Cleanaway** and **Goodman Group** in Australia. Further afield, **Kering (Gucci), Nestlé, Applied Materials** and **Deere & Co** will report their results.

International Equity Ideas

Post-reporting review

Alibaba (BABA.K) delivered a **solid 3Q21 result with total revenues ahead of expectations, and its cloud segment delivering positive EBITA for the first time.**

BABA is increasing investments in strategic areas and new businesses to capture opportunities in live streaming and groceries. While this investment may dampen earnings growth in the near-term, it will allow BABA to drive user acquisition and engagement in lower tier cities to compete with other ecommerce players such as Pinduoduo. We expect BABA will continue to benefit from accelerated user and merchant adoption of ecommerce, online grocery shopping, cloud computing and remote-work applications driven by the COVID-19 epidemic. Longer-term sales and profit growth is expected to be driven by global expansion and the monetisation of newer business segments such as advertising, logistics, media and entertainment.

Amazon (AMZN.O) posted **strong 4Q20 results, with revenues and operating income well above consensus and the high-end of guidance.**

AMZN guided to 1Q21 revenue being ahead of expectations, but the mid-point of EBIT guidance was below forecasts. The big news was that starting in 3Q21, Jeff Bezos will transition to the role of Executive Chair, while Andy Jassy (CEO of Amazon Web Services) will become CEO. We expect Mr Jassy will continue AMZN's key strategy of putting the consumer first, while Mr Bezos will remain heavily involved in the company. Earnings growth may slow as AMZN cycles the pandemic tailwinds for ecommerce from mid-2020 and makes investments into long term initiatives. However, the long term run-way for growth remains significant, given US ecommerce still represents only c.20% of total US retail sales, and it is estimated that only c.15% of corporate workloads are on the cloud. AMZN has significant optionality in secular growth trends such as ecommerce, cloud computing, media consumption, digital advertising and artificial intelligence assistants.

Baxter International (BAX) delivered a **respectable 4Q20 result given pandemic headwinds**, with sales up +2% for both 4Q20 and FY20 versus the corresponding periods in 2019. The key COVID-19 impact on BAX's short term performance has been the drop in demand for elective surgery, and increased COVID-19 related operating costs; these factors led to BAX's FY20 reported EPS declining -7% from a year earlier.

Company guidance was for a return to double-digit EPS growth in FY21 on modest organic sales growth of around +4-5%. In our view, Baxter is well positioned to benefit from a recovery in elective surgery and ongoing product enhancements, particularly with respect to its leading market position in monitoring and treating chronic kidney disease.

Boston Scientific's (BSX) 4Q earnings were largely known after the company pre-announced the results on 12 January, so the focus in the formal 4Q release was the 2021 guidance. In 2021 BSX expects to return to growth in excess of the MedTech sector average, guiding to organic revenue growth of +12-18% YoY.

BSX remains a COVID-19 recovery play in the MedTech space. BSX has demonstrated the ability to grow at above-market rates, and with a pipeline of new products and recent approvals, appears well placed to return to this growth trajectory as the pandemic subsides.

Ping An Insurance (2318.HK) reported **4Q20 results that were largely in-line with market expectations.**

There was an upbeat outlook for 2021, which is encouraging. Over the past decade Ping An has spent ~US\$7b on technology innovations, and is expected to spend another ~US\$15b over the next decade. Ping An is leveraging the investment across five key technologies: i) Cloud; ii) Artificial Intelligence; iii) Big Data; iv) Blockchain; and v) Biometrics (e.g. voice and facial recognition aps). We believe Ping An is poised for a re-rating given its favourable technology growth opportunities, whilst its large distribution network positions it well to capture growth in China's insurance market.

Takeda Pharmaceuticals (4502.T) is one of the world's largest pharmaceutical companies. Over the 3Q21 period, **despite a -2.6% decline in sales, core operating profit increased by +9%**, which provided management with the confidence to maintain its upbeat guidance for a return to positive sales growth heading into FY22. Takeda, like its Western Big Pharma peers, continues to trade on undemanding fundamentals.

Themes of the Week

NZ Equities

Electricity Sector – Index Weighting Changes Confirmed

S&P Global, a provider of stock market indices, has confirmed changes to the Global Clean Energy Index (GCEI) that will result in significant selling of Contact Energy (CEN) and Meridian Energy (MEL) shares by the iShares Global Clean Energy ETFs (ICLN.O and INRG.L), which track the GCEI index. The key change will be the inclusion of a liquidity measure, which will cap levels of CEN and MEL in the index (and therefore in the ETFs) at levels much lower than their current weightings.

These ETFs together now hold around 10% of CEN shares and 4% of MEL. The magnitude of changes in weightings will become clearer on the 19 March reference date for the index calculation, but for now we estimate the two ETFs will be forced to sell ~79m MEL shares (~6.3% of free float) and ~55m CEN shares (~7.7% of free float). The index changes will come into effect on Friday 16 April.

Whilst the market has already started to prepare for this significant adjustment, the short-term share price risk for CEN and MEL remains to the downside.

We do not expect Mercury (MCY) to enter the GCEI – whilst it meets the "clean energy" requirements, it is not liquid enough, and the liquidity measure to enter the GCEI has just got tougher. Genesis Energy (GNE) does not meet the "clean energy" threshold, although as it shifts away from coal and gas generation over the coming decade it could eventually become eligible.

Further analysis of the GCEI and the ETFs that track the GCEI can be found in our note, [ETFs Trumped Fundamentals, Temporarily](#), published 12 February 2021.

The A2 Milk Company (ATM) – Proprietary Channel Checking in China

The a2 Milk Company has had a tough 12 months, with the pandemic throwing a wrench into the ability of the informal/grey-market supply chain channels ("daigou") to get a2 infant formula into its biggest market (China). Those channels provide very limited visibility for management and investors. To help gain some clarity on the state of that market, we recently conducted the second iteration of our proprietary survey of 101 consumers on the ground in China. The results provide some confidence that ATM's brand and New Zealand as the source country are perceived favourably by Chinese consumers:

- **a2 ranked fourth among brands in our survey on brand choice** (up from fifth in our October 2020 survey), supported by a #3 rank for quality perception.
- Awareness of a2 was 41%, which reinforced that **there is still potential to grow by building brand awareness**.
- **Consumers believe the daigou import channel will recover**, but unlikely to pre COVID-19 levels. This aligns with our expectation of and ATM forecasts for a gradual recovery in the daigou channel to 70% of pre COVID-19 levels by FY24E.
- **Consumers continue to prefer foreign-sourced product, and New Zealand remains the highest ranked country** (by a wide margin) with respect to quality perceptions for infant formula.

The path forward for a2 is unlikely to be smooth and it will take time to rebuild investor confidence. That aside, our channel checks demonstrate ATM's positive brand health metrics and end consumer demand in China. Our rating of ATM remains OUTPERFORM.

Australian Equities

James Hardie (JHX.AX) – 3Q21 result review

Building materials producer JHX delivered a strong 3Q21 result that was well ahead of expectations, with global net sales up +20% yoy. JHX delivered volume growth of between +9% and +19% and market share gains across all its regional markets. Net profit of US\$123.3m was up +59% yoy and well above consensus of US\$106.2m. The beat was largely driven by a stronger than expected EBIT margin in the North America division. The result was helped by a strong backdrop of rising house construction as well as impressive operational performance. Results for Asia Pacific Fiber Cement and Europe Building Products were broadly in line with expectations. The company paid down debt during the quarter and declared a special dividend of US\$0.70 per share, given strong cash flow generation during the period. JHX expects ordinary dividends to be reinstated in FY22, beginning 1H22.

Management lifted FY21 NPAT guidance from a range of US\$380–420m to US\$440–450m (+7% at the top end of the range). Transport costs have been rising, and pulp prices have begun to tick up, but this probably won't show in JHX's performance until FY22. Management sounded very optimistic about new products coming to market in May and about the company's strategy of increasing direct marketing to consumers. New capex guidance for FY22–24 of US\$250m per year suggests the company will continue to add capacity.

All in all, JHX delivered a very solid result and EPS forecasts have been revised +1–2% higher, but shares had run hard into the result, so the price reaction on the day was muted. Ongoing fiscal and monetary stimulus policy initiatives and low borrowing costs should help sustain the strong construction demand backdrop for JHX's building materials. Unlike many of the peers in its sector, JHX stands out for its ability to steadily grow earnings over time and through cycles. The 3Q21 result highlighted this and the outlook remains positive, with new products on track for May 2021 which are expected to support further growth. **JHX remains one of our preferred Australian stocks, but we recommend holding it at a low portfolio weighting given its high valuation.**

Telstra (TLS.AX) – 1H21 result review

Australian telco **TLS's 1H21 numbers were a bit soft, but management reiterated full year EBITDA guidance** (with the range narrowed to A\$6.6–6.9b), implying a strong second half of the fiscal year. 1H21 Mobile EBITDA declined -6.8% vs pc, but this was a sequential improvement on the -11.6% decline in 2H20, indicating the earnings recovery is underway. The dividend was confirmed at 8cps and 16cps for the full year. The big positive was TLS's target for FY22 underlying EBITDA to grow by 'mid to high single' digits from a low base. TLS also raised cost reduction targets and cashflow guidance.

Confirmation of the full year dividend and of growth in FY22 EBITDA should put concerns about dividend sustainability to rest. **We believe the stock is substantially undervalued and that new investors will be attracted to the shares as they get increasing comfort that earnings are on the cusp of growth.** Additionally, the potential privatisation of the NBN (Australia's broadband fibre network) could help to unlock value in TLS's InfraCo assets.

Research Worth Reading

New Zealand

EBOS Group (EBO) – 1H21 Preview – Looking For A Strong Delivery

We expect EBO to report a strong 1H21 result on Wednesday 17 February, with growth across the portfolio, following on from a buoyant 1Q21. Animal Care will likely be the key highlight; a beneficiary of increased pet ownership, helped by consumer 'nesting'. While we expect it to be largely business as usual at a headline level, weekly/monthly trading has likely been more volatile than usual given COVID-19 and fluid government restrictions. EBO's portfolio and core product exposures are defensive and well positioned in the current backdrop. Key focus areas in the result will be: 1) outlook/trading insights, 2) balance sheet and M&A update – with material headroom available. **OUTPERFORM.** (Published by Forsyth Barr)

Food for Thought – China Flexes its Mussels

China's suspension of imports from two seafood processing plants highlights existing market risk, however, at face value can be addressed through implementation of stricter COVID-19 protocols. Imports from Sanford's (SAN) Havelock mussel factory and a Sealord finfish processing plant have been suspended following scheduled video audits of the plants. The key takeaways for the listed New Zealand Food & Beverage sector, in our view, are that the use of virtual audits:

1. Lowers risk that Chinese registration lapses given border restrictions, and
2. Provides advance warning for food exporters of China's expectations and increasing scrutiny on quality and safety.

We understand the companies under our coverage are able to adapt to stronger COVID-19 protocols relatively quickly, if required, albeit this likely brings some productivity/cost ramifications. (Published by Forsyth Barr)

Kathmandu Holdings (KMD) – A Tale of Two Brands

KMD provided a 1H21 trading update in-line with expectations, with the seasonally important Rip Curl delivering strong growth and offsetting travel-linked weakness in the Kathmandu segment. The company issued 1H21 EBITDA guidance of NZ\$47m–NZ\$49m (pre-IFRS16), which we estimate is broadly consistent with our post-IFRS16 estimate of NZ\$79m. Outlook commentary was positive, highlighting strong forward wholesale order books for both Rip Curl and Oboz, and we believe KMD is well positioned for a strong 2H21. KMD will report its 1H21 result on 23 March 2021. **OUTPERFORM.** (Published by Forsyth Barr)

Real Estate Reflections – Themes for 2021

The listed property vehicles (LPVs) were up +4.4% in 2020, but down -0.3% in January 2021. Taken at face value, these muted outcomes do not tell the story of the winners and losers of 2020 due to shifts in sentiment across the different property sub-sectors. With defensive assets coming into favour in times of stress, paired with ever-low interest rates, the LPV sector is starting 2021 from a high base. We believe that rising bond yields are a potential headwind for direct and listed property valuations, and for earnings growth due to higher interest costs. On the positive side, better than expected monetary and fiscal support should underpin property fundamentals in the near-term, and strong asset pricing provides an opportunity for LPVs to undertake strategic portfolio initiatives. (Published by Forsyth Barr)

Australia

Macquarie Group (MQG.AX) – Operational briefing

The third quarter of FY21 was a standout period for MQG, driven by very strong conditions in the Commodities & Global Markets division and an improvement in realisation gains for Macquarie Capital. Updated guidance for FY21 group net profit to be slightly below the level achieved in FY20 was well ahead of Ord Minnett's previous forecast, driving a +16% upgrade to Ords' forecast. Ord Minnett is reluctant to capitalise such a strong quarter across the forecast horizon and, as such, its already above-consensus FY22 and FY23 estimates have lifted by just +2–3%. Management's presentations provide more confidence in the medium-term growth outlook, and Ord Minnett remains upbeat on MQG's ability to deliver across the key focus areas of infrastructure, renewable investments, technology, and Australian mortgages. ACCUMULATE. (Published by Ord Minnett)

Treasury Wine Estates (TWE.AX) – Debating The Reallocation Timeline And Impact

The focus during 1H21e results is likely to be on strategy and timeline for reallocating wines it typically sold in China (following China's imposition of punitive tariffs on wine imports from Australia). Despite the drop off in China demand, some sales could still continue for TWE. Individual Chinese residents may buy wine through cross-border e-commerce. Also, wines over 2L/bulk wine are exempt from the tariffs. There is some evidence of re-routing of wine to Hong Kong, where December 2020 exports were up +58% in value. While the 1H21e result may be better, Citi expects lack of clarity about wine reallocation until later in 2021. SELL. (Published by Citi)

International

Alphabet (GOOGL.O) – Street Estimates Seem Too High, But We Remain Bullish

While COVID-19 has accelerated the migration to digital advertising, consensus estimates for the next three years seem too high to Citi. However, even with Citi's more conservative estimates, the GOOGL valuation seems compelling in both absolute terms and relative to history. As such, Citi has maintained its BUY rating and raised its target price to US\$2,415. But, given the risk of downward estimate revisions, Alphabet is no longer Citi's top pick in the sector (Amazon ranks higher, along with some small/mid-caps). BUY. (Published by Citi)

IQVIA Holdings (IQV.N) – 4Q20 Recap: Healthy FY21 Guidance Raise Still Has Upside – Momentum Set to Continue

Contract research organisation IQV raised FY21 revenue growth guidance at the midpoint to +12% y/y from ~11% y/y. Following a strong 4Q beat (+6% above the midpoint of guidance), Citi views IQV's FY21 y/y revenue growth guidance as conservative, particularly given the acceleration in 4Q20 and the inclusion of an incremental 100bps of currency tailwinds. While COVID-19 related real world evidence work drove the majority of the 4Q beat, Citi views continued strength in COVID-19 work, along with double-digit backlog growth in areas such as oncology, central nervous system, etc., as positive for the rest of the contract research organisation space in 2021. Citi continues to favour IQV, seeing room for upward estimate revisions along with multiple expansion in 2021. BUY. (Published by Citi)

PayPal (PYPL.O) – “Power to the PYPL” – Five Years, Fifty Billion Dollars

Growth at scale is a wonderful thing. PYPL's 2025 targets are:

- US\$2.8t in total payment volume (TPV)
- US\$50b in revenues
- US\$10b in free cashflow.

As a reference, the just-delivered 2020 numbers are \$936b in TPV, \$21.5b in revenues and \$5b in free cashflow. This may seem like a mountain to climb, with a number of questions about the source of account additions, consumer and merchant engagement, new product penetration, competition in newer product lines and so on. But Citi continues to believe post-2021 acceleration can safely get the company to its goals. Citi believes the “big flywheel” effect continues. BUY. (Published by Citi)

Calendar

Figure 1. Calendar

Date	New Zealand	Australia	International
15-Feb	Contact Energy 1H21	GPT Group FY20	CN: Spring Festival JP: GDP (Q4)
16-Feb	External Migration & Visitors (Dec) Permanent/Long-Term Migration (Dec) Infratil Investor Day	HIA New Home Sales RBA Meeting Minutes Ansell 1H21 BHP Group 1H21 Brambles 1H21 National Australia Bank 1Q21	US: Presidents' Day CN: Spring Festival HK: New Year's Day EU: German ZEW Economic Sentiment (Feb)
17-Feb	GlobalDairyTrade Price Index Ebos Group 1H21 Fletcher Building 1H21 NZX FY20	MI Leading Index RBA Govt Kent Speaks Carsales.com 1H21 Charter Hall Group 1H21 Coles Group 1H21 Rio Tinto FY20 Saracen Mineral Holdings 1H21 Treasury Wine Estates 1H21 Webjet 1H21 Westpac Banking Corp 1Q21	CN: Spring Festival UK: CPI (Jan) EU: ECB Monetary Policy Statement American Water Works 4Q20 Kering FY20 Zoetis 4Q20
18-Feb	RBNZ Offshore Holdings (Jan) Auckland International Airport 1H21 Refining NZ FY20 Skellerup 1H21 SkyCity Entertainment 1H21	Employment Change (Jan) Full Employment Change (Jan) Participation Rate (Jan) Unemployment Rate (Jan) ANZ Banking Group 1Q21 CSL 1H21 Origin Energy 1H21 Orora 1H21 OZ Minerals FY20 Santos FY20 Seven Group Holdings 1H21 Sonic Healthcare 1H21 South32 1H21 Wesfarmers 1H21 Woodside Petroleum FY20	US: Core Retail Sales (Jan) US: PPI (Jan) US: Retail Sales (Jan) US: FOMC Meeting Minutes Nestlé FY20
19-Feb	PPI Input & Output (Q4)	Manufacturing PMI Series PMI Retail Sales (Jan) Wage Price Index Cleanaway Waste Management 1H21 Cochlear 1H21 Goodman Group 1H21	US: Building Permits (Jan) US: Initial Jobless Claims US: Philadelphia Fed Manufacturing Index (Feb) US: Crude Oil Inventories UK: Retail Sales (Jan) UK: Composite PMI UK: Manufacturing PMI UK: Services PMI EU: German Manufacturing PMI (Feb) Allianz FY20 Applied Materials 1Q21
20-Feb	CFTC NZD Speculative net positions	CFTC AUD Speculative net positions	US: Existing Home Sales (Jan) Deere & Co 1Q21

Source: Forsyth Barr analysis

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