

Wealth Weekly

Australian Equity Shopping List

WEALTH MANAGEMENT RESEARCH

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Overseas equity markets soared last week on hopes the pandemic is coming under control, there is an end in sight for lockdowns, and continued support from central banks and governments. Oil prices got a lift in anticipation of an agreement by OPEC and its co-conspirators to cut production, but the cuts announced at the weekend weren't enough to excite investors (not even Trump's hopeful tweeting helped this week) and prices have eased down again. The US earnings season begins this week and it will be interesting to hear what managers have to say about the outlook — and how markets react. We see value in pockets of Australian equities, and with the NZ dollar close to parity with the AUD we see it as a favourable time for NZ investors to allocate across the Tasman.

Australian equity shopping list

We reviewed 11 Australian companies over the past few weeks, looking for investment ideas with a quality bias and where we felt the companies had been oversold. Despite a rally in equity markets **Australian stocks in which we see value at current prices are Scentre Group, Lendlease, Sydney Airport, APA Group, Macquarie Group, James Hardie and Treasury Wine Estates.**

Central banks ready to resuscitate whenever markets graze their knees

Apparently negative interest rates weren't the last tool in central banks' tool boxes. **The US Federal Reserve last week stepped in to buy bonds of fallen angel companies with up to 10,000 employees** — essentially the top echelon of junk bonds. Central banks can do this because they can (electronically) "print" unlimited amounts of money with which to buy bonds or other assets.

What does this mean for investors? Financial markets are still involved in setting prices for individual securities relative to each other, but central banks are influencing the underlying valuation of whole asset classes. In the bond market, central banks have already set the real return for risk-free government bonds at below zero. They are now extending their reach into the credit markets, suppressing the risk premium that investors receive for lower-quality bonds and thereby also making it easier for companies to leverage up while reducing the risk of default. **Because the resulting higher valuations of bonds and credit reduce the opportunity cost of holding equities, these moves in the bond and credit markets also provide support for equity prices.**

US joins OPEC+ cartel in trying to raise oil prices

OPEC, Russia and even the US agreed over the weekend to cut oil production to try to support the oil price. Prices had already risen over the last two weeks in anticipation of an agreement, and have fallen since. **Oil traders believe the announced cuts are only about a third to half as much as would be needed to bring the oil supply into balance with current COVID-19 impacted demand.** In the medium-term, once pandemic containment measures ease and inventories are depleted, oil prices could eventually overshoot again in the upward direction. **In Australia, Origin Energy offers exposure to a rising oil price with a relatively solid balance sheet.**

The week ahead

Economic data will remain bleak this week, but the market already expects it. **The US earnings season kicked off with Wells Fargo and JPMorgan Chase reporting disappointing results late on Tuesday. Bank of America will report on Wednesday evening, and LVMH, L'Oreal and Schlumberger on Friday evening.** 1Q profits will be weak due to the pandemic and guidance (where provided) is likely to be depressing, but this should come as no surprise to the market. It won't be until the 2Q that we get a true picture of the COVID-19 impact.

Australian Equities – First XI

We have reviewed 11 Australian companies over the past few weeks, looking for investment ideas with a quality bias and where we felt the companies had been oversold (refer to Figure 1). Last week we saw a solid bounce in global equities, with the average return (post our review) for these 11 Australian companies being +13%. Despite the bounce, this group of 11 still has a projected average 3-year return of c.+20%pa. We have broken these 11 companies into 3 groups: I) Quality Stocks that we would prefer to buy at lower prices; II) Oversold Stocks that still look excellent value for risk; III) Quality Stocks that still look good value for risk.

I. Four Quality Stocks to target but at lower prices: CSL, Qube, Transurban & Seek

The market has clearly targeted long term, quality growth, over deep value, and four companies have seen their share price increase to a level that no-longer represents great value-for-risk, namely: **CSL, Qube, Transurban** and **Seek**. All four of these companies still represent good value but given the elevated level of market uncertainty, we would prefer to target these companies at lower prices.

II. Three severely oversold stocks still offer excellent value for risk: Scentre Group, Lendlease & Sydney Airport

Retail, property development and tourism have been sectors hit hard by COVID-19. In Australia we reviewed three quality companies that we felt had been severely oversold: **Scentre Group, Lendlease** and **Sydney Airport**. The timing and magnitude of the earnings recovery for these three companies is extremely difficult to predict, and there is a prospect they will need to raise equity and/or suspend dividends. However, pragmatically we expect each of these three companies to prove to be more resilient than implied by their current share prices, and we reiterate our buy recommendations at current prices.

III. Four stocks that still look good value: APA Group, Macquarie Group, James Hardie & Treasury Wines.

We feel each of the remaining stocks in Figure 1 still meets our quality bias due to their strong comparative advantages, which should allow them to emerge well post COVID-19, and at current prices they still offer good value for risk:

- **APA Group's** gas pipeline network should be very resilient in the short term and still offers attractive, medium term, growth prospects. Investors looking for safety plus income should consider APA for their portfolios.
- **Macquarie Group** looks the best pick amongst the Financials (including the four major banks), for its growth potential and resilience to the impact of COVID-19 on its business given a significant part of its business is represented by its Asset Management operations.
- **James Hardie** has shown time and again that it can resume growth following periods of adversity, and unlike its cyclical building sector peers, has continued to add shareholder wealth through cycles.
- **Treasury Wine Estates** is definitely at the riskier end of the spectrum given the current management/operational challenges in the US. However, wine sales should perform well in the COVID-19 lockdown period and we continue to like TWE's long term growth prospects.

Figure 1. First XI - Summary of fundamentals and forecast 3-year returns

Company	Review Date	Price Review Date	Recom at Review	Price 14Apr20	% chg since Review	Recom Today	FCST PE	3-yr ESP g	PEG	Eq Beta	Target 3-yr Return (pa)
APA Group	30Mar20	A\$9.73	BUY	A\$11.25	+15.6%	BUY	39.9x	+10.7%	3.7x	0.90	12.0%pa
CSL	30Mar20	A\$279.12	BUY	A\$327.16	+17.2%	BUY	39.9x	+13.2%	3.0x	0.80	6.1%pa
Qube	30Mar20	A\$2.17	BUY	A\$2.31	+6.5%	BUY	29.6x	+17.0%	1.7x	0.90	13.4%pa
Scentre Group	30Mar20	A\$1.51	BUY	A\$2.01	+32.8%	BUY	8.2x	+3.3%	2.5x	0.80	51.4%pa
Lendlease	1Apr20	A\$10.30	BUY	A\$11.45	+11.2%	BUY	9.2x	+11.0%	0.8x	1.00	35.0%pa
Macquarie Group	1Apr20	A\$85.75	BUY	A\$98.44	+14.8%	BUY	11.7x	+7.0%	1.7x	1.20	22.8%pa
James Hardie	6Apr20	A\$19.02	BUY	A\$19.77	+3.9%	BUY	14.8x	+11.0%	1.3x	1.00	21.1%pa
Sydney Airport	6Apr20	A\$5.14	BUY	A\$5.62	+9.3%	BUY	70.2x	+43.0%	1.6x	0.70	26.1%pa
Transurban	6Apr20	A\$11.12	BUY	A\$12.36	+11.2%	BUY	na	na	na	0.90	13.2%pa
Treasury Wines	6Apr20	A\$10.22	BUY	A\$10.68	+4.5%	BUY	17.8x	+19.0%	0.9x	1.10	26.1%pa
Seek	8Apr20	A\$15.35	BUY	A\$16.01	+4.3%	BUY	48.0x	+34.0%	1.4x	1.10	12.9%pa
Median					+11.2%		23.7x	+12.1%	2.0x	0.90	21.1%pa
Average					+11.9%		17.9x	+16.9%	1.1x		21.8%pa

Source: Forsyth Barr analysis

Themes of the Week

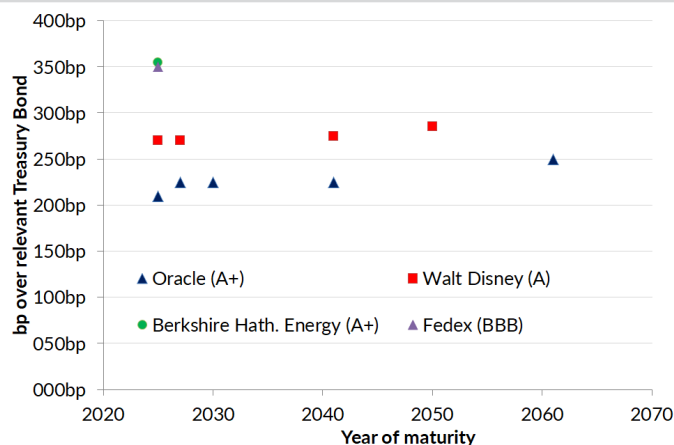
Fixed Interest

Nothing to see here, move along...

So much for capitalism! The US Federal Reserve announced last week that it will now buy investment grade and junk bonds, adding to its already massive array of securities it has purchased in order to support the markets. This sets a very dangerous precedent by not letting companies fail. The market pricing of risk may be almost non-existent when investors know that as soon as there are signs of any market turmoil, the Fed will step in and save just about everyone and everything. How is it that the S&P 500 posts its biggest weekly gain since 1974 in a week where an additional 6.6 million Americans joined the dole queue, making it 17 million in the past three weeks?!

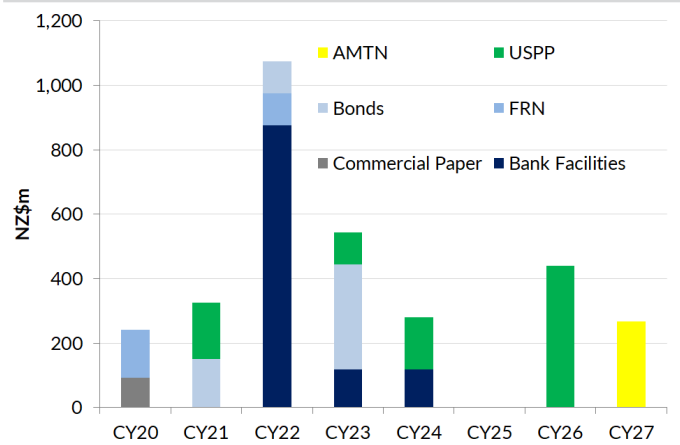
There was further good news for investors as they digested their chocolate eggs over the long weekend, with oil producers agreeing to an historic cut to production by 9.7m barrels per day. This is the single biggest output cut in history. So is everything all rosy now? One could argue that there are certainly some big positives for investors although we remain cautious given in the months ahead it will not be easy for economies and companies as a slow exit from the COVID-19 pandemic is likely. The credit markets appear to be working although US corporates appear to be doing particularly well, financing long-term debt at not much more additional cost than shorter-term debt (Figure 2). While the local banks have performed well in conjunction with the Reserve Bank of New Zealand (RBNZ) and the Government in supporting companies in these difficult times, not all companies will be saved and job losses will mount.

Figure 2. US corporate bond issuers not paying much extra for long-term debt



Source: Forsyth Barr analysis, Thomson Reuters

Figure 3. Auckland Airport debt maturity profile following bank facilities extension



Source: Forsyth Barr analysis, AIA Capital Raise presentation

New issuance and capital raises

Local markets remain stuck in a liquidity rut, making corporate bonds difficult to trade in some instances. The Local Government Funding Agency (LGFA) showed the market how it's done, raising NZ\$1.1bn at a margin of 78bp over swap last week. No doubt the fact the RBNZ is supporting this AA+ market is assisting investor confidence.

Corporate announcements have slowed after dividend cuts and COVID-19 updates were released relentlessly over the last couple of weeks. We have had a couple of capital raisings, with a few more expected in the coming weeks. While a capital raising can shore up a balance sheet, it is not always the panacea that one may assume. The Auckland International Airport (AIA) NZ\$1.2bn capital raise last week illustrated that, with AIA only able to utilise NZ\$500m to repay bank debt (Figure 3). AIA has NZ\$725m of retail bonds, which cannot be redeemed early and NZ\$702m of funding via the United States Private Placement (USPP) market, which AIA is still negotiating with in respect to its likely breach of debt covenants. Possible costs involved with its USPP lenders are not yet known. However, we know in the case of Fletcher Building (FBU), its USPP costs would have been in the order of NZ\$125m if it had chosen to redeem early. While the capital raise did certainly strengthen AIA's balance sheet and most likely its A- credit rating, it did not reduce its debt balance to help with covenants that require a certain amount of earnings (i.e. Debt to EBITDA).

Research Worth Reading

New Zealand

Infratil (IFT) – Trading Defensively, Mostly

IFT's COVID-19 trading update was largely as expected, highlighting the defensive characteristics of its portfolio, but also acknowledging the challenges facing Wellington Airport and RetireAustralia, in particular. However, the Vodafone commentary indicated it is facing greater short-term challenges than expected. We retain our OUTPERFORM rating as IFT is likely to be one of the more resilient stocks in the market and CDC provides potential upside. OUTPERFORM. (Published by Forsyth Barr)

Mainfreight (MFT) – Ready, Fire, Aim; Upgrade to OUTPERFORM

We upgrade MFT to OUTPERFORM from NEUTRAL given the opportunity to access a high quality New Zealand growth story with significant long term opportunities across its global platform, at a reasonable price. We acknowledge that MFT is exposed to cyclical risks, but these are often overstated by investors. The GFC showed that MFT (1) is adversely impacted by recessionary conditions, but not overly so given its focus on 'every day freight', and (2) that it can recover strongly. Near term challenges aside, MFT's competitive approach means share gains and cross-selling will remain key drivers. OUTPERFORM. (Published by Forsyth Barr)

Summerset Group (SUM) – Tracking Well Pre Lockdown

SUM has announced total sales of 141 retirement village units for the quarter to 31 March 2020, in line with 1Q19 levels, and SUM noted sales were maintained at normal levels. Although near-term uncertainties remain, including investor sentiment towards the sector given the COVID-19 outbreak and how long it will be until residential sales transact, sector share prices are back substantially and already factor in a highly negative outlook. We remain confident of the long term business model for SUM. OUTPERFORM. (Published by Forsyth Barr)

Ryman Healthcare (RYM) – Upgrade to OUTPERFORM

The recent significant pull back in the RYM share price is an opportunity to buy the market leader and a business that remains very well placed for medium to long term growth, given its needs-based portfolio and development expertise. Consistent with our sector view, we have reduced near-term earnings based on a scenario that assumes very soft conditions for sales of retirement units over the next six months, and no development activity, then a recovery over the following 18 to 24 months given the significant uncertainties that exist. OUTPERFORM. (Published by Forsyth Barr)

Australia

Australian Banks – APRA puts the heat on dividends

APRA has had a major re-think, writing directly to all banks instructing that it expects all discretionary capital distributions, particularly ordinary dividends, to be deferred or materially reduced. Executive bonuses are also to be curtailed. 1H20 dividends are to be linked to a robust stress test, with wide-ranging scenarios. APRA wants a forward looking view on capital requirements, using a robust stress test to inform these views. With little COVID-19 related credit quality data, APRA could adopt a wide range of possible scenarios. (Published by Citi).

Treasury Wine Estates (TWE.AX) TWE exploring a Penfolds de-merger: Interesting timing, but likely a positive long term in our view

UBS views TWE's decision to explore a demerger of Penfolds as positive, but was surprised by the timing given COVID-19 business challenges and CEO Michael Clarke leaving in ~3 months. That said, UBS believes a demerger would be value accretive, assuming no adverse impact to TWE's ability ex-Penfolds (Newco) to maintain points of distribution and customer demand without bundling/leveraging the Penfolds brand. Overall, UBS believes a potential demerger coupled with the US restructuring is positive for TWE. BUY. (Published by UBS).

Airports – Could cash flow become a concern for SYD?

Citi has conducted a scenario analysis to investigate (1) the potential cash burn for SYD if current conditions continue and (2) covenant pressure and the potential for SYD to raise equity to provide additional headroom. As things stand, Citi believes SYD has reasonable runway from a liquidity perspective. There is potential for cash flow covenants to be a point of concern in a scenario of a

prolonged period of travel restrictions (more than 6 months). SELL. (Forsyth Barr WMR has a positive view on SYD). (Published by Citi).

CSL (CSL.AX) – Plasma industry alliance to develop a coronavirus hyperimmune IG

CSL and Takeda (which acquired Shire last year) have formed a broad plasma industry alliance (joined by BPL, Biotest, Octapharma, LFB) to develop a potential plasma-derived therapy for treating COVID-19. In addition to pooling industry resources, the alliance will collaborate with government/academic efforts and will include clinical trial activities. Alliance experts will begin collaborating across plasma collections, clinical trial development and manufacturing. BUY. (Published by UBS)

Origin Energy (ORG.AX) – ORG successfully navigates two key risks, reiterate Buy

Origin has confirmed Citi's views that its balance sheet is resilient, notwithstanding no mention of its credit rating. Under a stress test scenario, ORG continues to have headroom above its covenants, and solvency is protected by liquidity. Citi forecasts ORG to materially breach its 3x Net Debt/EBITDA limit temporarily; however, Citi expects the rating agency will likely look through one year of weakness. Two key risks have been averted: 1) FY20 dividends are not at risk from APLNG cash retention, and 2) Energy Markets guidance was reiterated. BUY. (Published by Citi)

Seek (SEK.AX) – UBS SnapShot: COVID update

1) Seek ANZ and Seek Asia announced that billings declined by 40%+ in the week ending 22 March, and 60%+ in the week ended 29 March; billing declines have since stabilised at this level. 2) Zhaopin billings fell -60% in February but prudent cost management delivered EBITDA in line with pre-virus expectations; March billings have performed ahead of the -30% example provided at the 1H20 result. 3) Seek ANZ announced customer support measures: Hirers were relieved of minimum commitments from 1 April to 30 May, pre-purchased ad pack expiries have been extended, and similar measures are to be implemented across Seek Asia, Brasil Online and OCC. 4) Online Education Services (OES) is performing well and has not been impacted by the virus through to 31 March. 5) Early Stage Ventures (ESVs) has adapted quickly to the challenging conditions and reduced cash burn. NEUTRAL. (Published by UBS)

Webjet (WEB.AX) – Keep a tight lid on the war chest and then go for Gold

The WEB capital raising illustrated the unprecedented severity of the pandemic's impact on the travel industry. In this climate, Ord Minnett has now elected to assess WEB (and other pure travel stocks) using two key criteria, namely: 1) Do they have enough cash to survive the crisis assuming little or no revenue for the next 12-18 months? and 2) Are they likely to have a sound business model/attractive investment thesis post the virus? In the case of WEB, the answer to both questions is yes. Ords retains its BUY rating and considers the business well positioned to thrive in the B2B segment post virus. BUY. (Published by Ord Minnett)

International

Starbucks (SBUX.US) – UBS Evidence Lab inside: How's Starbucks Positioned in China Now?

Starbucks' China business is positioned for recovery, with the reopening of ~95% of stores, same store sales improvement from lows, and UBS thinks competitor pressure is potentially easing given Luckin's challenges. A recent UBS Evidence Lab survey of 1K+ coffee drinkers in China highlights expectations for a rapidly expanding coffee market and strong demand for SBUX. But with a focus on the US as the primary driver for shares, upside could be limited given concerns that comparable store sales could be down significantly in the coming months. UBS believes SBUX maintains strong liquidity (~\$5bn cash plus revolver capacity), global brand strength, and an intact attractive long-term growth algorithm, which result in a balanced risk/reward. NEUTRAL. (Published by UBS)

Walmart (WMT.US) – Their Time to Shine; Assume with a Buy

When Citi thinks about what has been working in general within the US retail landscape (and what will likely continue to work), it would characterise it as online, off-mall, convenience and value. WMT checks all four boxes. And in the current COVID-19 crisis, WMT is in a favourable position. It is a largely consumables based business (grocery is 55% of sales) and is value-priced. Because the company is there to serve customers through this period, Citi believes it will result in more customer loyalty with existing customers and help WMT gain new customers that might not have shopped WMT before. (Published by Citi).

Figure 4. Calendar

Date	New Zealand	Australia	International
14-Apr	Electronic Card Retail Sales (Mar) External Migration & Visitors (Feb)	NAB Business Confidence (Mar) NAB Business Survey (Mar) Caltex Australia March 2020 CRM Result	Wells Fargo 1Q20 JPMorgan Chase 1Q20 Johnson & Johnson 1Q20
15-Apr	FPI (Mar)	Westpac Consumer Sentiment (Apr)	Bank of America 1Q20 Goldman Sachs 1Q20
16-Apr		MI Inflation Expectations Employment Change (Mar) Full Employment Change (Mar) Participant Rate (Mar) Unemployment Rate (Mar) South32 3Q20 Operational Result Woodside Petroleum 1Q20 Transurban March 2020 Traffic Result	US: Core Retail Sales (Mar) US: Retail Sales (Mar) US: Crude Oil Inventories Citi 1Q20
17-Apr	Business NZ PMI (Apr) Seeka AGM	Retail Sales Rio Tinto 1Q20 Operations Review Brambles 3Q20 Trading Update	US: Building Permits (Mar) US: Initial Jobless Claims US: Philadelphia Fed Manufacturing (Apr) CH: GDP (Q1) CH: Industrial Production (Mar) EU: CPI (Mar) LVMH 1Q Revenue L'Oreal 1Q20 Sales Schlumberger 1Q20

Source: Forsyth Barr analysis

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