

# Wealth Weekly

## Checking for Value in Tech & Telcos

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With markets having been partly driven higher by speculative investing, Wednesday's pessimistic outlook from the US Federal Reserve and several days of rising COVID-19 case numbers in some US states led to a short, sharp, correction in equity markets on Thursday. Things were back to normal by Friday though, with markets rebounding again. In this heady environment we remain focussed on fundamentals, preferring quality companies at reasonable valuations over momentum and value plays.

**International technology & communications sector reviews**

We have reviewed the US Information Technology and Communication Services sectors. The S&P 500 Information Technology sector has staged a solid recovery from lows seen in March and is only down -4% from the highs reached prior to the COVID-19 pandemic. Information Technology companies have proved to be more defensive than most had expected and the sector is one of few forecast to deliver positive growth in FY20, despite headwinds created by COVID-19. We are attracted to the Information Technology sector for its above average long-term growth attributes, albeit this is largely reflected in company valuations. **We believe Salesforce.com and Visa offer good value-for-risk at current prices, while Microsoft and Nvidia are looking particularly expensive.**

The Communication Services sector includes low-growth incumbent Telecommunication Services companies, as well as higher growth Media and Entertainment companies. **Our preference is for companies with attractive long-term growth attributes and attractive valuations, such as: Alphabet, Charter Communications, Comcast and Netflix.** Outside the US we like Chinese social media conglomerate **Tencent.**

**Themes of the week**

Ryman Healthcare's FY20 result on Friday was solid, with underlying profit rising +7%. Resales were strong with a higher turnover rate than forecast before the country went into lockdown. Demand metrics remained robust. The company didn't provide earnings guidance, but building activity looks to be coming back. We have lifted our near-term resales forecasts significantly based on a higher turnover rate and a quicker recovery. **We remain positive on Ryman's growth opportunity in NZ and Australia.**

**Infratil took the opportunity of a recent rally in its share price to raise capital** through a placement and share purchase plan. The proceeds will fund growth projects at some of Infratil's businesses, and provide some downside protection to the balance sheet.

After several central banks recently commented that their most dire economic scenarios are unlikely to play out, **markets were taken aback on Thursday after the US Fed on Wednesday gave a cautious assessment and said rates would stay low for a long time.** The S&P 500 fell nearly -6% and bond prices rose (yields fell) as investors sought out safe assets. But Fed Chair Jerome Powell also said that even if it is fuelling an asset price bubble, the Fed won't hold back from using ultra-loose monetary policy in an attempt to meet its growth and employment objectives.

Probably equally responsible for Thursday's one-day plunge in stock markets was the speculative trading that has been driving the market rally. **Citi's composite indicator of market panic/euphoria suggests investor sentiment is more positive than any other time since 2002.** Such speculative enthusiasm can wane quickly if there's bad news or if the upward trend hits a speed bump. Nonetheless, on Friday equities continued on their merry way higher.

**Looking ahead**

Jerome Powell is scheduled to deliver the Fed's semi-annual update to Congress on Wednesday and Thursday (NZ time), where he's likely to field questions about the state of the economy and the (unintended?) consequences of the Fed's actions. Locally, Asset Plus will report its FY20 result on Tuesday and Metro Performance Glass on Friday.

## Reviewing Preferred Technology & Communications Stocks

### Technology

In some cases companies within the Information Technology sector have even benefited from COVID-19, as lockdowns and work at home mandates accelerated online shopping trends and adoption of Software as a Service (SaaS) and cloud services. The S&P 500 Information Technology sector trades on a Forward PE multiple of ~26x, and is forecast to deliver +13% annualised EPS growth from FY2023.

When investing in the IT sector, we have a preference for global leaders that offer strong incumbency positions with high barriers to entry, attractive growth outlooks, and more attractive valuations than smaller, less profitable technology companies in Australia and New Zealand. In addition to reviewing the largest US listed companies, we have also reviewed companies that are widely held across our client portfolios.

Of the companies held in our International Model Portfolio and/or the Forsyth Barr Global Equities Fund, **Salesforce.com** (CRM) and **Visa** (V) still appear to offer good value-for-risk at current prices.

In contrast, **Microsoft** (MSFT) and **Nvidia** (NVDA) are looking particularly expensive, and we will be reviewing these with the intention of trimming holdings.

New ideas to consider for portfolios include **Fiserv** (FISV) and **Intel** (INTL), which both trade on undemanding valuations and are forecast to deliver double-digit EPS CAGRs from FY2023.

### Communications

The S&P 500 Communications sector trades on a 12 month forward PE multiple of 23x, and is forecast to deliver an EPS CAGR of +18% from FY2023.

The following are our preferred stocks in the sector:

- **Alphabet** (GOOGL) is a global technology holding company with Google being its flagship brand. Over 80% of Alphabet's revenue is derived from advertising. Alphabet is also working on a number of "moon shot" ventures, and is a key player in the race to driverless vehicles.
- **Charter Communications** (CHTR) is an American telecommunications and mass media company that offers its services to consumers and businesses under the branding of Spectrum.
- **Comcast** (CMCSA) is a global media and technology company with three primary businesses: Comcast Cable, NBC Universal, and Sky. Comcast Cable is one of the United States largest video, high-speed internet and phone providers, under the Xfinity brand.
- **Netflix's** (NFLX) primary business is its subscription-based streaming service which offers online streaming of a library of films and television programs, including those produced in-house.
- **Tencent** (700.HK) specialises in various internet-related services and products, entertainment, artificial intelligence and technology both in China and globally.

We are less enthused about some other companies in the sector:

- Games developer **Activision Blizzard**, **Facebook**, telco **T-Mobile US**, and **Walt Disney** offer attractive growth outlooks, but at current prices we believe valuations are at the expensive end.
- Although **AT&T** and **Verizon**, two US telcos, have cheap valuations relative to other stocks, we are wary that they could prove to be value traps given subdued growth outlooks.

## Themes of the Week

### NZ Equities

#### **Ryman Healthcare (RYM) – FY20 Result – Very Good For Mum**

RYM's long track record of looking after its elderly residents was tested under COVID-19 and it again delivered. The FY20 result was close to expectations in most areas, with stronger than expected new sales gains almost offsetting the bigger than expected rise in operating expenses. Having indicated that it was tracking to the lower end of its guidance range in March before lockdown, RYM reported underlying profit was NZ\$242m, up +7%, in line with forecasts. The NTA lifted +6% despite more conservative valuation assumptions.

RYM built 841 units/beds in FY20, which was ahead of forecast. Development progress in Melbourne continues to be a key focus, with the target remaining five villages open by the end of CY20, which is pleasing given COVID-19 constraints. RYM has purchased an impressive looking new site in Takapuna on Auckland's North Shore. RYM's build guidance presents significant upside to the forecast changes we made in early April where we conservatively assumed it would take around six months to get from Alert Level 4 to Level 2.

We have upgraded our near-term forecasts given a faster than expected recovery in the target build rate and the resales turnover rate. Our target price has lifted +6% to NZ\$14.80 due to a lift in the near-term build rate and level of sales activity. We retain our OUTPERFORM rating. We remain positive on RYM's growth opportunity in NZ and Australia and its strong 'needs based' focus; a full continuum of care and sector low fees give it defensive qualities in a slower and more discerning market.

#### **Infratil (IFT) – Raising for Growth**

We downgraded Infratil (IFT) from OUTPERFORM to NEUTRAL last week after the share price had rallied. This week, in a well-timed surprise move, IFT raised ~NZ\$250m in an institutional placement and announced a \$50m share purchase plan. The equity raise price of NZ\$4.76 is an -8% discount to the closing price on 8 June.

Most of the funds are likely to go to growth projects in CDC Data Centres (CDC) and IFT's northern hemisphere renewable energy platforms, Longroad Energy (LE) and Galileo Green Energy (GGE), although the equity raise also provides some downside protection to the balance sheet.

IFT has provided no specific commentary or guidance on the dividend going forward. We have retained our 17.25cps dividend forecast, but maintain our view that a reduction is more likely than an increase over the next few years.

The dilution effects of the capital raise lowered our target price -10cps (-2.1%) to NZ\$4.70. We retain our NEUTRAL rating.

#### **AFT Pharmaceuticals (AFT) – Initiation of coverage and capital raising**

On Tuesday Forsyth Barr Research initiated coverage on AFT Pharmaceuticals (AFT) as part of the Research Insights series (with no valuation, target price or rating). AFT is a pharmaceutical business that is aiming to grow through international expansion with its Maxigesic product family. It also has diverse other products. The company has a strong track record of revenue growth since inception and has runway of opportunities for this to continue. This, coupled with expected operating leverage and lower interest costs, should support near-term earnings growth and an improving free cashflow profile. AFT trades on elevated forward multiples reflecting the growth outlook. There is a wide range of justifiable long-term outcomes.

On Wednesday AFT announced a NZ\$12m equity raise (\$10m placement at \$3.75 and \$2m share purchase plan) to retire one of AFT's working capital facilities, improve free cash flow and provide more flexibility to fund future anticipated growth. A private equity fund also sold down its \$60m stake, and a family trust associated with AFT's founders sold \$3.5m worth of shares (~1.3% of its c.70% stake in AFT) – the trust's first sale since the IPO in 2015.

**Forsyth Barr's forecasts for FY21E and beyond have not been updated to reflect the announcement.**

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## Fixed Interest

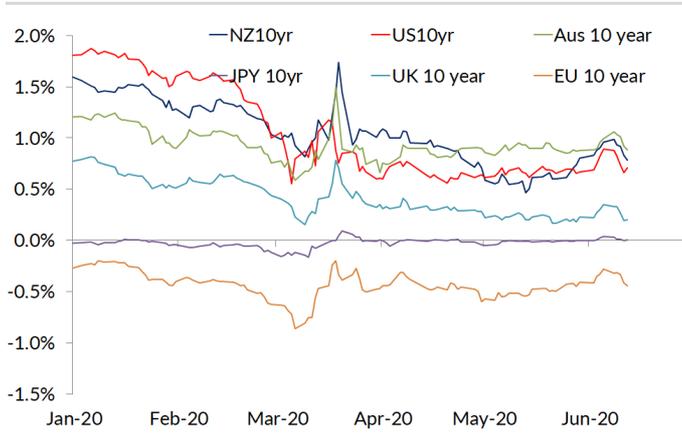
### Central banks a mixed bag

Central banks around the globe have been holding their respective monetary policy meetings recently with mixed results. While a couple have been largely upbeat in the sense that they believe their most dire economic forecasts post COVID-19 are unlikely, the US Federal Reserve (Fed) completely overshadowed those positive comments, sending interest rates lower along with equity markets.

The Fed's comments following its monetary policy meeting last week were described by some as pretty bleak. Comments of the nature of not even thinking about raising rates should have come as no surprise to anyone. Unemployment levels are likely to remain elevated, whilst growth is expected to bounce back in 2021 after a rather ugly 2020.

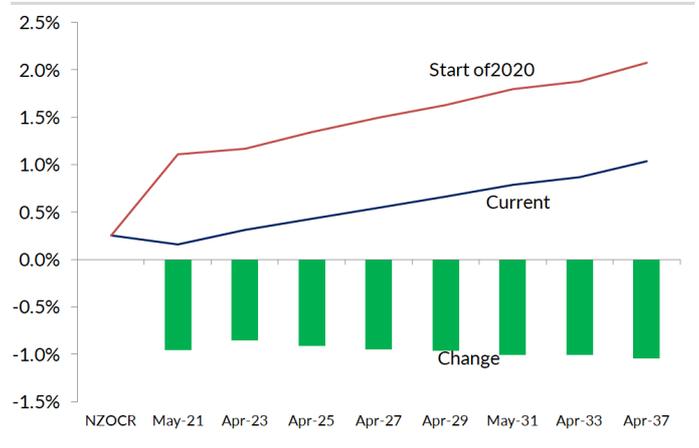
Market reaction was swift with bond yields falling (prices rising) as investors sought the safety of bonds as the S&P 500 equity index fell nearly -6% on Thursday. The volatility came after a period of optimism from the Reserve Bank of Australia (RBA) and the Bank of Canada (BoC) which both reported that their worst economic forecasts are unlikely to play out. The Reserve Bank of New Zealand (RBNZ) will meet again on 24 June where its commentary will be intensely analysed for any hints about its own COVID-19 forecasts.

**Figure 1. Global 10yr interest rates**



Source: Forsyth Barr analysis, Thomson Reuters

**Figure 2. NZ Government Bonds**



Source: Forsyth Barr analysis, Thomson Reuters

## Macro Snapshot

### Investing vs speculating

Over Thursday night (NZ time) we saw the largest drop in equity markets since 13 March. The pullback was attributed to the pessimistic outlook from the US Federal Reserve, and to a resurgence in cases of COVID-19 in numerous US states.

In normal times there wouldn't have been enough new news in either of those headlines to warrant the -6% plunge in the S&P 500 index. But the index has been on an almost uninterrupted upward tear for two-and-a-half months. **We believe a more plausible explanation for the drop is the preceding surge in speculative investing we've seen in markets**, which has helped the strong recovery in markets off the March lows. Speculative enthusiasm can wane quickly, exacerbating market volatility.

A noteworthy feature of markets in recent months has been the wave of retail trading, as investors with time on their hands turned to equities to get their punting fix – or (understandably) to seek an alternative to the near-zero interest rates they're getting in the bank.

Much of this retail interest has focussed on higher risk sectors and stocks. At US online discount broker Robinhood, the ten stocks that saw the greatest interest over the past month included airlines (American Airlines, Delta, Spirit Airlines, United Airlines and Boeing), casinos (MGM resorts), cruise ship operators (Carnival, Norwegian Cruise Lines), and rental cars (Hertz, which has actually filed for bankruptcy protection). Unsurprisingly, these higher risk stocks were amongst the largest decliners on Thursday.

**We believe it's very important to distinguish between investing and speculating.** When investing in stocks we think about buying part of a company (ideally at a favourable price). Over time an investor will benefit as the company grows profits and dividends. A

speculator's mindset is different. As legendary investor Benjamin Graham described it: A speculator gambles that a stock will go up in price because somebody else will pay even more for it.

We do not suggest that investors shouldn't invest in higher-risk sectors. There are good businesses whose earnings do fluctuate with the economic cycle. At times, particularly when the economic outlook appears bleak, the stock prices of these businesses can be attractive. However, prudent investment in these stocks requires thoughtful consideration of a business's prospects and risks, not just the hope that someone else will buy it at a higher price tomorrow.

## Research Worth Reading

### New Zealand

#### **Air New Zealand (AIR) – Can Bernoulli or Newton Explain the Lift?**

AIR remains severely challenged by COVID-19 given border closures and the adverse impact on passenger demand. Cash losses and asset impairments will materially deplete its net asset value (NAV) as at 30 June 2020, and likely further to 30 June 2021. Our demand/capacity assumptions are broadly consistent with management commentary that the airline will be ~70% of its former size in two years' time. We lower our target price to NZ\$0.70 from NZ\$1.00 to reflect heavier losses (and therefore a lower NAV) in FY21 than previously anticipated. With the share price trading substantially higher than our forecast NTA, we retain an UNDERPERFORM rating. (Published by Forsyth Barr)

#### **Equity Strategy – Recovery Heat Map; Closer to Normality**

Our real time, high frequency, data heat map shows that New Zealand is continuing to benefit from easing restrictions on consumers and businesses, with most indicators having improved since last week. Further improvements are likely over the coming weeks given last week's move to Alert Level 1. Consumer activity is now largely back to prior year levels. The weakest parts of the economy are those exposed to international travel and tourism. These sectors will remain challenged under Alert Level 1 until border restrictions ease. Unsurprisingly, the nature of the recovery to date lags the sustained equity market rally since the trough on 23 March 2020; however, we remain wary of economic headwinds from rising unemployment. (Published by Forsyth Barr)

#### **Property For Industry (PFI) – Shock Absorber – Downgrade to NEUTRAL**

PFI has performed strongly through the pandemic driven market volatility, with the share price having now largely recovered from the initial sell off as the defensive qualities of industrial property gained favour. The industrial property sub-sector has seen 1) strong rent collection vs. other types of properties, 2) increased demand particularly in logistics, and 3) limited downward revaluations to date. We now see limited scope for further outperformance vs. the sector and downgrade our rating to NEUTRAL. (Published by Forsyth Barr)

#### **Tourism Holdings (THL) – A Classic RV Rally**

THL provided a market update highlighting the COVID-19 impact on its balance sheet has been modest, with some diminution in net asset value (NAV) in light of operating losses, but vehicle sales have picked up in all markets with realisable values in excess of book value. THL is now trading at a lofty ~55% premium to our assessment of its NAV as at 30 June 2021. While in recent years THL has been able to generate a return on capital in excess of its cost of capital, which ordinarily should justify a NAV premium, we can no longer say with any certainty that its returns profile will sufficiently recover over the foreseeable future. UNDERPERFORM. (Published by Forsyth Barr)

### Australia

#### **Afterpay (APT.AX) – Taking the pulse: US and UK metrics accelerate in May**

In this report, Citi analyses Similarweb data for website visits and app downloads across ANZ, the US and the UK. Citi's analysis points to accelerating trends in the US and UK, with US visits beating December highs. Citi also reviews the US competitive landscape and discusses Shopify's entry into the buy-now-pay-later market, and the risks to consider. NEUTRAL. (Published by Citi)

#### **Amcor (AMC.AX) – North America beverage data**

Ord Minnett continues to track the beverage, packaged food and tobacco segments, which it estimates provide a read on 78% of Amcor's North America sales or 36% of group sales. Overall, if the observed sales trends flow through to demand for AMC's packaging products, Ords believes AMC should continue to benefit from the shift to at-home consumption. ACCUMULATE. (Published by Ord Minnett)

**CSL (CSL.AX) – Vitaeris acquisition and other R&D updates**

CSL has made three separate announcements – the acquisition of organ transplant drug company Vitaeris, the results of a phase 2 clinical trial of CSL312 for hereditary angioedema (HAE), and CSL's latest involvement in the development of a COVID-19 vaccine. Citi made no changes to its forecasts and assumes FY22 is a normal earnings year. BUY. (Published by Citi)

**Newcrest Mining Limited (NCM.AX) – Havieron Is Getting Bigger**

UBS recently upgraded Newcrest to BUY, driven by the work on two growth projects, Red Chris and Havieron. New drilling results at these projects reinforce their emerging value. In UBS's view the results at Havieron increase the likelihood it will be mined. UBS thinks this potential is also not well understood by the market and not priced in. It expects this to change over the next 12 months when 1) a maiden resource is declared at Havieron in 2H20, and 2) a decision is made to invest in an exploration decline in 2021Q1. BUY. (Published by UBS)

**International****Walt Disney (DIS.N) – Updating Model for F2Q20 Results**

Citi updated its DIS model to reflect F2Q20 results as well as updated views on the firm's operating outlook. In broad terms, the firm continues to endure near-term operating headwinds as a result of the COVID-19 pandemic and Citi has taken a more conservative stance regarding the cadence of recovery within DIS's core operations. But, at the same time, Citi has raised its outlook for DIS's direct-to-consumer segment given robust consumer adoption of the firm's various apps. BUY. (Published by Citi)

## Calendar

Figure 3. Calendar

Date	New Zealand	Australia	International
15-Jun	Westpac Consumer Sentiment (Q2) External Migration & Visitors (Apr) FPI (May) Permanent/Long-Term Migration (Apr)		CH: Industrial Production (May)
16-Jun	Westpac Consumer Sentiment (Q2) Asset Plus FY20	House Price Index (Q1) RBA Meeting Minutes	UK: Average Earnings Index (Apr) UK: Claimant Count Change (May) EU: German ZEW Economic Sentiment JP: BoJ Monetary Policy Statement JP: BoJ Press Conference
17-Jun	GlobalDairyTrade Price Index Current Account (Q1) Current Account % of GDP (Q1)	HIA New Home Sales (MoM) MI Leading Index (MoM) RBNZ Offshore Holdings (May)	US: Core Retail Sales (May) US: Retail Sales (May) UK: CPI (May) Oracle 4Q20 Earnings
18-Jun	GDP (Q1) GDP Annual Average (Q1) GDP Expenditure (Q1) Z Energy AGM	Employment Change (May) Full Employment Change (May) Participation Rate (May) RBA Bulletin Unemployment Rate (May) Caltex Australia May Sales & Revenue	US: Building Permits (May) US: Crude Oil Inventories UK: BoE Interest Rate Decision (Jun) UK: BoE MPC Meeting Minutes
19-Jun	Metro Performance Glass FY20	Retail Sales	US: Initial Jobless Claims US: Philadelphia Fed Manufacturing Index (Jun) UK: Retail Sales (May)
20-Jun	CFTC NZD Speculative Net Positions		

Source: Forsyth Barr analysis

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