

Wealth Weekly

Buy Australian Made

WEALTH MANAGEMENT RESEARCH

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Fiscal stimulus was in focus last week, both in the US and in Australia. Trump scuttled the on-again, off-again stimulus negotiations, sending the US stock market into an abrupt decline, only to realise his mistake and backtrack within hours. Irrespective of whether the two sides reach an agreement pre-election, the growing view that Joe Biden will win the Presidency by a clear margin, and the increasing odds that the Democrats will capture the Senate is lifting confidence stimulus will eventually be forthcoming. Closer to home, Australia's federal budget last week contained a plethora of extra spending, which helped the Aussie market to a +5.4% gain for the week.

Australian Federal Budget spend-up provides tailwinds for Aussie earnings

The Australian budget handouts confirmed our expectation that **the Morrison government is prepared to throw a lot of capital at turning the Australian economy around**, including through tax cuts and increased investment. That should support solid earnings growth for some Australian companies.

In our view it is a good time to add Australian equities to portfolio holdings. So how should you do it? First, don't get caught buying just the cyclical companies for the short term bounce; this can often lead portfolios in the wrong direction. **Our preference is to stay focussed on the stocks that have enduring investment attributes like above-average profit growth prospects.**

Our approach to investing in Australia following the budget handout is to split our Australian portfolio stocks into three groups:

- Group 1: Top five "value-for-risk" portfolio stocks at current prices: **Ampcor, APA Group, Lendlease, Qube and Telstra**
- Group 2: Other core portfolio stocks: **Aristocrat Leisure, Cleanaway, CSL, Macquarie Group, Ramsay Healthcare, ResMed and Sydney Airport**
- Group 3: "Deep value" stocks, which should rebound through a recovery phase: i) Recovery in the banks (**ANZ**); ii) Beneficiaries of increased infrastructure spending (**Downer**); and iii) Post COVID-19 recovery in retail & tourism (**Scentre Group and Webjet**).

Themes of the week

The shifting sands of the New Zealand electricity scene prompted an update of some of our stock ratings last week. The increasingly positive signals throughout September that New Zealand Aluminium Smelter (NZAS) is more likely to stay open have resulted in a strong couple of months for stocks in the sector, with all of the electricity generators outperforming the S&P/NZX 50 Index since the end of August. We still see further upside for the sector as a whole, on the basis of higher and de-risked dividends, if NZAS remains open for longer. **We see the greatest upside potential from Genesis Energy** (upgraded to OUTPERFORM last week) **and Contact Energy**. Meridian Energy has more limited dividend upside and we downgraded its rating to NEUTRAL last week, but it remains a quality stock for long-term investors.

Looking ahead

The US earnings season gets underway this week with Johnson & Johnson, JPMorgan Chase, Citigroup and ASML reporting quarterly results on Wednesday; Goldman Sachs, Bank of America, Wells Fargo and UnitedHealth on Thursday (also The Warehouse Group in NZ); Roche, Walgreens Boots Alliance and Intuitive Surgical on Friday; and Schlumberger on Saturday (NZ time). Medtronic will hold an investor day on Thursday.

It's also AGM season. EBOS provided a strong trading update today. CSL, Cleanaway and BHP are tomorrow; Livestock Improvement on Thursday; and SkyCity on Friday.

The New Zealand general election will be held on Saturday; given the similarities between the main parties' policies, we don't expect the outcome (whatever it is) to have significant and lasting impacts on the equity market.

Why Australian Equities?

Better value across the ditch

Australian equities have substantially underperformed NZ equities over the past 12 months and for the year-to-date, which we expect to reverse as the Australian economy looks more likely to respond positively to a post COVID-19 world.

For the year-to-date the Australian S&P/ASX 200 is down -6.4% (-2.7% in NZD), underperforming the NZX 50 by -10.0% (in NZD). Over the past 12 months the S&P/ASX 200 has underperformed the NZX 50 by -16% (in NZD).

We see relatively attractively value opportunities in some of the Australian stocks that have lagged, yet which offer defensive growth or recovery potential in an economic upswing.

That upswing is being helped along by the Australian Government. **Last week's federal budget included the biggest injection of fiscal stimulus in a single year since World War II.** To put the size of the stimulus in perspective, the government's budget deficit of 11% of GDP in 2021 is similar in size to the reduction in private sector demand caused by the pandemic, and the deficit will be around three times larger than those reported around the global financial crisis.

This government spend-up comes on top of ultra-low interest rates and looser bank prudential regulation, which is already lighting a fire under the Aussie housing market.

Something in the budget for (almost) everyone

The biggest budget policy announcements focussed on boosting domestic demand. The measures include:

- Bringing forward income tax cuts
- Providing direct handouts to pensioners
- Providing hiring credits for small and medium businesses
- Allowing businesses with under A\$5b of revenue to expense all non-property related capital investment for the next three years
- Increasing infrastructure spending (particularly road and rail)
- Subsidising high-end manufacturing companies ("picking winners")

The spend-up supports our positive view on Australian equities. We expect a +20% earnings recovery across the market over the next 12–24 months as the economy normalises from the pandemic.

Top five Australian investment ideas

- **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. **Amcor is set to deliver an earnings and cash uplift from restructuring initiatives and the integration of its Bemis acquisition.** 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.5% annualised earnings growth rate and a sustainable ~4.5% dividend yield over the next three years.
- **APA Group (APA.AX)** owns and operates gas transmission, storage and generation infrastructure in Australia. **APA is poised to benefit from the rising usage of gas as a source of energy.** 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 of its debt over the next three years.
- **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. It is expected to divest its engineering business before the end of 2020. The company targets opportunities underpinned by urbanisation, funds growth, ageing populations, sustainability and technology. LLC's April 2020 capital raise helped fund its ~\$110b development pipeline. **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.**
- **Telstra (TLS.AX)** provides phone, internet, online and directory services. TLS 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 use for artificial intelligence and internet-of-things applications. We expect a positive step-change in profit growth by FY23. **The potential privatisation of NBN Co could help to unlock the hidden value in TLS's InfraCo assets.**

- **Qube (QUB)** 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.** Moorebank will allow QUB to develop a logistic/warehousing hub, connecting via freight services to Port Botany, which will provide a long-term competitive advantage in NSW. QUB is currently reviewing offers to monetise Moorebank through 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.**

Themes of the Week

NZ Equities

Electricity Sector — Power Points: Waiting on RIO, October 2020

Last week we highlighted the Labour Party's policy of continuing to negotiate with Rio Tinto (RIO) in the hope of averting or delaying the closure of the NZ Aluminium Smelter (NZAS) at Tiwai Point. Following further analysis we've quantified the estimated upside for the electricity stocks at around +10% based on the higher dividends the companies would be able to pay if NZAS stays open for longer.

In particular **Genesis Energy (GNE)** and **Contact Energy (CEN)** would have the greatest upside potential and these are now our preferred electricity stocks. Both are rated OUTPERFORM following our upgrade of GNE last week. Meridian Energy (MEL) has more limited dividend upside and we downgraded its rating to NEUTRAL.

- **Contact Energy** has a good chance of entering the MSCI NZ index at the November 2020 index rebalance, in our opinion. CEN is currently trading at \$8.10, above our current estimated minimum price to enter the index of ~\$7.33. The prospect of being added to the index is providing a strong share price tailwind. Companies typically experience a spike in trading volumes after inclusion as passive funds tracking the index buy shares. Our target price is NZ\$8.60/share. We reiterate our OUTPERFORM rating.
- **Genesis Energy:** Whilst our forecasts assume that NZAS closes in August 2021 as originally signalled, if NZAS remains open for longer, we expect GNE to deliver a fully imputed FY21 dividend of ~17.5cps, vs 14.0cps in a closure scenario. Factoring in a 50% chance of NZAS staying open (which is conservative vs. what the electricity futures market is implying) has been the driver for our +38cps (+13%) target price increase to NZ\$3.38/share.
- **Meridian Energy:** MEL's low cost generation assets provide it with a defensive position. We downgraded our MEL rating to NEUTRAL last week following a tough 1Q21 and due to limited dividend upside, even if NZAS remains open. Following two stellar years, 1Q21 has proved to be more challenging with below average hydrology impacting earnings such that we downgraded our FY21 EBITDAF forecast -NZ\$46m (-6%) to NZ\$748m. In addition, relative to other electricity stocks, dividend upside if NZAS remains open beyond August 2021 is limited due to MEL likely having to provide a significant electricity price discount to NZAS to secure an agreement, and due to record FY20 earnings pushing up MEL's ordinary dividend. We trimmed our target price -6cps to NZ\$5.44/share.
- **Mercury NZ:** We retained a NEUTRAL rating on Mercury (MCY) given limited upside. MCY is a strong operator in the sector with well-positioned generation assets. The closure of NZAS has no direct impact on MCY, but it will be affected by lower retail prices. MCY offers a secure dividend that we expect will grow further, even if NZAS closes.

Figure 1. Summary electricity company valuation metrics

Company	Price	Target Price (NZ\$m)	Target Return	Rating	FY21				Movements			
					EV/EBITDA	PE	Gross Yield	EBITDAF (NZ\$m)	EBITDAF change	% change	Target Price change	Rating change
CEN	\$8.10	\$8.60	10.1%	OUTPERFORM	14.7	23.5	4.8%	463	+\$26m	+5.9%	+\$0.60	-
GNE	\$3.19	\$3.38	10.3%	OUTPERFORM	13.7	23.9	6.1%	402	+\$5m	+1.2%	+\$0.38	▲
MCY	\$5.51	\$5.37	0.5%	NEUTRAL	17.3	28.5	4.3%	501	-\$9m	-1.8%	+\$0.07	-
MEL	\$5.55	\$5.44	1.1%	NEUTRAL	21.0	32.8	3.9%	754	-\$46m	-5.7%	-\$0.06	▼
TLT	\$3.95	\$4.10	3.8%	OUTPERFORM	17.5	36.9	0%	76	\$0m	0%	\$0	-
TPW	\$7.57	\$7.78	6.8%	NEUTRAL	15.5	26.6	5.6%	192	+\$2m	+1.0%	+\$1.23	-

Source: IRESS, Forsyth Barr analysis

Research Worth Reading

New Zealand

Vital Healthcare (VHP.NZ) – NZ\$150m Capital Raise

VHP has announced a capital raise of NZ\$150m at an offer price of NZ\$2.80 per share, representing a -6% discount to the previous closing price of NZ\$2.98. The raise is being completed to fund c.NZ\$100m of brownfield developments, and provide capacity for a potential acquisition. VHP also announced that it has progressed the sale of several regional assets which are anticipated to raise approximately NZ\$100m in early 2021. Our rating is RESTRICTED. **Forsyth Barr Limited is a Joint Lead Manager and Forsyth Barr Group Limited is an Underwriter of the Placement and will receive fees in connection with those roles.** (Published by Forsyth Barr)

Australia

Buy Now, Pay Later Sector – Taking the pulse: Bumper September for Z1P, Afterpay US metrics accelerate

Citi opened a positive catalyst watch for Zip Co Ltd (Z1P.AX) ahead of its 1Q update, as analysis of Similarweb data pointed to a record month for Quadpay and a strong September for Z1P. Afterpay (APT) saw improving momentum in the US in September. Citi sees upside risks to group 1Q gross merchandise value forecasts for APT driven by acceleration in e-commerce in Australia and New Zealand and strong momentum in the US. APT – NEUTRAL; Z1P – SELL. (Published by Citi)

Global Plasma Market – Lower plasma collection a short term issue – room to double the number of collection centres

The three major plasma products manufacturers are CSL, Grifols and Takeda who have a combined global market share of >60%. The collection of plasma is a growth-limiting factor for the industry – manufacturers have been struggling to ramp up collections fast enough to meet growing plasma therapy demand. This has been amplified during the pandemic in 2020. Citi analysed the locations and a number of socio-economic factors of the existing plasma collection centres in the USA to determine how many additional centres the industry could open. Citi concludes that there remains ample room to increase the number of plasma collection centres to maintain the industry growth. Citi retains its current stock ratings – CSL and Takeda are both rated BUY and Grifols is rated NEUTRAL. (Published by Citi)

CSL (CSL.AX) – The next phase

CSL's decline in plasma collection volumes has been widely documented over the last six months, and appears to be priced in, with CSL underperforming the ASX200 by ~20% over this same time period. As such, and with a number of key clinical trial milestones over the coming years, UBS focusses on the medium-term outlook for the business and assesses both the opportunities and risks to the CSL Behring division. UBS's current valuation and price target is consistent with a scenario where CSL's and its competitors' clinical trials are all successful and complete to commercialisation. BUY. (Published by UBS)

BHP (BHP.AX) – Oil footprint grows with greater interest in Shenzhi

BHP has announced the acquisition of an additional 28% working interest in Shenzhi, a six-lease development in the deep-water Gulf of Mexico oil and gas field from Hess for US\$505m. Following the acquisition BHP will have an effective interest of 72% and will remain the operator. The increased interest sees BHP production lift to 11kboe/d with 90% oil. The transaction has an effective date of 1 July 2020 and completion is expected by December 2020. BUY. (Published by UBS)

Cleanaway Waste Management (CWY.AX) – EfW project update

CWY has gone on public exhibition with its proposed energy-from-waste (EfW) facility, with submissions allowed over the next 42 days. The proposal has been deemed a state significant development and will be assessed and determined by the Minister for Planning and Public Spaces or the Independent Planning Commission. ACCUMULATE. (Published by Ord Minnett)

Mining Sector – BHP, FMG, RIO, S32 quarterly production previews

Overall, Ord Minnett's net profit forecasts for the iron ore players remain well above consensus for FY21/CY20: 27% for Fortescue, 13% for Rio Tinto and 36% for BHP. The quarterly results may see upgrades as brokers wash through higher commodity prices. After very strong iron ore shipments in the June quarter, with Fortescue Metals Group (FMG) and BHP Group (BHP) at record rates, Ord

Minnett expects iron ore volumes to fall sequentially due to the impact from regular maintenance. With this note Ord Minnett upgraded BHP Group, Rio Tinto and South32 to BUY from ACCUMULATE based on valuation. (Published by Ord Minnett)

Newcrest Mining (NCM.AX) – Move to Buy after pullback

As expected, NCM has approved the second stage in the Cadia Expansion project. Pleasingly, NCM will spend US\$65m at Lihir to pick up gold that doesn't get recovered via flotation. NCM has underperformed the gold sector by -15% over the last six months and Citi moves to BUY after the pullback. In Citi's view, expectations at Lihir have been reset after the June quarter and consensus 12-month forward earnings momentum is now positive. On a one-year view, Citi maintains its thesis that upcoming news flow on Red Chris and Havieron will paint a clearer picture of the pathway to diversify earnings and sustain 2.0Mozpa. BUY. (Published by Citi)

Sonic Healthcare (SHL.AX) – US COVID funding extended

Over the weekend the US extended its Public Health Emergency for a further 90 days due to the "continued consequences" of the pandemic. This extends the elevated Medicare reimbursement for COVID-19 testing, which Ord Minnett notes is materially positive for SHL. Ord Minnett has revised its forecasts for the extension, having previously assumed a -40% reimbursement drop from November, along with its COVID test volume estimates. This has resulted in an +11.6% increase in FY21 earnings forecasts, but only a negligible adjustment in FY22 and beyond. HOLD. (Published by Ord Minnett)

International

NVIDIA (NVDA) – NVIDIA-Arm CEOs' Fireside Chat at Arm DevSummit

NVDA (which is acquiring semiconductor designer Arm Holdings from Softbank) likes Arm's super energy efficient architecture combined with the license model, and intends to protect and nurture the company by adding more to the business model to give as many opportunities as possible to the developers. Regarding the regulatory process, NVDA expressed confidence that the acquisition will go through, as two complementary companies that will create new innovation is good for the market, and NVDA will protect the business model as a neutral and trusted platform. BUY. (Published by Citi)

Calendar

Figure 2. Calendar

Date	New Zealand	Australia	International
12-Oct	Permanent/Long-Term Migration Visitor Arrivals		
13-Oct	Electronic Card Retail Sales (Sep) Food Price Index (Sep) Ebos Group AGM Sky Television AGM	NAB Business Confidence (Oct) NAB Business Survey (Oct) Telstra AGM Commonwealth Bank AGM	UK: Average Earnings Index +Bonus UK: Claimant Count Change (Sep) EU: German ZEW Economic Sentiment
14-Oct		Westpac Consumer Sentiment (Oct) HIA New Home Sales CSL AGM Cleanaway AGM BHP Group AGM	US: Core CPI (Sep) Johnson & Johnson 3Q20 JPMorgan Chase 3Q20 Citigroup 3Q20 ASML 3Q20
15-Oct	Warehouse Group FY20 Livestock Improvement Corp AGM Auckland Airport Aug Traffic	MI Inflation Expectations Employment Change (Sep) NAB Quarterly Business Confidence Participation Rate (Sep) Unemployment Rate (Sep) Aurizon AGM & Sep Rail Volumes	US: PPI (Sep) Goldman Sachs 3Q20 Bank of America 3Q20 Wells Fargo 3Q20 UnitedHealth 3Q20 Medtronic Investor Day
16-Oct	Business NZ PMI (Sep) Consumer Price Index (Q3) RBNZ Offshore Holdings (Sep) SKYCITY Entertainment AGM	Melbourne Institute Leading Index	US: Initial Jobless Claims US: Philadelphia Fed Manufacturing Index (Oct) US: Crude Oil Inventories UK: Autumn Budget EU: CPI (Sep) Roche 3Q20 Rio Tinto 3Q Operations Review Wallgreens Boots Alliance 3Q20 Intuitive Surgical 3Q20
17-Oct		CFTC AUD Speculative Net Positions	US: Core Retail Sales (Sep) US: Retail Sales (Sep) Schlumberger 3Q20

Source: Forsyth Barr analysis

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