Wealth Update

Spring 2022

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Welcome to our latest Wealth Management Update.

This edition covers the following topics:

- Reporting season update – Australian equities
- Reporting season update – International equities
- Australian property market update

Reporting season update

Australian equity portfolio

Note: Default is in AUD unless otherwise stated.

Amcor Plc (ASX: AMC)[1]

Share price	14/9/22: $17.70
Result	FY22
Revenue	US$14.544b, up 13% on the pcp.
Underling EPS	US$0.805, an increase of 7% on the pcp (at the upper end of the FY22 guidance).
Key points	• FY23 guidance was given for adjusted EPS growth of 3-8% after allowing for a drag of 4% from higher interest costs. • Organic sales (i.e. excluding acquisitions) grew 4% for the full year. • The company remains committed to strong capital management with $600m spent on share buybacks and a further $400m guided for FY23. • CEO, Ron Delia reiterated the commitment to investing for future growth by targeting areas presenting a higher value-add, while also leaving room for further acquisitions where appropriate (an area the business has excelled in over the longer term).
Our comments	• Amcor remains a solid albeit unexciting industrial business that continues to exhibit pricing power. In the June quarter for example, net sales rose by 6% for its core Flexibles division with this growth split evenly between prices hikes (3%), volume growth and changes in business mix (3%). • The inflation protection remains an attractive feature of the Amcor thesis, although we are conscious that there are limits on how much customers and the end consumer can bear in terms of price increases. • The substantial debt balance has been managed well historically and net debt of 2.7x EBITDA is manageable in the context of this business quality. It cannot be denied that it is a meaningful drag on earnings going forward and remains another area besides inflation we are monitoring closely across the portfolio.

[1] Transcripts, Reuters, Bloomberg and CapitalIQ.

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BHP Group Ltd (ASX: BHP)[1]

Share price	14/9/22: $38.60
Result	FY22
Revenue	US$65.1b, up 7% on the pcp.
Underling EPS	US$4.706, an increase of 39.4% on the pcp.
Key points	• FY22 was a strong year for BHP with a meaningful uptick in earnings of over 39% and ongoing capital returns to investors with an 8% increase in the Group dividend. • Relative to other commodity producers, the business has negligible gearing with net debt of only US$300m, leaving it well placed to execute on capital spending or judicious acquisitions. • One example was an indicative proposal to acquire Oz Minerals, a midcap producer of nickel and other base metals. Commodities necessary to achieve a transition away from fossil fuels remain a target for BHP and it would be unsurprising to see acquisitions in order to expand its presence there. • In terms of its existing portfolio, copper is one major target area for expanding existing projects, while iron ore in Western Australia is another key segment for achieving organic growth.
Our comments	• BHP remains well-placed to capitalise on a range of trends demanding commodity exposure. • It does remain a price taker in the sense that earnings will be sensitive to shifts in commodity prices, most notably iron ore with copper and coking coal other key contributors. Its existing portfolio does suggest an ability to maintain volume growth in a cost-efficient manner, a key aspect of navigating the ebbs and flows of the commodity cycle. • Nickel is a major area where BHP operations are limited, increasing the prospects of bolt-on acquisitions over the next few years in our opinion. • Our expectation for slowing global growth would suggest caution is warranted, given the tendency for resource names to underperform in a weaker global economy.

Carsales.com Ltd (ASX: CAR)[1]

Share price	14/9/22: $21.44
Result	FY22
Revenue	$509.1m, up 19.2% on the pcp.
Underling EPS	$0.568, an increase of 11.3% on the pcp.
Key points	• Carsales announced the acquisition of the outstanding 51% interest in Trader Interactive, a US online marketplace acquisition with a low double-digit EPS boost expected in FY23. • Carsales Australia saw adjusted revenue growth of 18% for the year driven by its Private offering (used for person-to-person sales for example). Meanwhile the international businesses saw double-digit growth in revenue and earnings. • The FY23 Outlook guided to strong growth in revenue and EBITDA on a pro-forma basis (this assumes 100% ownership of Trader Interactive in FY22) without explicitly quantifying its exact magnitude, while margin expansion is also anticipated.
Our comments	• Carsales continues to maintain its commanding position in established markets with the international business providing another material source of earnings growth over the medium term.

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	• One risk is the macroeconomic climate and the extent to which business has been boosted by stimulus spending with margins at elevated levels relative to history. A slowing global economy would likely be a meaningful drag on business results. • While Trader Interactive was an expensive acquisition, it appears to be executing well at present and offers a meaningful vertical for further international expansion, which has been a challenging environment for Carsales in other markets.

Coles Group Ltd (ASX: COL)[1]

Share price	14/9/22: $16.69
Result	FY22
Revenue	$39.4b, up 2% on the pcp.
Underling EPS	$0.788, an increase of 4.6% on the pcp.
Key points	• Sales growth of 2% was boosted by strong eCommerce performance in their Supermarket division offset by weaker growth in the Liquor business (this was cycling a period of strong growth due to longer coronavirus lockdowns in FY21). • A year of challenges between coronavirus lockdowns, impact of East Coast floods and weaker Express earnings (due to lockdown restrictions on mobility) saw a flat result at an EBITDA and EBIT level. • Cost inflation remains a point of challenge for the business, which is arguably behind Woolworths in its rollout of more modern distribution facilities. This is changing in 2023 with three of four automated distribution and online customer fulfilment centres opening allowing for greater operational efficiency. • Store renewal continues to be a focus with 50 supermarkets renovated in FY22. • Inflation was a challenge with 1.7% in input cost increases for FY22, although much of this was recovered from customers given aggregate revenue growth rose. • eCommerce sales of US$2.8b was a 41% increase on the pcp with the existing Click & Collect network expanding to over 740 stores and same home delivery to over 520 stores.
Our comments	• Coles continues to exhibit pricing power with an ability to pass on higher inflation to end consumers. • The business was cycling a difficult period for its Express division (e.g. service stations) that looks to be lifting. • The thesis of a defensive portfolio holding with an ability to grow earnings (and dividends) in excess of inflation remains intact.

CSL Ltd (ASX: CSL)[1]

Share price	14/9/22: $289.63
Result	FY22
Revenue	US$10.562b, up 2.4% on the pcp.
Underlying EPS	US$4.80, a decrease of 8.05% on the pcp.
Key points	• CSL saw a decline in profitability for FY22 driven by weaker sales of immunoglobulin. This in turn was due to a weaker year for plasma collections that has begun to recover as lockdown restrictions eased in the second half of FY22.

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	• CSL completed its acquisition of Vifor Pharma, which will contribute to earnings for FY23 and expands the CSL portfolio into new areas of renal disease and iron deficiency diseases. • The company expects profits to grow 8.6% in FY23 (midpoint of guidance range), excluding its Vifor acquisition and costs related to it.
Our comments	• Coronavirus lockdowns and related restrictions have been a major challenge to the CSL business, cutting back its ability to collect plasma which feeds into sales of its core therapies such as immunoglobulin and albumin. • Higher plasma costs will remain a feature of FY23 as well but are expected to be at least partly offset by higher collection volumes. • Vifor will offer additional upside over the medium term with an expectation that it will be EPS accretive (including cost synergies of $75m per annum). • Overall, the business looks set for a return to its historic performance of mid to high single digit earnings growth and attractive returns on capital.

JB Hi-Fi Ltd (ASX: JBH)[1]

Share price	14/9/22: 40.75
Result	FY22
Revenue	$9.232b, up 3.54% on the pcp.
Underlying EPS	$4.775, up 8.05% on the pcp.
Key points	• Domestically, JB Hi-Fi Australia saw total sales growth of 4% and EBIT growth of 4.2%, while The Good Guys saw sales growth of 2.7% and EBIT growth of 12.5%. In both cases, the second half of the year saw a pronounced uptick as lockdown restrictions eased. • Its NZ business was weaker with total sales growth of only 0.3% and underlying EBIT down slightly by 1.3m to NZD 4.7m. A new Managing Director was announced for the NZ business; Tim Edwards, an experienced operator in the NZ consumer electronics and technology market, with an ambition to grow and expand its presence. • Total online sales rose 52.8% to $1.63b or 17.6% of total sales. This growth slowed in the second half, with online sales representing 11.9% of the total as the Australian economy reopened with all stores open during this period. • Strong sales growth from the second half of FY22 was maintained into July 2023, particularly in the Australian business.
Our comments	• Overall, JB Hi-Fi continues to execute well as a discretionary retailer. • It has clearly benefitted from the coronavirus lockdown period with a meaningful bringing forward of demand for household goods and electronics. • This is expected to subside and earnings to fall over FY23 and FY24 before beginning to recover according to market consensus estimates. • The business quality in our view remains intact as one of the best discretionary retailers in the Australian market. It is trading at an undemanding valuation of 12.2x FY24e earnings and there is scope for additional upside in the medium term if it is able to turnaround its relatively underperforming NZ business.

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Netwealth Group Ltd (ASX: NWL)[1]

Share price	14/9/22: $13.27
Result	FY22
Revenue	$169.54m, up 19.4% on the pcp.
Underlying EPS	$0.228, an increase of 3.1%.
Key points	• Net inflows continued to grow appreciably with $13b in FY22 increasing overall funds under administration (FuA) by 18.1% to $55.7b, more than offsetting a $4.5b decline to corrections in bond and equity markets. • Its overall market share climbed to 5.8% as of March 2022 according to a Plan For Life survey of the platform market. According to Investment Trends industry surveys, Netwealth also retained its leading position as a technology and platform offering to advisers. • Netwealth founder Michael Heine stepped down from the joint Managing Director role with his son Matt taking on the sole responsibility of Managing Director. • Overall, margins shrunk this year with a material uptick in capital spending and hiring new staff to improve the technology infrastructure and product offering and maintain its leading position in the platform market.
Our comments	• Netwealth remains well-positioned to grow at rates materially above the market over the medium term, with legacy providers seeing outflows as advisers depart and seek better option for clients. • Given its small size relative to the broader industry, there remains scope for inflows to offset potential market corrections (which reduce overall FuA). • In addition, if interest rates remain elevated over the medium term, its margin on client cash accounts will be an important boost to overall earnings growth.

REA Group (ASX: REA)[1]

Share price	14/9/22: $124.09
Result	FY22
Revenue	$1.160b, up 25% on the pcp.
Underlying EPS	$2.913, an increase of 17.7% on the pcp.
Key points	• REA increased its leadership relative to Domain according to Nielsen Digital Media Ratings with 12.7m people visiting its website on average each month and a 25% increase in active members. • In its outlook statement, the company guided to low-double digit growth in operating costs as a result of continued investment in staff and technology and further support for its international associate businesses. • The business outlook also acknowledged concerns over the macroeconomic backdrop, noting it can be a positive for demand of REA offerings as agents tend to lean more on these when demand becomes more subdued.
Our comments	• A strong result boosted by the large credit growth we saw in FY22. • The company is entering a potentially weaker phase now with reinvestment in its international operations and a likely slowdown in Australian demand. Over

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	the medium term it retains strong growth prospects but may risk weaker earnings in the near term. • Consensus is still pricing in a strong performance for FY23 with 10.6% in revenue growth and 13.3% in underlying EPS growth, and seeing this pace maintained out to FY25. • Overall, this remains a high-quality technology business with a strong earnings growth profile. It trades at a premium valuation but even after allowing for valuation derating presents an attractive return profile for the medium term.

Rio Tinto Ltd (ASX: RIO)[1]

Share price	14/9/22: $94.83
Result	H1 FY22
Revenue	US$29.775b, down 10% on the pcp.
Underlying EPS	US$5.327, a decline of 29.15% on the pcp.
Key points	• The biggest driver of the Rio result was the decline in iron ore prices (a comparably bigger slice of earnings than for BHP), with iron ore prices declining to $US120.50 per dry tonne compared to an average price of $US168.4 in the pcp. • Rio also increased their bid for Canadian-listed Turquoise Hill Resources for a total of US$3.3bn to be paid out of existing cash reserves. This will consolidate ownership of their flagship Mongolian operation You Tolgoi, which is set to be a major producer of copper and gold but has been beset by cost overruns in its development phase. • You Tolgoi looks set to achieve sustainable production in the first half of 2023. • The firm continued efforts to rectify its ESG failings with stronger governance in its relationship with Indigenous Australians and looking to improve its gender diversity from current levels. • The firm delivered production from its first new Pilbara min in over a decade at Gudai-Darri, supporting future volume growth.
Our comments	• Rio remains a leading global iron ore miner. • Consolidating ownership of You Tolgoi should diversify its earnings base away from iron ore which constitute almost 65% of EBITDA for the half (almost 75% for the prior half) even with the decline in iron ore prices. • Overall, the business remains well-placed to deliver volume growth in the medium term and should commodity trends remain favourable, shareholders will receive increased capital returns via dividends and buybacks in line with its tighter capital allocation policy.

South32 Ltd (ASX: S32)[1]

Share price	14/9/22: $4.32
Result	FY22
Revenue	US$9,3b, up 69% on the pcp.
Underlying EPS	US$0.543, an increase of 427% on the pcp.
Key points	• The company delivered an underlying profit of US$2.6b driven by elevated prices of coking coal (used for steel production) and aluminium. • It withdrew its extension proposal for its coking coal mine in Southern NSW, citing prospective returns as inadequate relative to the extensive.

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	• Group copper production is expected to increase by 14% in FY23, adding further diversification to its earnings base. • FY22 marked record shareholder returns of US$1.1b, equal to 10% of its market value (as of 19 August 2022). • Production volumes are anticipated to increase across most South32 mines with operating costs also climbing due to higher input costs e.g. electricity for aluminium and higher labour costs due to tight labour markets in the likes of Australia.
Our comments	• South32 remains a well-diversified exposure to several commodities needed for renewable energy transition efforts. • The miner continues to contain operating costs effectively and its focus on capital spending to drive efficiency should continue to support these efforts, while also boosting production volumes, which should help offset any price declines from a weaker global economic backdrop.

Steadfast Group Ltd (ASX: SDF)[1]

Share price	14/9/22: $5.03
Result	FY22
Revenue	$1.136b, up 26.2% on the pcp.
Underlying EPS	$0.176, an increase of 16.5% on the pcp.
Key points	• Steadfast announced a binding deal to buy the 41-year-old insurance broker, Insurance Brands of Australia (IBA) for up to $301m, with the price amounting to a 13.4x forecast EBITA multiple (including synergy benefits). • In addition to IBA, the company has guided to a further $220m in acquisitions of other broker businesses under its "trapped capital" strategy for FY23. This is where it is buying stakes in brokers within its network and capitalising on the mismatch between its higher valuation (~15x EBITDA) and the cheaper prices (~10x EBITA) that it typically pays for these positions. • This roll-up strategy would still have room to continue with the firm's broker network only accounting for a third of the intermediated general insurance market by revenue. Its ownership stake in these businesses is comparably smaller with equity positions in only 67 of the 427 within the network i.e. much less than the third of the market these businesses represent. • Both Steadfast Network brokers and Steadfast Underwriting Agencies saw double-digit revenue growth with a mix of volume growth and passed through premium increases from its strategic partners (general insurance companies).
Our comments	• The firm remains a defensive exposure with strong underlying growth from its acquisition strategy and organic growth in line with the broader intermediated insurance market. • The acquisition pipeline and execution is still validating the industry consolidation story for Steadfast. It does remain an area we monitor closely as slowing growth could see its premium valuation contract sharply. This has occurred in the past for other rollup businesses, e.g. Invocare consolidating the fragmented funeral home industry once acquisitions become insufficient in scale to boost business growth beyond the industry average.

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Seven Group Ltd (ASX: SVW)[1]

Share price	14/9/22: $18.39
Result	FY22
Revenue	$8.013b, up 65.6% on the pcp.
Underlying EPS	$1.53, an increase of 4.8% on the pcp.
Key points	• The overall boost in profitability was driven by strong performance in its Coates, Media and Energy (Beach Energy) holdings, which saw EBIT growth of 16.3%, 39.6% and 49.8% respectively. • FY22 marked a year of capturing control of Boral and refocusing its business onto the Australian construction sector. • Boral is being repositioned with repricing and cost control efforts to support earnings growth for FY23 after a decline of 32.3% in underlying EBIT for FY22 driven by lockdowns, weather disruptions and energy price increases. • Seven remains a major shareholder in Seven West Media (ASX: SWM), which also saw strong underlying earnings growth (up 51.9%) and guided to a share buyback of up to 10% of its market value in response to a depressed valuation. • The Coates industrial services business benefitted from increased infrastructure spending and saw a growing pipeline of renewables construction activity as a future growth opportunity. It also showcased pricing power and operating leverage in its ability to grow margins and offset inflationary cost pressures.
Our comments	• The Seven result highlighted the diversification benefits of a conglomerate structure with enough parts of the business performing strongly to offset a weaker result from Boral. • Business repositioning of Boral should support earnings growth in FY23 but may be complicated by the slowdown underway in the property sector due to higher interest rates. • The broader business trades at an undemanding multiple given its pricing power and growth prospects, remaining attractive in our view.

Transurban Group (ASX: TCL)[1]

Share price	14/9/22: $13.40
Result	FY22
Revenue	3.406b, an increase of 18% on the pcp.
Operating profit	$574m, up 4.2% on the pcp.
Key points	• Transurban saw a continued recovery in traffic across its network over FY22. While traffic was still down 0.5% for the year, it saw a marked bounce in the June quarter to exceed pre-pandemic levels and a Transurban record of 2.4 million trips per day. • The pricing power, inherent in its toll road concessions, remained supportive of earnings and distributions while its debt hedges saw its financing costs decline in FY22. • The firm guided to a continued recovery in distributions with a 30% increase anticipated for 2023 to 53c per share. This may be exceeded if traffic flows continue to improve notwithstanding the cost of higher interest rates given the company's debt burden. • Project construction costs remained a point of concern with an extra $2bn required to construct Melbourne's West Gate Tunnel and conclude a dispute with the Victorian State Government over cost blowouts.

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Our comments	• The company's toll road assets remain an attractive exposure in the current period of elevated inflation with pricing power and an expected recovery in volumes to drive revenues for FY23 and beyond. • The business is not immune to inflation, however, particularly in its spending to grow further with rising construction and energy costs necessitating more funding from internal cashflows or additional borrowing. • We remain attracted to the quality of its concession assets with no other parallel on the Australian market and see additional value as an ongoing beneficiary of the coronavirus reopening theme.

Telstra Corporation Ltd (ASX: TLS)[1]

Share price	14/9/22: $3.88
Result	FY22
Revenue	$22.045b, down 4.7% on the pcp.
Underlying EPS	$0.144, a decline of 7.7% on the pcp.
Key points	• Underlying EBITDA saw a boost of 8.4% on the pcp thanks to strong performance for Telstra's mobile phone division with price increases, a boost from roaming services on the reopening of international borders and cost-cutting efforts (expenses fell $540m for the full year). • The existing pricing model for the NBN continued to drag on earnings per share, contributing to a weaker result alongside other one-off expenses. Signs of a potential repricing of the existing NBN model may be a welcome offset for telco businesses to generate more profitability out of their broadband divisions. • The firm is moving ahead on its efforts to restructure the business ahead of potential divestment. • The full-year dividend rose for the first time since 2015 by 3.1% to 16.5con the back of the improvement in underlying earnings per share.
Our comments	• The Telstra result saw some welcome growth in underlying earnings and potential for an NBN repricing would be a welcomed boost to overall profitability. • In the near term, we expect the firm to trade as though it were under a takeover bid consistent with the expected value garnered from a breaking up of the business. This has been how shares have traded since the launch of its T25 strategy in September last year, which laid out the potential separation of its infrastructure business from the retail-facing divisions.

Wesfarmers Ltd (ASX: WES)[1]

Share price	14/9/22: $46.45
Result	FY22
Revenue	$36.838b, up 8.5% on the pcp.
Underlying EPS	$2.076, a decline of 1.7% on the pcp.
Key points	• Business results are cycling a period of strong performance, particularly at Bunnings which saw 0.9% growth in EBT for FY22. • This was insufficient to offset EBT declines of 31.7% and 14.6% in Kmart and Officeworks respectively. • Continued investment in the Wesfarmers online offering, Catch, was also a drag on results with EBT losses almost doubling from 46m to 88m in FY22.

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	• Results at the Wesfarmers Chemicals, Energy and Fertilisers division (WesCEF) were a welcome offset with a 40.6% jump in EBT thanks to stronger global commodity prices for energy and fertiliser products.
Our comments	• FY22 was always set to be a tough year to continue growing with COVID-19 stimulus programs pulling forward demand, particularly at the flagship franchise of Bunnings. • This result was, under the circumstances, a positive one with other arms of the conglomerate, such as WesCEF, helping lift overall profits and offset a slowdown in Bunnings growth. • One concern is the increased spend on Catch and when (or if) this will pay off with the uplift in spending accompanied by a 3.4% decline in revenue as it appears there was excessive inventories requiring discounting and negatively impacting profits. • Exposure to the Mt Holland project (a joint venture with Chilean miner SQM) offers renewable commodity exposure and diversification to the broader business over the medium term.

Woolworths Ltd (ASX: WOW)[1]

Share price	14/9/22: $35.23
Result	FY22
Revenue	$60.849b, up 9.3% on the pcp.
Operating Profit	$2.623b, a decline of 5.9% on the pcp.
Key points	• Woolworths saw a decline in profitability driven by substantial coronavirus-related costs including elevated input price inflation. Other contributors included stronger wage increases and the impact of East Coast floods on vegetable supply (and ultimately prices). • The firm's New Zealand division was materially impacted by coronavirus costs, which saw a decline in earnings. • In line with its ecommerce strategy, Woolworths moved to acquire control of online marketplace MyDeal.com.au to broaden its existing marketplace capabilities and branch out into verticals, such as furniture and other bulky goods not typically offered.
Our comments	• Woolworths has navigated the pandemic relatively well but has not been immune to cost challenges that saw earnings retreat this financial year. • Investments in its ecommerce business continue to expand with MyDeal representing a material uptick. While on the one hand, it plugs in to the broader Woolworths distribution infrastructure, managing a marketplace strategy can be difficult to scale profitably and the end success of this approach remains to be seen. • In the meantime, the business continues to display a measure of pricing power and resilient consumer demand that should continue to serve it well as a defensive holding in the portfolio.

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International equity portfolio

Note: All figures in USD unless otherwise stated. Results referring to percentage changes (increases/decreases) relate to the previous corresponding period (pcp) e.g. Q4 FY22 results are compared to those of Q4 FY21.

Apple Inc (AAPL: US)[1]

Share price	14/9/22: US$155.31
Result	Q3 FY22
Revenue	US$82.96b, up 1.9% on the pcp.
Underlying EPS	US$1.20, a decrease of 7.4% on the pcp.
Key points	• A record revenue result was led by growth in its iPhone and Services divisions. • The business continued to return capital to shareholders with over US$28b in dividends and share buybacks. • The company also noted easing shortages for parts (still costly at $4b in the June quarter), and iPhone demand holding up even against a tougher economic backdrop with US rate hikes impacting consumer confidence. • The slowing economy did see some segments underperform, notably advertising and more fringe consumer goods e.g. accessories and home products. • A rising US dollar was another headwind, reducing sales by 3% in the June quarter and expected to drag in the September quarter with the US trade-weighted dollar index up 3.8% quarter-to-date.
Our comments	• The quality of Apple franchise remains undiminished in our view. The recent iPhone 14 launch could serve as a meaningful catalyst for stronger revenue growth in line with the company's outlook. • A strong US dollar will impact earnings but offset partially by easing of supply chain challenges. • Apple has remained a safe haven for investors this past year notwithstanding the macro backdrop. This has supported the share price but leaves the valuation more challenged notwithstanding the quality of the business.

Adobe (ADBE: US)[1]

Share price	14/9/22: US$371.52
Result	Q2 FY22
Revenue	US$4.386b, up 14.4% on the pcp.
NPAT	US$3.35, an increase of 10.6% on the pcp.
Key points	• Adobe saw 15.5% revenue growth in its digital media segment, 12% in its Creative revenue and 27% in its Document Cloud offering. • The business continued to build annualised recurring revenue (ARR), a measure of repeat business, across its key segments with $464m added for the quarter in net terms after allowing for customer churn. • The firm is targeting another US$430m in net ARR for the September quarter. • It has however downgraded its guidance due to headwinds from the strong US dollar and discontinued Russian sales with a 1.5% downgrade to adjusted EPS to $13.50 and a 1.4% downgrade of revenue to US$17.65bn for FY22 in contrast to its remarks at the beginning of 2022.

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Our comments	• While the derating in the first half of 2022 was painful, the Adobe business continues to execute well in our eyes. • Its breadth of tools makes it well-suited to the rise of new or more popular forms of media for creatives, and the building ARR book suggests it retains stickiness amongst users. • Overall, notwithstanding currency headwinds and other challenges, we believe the business remains well-placed to compound earnings in the high single-digits or low double-digits over the medium term. • At 24.8x FY23 estimated earnings, we believe that remains an attractive investment proposition with buybacks helping add to earnings growth over time.

Abbott Laboratories (ABT: US)[1]

Share price	14/9/22: US$105.78
Result	Q2 FY22
Revenue	US$11.26b, up 10.1% on the pcp.
Underlying EPS	US$1.43, an increase of 22.2% on the pcp.
Key points	• The company is working to recapture market share in the baby formula market. • Production has resumed in its Michigan facility after being halted on quality concerns with initial reports highlighting early success, although the shutdown had given opportunity for new competition including overseas producers from Australia. • The company is facing a class action over said quality concerns with some claims alleging damage or even wrongful death. The company has been forceful in its rejection of these claims and leaned on its own testing that the bacteria associated with the wrongful deaths was not related to any located on site, which could be the result of mishandling the product after it left their plant. • The company upgraded its 2022 guidance for underlying EPS by 4.3% from US$4.70 per share to $4.90. Key drivers were strong demand for its medical devices and diagnostics products. • The company's innovative Aveir pacemaker received FDA approval with its leadless nature, allowing for it to be replaced much more easily than rival options, which is one example of their continued innovation bearing results.
Our comments	• COVID-19 testing sales remain a potent earnings driver with US$6.1bn anticipated for 2022, although this has declined substantially from peak levels. • The plant resumption is welcome news for its Nutritional division, although we note baby formula in the context of the overall company is a material but small contributor, with other nutrition products continuing to see growth to June 2022. • The company declared its 394th consecutive quarterly dividend and has increased its dividend for 50 consecutive years, highlighting its growth over time and the quality of its operations to continue paying dividends through several recessions over that period. • Despite challenges in the form of losing COVID-19 diagnostic sales and lawsuit disruptions, the business remains well-positioned for strong growth over time and investors will benefit from both this and a regular increasing dividend, presenting an attractive total return versus the broader market in our view.

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Alphabet Inc. (GOOGL: US)[1]

Share price	14/9/22: US$105.00
Result	Q2 FY22
Revenue	US$57.47b, up 12.8% on the pcp.
Underlying EPS	US$1.21, a decrease of 7.7% on the pcp.
Key points	• Google showed signs of greater sensitivity to the global economy with weaker demand offsetting the secular trend of ads transitioning from traditional media to online. • YouTube ad sales, for example, grew at their slowest pace since the company first disclosed its individual results in 2018. • The weaker global economy and higher inflation has seen some businesses cut back on advertising spending, although Google has fared better than other players, such as social media options in Snap or Meta, with sales for Google Search beating consensus expectations. • Currency was a notable drag with more impact anticipated for the September quarter as the US dollar has remained elevated. • Sales at Google Cloud and YouTube missed expectations slightly by US$100m and US$200m respectively.
Our comments	• The Alphabet group has shown signs of sensitivity to global economic conditions, which is unsurprising given the elevated growth since the pandemic began. • Google Cloud remains a source of longer-term revenue growth (up 35.6% for the June quarter year-on-year) and operating losses are continuing to shrink. • The current valuation is undemanding for a business of its quality and it has shown greater sensitivity to antitrust concerns with its Google Play store (reducing its take rate on third party apps according to Reuters) relative to the Apple position, which should serve it in good stead should this become a material issue in the future.

Johnson & Johnson (JNJ: US)[1]

Share price	14/9/22: US$164.66
Result	Q2 FY22
Revenue	US$24.02b, up 3% on the pcp.
Underlying EPS	US$2.59, up 4.4% on the pcp.
Key points	• The stronger-than-expected demand for cancer drug Darzalex and its coronavirus vaccine were notable positives, with the latter generating revenues of US$544m vs a consensus estimate of US$138m. • The stronger US dollar dragged on international business performance, similar to other American multinationals. It also led the company to reduce its FY22 profit guidance by 1.5% from US$10.15 to US$10.35 per share to US$10.00 to US$10.10 per share. • China's coronavirus-related lockdowns dragged on medical device sales, while a mix of inflation and supply shortages negatively impacted results in its consumer health unit. • It has responded to the latter with price increases on select products, including painkillers and mouthwash, highlighting its pricing power for products, such as Listerine.

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Our comments	• The revised guidance is a disappointment but unsurprising given the strength of the US dollar, which is up over 13% on a trade-weighted basis (against a basket of other currencies). • The business has shown the benefits of its diversified operations in being able to navigate a difficult macroeconomic backdrop and eke out earnings growth. • Our opinion on JNJ as a mature but growing business at a reasonable valuation remains intact. The ability to reprice its pharmaceutical products also highlights the quality of the brands within its stable.

Microsoft Corporation (MSFT: US)[1]

Share price	14/9/22: US$252.22
Result	Q4 FY22
Revenue	US$51.865b, up 12.4% on the pcp.
Underlying EPS	US$2.23, an increase of 2.8%.
Key points	• Microsoft guided to continued strength in sales with FY23 expected to see double-digit growth driven by demand for its cloud computing services, including Azure. • Microsoft is benefiting from an ongoing trend of shifting work online with a range of offerings, such as Office365 and its Azure cloud computing services, being able to profit on this trend. • The company missed slightly on consensus results due to the strength of the US dollar (weakening international revenues in USD terms), as well as reduced sales of PCs and advertising (predominantly via its LinkedIn and search engine operations). • Azure saw revenue growth of 40% with a record number of US$100m+ and US$1bn+ deals according to the CEO Satya Nadella, who also guided to additional data centre launches over the next year to satisfy customer demand.
Our comments	• Microsoft is continuing to defy expectations, thanks in part to the strong execution of its Cloud offering, which is also capitalising on its embedded position in many established firms. • The business is still subject to broader macroeconomic trends with US dollar strength and a slowing economy impacting some of its operations notably in Gaming and advertising. • Our overall thesis on the business remains intact, with the shift to the cloud offering a path to continued earnings growth, returns on capital at a premium to the broader market and a reasonable valuation in our view.

Nestle S.A. (NESN: CH)[1]

Share price	14/9/22: CHF 109.10
Result	H1 FY22
Revenue	CHF 23.342b, up 12.95% on the pcp
Key points	• Nestle saw organic sales growth of 8.1% split between 1.7% of real internal growth (RIG, a volume measure) and 6.5% of pricing growth. • Total sales rose 9.2% for the half, with net acquisitions contributing 1% and foreign exchange a further 0.1%. • Overall margins were impacted by builds in working capital (supply chain and high demand), as well as capital spending needs for taking parts of the business online and improving sustainability in line with Nestle's ESG goals.

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Our comments	• The company updated its FY22 outlook with an expected organic sales growth rate of 7-8% and an underlying operating profit margin of approximately 17%. This amounted to a slight uptick on sales growth (up from 5%) and slight reduction in profit margins (down from a range of 17-17.5%). • The business announced the acquisition of several brands to augment its Health Science division in adding new nutritional products that will add to overall sales growth but be slightly dilutive to profit margins in 2022 consistent with its restated guidance.
	• Nestle continues to exert strong pricing power, leveraging the power of its brands to maintain positive volume growth. • The business has performed well, given its global scope, in containing inflationary pressures in its cost base and also passing on increases to end consumers. • Emerging markets remain a growth segment with organic growth of 10% vs 6.9% in developed markets. • Overall, the business remains well-placed to continue generating high single-digit earnings growth without being overly troubled by inflationary challenges and returning capital back to shareholders in the form of dividends and buybacks.

Samsung (SMSN: UK)[1]

Share price	14/9/22: US$1,016.00
Result	Q2 FY22
Revenue	US$61.22b, up 7.8% on pcp.
Underlying EPS	US$1.279, an increase of 3.1% on the pcp.
Key points	• Samsung saw an operating profit increase of 11% and a 21% increase in revenue. • This came against a backdrop of an expected supply glut for memory chipmakers as demand cooled in the face of elevated inflation crimping spending. • Samsung's result was supported by ongoing demand amongst US tech companies for data server chips to meet growing demand for their cloud offerings. • Smartphone demand saw some weakness amid slowing global demand with low and mid-end smartphones seeing a bigger comparable hit.
Our comments	• Our thesis of Samsung as a diversified industrial conglomerate continuing to target high growth areas of the economy, such as tech hardware, remains intact. • Currency impacts help cushion earnings with much of its business located offshore and the Korean Won tending to depreciate in periods of market dislocation. • Exposure to a weaker global economy is hitting some divisions, e.g. smartphones, but is being cushioned by other segments with secular growth drivers, such as the chips supporting the transition to cloud computing. • The business continues to reinvest aggressively, which should support its technological edge over the medium term.

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Union Pacific Corporation (UNP: US)[1]

Share price	14/9/22: US$217.95
Result	Q2 FY22
Revenue	US$6.27b, up 13.9% on the pcp.
Underlying EPS	US$2.93, an increase of 7.7% on the pcp.
Key points	• Union Pacific saw both operating revenue and EPS growth of 14% and 7.7% on its June 2021 quarter result. • This result belied substantial challenges in the form of elevated fuel prices and strong inflation in the quarter (wages and other input costs). • Key offsets included higher revenue from fuel surcharges, a more positive business mix (some cargos allow for higher margins) and price increases. • Volumes slipped slightly, down 1%, while the operating ratio (a measure of business efficiency) worsened by 5.1%, driven in part by higher fuel prices. • The company affirmed its pricing would offset inflation impacts for 2022 but downgraded its prior targets for full year volume and operating ratio performance. Previously it has forecast volume growth in excess of US Industrial Production (consensus forecast 4.3%) with the new target growth of 4-5%.
Our comments	• Our overall view on the business remains intact. • Arguably, more than other businesses, it has seen meaningful challenges from supply chain disruptions, higher labour costs and energy prices. • It has however demonstrated the quality of its moat with pricing power being a key lever in countering these impacts and passing them on to the end customer instead of absorbing through lower profit margins. We continue to see Union Pacific as an inflation-protected annuity stream that supports our portfolio with its defensive nature.

Visa Inc. (V: US)[1]

Share price	14/9/22: US$199.41
Result	Q3 FY22
Revenue	US$7.275b, up 18.7% on the pcp.
Underlying EPS	US$1.98, an increase of 32.9% on the pcp.
Key points	• Visa saw a strong result ahead of consensus estimates in the June quarter with EPS of US$1.98 (consensus: US$1.75). • Key drivers included the resilience of consumer spending to date and increased travel demand in the Northern hemisphere, notably the US. • The payments processor saw payment volumes rise strongly by 12%, boosted by a 40% surge in cross border volumes with this latter segment seeing travel-related cross-border volumes now 16% above pre-coronavirus 2019 levels.
Our comments	• Visa continues to play a role in global commerce as a key payments processor, with its duopoly with Mastercard remaining intact. • Travel volumes are a notable boost to overall sales and as travel demand continues to recover, it remains a useful upside catalyst in the near-term notwithstanding the challenges of higher energy prices to discourage consumer spending.

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	• The business has maintained margins and seen earnings recover in line with the boost to consumer spending, justifying our position as a high-quality exposure to global commerce.

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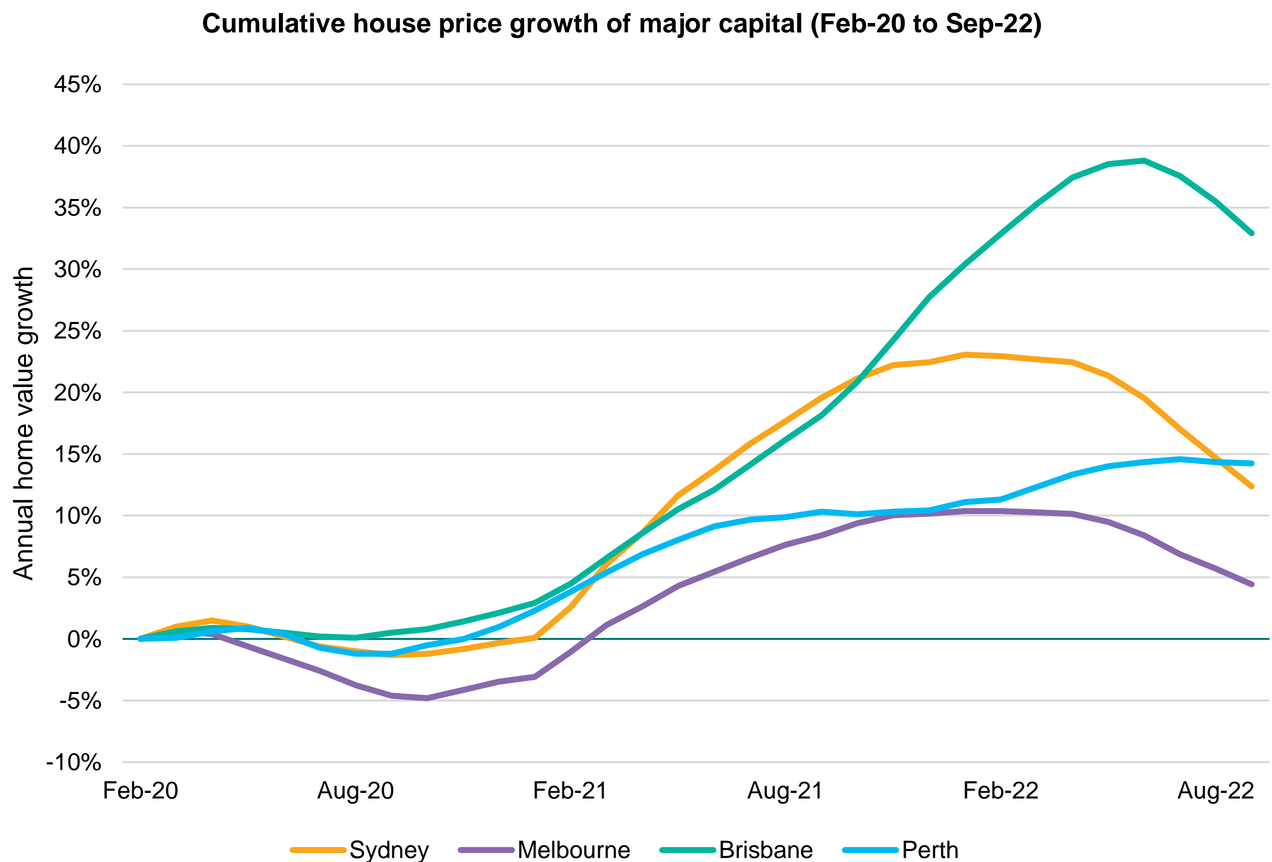
Australian property market update

Introduction

The Australian property market has seen substantial ebbs and flows in recent years following the onset of the coronavirus pandemic in 2020. Concerns over economic weakness saw a spell of static price growth as residents struggled through lockdowns before a wave of fiscal and monetary support saw material house price appreciation from late 2020 until earlier this year.

We can see this depicted below where the chart shows the cumulative growth in house prices since February 2020 until September 2022. Interestingly, smaller capitals have been leading price appreciation since the onset of the pandemic. This includes Brisbane, which benefited from increased interstate migration flows as the pandemic saw people readjust their household arrangements.



Source: Bloomberg, CoreLogic

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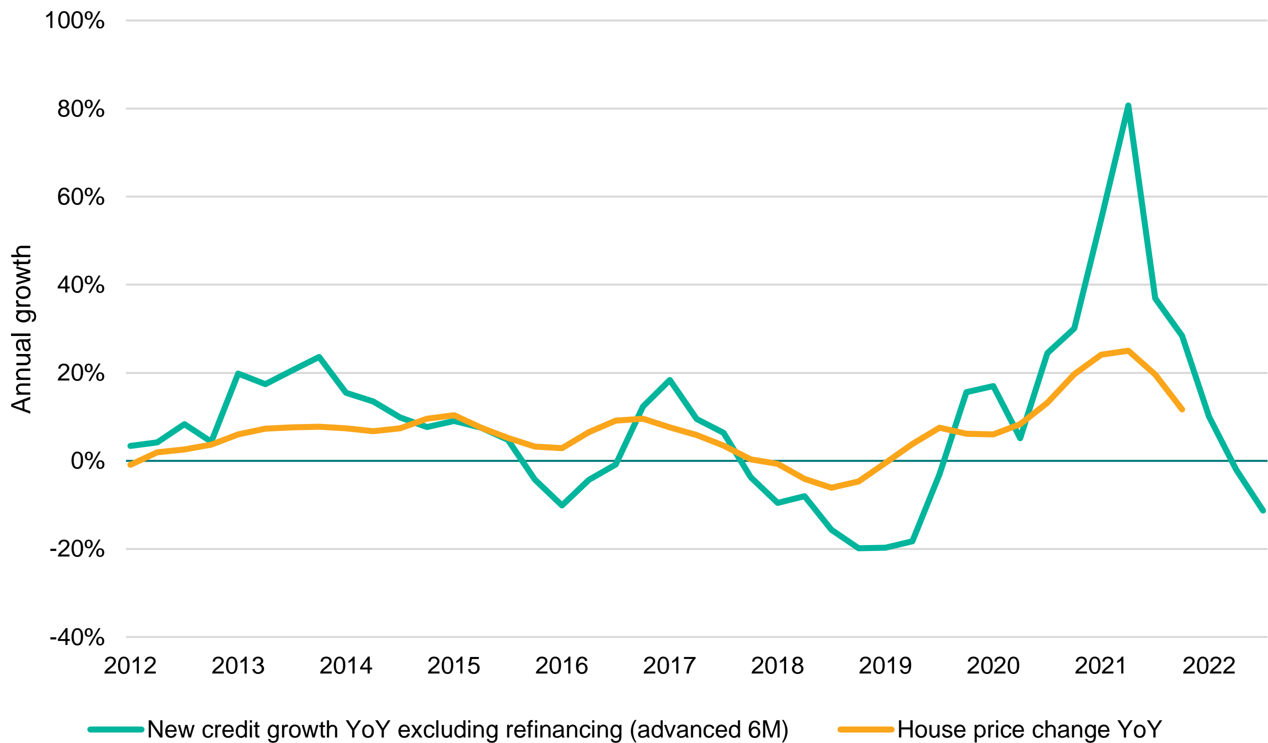
Potential path of property prices

The potential decline in prices from their peak earlier this year has drawn a variety of forecasts from the economist and fund manager community, with some, such as CBA, seeing a 15% decline[2] and others, such as Coolabah Capital, arguing for a drop of 20% or potentially even worse[3].

In our view, the exact quantum is difficult to determine. We do know however that the supply of new credit is a key driver of higher house prices. It also typically leads the latter by several months. The below chart suggests material downside for house prices (at least -10% off peak levels) until credit growth is able to stabilise.

Annual growth in new housing credit (excluding refinancing) vs House Prices (Sep-12 to Mar-23)



Source: ABS

The rise in the cash rate from 0.1% in April to 2.35% in early September has made mortgages more expensive without a matching rise in incomes over that period. To be specific, mortgage repayments for a median Sydney house (assuming a 30-year loan and repayment of principal and interest) for example, has jumped over 18% since March 2022 for fixed and variable rate loans. Wage growth over the June quarter was only 0.7% according to the ABS and will not see a meaningful uptick in the September quarter that would match the increase in repayments. Until prices correct further, it is difficult to see credit growth turn positive.

Sydney median house mortgage repayments – variable vs fixed rate (Sep-07 to Sep-22)

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[2] J. Bragg, 'CBA forecasts 15% decline in house prices by mid-23', *Investor Daily*, 2022, https://www.investordaily.com.au/news/51946-cba-forecasts-15-decline-in-house-prices-by-mid-2023#:~:text=The%20bank%20now%20believes%20prices,reached%20in%20April%20this%20year (accessed 15 September 2022).

[3] C. Joye, 'Sydney house prices on track for 20pc fall', *Australian Financial Review*, 2022,https://www.afr.com/wealth/personal-finance/sydney-house-prices-on-track-for-20pc-fall-20220713-p5b1a6 (accessed 15 September 2022).

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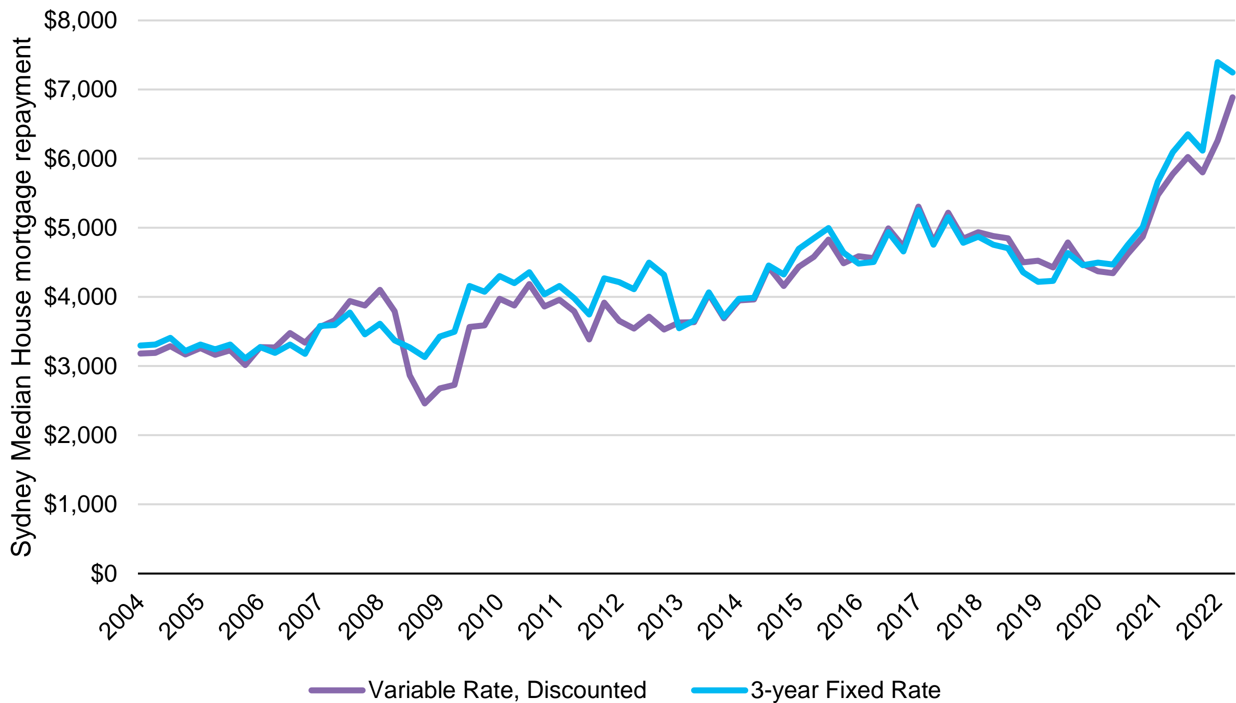
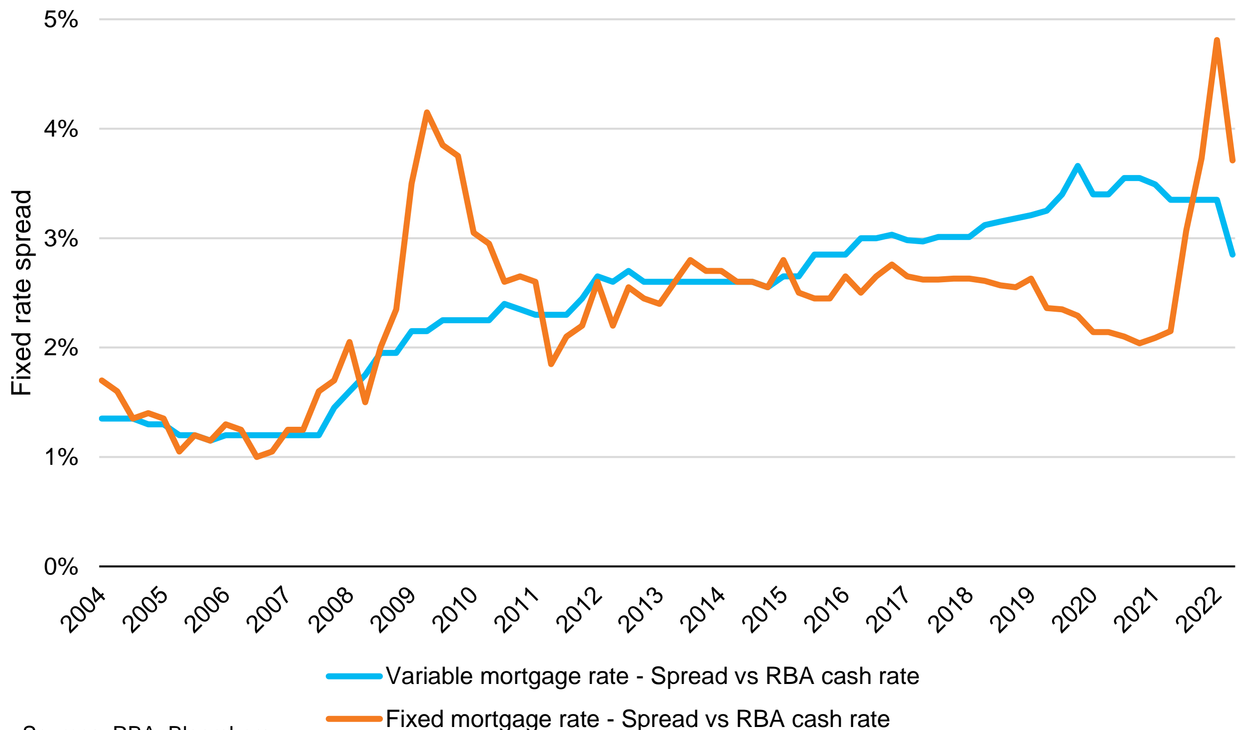


Sources: ABS, Bloomberg, RBA, CoreLogic, PPSWM calcualtions

Should you fix your mortgage rate now?

In short, no. Mortgage rates are priced at a premium above the RBA cash rate. Currently fixed rates are at a meaningful premium to variable rates that makes them relatively unattractive as an option.

Australian fixed and variable mortgage rate spread versus the RBA cash rate target



Sources: RBA, Bloomberg

Note: Above chart uses August 2022 rates instead of September 2022 rates due to data availability.

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In periods of market dislocation, this relationship can break down and fixed rates are offered at a meaningfully higher premium to average. To fix rates today would mean locking in that premium with a rate of 6.1% and is unattractive, especially when contrasted to the average discounted variable rate sitting at 5.2% (both as at August 2022). In addition, the economic outlook is expected to soften which should meaningfully slow or halt RBA interest rate hikes. If the anticipated slowdown is sufficiently severe, we may even see cuts to interest rates. Both are factors that would benefit variable rate borrowers relative to those fixing at today's levels.

Accordingly, we suggest that until the spread between variable and fixed rate offerings meaningfully contracts, you are best advised to avoid fixing your mortgage rate.

Conclusion

In summary we expect house prices to continue correcting in the near-term with a peak to trough decline in the range of -10 to -20 per cent, given the relationship with new credit growth. We also suggest that you hold off on fixing your mortgage today due to the excessive premium being demanded for fixing your rate. There is potential for further upside in this scenario if rate hikes are halted or even reversed over the next year.

This view is general advice only and does not take into account your personal circumstances or finances. If you have further questions, we encourage you to consult with your adviser.

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