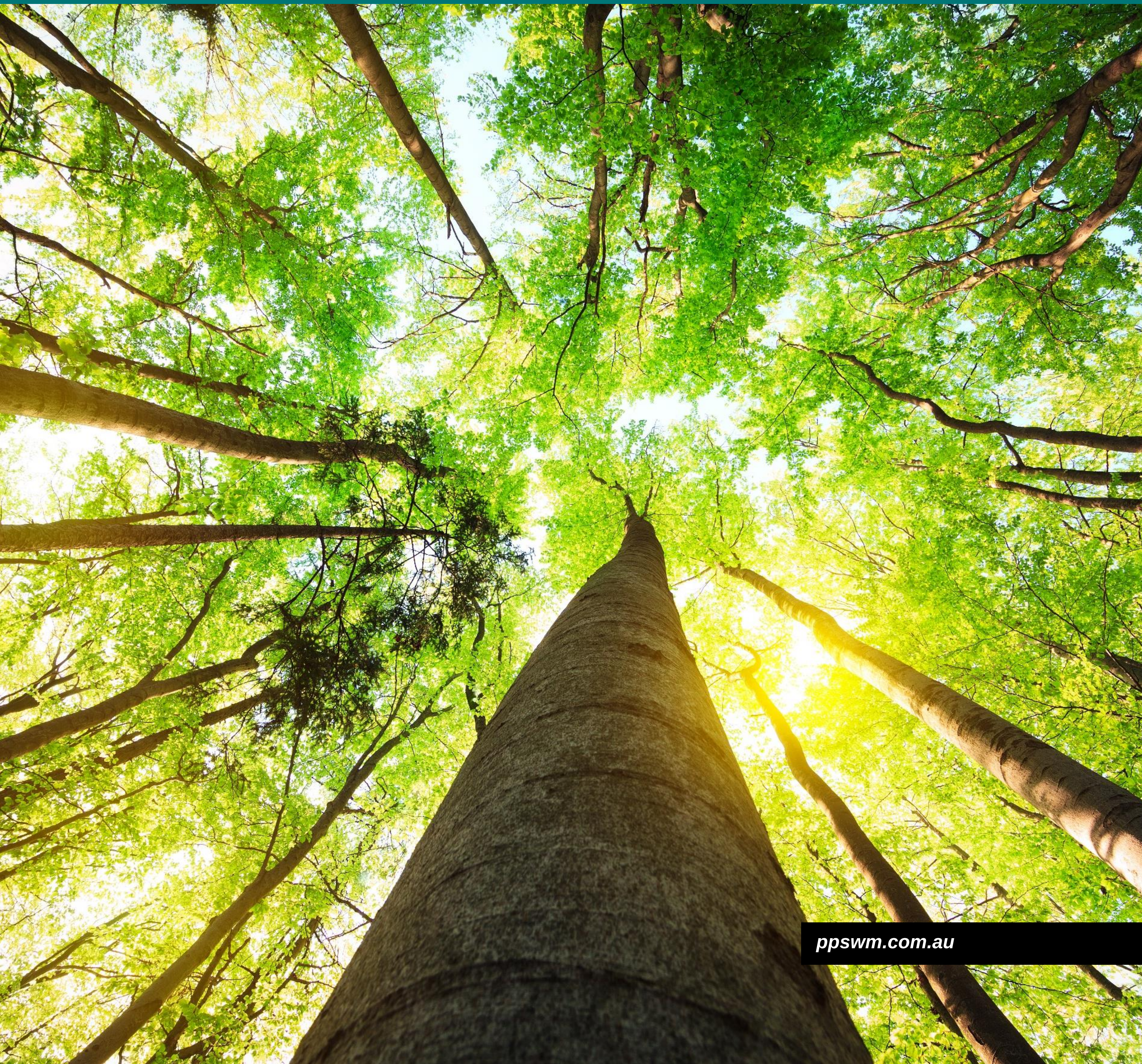
Wealth Update

Summer 2023-24



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Summer 2023-24

Welcome to our latest Wealth Management Update.

This edition covers the following topics:

- Proposed tax on superannuation balances above $3 million
- Australian banking sector update
- Reporting season update – International equities

Proposed tax on superannuation balances above $3 million

On 3 October 2023, Treasury released detailed draft legislation[1] and explanatory materials[2] on the proposed tax on superannuation balances exceeding $3 million. This has helped clarify a lot of the uncertainty surrounding the proposal when it was first announced. Interestingly, the legislation is not housed in the Superannuation Act but in a new Division (296) of the Income Tax Assessment Act 1997. Members that will be subject to this new tax regime will be issued a notice of assessment personally and given 84 days to pay the tax. They will also be given the option for the tax to be released from their super fund if they wish.

How will it operate?

In summary, the tax is proposed to start from the 2025/26 financial year and is intended to operate as follows:

To calculate tax payable, there are a number of steps that we have simplified below;

Step 1: Calculate taxable superannuation earnings

Current adjusted total superannuation balance - previous total superannuation balance (TSB)

Where:

Current adjusted total superannuation balance means the greater of:

1. Your *adjusted total superannuation balance* (as defined below) at the end of the year; and
2. The large superannuation balance threshold ($3 million)

Previous total superannuation balance means the greater of:

1. Your *total superannuation balance* (TSB) as at 30 June in the prior financial year; and
2. The *large superannuation balance threshold*.

Adjusted total super balance includes a list of adjustments but in most instances, it will be your TSB at the end of the financial year

Plus:

- *Super benefits paid during the year*

Less:

- *Non-concessional contributions made during the year*
- *85% of concessional contributions made during the year*

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[1] *Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 Exposure Draft*, Parliament of the Commonwealth of Australia, September 2023: https://treasury.gov.au/sites/default/files/2023-09/c2023-443986-laws-ed.pdf

[2] *Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 Exposure Draft Explanatory Materials*, Parliament of the Commonwealth of Australia, September 2023: https://treasury.gov.au/sites/default/files/2023-09/c2023-443986-em.pdf

Step 2: Calculate the proportion (%) of earnings that is attributable to a superannuation balance in excess of $3 million

$$\frac{\textit{Your total superannuation balance at the end of the year} - \textit{The large superannuation balance threshold}}{\textit{Your total superannuation balance at the end of the year}} \times 100$$

Step 3: Calculate Division 296 tax payable by multiplying outcomes of (Step 1) x (Step 2) above by the 15% tax rate

Note: If the calculated taxable superannuation earnings amount is ***negative*** – this will create a carry-forward loss (for Div 296 purposes only) known as the ***unapplied transferrable negative superannuation earnings.*** This can be deducted from future earnings and can be carried forward indefinitely.

Example

Facts

- Tara has a self-managed super fund and is the sole member
- Pension fund balance 30/6/25: $1.7m
- Accumulation fund balance 30/6/25: $2.0m
- Total super balance of combined funds as at 30/6/26: $4.1 million
- Income + realised gains in FY26: $150,000 ($80,000 accumulation/$70,000 pension)
- Unrealised gains FY26: $350,000
- Pension drawn in FY26: $100,000
- Realised gains made on investments held for less than 12 months

Workings

- Taxable superannuation earnings: ($4.1m + $0.1m) - $3.7m = $0.5m
- Proportion of earnings above $3m: $\frac{\$4.1\text{m} - \$3.0\text{m}}{\$4.1\text{m}}$ = 26.83%
- Division 296 tax payable: $500,000 x 26.83% x 15% = $20,122

Summary

- **Total tax paid**
  Division 296 payable by Tara: $20,122
  Plus: Tax payable by SMSF on regular earnings
  (income + realised gains) in accumulation phase: 15% x $80,000 = $12,000
  Total tax: $32,122
- Effective tax rate (on $500,000 total earnings): 6.4%
- Effective tax rate (on $150,000 of ordinary taxable income): 21.4%

Conclusion

In this example, Tara would be subject to an extra $20,122 in tax. There is however no tax benefit in Tara reducing her member balance to below $3 million by taking funds out of the superannuation environment once she has met a condition of release. This is because the effective tax rate on the $500,000 gain on her combined super balances is 6.4% p.a., which is still much lower than the tax rate that would apply by holding assets in her personal name, or via a trust or company structure.

Scenario analysis

To understand the potential impact of the tax on different account balances in an average year for investment markets, we have performed modelling below assuming a super fund member is in accumulation phase.

Assumptions

The assumptions used are as follows:

- The average balanced (60/40) super fund returns 7.5% p.a. over the long run[3]
- The 7.5% return consists of 4% income and 3% realised gain
- Realised gains have been held for less than 12 months
- Latent tax has been calculated on unrealised gains for consistent comparisons across different structures.

Outcomes

The tax position for different accumulation balances can be shown as follows;

Superannuation – Accumulation phase examples assuming different fund balances invested in balanced option

(A) Accumulation Fund balance start of year	(B) Income and Realised gains 4%pa	(C) Unrealised gains 3.5%pa	(D) Closing balance	Proportion of earnings over $3m	(E) Division 296 tax	(F) =(B) x 15% Tax on Accumulation Earnings	(G)= C x 10% Latent CGT on Unrealised gains	(H)=E+F+G Total tax	H/(B+C) Effective tax rate Total earnings
3,000,000	120,000	105,000	3,225,000	7%	2,355	18,000	10,500	30,855	14%
4,000,000	160,000	140,000	4,300,000	30%	13,605	24,000	14,000	51,605	17%
5,000,000	200,000	175,000	5,375,000	44%	24,855	30,000	17,500	72,355	19%
6,000,000	240,000	210,000	6,450,000	53%	36,105	36,000	21,000	93,105	21%
7,000,000	280,000	245,000	7,525,000	60%	47,355	42,000	24,500	113,855	22%
8,000,000	320,000	280,000	8,600,000	65%	58,605	48,000	28,000	134,605	22%
9,000,000	360,000	315,000	9,675,000	69%	69,855	54,000	31,500	155,355	23%
10,000,000	400,000	350,000	10,750,000	72%	81,105	60,000	35,000	176,105	23%
11,000,000	440,000	385,000	11,825,000	75%	92,355	66,000	38,500	196,855	24%
12,000,000	480,000	420,000	12,900,000	77%	103,605	72,000	42,000	217,605	24%

Source: PPSWM calculations.

Based on these scenarios, we can offer the following comments:

- Ordinarily, the tax rate on superannuation in accumulation phase is 15%. Tax is levied on income plus realised gains. Realised gains where the asset was held for more than 12 months is taxed on only 2/3 of the gain, bringing the effective rate down to 10%.
- The proposed Division 296 tax is unusual in that it includes unrealised gains in the calculation.
- The effective rate of tax shown in the table above is the total tax paid (including latent CGT on unrealised gains) divided by the total earnings. In this example, we have included unrealised gains in the definition of total earnings.
- The effective tax rate in these examples peaks at 24% above $12 million. If a client could achieve a lower effective tax rate in a different structure, then consideration could be given to alternate ownership structures.

[3] According to Chant West, this represents the average balanced fund return for the 7 years ending 30 June 2023.

Where clients have met a condition of release, should they consider moving funds outside of superannuation instead to reduce tax?

If funds were instead held outside of super, then the effective tax rate paid by an individual or corporate is shown below:

Tax implications of portfolios held outside of super

(A) Portfolio balance start of year	(B) Income and Realised gains 4%p.a.	(C) Unrealised gains 3.5%p.a.	(D) Closing balance	Individual *Assessable Income + Latent CGT*	Individual *Tax payable (including tax on Latent CGT)*	Individual *Effective tax rate Total earnings*	Corporate *Effective tax rate Total earnings*	Superannuation *Effective tax rate Total earnings*
3,000,000	120,000	105,000	3,225,000	172,500	46,792	21%	30%	14%
4,000,000	160,000	140,000	4,300,000	230,000	69,691	23%	30%	17%
5,000,000	200,000	175,000	5,375,000	287,500	96,716	26%	30%	19%
6,000,000	240,000	210,000	6,450,000	345,000	123,741	27%	30%	21%
7,000,000	280,000	245,000	7,525,000	402,500	150,766	29%	30%	22%
8,000,000	320,000	280,000	8,600,000	460,000	177,791	30%	30%	22%
9,000,000	360,000	315,000	9,675,000	517,500	204,816	30%	30%	23%
10,000,000	400,000	350,000	10,750,000	575,000	231,841	31%	30%	23%
11,000,000	440,000	385,000	11,825,000	632,500	258,866	31%	30%	24%
12,000,000	480,000	420,000	12,900,000	690,000	285,891	32%	30%	24%

Source: PPSWM calculations.

Although each client circumstance will need to be assessed on its individual merits, the conclusions we can draw from this modelling are as follows:

- The above assumptions suggest that retaining monies in superannuation in most instances is likely to be more tax effective than cashing out balances and reinvesting in alternative structures (individual names, trusts or companies).
- Most clients that have balances above $3 million will typically have already started a pension and so will have a combination of pension and accumulation phase balances. The effective tax rate on earnings in super in those instances will be even lower.
- For individuals, tax on capital gains on assets held for more than 12 months in their own names can be capped at 23.5% due to the 50% capital gains tax discount. Based on the examples above, only when superannuation member balances (in accumulation phase) reach above $10 million does the effective tax rate creep above 23.5%. This may support holding growth assets outside of super for individuals with very large balances, but the benefit is likely to be marginal and negated if the investment generates reasonable income.
- Where super funds hold a large proportion of illiquid assets, funding Division 296 tax commitments where those illiquid assets cannot easily be sold could be challenging in years where unrealised gains are significant. Under those circumstances, members could consider selling certain assets and reinvesting outside of super if they wish to retain exposure.
- This analysis should be interpreted with caution as it is not designed to be holistic in nature as it does not take into account individual circumstances or potential death benefit tax issues within superannuation. As a result, this should be interpreted as general information only and not personal advice.

By Martin Fowler,
Partner | Pitcher Partners
Sydney Wealth Management
p. +61 2 8236 7776
e. martin.fowler@pitcher.com.au

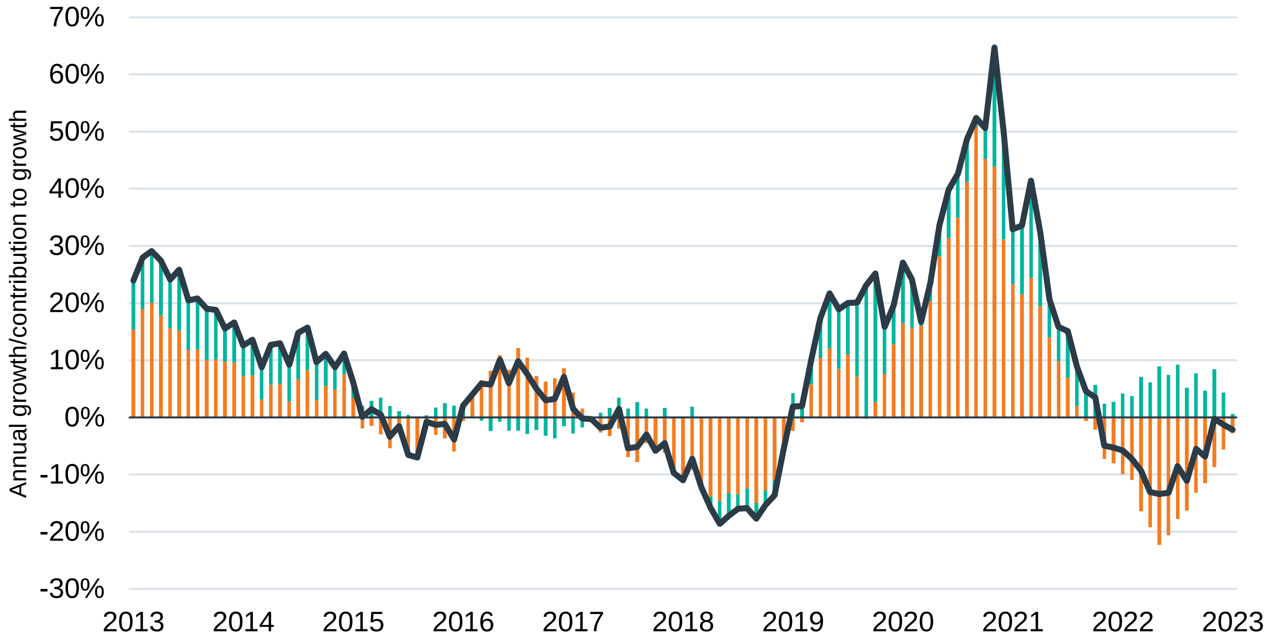
Australian banking sector update

The following article highlights key drivers of bank earnings and offers our near-term outlook for the sector. Our focus is on the “Big 4” banks comprising of the Commonwealth Bank of Australia (CBA), Westpac (WBC), National Australia Bank (NAB) and ANZ Group (ANZ).

Credit growth

Looking at growth on a headline level, we see credit contracting albeit at a slower pace after a sizeable boom from 2020 to 2022. New loan creation (in orange) has been persistently negative since the RBA began hiking interest rates. Fewer households have the capacity or willingness to take on mortgage debt in a much higher interest rate environment. The surge in refinancing as households sought more attractive mortgage rates has also abated somewhat as banks actively stepped away from the market in 2023 due to heightened levels of competition with far lower incentives, such as upfront cash payments being currently offered.

Annual housing loan growth vs prior quarter; split by type (Sep-13 to Sep-23)



Source: ABS, PPSWM calculations.

Credit growth is expected to remain challenged while interest rate conditions remain elevated in the near term, as higher rates have sizeably reduced household borrowing capacity. A surge in population growth (tracking at ~2.4% according to the Jun-23 National Accounts[4]) may provide a tailwind bit it will be difficult to sustain given the elevated levels of current interest rates.

Credit quality

The current direction on credit quality is a slight headwind to profit margins with arrears (borrowers behind on their mortgage payments) trending slightly higher after troughing in the six months to March. This means higher provisions (cash held aside) may be required to protect against expected loan losses. Those funds would be withheld and potentially reduce shareholder capital returns via dividends and share buybacks.

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[4] *Australian National Accounts: National Income, Expenditure and Product (June 2023)*, Australian Bureau of Statistics, 6 September 2023: https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release

90+ days of delinquency	1H22	2H22	1H23	2H23	Recent trend
CBA	0.51%	0.44%	0.44%	0.49%	↑
WBC	0.88%	0.75%	0.73%	0.90%	↑
ANZ	0.70%	0.60%	0.60%	0.63%	↑
NAB	0.75%	0.66%	0.66%	0.76%	↑

Source: Company filings; CBA reporting is off-cycle so quarterly updates are used to match to other majors.

The economic outlook suggests some challenges lie ahead. Growth domestically is expected to slow over the course of 2024 before bouncing back in 2025 with unemployment also rising. These two views (slowing growth and higher job losses) would normally weigh on borrowers' ability to repay their debts in aggregate. This is because higher unemployment could lead to more lossmaking loans. Weaker economic growth typically sees businesses struggle due to depressed demand for goods and services, which also increases the risk of loan impairment.

	Australia	
Metric	2024	2025
Growth	1.5%	2.2%
Inflation	3.4%	2.8%
Interest rates	4.0%	3.3%
Unemployment rate	4.3%	4.5%

Source: Bloomberg consensus as of 1 December 2023.

In summary, current credit metrics are worsening albeit from low levels. In addition, we are likely to see some deterioration as the economy slows and we see a pickup in unemployment. It is reasonable, in our view, to expect more provisioning will be required going forward, which will detract from bank earnings and dividend growth.

Net interest margin trends

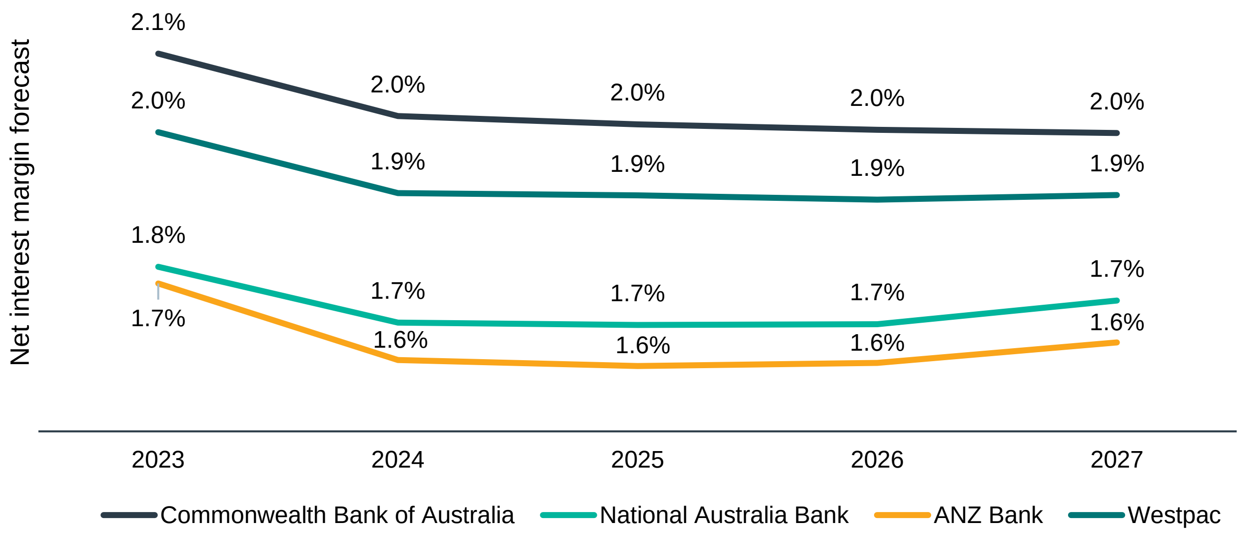
Net interest margin refers to the spread between the income received on loans made by a bank versus the cost of the funds it borrows to make these loans. In recent periods, with the uptick in interest rates, banks have been able to expand this spread benefitting from their deposit franchise (by repricing loans higher and being slower to change rates on deposits, banks can capture that difference in rates as profit).

Net Interest Margin	1H22	2H22	1H23	2H23	Recent trend
CBA	1.92%	1.87%	2.10%	2.07%	↓
WBC	1.91%	1.96%	1.96%	1.94%	↓
ANZ	1.58%	1.68%	1.75%	1.65%	↓
NAB	1.63%	1.67%	1.77%	1.71%	↓

Source: Company filings.

The consensus outlook expects the trend for declining profitability to persist into FY26 before beginning to recover. This will likely drive bank earnings lower unless offset by an uptick in credit growth, which is seeing a challenged outlook as discussed above. This consensus view is informed by increased competition for mortgage volumes amidst a weaker credit environment. While many of the majors have since pulled back from these efforts, that comes at the cost of reducing overall volumes growth which can cause lower overall profits, a trend we saw emerge in the second half of FY23.

Forecast Net Margins (FY23 to FY27)



Source: Bloomberg.

In summary, we see the near-term trend of weaker net interest margins persisting and posing a headwind to bank earnings and dividends to shareholders as a result.

Operational efficiency (cost to income)

Efficiency ratios, which measure operating costs relative to revenues and other income, are a key driver of overall profitability. Driving greater efficiency can lead to larger profits and ultimately, franked dividends or buybacks that return capital to shareholders. Currently, we have seen mixed performance amongst the majors. There has been gradual improvement into 1H23 before worsening in the second half of FY23 amidst rising competition for new borrowers.

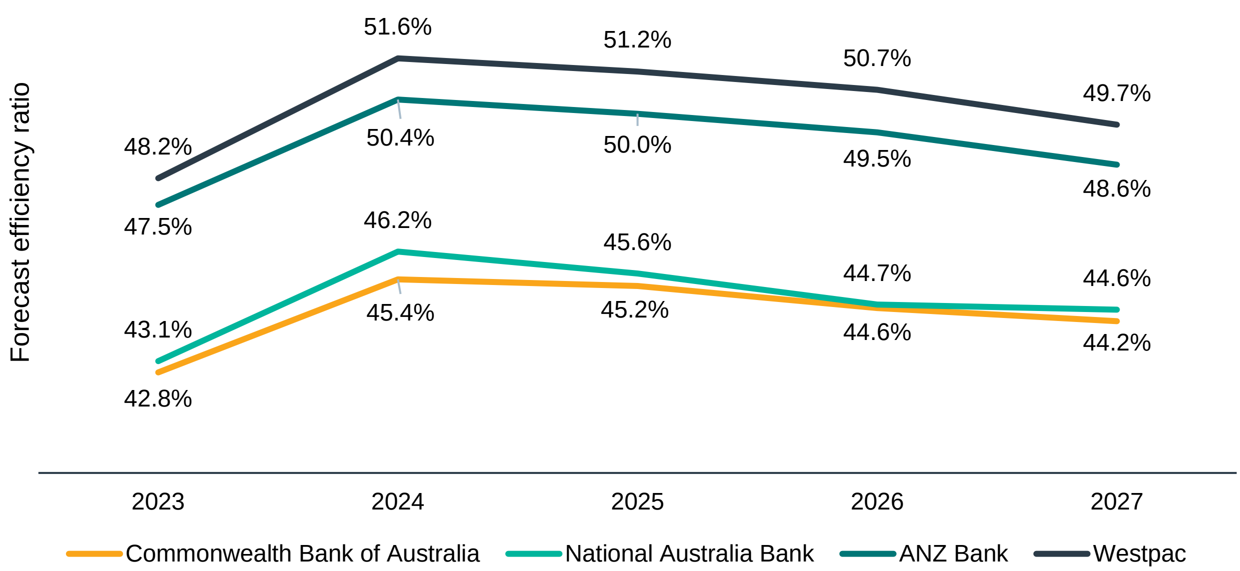
Cost to income	1H22	2H22	1H23	2H23	Recent trend
CBA	45.3%	45.7%	42.5%	43.0%	↑
WBC	55.2%	53.3%	46.0%	49.0%	↑
ANZ	53.5%	49.9%	47.6%	49.6%	↑
NAB	44.9%	45.2%	42.0%	43.7%	↑

Source: Company disclosures, PPSWM calculations.

The current outlook from consensus forecasts anticipates climbing costs relative to income for FY24 before gradually recovering but remaining above FY23 levels (i.e. margins will be structurally lower). This outlook will also see bank earnings pressured if it eventuates and poses a near-term headwind. Another potential downside risk may be larger-than-expected capital spending requirements to upgrade legacy technology infrastructure, for example. Westpac CEO, Peter King, flagged the scale of demands here with a large-scale consolidation of its technology infrastructure over the next four years. The changes will cost an estimated $4bn[5] and consolidate existing technology systems from a current 180 to just 60, a major change that carries the risk of cost blowouts and execution risk.

[5] *Westpac to cut tech stack by two thirds amid $4bn overhaul, CFO sounds warning for vendors mulling price hikes*, Mi3, 7 November 2023: https://www.mi-3.com.au/07-11-2023/westpac-plans-massive-technology-investment-radically-simplify-bank-will-cut-total-tech#:~:text=The%20tech%20stack%20components%20(all,operations%2C%20per%20CEO%20Peter%20King.

Forecast Efficiency Ratios (FY23 to FY27)



Source: Bloomberg

The key point though is that going forward, this is not anticipated to be a source of "easy wins" for bank profitability across any of the majors. The material improvements are expected to have already occurred. Consequently, it is an area likely to be another headwind to overall earnings growth and ultimately challenge dividend improvement. One area of upside surprise has been the degree to which banks are well-capitalised, which could see (while loan arrears remain stable) some one-off capital returns to investors.

Valuation

On valuation we have a mixed bag. Price to earnings (P/E) ratios see two of the four majors trade at attractive levels versus their longer-term average, while NAB sits at a premium. CBA stands out as a notable exception in the scale. That reflects its stronger retail franchise (lower financing costs) and better profitability in recent years.

On price to book (P/B) ratios the story is somewhat different. Both ANZ and Westpac trade at a material discount to their stated book value in contrast to the premium they had enjoyed historically, alongside NAB and CBA. This arguably reflects difficulties in execution and a loss of market share (smaller loan books and lower asset growth) for the other majors that has seen CBA trade at a material premium to peers.

Bank	P/E Ratio	Current valuation vs long-term average
CBA	18.3x	**+30.8%**
NAB	12.8x	**+11.2%**
WBC	11.6x	**-3.9%**
ANZ	11.3x	**-1.5%**

Bank	P/B Ratio	Current valuation vs long-term average
CBA	2.3x	**+9.0%**
NAB	1.4x	**-7.1%**
WBC	1.0x	**-41.4%**
ANZ	1.0x	**-32.5%**

Source: Bloomberg, long-term average calculated from Sep-05 to Nov-23

On this basis, we would say the sector appears modestly attractive with CBA the main exception.

Outlook

Credit growth is negative but troughing with the influx of immigration a potential support. Materially higher growth would require interest rates to abate or wage growth to improve both of which are difficult to see happening as accelerating wage growth would likely prompt the RBA to maintain a higher rate policy which, would limit the amount of credit households could borrow or afford. We saw an example of this with November's 0.25% rate hike. Meanwhile **credit quality** has risks to the downside in the near-term given unemployment is expected to rise and arrears appear to have turned upwards from their lows. There is, consequently, an elevated risk of higher credit provisioning required, which would pressure profitability.

Key profitability drivers include moderating **net interest margin trends**, which are unlikely to be a source of material profit growth. **Operational efficiency** is one area that has historically offered scope for margin improvement by controlling costs, but the consensus outlook suggests limited scope for improvement and in fact implies it will be another area pressuring earnings.

Finally on **valuations**, this is again company-specific, but CBA would still appear to be overvalued on most conventional metrics in both an absolute (versus history) and relative sense (versus peers both globally and domestic). Similar logic applies to NAB albeit to a less egregious extent. The other majors are looking slightly more attractive on this basis but not overwhelmingly so relative to history. It looks to be a modest support for increasing exposure, but the margin of safety is not materially attractive per se.

In summary, headwinds remain in place for the sector, the question is whether these have sufficiently been priced in. Further weakness in bank share prices may suggest a positive on that front but the margin of safety implied by current valuations is not sufficiently material to be attractive.

By Cameron Curko,
Head of Macroeconomics & Strategy |
Pitcher Partners Sydney Wealth Management
p. +61 2 9228 2415
e. cameron.curko@pitcher.com.au

Reporting season update

International Equity Portfolio

Note: All figures are in USD unless otherwise stated. Results referring to percentage changes (increases/decreases) relate to the previous corresponding period (pcp), for example, Q4 FY23 results are compared to those of Q4 FY22.

Aena SME SA (AENA: EU)[6]

Share price	30/11/23: €157.95
Result	9M 2023
Revenue	€3.74 billion, up 20.1% on pcp.
Underlying EBITDA	€2.11 billion, an increase of 38.9% on the pcp.
Key points	• Aena surprised on the upside with underlying EPS exceeding expectations by 12.8% for the September quarter. • The key driver has been an ongoing recovery in passenger volumes (+17.4% for the 9 months ending September 2023 vs pcp), which are now exceeding 2019 levels and on track for 102% of 2019 levels for the full year. • The ongoing strength in passenger values has also been an important driver of ancillary businesses, such as its Commercial division (duty-free shops, food and beverage outlets etc), which saw revenue growth of 23.7% for the 9-months ending September 2023 (compared to pcp). Real Estate revenues also grew strongly up 17.7% as the company continued to leverage its existing land bank for profitable development. • Limited cost expansion was the last material driver of the stronger EBTIDA result. Energy prices, in particular, have retreated sharply from last year with the average cost of energy megawatts per hour declining from €167 to €95 in 2023 (estimated), a drop of 43%. • Its UK asset in London Luton Airport remained a portfolio laggard at 90% of 2019 traffic levels, which is consistent with general UK trends of lagging the broader EU experience according to management. • In addition, for its Spanish network there is further prospect of revenue growth next year with a requested increase of 4.09% to regulated charges. • Rising interest rates have had an impact on profitability with the weighted average cost of debt rising from 1.04% to 2.07% on the pcp. This was dwarfed however by the impact of stronger revenues and contained cost growth.
Our comments	• The expansion of its Brazilian footprint with new acquisitions, including Congonhas (exposure to the busy São Paolo thoroughfare), should be supportive of continued growth in its International segment, reducing the reliance on the core Spanish network over time. • Overall, this marked a continuation to the airport operator's strong first half and despite obvious headwinds, such as weaker economic growth in Europe, demand has remained resilient, which should underpin further earnings and dividend growth for the year ahead. • In addition, the current valuation remains relatively undemanding vs history at 14.9x 2024e EPS vs its pre-COVID valuation of ~17x (a 12% discount) offering a margin of safety for a highly profitable, growing business with a strong moat.

[6] Company Transcripts, Reuters and Bloomberg.

Apple Inc (AAPL: US)[6]

Share price	30/11/23: US$189.95
Result	Q4 FY23
Revenue	US$89.5 billion, down 1% on the pcp.
Underlying EPS	US$1.46, up 13% on the pcp.
Key points	• Outperformed consensus expectations with stronger than expected revenue (0.2% above) and earnings (4.7% above) results for the quarter. • The September quarter saw an all-time revenue record for its Services division with CEO, Tim Cook, flagging a strong line-up of products, including the iPhone 15 heading into the end-of-year holiday period. • The outlook for the December quarter dampened investor sentiment, however. CFO, Luca Maestri, stating the company expected revenues to be flat versus the Dec-22 quarter performance in contrast to consensus expectations for 5% growth. • Supply constraints remain a challenge with sales for the more expensive iPhone 15 offerings, the Pro and Pro Max, suffering from limited availability. Overall, iPhone sales were in line with consensus expectations with 2% sales growth relative to the September quarter (only including one week of iPhone 15 sales). The other hardware lines struggled with declining growth for the quarter but management flagged improvement in the December quarter, particularly for the Mac, which was cycling supply challenges in 2022 that distorted quarterly results. • Lastly, the Services division remained a point of strength with 16% revenue growth and every main service offering hitting a record according to CEO, Tim Cook. In addition, the installed device base hit an all-time high with over 1 billion paid subscriptions, which should support future growth via price increases over time. • Geographically, China, a key market (Apple's third largest), remains challenging with $US15.1bn in sales, down 2.5% on 2022 compared to consensus expectations for a 10% increase. This heightened concerns over increased Huawei competition with the latter recovering from US sanctions that had deprived it of key phone components. Another factor has been weaker consumer demand in the region that may impact the success of iPhone 15.
Our comments	• Supply constraints and cycling a period of excessive demand (fuelled by pandemic stimulus) have been amongst several key challenges for the business that are only now beginning to dissipate (2024 numbers should offer better comparison of the underlying strength). • Offsetting these challenges on the hardware side has been the ongoing strength of Apple's Services division. Churn (people leaving the Apple ecosystem) has remained markedly low, and this coupled with a lower cost-to-serve has underpinned margin expansion for the overall business with gross margins continuing to outperform in the latest quarter. • The business continues to be managed well in aggregate and remains well-capitalised with a cash pile in excess of $US150bn that will continue supporting both buybacks and dividends over time. The new iPhone cycle is one we are observing closely as it will prove important for a return to material top line growth and may be challenged by the headwinds of a higher interest rate and slower economic growth environment.

Abbott Laboratories (ABT: US)[6]

Share price	30/11/23: US$104.29
Result	Q3 FY23
Revenue	$US10.1 billion, down 2.6% on the pcp (up 13.8% on organic basis excluding COVID-19 test sales).
Underlying EPS	$US1.14, a decrease of 0.9% on the pcp.
Key points	• Organic sales growth (excluding the impact of COVID-19 test sales) was in the double-digits across all four of Abbott's major divisions. • Recovery in the nutrition segment is on track with organic sales growth of 18.1%. This was driven by a surge in US sales for paediatric nutrition (baby formula) products as the company reclaims share lost due to production shutdowns and product recalls last year. • The "sugar hit" of COVID-19 testing sales continued to drag on revenue growth for its Diagnostics division with a 31.9% decline on the pcp. Excluding these sales, organic sales growth was 10.1% with the impact continuing to dissipate with each quarter that passes by and should be immaterial from next year. • Medical Devices remained a star with organic sales growth of 14.7% that was broad-based, including double-digit growth in both cardiovascular and diabetes care products. • Finally, management upgraded its full-year adjusted EPS guidance to $US4.42 to US$4.46 per share, a 0.9% increase from prior guidance of $US4.40. It also maintained a forecast for organic sales growth of low double-digits for the full year.
Our comments	• Abbott was one of many companies that benefitted from the pandemic. In its case boosting sales of COVID-19 tests. This is rapidly retreating particularly after the US government ended the emergency status of the pandemic as of 11 May earlier this year. • Thankfully however we are seeing a pronounced bounce back in surgical volumes leading to a recovery in Abbott's medical device segment with stronger than expected demand offsetting weaker sales of COVID-19 tests. • In addition, in Nutrition, the company has worked hard to recover market share and we should see this normalise further over time, helping boost both revenue and earnings growth. We do caution however the potential for adverse development in this space due to ongoing legal action over safety concerns in its infant formula products (which triggered the initial shutdown). • Another factor impacting the medical devices subsector is investor concern over burgeoning demand for weight loss drugs, such as Ozempic. The fear there is that if a material proportion of chronically overweight people are permanently "cured" then devices treating related chronic conditions, such as diabetes or heart disease, will likewise see a slowdown in growth rates, warranting a lower valuation. This has contributed to a "de-rating" for Abbott and other peers but on a fundamental level we are not yet seeing a material impact on demand for Abbott's offerings with the business instead trading from a position of strength. • Overall, the business is effectively navigating to a post-pandemic world and emphasising its strengths in medical device innovation, which should see it continue to grow earnings and dividends strongly over the medium term (consensus anticipating 8.1% EPS growth p.a. until 2026).

Adobe (ADBE: US)[6]

Share price	30/11/23: US$611.01
Result	Q3 FY23
Revenue	$US4.89 billion, up 10% on the pcp.
Underlying EPS	$US4.09, an increase of 20.3% on the pcp.
Key points	• Adobe surpassed expectations for the three months ending August with both revenue and earnings per share ahead of consensus expectations by 0.5% and 2.8% respectively. • CEO, Narayen, guided to underlying EPS of US$4.125 per share and revenues of US$5bn with consensus forecasts towards the upper end of the guidance range. • Adobe's generative AI technology, Firefly, continues to be a major drive of customer activity with over 2 billion in image generations now (up from 0.5 billion in its first three months). It is at the core of a new "generative credit" subscription offering that allows customers to turn text-based prompts into images, vectors and text effects with other types of content to follow. • This integration of AI supported strong sales growth for the Creative Cloud business of 14% on the pcp in constant currency terms. On the same basis, Digital Media overall grew 14%, while the Digital Experience segment was slightly slower at 11% on the pcp. • Currency remained a drag on results with overall revenue up 13% if currency was held constant as opposed to the 10% reported. • There was no material update on its acquisition of rival Figma, which is expected to clear regulatory challenges and close by the end of 2023. Subsequent to the results, it appears that UK regulators are set to contest aspects of the acquisition, which may drag out the process into 2024.
Our comments	• Adobe continues to perform well as it exercises pricing discipline and deepens its product suite to enable revenue growth and profit margin expansion. • While the core business continues to remain "sticky" with customers, we would like to see definitive progress on the Figma acquisition to help deepen customer lock-in and head off the longer-term competitive threat. The potential challenges on the regulatory front remain a point of concern. • Artificial intelligence is fast emerging as a source of increased customer demand as the take-up for its generative AI offering, Firefly, has clearly illustrated with strong acceleration for the second quarter after its initial introduction. It will also be a source of ongoing investment spending, but we take comfort in management's continued emphasis on maintaining profitability. • Lastly, new customer wins, such as Amazon and Novo Nordisk, are a welcome confirmation of the attractiveness of the Adobe product suite particularly amongst larger enterprise clients, particularly Creative applications. Management highlighted the potential efficiencies of AI applications as being a key lure for new customer wins given the focus on improved productivity.

American Water Works (AWK: US)[6]

Share price	30/11/23: US$131.84
Result	Q3 FY23
Revenue	$US1.17 billion, up 7.9% on the pcp.
Underlying EPS	$US1.66 per share, an increase of 1.8% on the pcp.
Key points	• AWK saw a reasonably strong result in the September quarter with revenue and underlying EPS exceeding expectations by 0.6% and 0.7% respectively. • Favourable weather had a sizeable contribution on the EPS beat adding US$0.04 per share as drier-than-expected conditions saw higher water usage. • The larger component of EPS however came through higher pricing and a larger regulated asset base with higher revenues driving a $US0.37 per share uplift offset by other factors. Recent rate filing decisions continue to help offset higher operating expenses with recovery of over 75% of cost inflation. A further US$611m of acquisitions were under agreement as of 30 June, which should underpin revenue growth for the second half. • The increase in revenues did not see a corresponding uplift in EPS growth due to the impact of share issuance to fund the company's longer term growth targets, which detracted US$0.12 per share from the EPS result. • Management issued guidance for 2024 EPS of US$5.15 (on a midpoint basis) amounting to ~7% growth on an underlying basis. This is towards the lower end of its long-term 7-9% target.
Our comments	• The substantial capital raising this year should continue to lay the ground for additional investment and earnings growth. • The value of its water infrastructure assets, including embedded inflation protections, has been showcased even in a tougher interest rate regime for the US with the business able to maintain its longer-term earnings growth targets despite this headwind (in contrast to other businesses that have weaker pricing power). • One near-term risk may be share price sensitivity to concerns over interest rate hikes but infrastructure assets unlike global real estate have proven to be far more resilient in terms of the price investors have been willing to play. The critical value of their assets coupled with the ability to increase prices in line with inflation quickly has been a key driver of the divergence. • Overall, AWK is well-positioned to continue expanding earnings and dividends with the latter on track for 8% growth in 2024, consistent with the long-term target of 7-9% growth p.a.

Alphabet Inc. (GOOGL: US)[6]

Share price	30/11/23: US$132.53
Result	Q3 FY23
Revenue	$US76.7 billion, up 11% on the pcp.
Underlying EPS	$US1.55, an increase of 46.2% on the pcp.
Key points	• Google advertising revenue was a key driver of the acceleration in top line growth, up 9.5%. This was driven by stronger than expected YouTube advertising revenues with YouTube's TikTok rival, Shorts, seeing 70 billion daily views, up from 50 billion at the start of the year, highlighting its increased traction with users. • Google Cloud maintained profitability albeit with deceleration of revenue growth to 22% year-on-year (down from 28% in the June quarter). Management noted that client efforts to optimise their cloud spending had driven the slowdown in revenue growth. The platform also continues to lag peers, such as Amazon Web Services, in scale and overall profitability, a factor potentially weighing on investor expectations notwithstanding the still-strong revenue growth the business is seeing. On the positive side however is the demand from newer ventures for Google Cloud with over half of all funded generative AI start-ups as customers. • Other Bets, the division comprising Alphabet's venture-style investments, such as self-driving car business Waymo, continues to be loss making at US$1.2 billion even with a 42% increase in revenues to US$0.3 billion. The lack of concrete results is a recurring theme, and our focus is on monitoring to ensure losses are not allowed to escalate materially higher. • AI enhancements was also a feature of these results with management flagging the improvement in its existing product base using AI to make Search more cost-efficient for customers. They also highlighted the pilot offering Assistant with Bard that will be their offering to retail customers with opt-in available across mobile devices in the coming months.
Our comments	• Overall, this was a mixed result. The core part of the business, Search, saw a material acceleration on prior quarters, which is highly welcome. • The slowdown in Cloud growth was a disappointment and the limited margin expansion in this business line remains a potential concern for the investment thesis, i.e. the lingering question of whether Google Cloud profitability will structurally lag larger peers, such as Amazon and Microsoft. • AI was a feature of the earnings call showcasing its use in empowering new product offerings but there remained limited, concrete information to illustrate the revenue or earnings impact to date. • Finally, after a period of largesse due to surging demand in the pandemic, cost discipline has emerged as a larger priority. This has bolstered profitability and should be supportive of earnings growth going forward.

Johnson & Johnson (JNJ: US)[6]

Share price	30/11/23: US$154.66
Result	Q3 FY23
Revenue	$US21.35 billion, up 6.8% on the pcp.
Underlying EPS	$US2.66, an increase of 19.3% on the pcp.
Key points	• The company exceeded consensus expectations on both sales and earnings for the September quarter by 1.5% and 5.5% respectively. • Management issued another guidance upgrade for its 2023 guidance. It anticipates adjusted operational sales growth (adjusted for currency movements and COVID-19 vaccine sales) of 7.5%, up from 6.7% guidance in August. In addition, underlying EPS is expected to grow 13%, up from previously-guided growth of 12.5%. • This quarter also marked the first set of results since its separation from consumer health division, Kenvue. • Its Innovative Medicine (pharmaceutical) division exceeded consensus sales expectations by 4% driven by sales for Darzalex (a cancer drug) and Stelara. Covid vaccine sales are still slightly impacting performance of this division, although its impact is becoming increasingly negligible and by this time next year will be completely immaterial. • J&J saw strong demand for products from its MedTech segment (revenue up 6% on pcp) driving growth for the quarter. The revenue figure was mildly below (1.6%) consensus expectations. Much of the annual growth was driven by cardiovascular tech business, Abiomed, (acquired in Dec-22) with electrophysiological products (that monitor the heart) a key driver. • Claims of the company's talc products remain a lingering issue with a second attempt caught up in appeal proceedings. • Finally, the divestment of Kenvue saw a $US21bn non-cash gain recorded as a result of spinning off its Kenvue holdings. The subsequent sale of these shares in exchange for JNJ shares will only have a partial impact on EPS for 2023 with the full impact flowing through to the 2024 results.
Our comments	• The overall result for J&J was encouraging particularly the upgraded guidance for 2023. The Kenvue deal in particular looks to have benefitted shareholders strongly on an underlying basis with overall shares outstanding declining over 7% as a result of the transaction. • The overall strength in Medtech should continue to support the stock as a gradual compounder going forward supported by the development of new drugs for its pharmaceutical division. • Lingering talc claims will continue to be a source of angst for investors and may pose a headwind to its valuation until definitively resolved.

Microsoft Corporation (MSFT: US)[6]

Share price	30/11/23: US$378.91
Result	Q1 FY24
Revenue	$US56.5 billion, up 13% on the pcp.
Underlying EPS	$US2.99, an increase of 27% on the pcp.
Key points	• Microsoft recorded a strong result to begin FY24 with the company beating consensus expectations on both top line and earnings outcomes by 3.6% and 12.6% respectively. • A key driver was its Intelligent Cloud division, which saw the top line grow at 19% driven by Azure and other cloud services that were up 29% for the period. There was also strength in its Productivity and Business Processes segment (encompassing its Office product suite, LinkedIn amongst other solutions) with revenue up 13% (12% in constant currency terms). There was slight improvement in its personal computing division with 3% growth in sales driven by Windows (up 5%), Search (up 10%) and its Xbox offerings (up 13%), which helped offset a 22% decline in Devices revenue. • Currency was a slight tailwind, adding 1% to revenue and earnings growth for the quarter after being a headwind more recently. • The company emphasised the strength of artificial intelligence (AI) demand it was seeing amongst its customer base and its focus on delivering new AI-driven solutions to clients. These include its Copilot assistant for Microsoft 365 with the developer option having over 1 million paid users and 40% quarter-on-quarter growth in business subscriptions to over 37,000 businesses as of 30 September. • Management is excited at the growth potential for this space and expects to grow investment spending each quarter through FY24. It is aiming to be measured in overall cost growth with revenue growth broadly matching any expansion in investment spending ensuring profit margins remain stable. • On 13 October 2023, the company completed its acquisition of video gaming giant, Activision Blizzard King. This broadens its collection of valuable franchises with plans to grow this content base and broaden distribution both within its Xbox devices, as well as external offerings, for example Sony. • Management issued its full year outlook with foreign currency expected to have an immaterial impact for FY24, while operating margins are expected to remain stable with benefits from the transaction being offset by one-off costs. • Finally, following quarter-end, there was internal upheaval at Microsoft's AI partner OpenAI (the firm behind leading model ChatGPT). This saw CEO, Sam Altman, initially being forced to exit the business before returning to the CEO role following a widespread staff revolt. In addition to his reinstatement, the firm has gained a new board and Microsoft itself now has a board seat as a non-voting observer. The saga arguably entrenches Microsoft's influence over one of the leading industry players and appears in net terms to be a victory for the firm. ‘
Our comments	• Microsoft remains well-placed to provide both "picks and shovels", the tools necessary to power AI services, as well as improving its own product suite with AI tools. Management clearly sees a large opportunity as flagged by the capital spending targets and is already beginning to see paid user growth as showcased by its success with Copilot. The entrenchment of influence over OpenAI also offers scope to tap into leading AI research development as the firm's flagship offering ChatGPT continues to evolve and gain traction. • The core business remains impressively profitable with Azure Cloud a strong growth engine (maintaining higher growth than Google Cloud off a higher base) albeit with growth decelerating from its pandemic highs.

	• The business also continues to be disciplined in capital returns to shareholders via a mix of dividends and buybacks with US$9.1bn returned to shareholders in the September quarter, which should help underpin share price appreciation going forward. • Overall, the stock remains well-placed to continue growing earnings strongly via its cloud solutions and AI offers a further tailwind to future growth that should continue to underpin the stock over the medium term.

Nestle S.A. (NESN: CH)[6]

Share price	30/11/23: CHF 99.35
Result	9M FY23
Revenue	CHF 46.3 billion, down 0.4% on the pcp (up 7% on a constant currency basis).
Key points	• Nestle management confirmed its full year outlook for organic sales growth of 7-8% and underlying EPS growth of 6-10%, both on a constant currency basis. • For the first nine months of 2023, organic sales growth (excluding FX impact) was 7.8% comprising pricing growth of 8.4% slightly offset by volume decline of -0.6%. • The company announced an agreement to acquire a majority stake in Brazilian premium chocolate producer, Grupo CRM. • Negative volume growth, albeit mild, remained a concern. Management flagged that adjusting for one less trading day, volume growth was positive. In addition, it expects further improvement due to portfolio optimisation efforts (divesting underperforming brands). • The Health Science division was flagged as a highlight with affirmation of the mid-term goals for high single digit growth and operating margins above 18%. This represents a significant growth opportunity for the business with Nestle occupying a leading position in US e-commerce, as well as benefiting from meaningful cost synergy opportunities. • On a constant currency basis, sales growth continued to be led by emerging markets, which were up 9% versus 6.9% for developed markets. That result was largely price driven however, with volumes only up 0.3% for emerging markets and negative (down 1.3%) for developed market customers. • Currency movements were a notable drag on results however, reducing revenue growth by 7.4% for the first 9 months of 2023.
Our comments	• We think Nestle trades at an attractive valuation relative to its fundamentals and longer-term averages. Currency headwinds are notable but looking past them the underlying business has weathered this period well with relatively minor volume losses due to higher prices. • The stock has derated recently in line with higher bond yields but still retains meaningful pricing power and looks set to continue compounding earnings growth and return capital to shareholders over the medium term. • A return to growth in underlying volumes remains important as we look ahead. Management's positive statements on this area will be tested but there are some promising signs of input cost inflation abating, which should enable lower price growth without impairing margins.

Novo Nordisk (NOVOB: DK)[6]

Share price	30/11/23: DKK 695.50
Result	9M 2023
Revenue	DKK 166.4 billion, up 29% on pcp.
Underlying EPS	DKK 13.71, an increase of 49% on pcp.
Key points	• Novo Nordisk saw strong revenue growth of 36% in its Diabetes and Obesity Care businesses for the first nine months of 2023. This was concentrated in its GLP-1 products and obesity care with growth rates of 45% and 167% respectively. An offsetting factor was the Rare Disease segment, which saw revenue decline by 20% over the same period. • The business reported a positive research study (known as FLOW) highlighting the benefits of GLP-1 treatment in addressing both type 2 diabetes and chronic kidney disease, signifying a positive development for its research pipeline. • Novo's position as a market leader remained broadly stable. In GLP-1 products, its market share rose slightly to 54.3% (up from 54.1%) while Diabetes care saw continued gains both in the US and the rest of the world, climbing to 33.3%. Share in insulin sales continued to hold steady at ~44% consistent with the trend in recent years. • Management issued another guidance upgrade for 2023 revenue and earnings growth. Revenue is now expected to rise by 35% (up from 30%) and operating profits to grow by 43% (up from 34%). The key drivers are stronger expectations of US sales for its leading GLP-1 medication, Ozempic.
Our comments	• Overall, this was a strong result particularly with another upgrade to FY23 guidance. The result also amounted to a beat for the September quarter relative to consensus expectations for both sales revenue and underlying EPS. • A key driver of further growth will continue to be improving supply with Wegovy in particular flagged as supply constrained relative to market demand. As flagged previously, this was a key catalyst to the guidance upgrade. The positive results from the FLOW research study could be another promising catalyst for broadening the use cases of GLP-1s and spurring additional demand. • While there are competitor treatments, such as Eli Lilly's offerings in the GLP-1 space, the pace of demand is offering ample scope for both businesses to grow in the near term. A material inflection in market share might herald a change in this dynamic but that is not evident at present. It nonetheless remains an area we continue to monitor. • Weakness in the Rare Disease segment is another risk factor we monitor albeit less material given the recent success in GLP-1 drugs with this division less than 10% of overall sales in the first nine months to start 2023. It could prompt calls from other shareholders for the business to explore divestment options in the near term however. • Novo remains well-placed as a leading provider of diabetes and obesity care with a commanding market position. While there are competitive threats on the horizon from peers, such as Eli Lilly, we believe they are well-placed to take advantage of the current growth opportunity set and continue growing at a high rate and gaining attractive margins over the medium term.

Universal Music Group (UMG: EU)[6]

Share price	30/11/23: €24.24
Result	Q3 FY23
Revenue	€2.75 billion, up 3.3% on pcp.
Underlying EBITDA	€0.58 billion, an increase of 5.1% on the pcp.
Key points	• UMG saw slight EBITDA margin expansion to 21.1% (up from 20.8%) boosted by revenue growth across all business segments, as well as cash savings from the new employee share compensation plan launched earlier this year. • Adjusted EBITDA margin expanded by 1.3% to 21.6% supported by a mix of revenue growth and operating leverage. Another factor was cash savings of €33m from an equity compensation plan rolled out at the start of the year. • Currency fluctuations posed a material headwind on sales growth of -6.6% with top-line growth at 9.9% for the quarter in constant currency terms vs the 3.3% reported. • The Recorded Music segment saw revenue growth of 5.2% on the pcp in constant currency terms. This was driven by a healthy 13% growth in subscription revenues and an even stronger 20% rise in physical product sales. • Music publishing had an even stronger result with top line rising 24.6% on the pcp in constant currency terms. This was inflated by a non-cash accrual which, if excluded, saw revenue growth soften to a still healthy 11.2%. Performance-related sales were the major driver of this segment with a 21.8% increase on the pcp. Strong performance sales also flowed through to the Merchandising segment, which grew 27.5% in constant currency terms thanks to direct-to-consumer revenues, as well as stronger touring merchandise sales. • Artist success also continued apace with Taylor Swift making history as the first woman with four albums in the Top 10 charts at the same time and the first artist since the Beatles to have three songs in the Top 10 simultaneously. • One factor that emerged in 2023 is market concerns about the prospect of artificial intelligence (AI) being used to replicate and generate music that UMG held copyright over. UMG and a subset of its artists are exploring a Music AI Incubator with YouTube in an effort to be proactive to this emerging technology.
Our comments	• Overall, this result marked a continuation of a strong first half with high single digit revenue growth and earnings expansion in constant currency terms. The latter was flattered somewhat, we would note by a shift from cash compensation for staff to equity compensation (which increases shareholder dilution). • The overall quality of the result was strong notwithstanding this factor with operating leverage and the quality of its artist catalogue continuing to underpin strong growth and profitability. • On the AI front, management are being proactive in their responses with the YouTube trial that could lead to another attractive channel to monetise its content base. • Finally, management flagged potential upside from streaming platform pricing initiatives with YouTube and Spotify price hikes to flow through December quarter revenues. This highlights the pricing power of UMG as a content owner and should be supportive of further revenue growth and profit expansion.

Vinci SA (DG: EU)[6]

Share price	30/11/23: €112.30
Result	9M FY23
Revenue	€50.6 billion, up 12% on pcp.
Key points	• Revenue growth of 12% for the first nine months of 2023 was driven by Vinci's overseas operations (up 18% outside of France) with its domestic operations growing a more respectable 5% over the same period. • International operations now accounted for a record 57% of total revenues even with exchange rate movements having a slightly negative impact. • Its order book across the Construction and Energy Business continued to grow, hitting a new record high of €63.3bn as of 30 September. This represented growth of 10% year-on-year and importantly gives significant visibility on future revenues with the order book representing over a year of average business activity for these divisions. One of the potential concerns for Vinci investors is that these businesses can be more cyclical relative to other parts of the group, such as its toll roads. The strength of the order book goes a considerable way towards giving higher surety over business performance even if the economic environment weakens further over the course of 2024. • The Concessions division (a mix of highways and airports within France and overseas) saw revenue up 19% driven by its airport franchise with a 49% increase on the pcp. Recovery in passenger numbers has continued in 2023 with the month of September seeing 99% of passenger numbers experienced in 2019 (the last year unaffected by coronavirus disruptions). • The Cobra IS business continues to perform strongly driven by energy transition contracts, as well as large scale engineering projects. Overall revenues were up 14% on the pcp and notably the order book was up 33% year on year. It sat at €14.9bn on 30 September, which represents almost 2.5 years of average business activity for Cobra, highlighting the resilience of this division on a go-forward basis. • Vinci Immobilier (a domestic-based property development division) remained a point of weakness with revenues down 24% on the pcp as higher interest rates weighed on the housing sector in France. This remains a comparably smaller part of the overall growth and its weakness was more than offset by strength in other business units. • Management confirmed that they will be challenging proposed legislation to increase taxation on its French toll roads and will be leveraging all contractual provisions to do so. • Finally, management updated their 2023 outlook with free cash flow now expected to be a minimum of €4.5 billion while its Airports business should see passenger numbers further recover in the December quarter and a corresponding uplift in earnings. Across all of its major divisions, margin improvement continues to be expected as well.
Our comments	• The strength of its Concessions business with more recovery still to come from the airport network should continue to underpin revenue and earnings growth through the cycle. Given the sizeable order book, its more cyclical businesses, such as Construction, are well-placed to navigate a weaker macroeconomic environment. The resilience of its French operations in growing revenue 5% despite subdued economic growth (0.7% over the year to September) highlights the essential nature of its assets and services. • At current guidance, the stock is trading at an attractive valuation with a free-cashflow yield of almost 7% that should support additional acquisitions or capital returns to investors with a consensus forecast yield of 4% this year.

Visa Inc. (V: US)[6]

Share price	30/11/23: US$256.68
Result	Q4 FY23
Revenue	$US8.6 billion, up 11% on the pcp.
Underlying EPS	$US2.33, an increase of 21% on the pcp.
Key points	• Visa continued to perform strongly with both revenue and underlying EPS coming ahead of expectations by 0.6% and 3.9% respectively. • Resilience in consumer spending was a key driver with growth in both payments volume (up 9%) and processed transactions (up 10%). • Cross-border volume (up 16%) also continues to be a tailwind with rebounding travel activity encouraging tourism spending. Processed transaction growth held steady at ~10% but remains well above 2019 levels (by over 50%). • Foreign currency was a slight headwind, dragging on earnings growth by ~0.7%. • Profit margins expanded slightly on an underlying basis with the 11% uplift in revenue more than offsetting a 9% expansion in operating costs (excluding one-off items). • Management issued guidance for FY24 with revenue growth ranging from high single-digit to low double-digit levels with EPS growth expected to be in the low-teens as well.
Our comments	• Visa continues to benefit from growth in spending globally as a key payments' platform and capital-light business with above-market earnings growth and returns on capital. • The company is also working towards further developing its services adjacent to payments processing. The prospect of banking reform in the US was flagged as a potential opportunity for Visa acquisition, Tink, which has performed well in Europe as an open banking platform offering. • Capital return discipline is also remaining intact with over US$16 billion between share buybacks and dividends to investors for 2023. The Board also approved a US$25bn multi-year buyback program in October (representing almost 5% of shares outstanding). This should continue to bolster shareholder returns by boosting earnings growth over time.

By Cameron Curko,
Head of Macroeconomics & Strategy |
Pitcher Partners Sydney Wealth Management
p. +61 2 9228 2415
e. cameron.curko@pitcher.com.au

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Authors

Jordan Kennedy
Partner | Pitcher Partners Sydney Wealth Management
+61 2 9228 2423
jordan.kennedy@pitcher.com.au

Cameron Curko
Head of Macroeconomics & Strategy | Pitcher Partners Sydney Wealth Management
+61 2 9228 9173
cameron.curko@pitcher.com.au

Charlie Viola
Partner | Managing Director – Pitcher Partners Sydney Wealth Management
+61 2 8236 7798
charlie.viola@pitcher.com.au

Martin Fowler
Partner | Pitcher Partners Sydney Wealth Management
+61 2 8236 7776
martin.fowler@pitcher.com.au

Andrew Wilson
Principal | Pitcher Partners Sydney Wealth Management
+61 2 9228 2455
a.wilson@pitcher.com.au

Adelaide Brisbane Melbourne Newcastle Perth Sydney

ppswm.com.au