ORD MINNETT
PRIVATE WEALTH

August 2018

ORDS MONTHLY

FOUR WEDDINGS AND A FAREWELL

GETTING THE MIX RIGHT

A spate of large acquisitions – and one very large divestment – feature in this edition of the Ords Monthly, while the local reporting season is heating up.

In our investment strategy note starting page 2, we examine the strong signals emanating from robust earnings reports around the globe to help form a view on the outlook for local results. Results in major developed markets have generally been ahead of expectations – the S&P 500 is a standout with an 80% 'beat' rate – while Australian consensus estimates have been receiving upgrades for the past two years.

BHP Billiton has extricated itself from its difficult US onshore oil and gas business for US$10.8 billion, with the company pledging to return the proceeds to shareholders.

In effect, this respresents a shortfall of US$18 billion, but we still see the exit as a positive factor given the assets have struggled to generate free cash flow and are significant consumers of capital and management time.

It is unclear how BHP will return the funds. A special dividend is possible, but we see a share buyback as more likely due to the benefits of less issued capital on metrics such as earnings per share. See page 4 for our view.

> " The Bemis buy makes Amcor the largest producer of flexible packaging in the world."

Unibail-Rodamco-Westfield is now one of the leading owners and developers of shopping centres. The Westfield acquisition has strengthened its global footprint, exposing Unibail to the US and UK retail markets as well as Europe. Unibail has great access to capital markets and its management team is excellent, leading us to initiate coverage with a Buy rating and a $19.00 target price. Page 5 has the details.

Amcor has taken a big bite of the American food packaging market with a proposed US$6.5 billion all-scrip takeover of rival Bemis Co, in a deal that will also see Amcor make the New York Stock Exchange its new primary listing. It will retain a secondary listing on the ASX.

The Bemis buy makes Amcor the largest producer of flexible packaging in the world.

The deal, which we view as firmly in line with Amcor's strategy, has been unanimously approved by the boards of both companies.

It is now subject to regulatory and shareholder approvals, with completion expected in early 2019. See page 6 for more.

We have resumed coverage of **Reliance Worldwide** with an Accumulate rating after the plumbing supplier's purchase of UK engineering company John Guest for $1.22 billion.

The investment fits with its strategy, giving Reliance significant manufacturing and distribution capabilities in the large European market.

Reliance paid a full price, but the British company's historical performance and operating metrics are impressive, and imply an uplift to Reliance's margins, returns and cash conversion. We lay out our investment thesis on page 7.

Lastly, **Pinnacle Investment Management** is a multi-boutique investor that holds minority equity stakes in seven Australia-based boutiques.

Its two recent acquisitions, and significant jump in funds under management to $38 billion, have led us to raise our earnings estimates, prompting a rise in recommendation to 'Buy'. Page 8 has more.

INVESTMENT STRATEGY

CASHED UP

As the Australian corporate reporting season heats up, Ord Minnett notes that earnings reports from around the world appear to be robust, coming in ahead of expectations in general, while Australian consensus estimates have been receiving upgrades for the past two years.

Our global research partner's earnings season tracker up to 2 August shows that overall results are strong from the companies that have reported to date, with double-digit EPS growth in the US and Europe, and high-single-digit earnings growth in Japan.

All three regions are seeing positive surprises; in particular, we note that circa 80% of companies in the S&P 500 Index that have reported so far have exceeded forecasts. If that surprise rate persists, it will be the strongest results season on Wall Street in nearly a quarter of a century, based on Thomson Reuters I/B/E/S data.

At home, forward earnings estimates for the S&P/ASX 200 Index have been trending upwards since 2016. (See Figure 1 for how the 'EPS worm' has turned and Figure 2 for earnings upgrades by sector in the same period.)

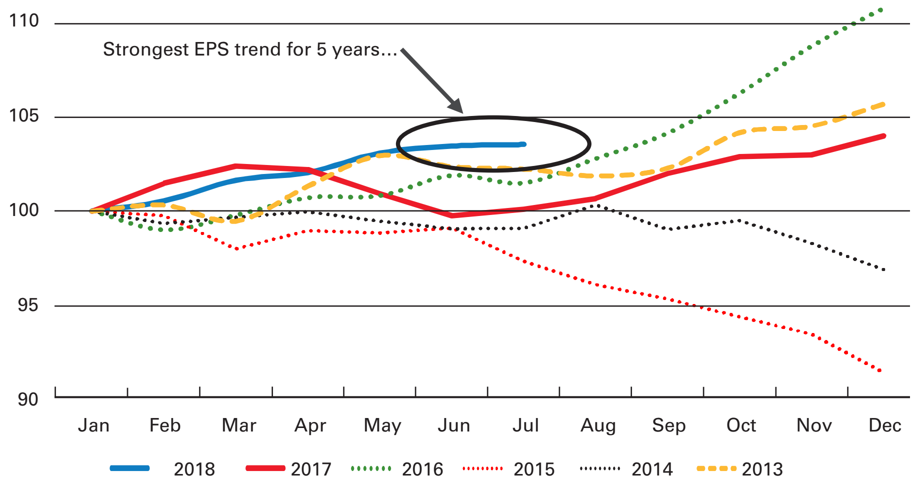
Factset data shows a consensus forecast for robust growth of 11.3% in 2018, with most of this coming from the resources sector – the S&P 200 Resources group is expected to post growth of 29.6%, while the S&P 200 Industrials group is poised to post a much more modest rise of 4.8%.

The only sector where consensus estimates have been lowered is telecommunications, where the operators face a fiercely competitive and rapidly changing industry environment. (See Table 1 for a breakdown of the contribution to growth by sector.)

Added to this optimistic backdrop, our research partner's analyst reporting season poll shows 33% of companies are expected to 'surprise' on the upside relative to consensus forecasts, with just 17% to surprise on the downside. Some 52% of stocks have a medium or large degree of uncertainty.

This positive bias further fuels our confidence about this results season, and is a strong positive tilt compared with historical polls.

Figure 1: 2018 EPS estimate upgrades (Index)



Source:Ord Minnett Research, Bloomberg

Table 1: Consensus earnings growth estimates by sector (%)

Sector	2018
S&P/ASX 200	**11.3**
S&P/ASX 200 Industrials	**4.8**
S&P/ASX 200 Resources	**29.6**
Energy	50.6
IT	27.1
Materials	22.7
Utilities	21.3
Industrials	16.5
Healthcare	16.1
Consumer Discretionary	11.0
Consumer Staples	7.2
REITS	4.0
Financials	2.1
Telecoms	-7.9

Source: Factset

On a more qualitative note, the absence of bad news should also prove a boon for companies, particularly in financial services, where many of the largest players are still reeling from the Royal Commission into the industry.

At time of writing, both AMP and Commonwealth Bank – which have featured heavily in regulatory despatches in recent months – had released results containing no nasty surprises, pushing their share prices up 3.9% and 2.6%, respectively, on the day of release.

Returning capital to shareholders will also be front of mind, both as companies restructure and reshape their businesses and as boards focus on the best use of balance sheets.

BHP Billiton, as detailed on page 4, is pencilled in to return US$10 billion to shareholders from the sale of its US onshore oil and gas assets.

Rio Tinto plans to return US$4 billion, principally from the sale of its Queensland coal assets.

Neither has determined the method for returning the sale proceeds, although Ord Minnett sees buybacks as more likely than special dividends.

Suncorp paid a special dividend of 8 cents per share in its full-year result, while also agreeing to sell its life insurance business for

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$600 million post separation costs, with that amount to be returned to shareholders.

Meanwhile, we also forecast capital management of $900 million from **Insurance Australia Group**.

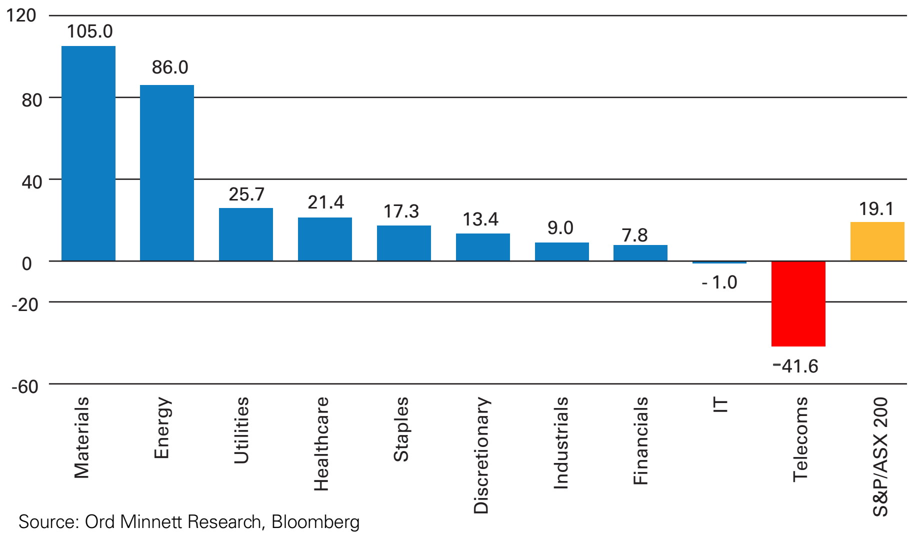
After examining their capital positions, we also see the following companies as having the potential to initiate a new buyback program – **Ansell, BlueScope, Harvey Norman, Perpetual, Seven Group, Wesfarmers, Westpac** and **Woolworths**.

Capital returns also feature in the other major developed markets, with companies in the S&P 500 Index expected to undertake US$800 billion in buybacks in 2018, a more than 50% increase on US$530 billion in 2017.

That theme – driven by stronger corporate balance sheets along with a good macroeconomic environment, a robust earnings outlook and, in the US market, tax cuts and deregulation – means equities remain relatively attractive, both locally and offshore.

Our preferred themes in Australian **equities remain 'global over local' e.g. Boral, Reliance Worldwide and WorleyParsons;** 'inflation beneficiaries', e.g. **Qube;** and 'balance sheet appeal' e.g. **Ansell, ANZ Bank, Orora** and **Service Stream**.

Figure 2: Earnings estimate change by sector since 2016 (%)



Source: Ord Minnett Research, Bloomberg

BHP BILLITON

PAYBACK TIME

Sector: Diversified resources Recomm: Accumulate Risk rating: Higher Share price: $33.94

Year to June	2017A	2018E	2019E
Profit after tax ($m)	8,918	11,767	13,143
Earnings per share ($)	1.68	2.21	2.47
Price/earnings (x)	20.3	15.4	13.7
Dividend ($)	1.10	1.51	1.72
Dividend yield (%)	3.2	4.4	5.1
Franking (%)	100	100	100

Source: Company reports, Ord Minnett Research. Profits are on a normalised basis.

BHP Billiton (BHP) share price

Source: IRESS

BHP Billiton has sold its problematic US onshore oil and gas assets for US$10.8 billion, with the company pledging to return the proceeds to shareholders.

British giant BP bought the bulk of the assets for US$10.5 billion, while US group MMGJ Hugoton bought the rest for US$300 million.

The US onshore saga has cost BHP US$18 billion, comprising the US$20 billion purchase price and US$19 billion in capital expenditure, minus operating earnings of US$10 billion and US$10.8 billion from the sale.

Ord Minnett's net present value (NPV) measure of the assets was US$10.4 billion, so overall we view it as a value-neutral deal. BHP will record a US$2.8 billion post-tax impairment charge in the fiscal 2018 result, equivalent to about US$13.4 billion in book value.

Notwithstanding that, we see the exit as positive given the assets have struggled to generate free cash flow, and are significant consumers of capital and management time.

Stripping the loss-making US onshore assets out of our forecasts lowers BHP's price-earnings multiple by about 2.0 points and leads to an 8% higher fiscal 2019 net profit estimate (pre capital management). Meanwhile, our fiscal 2019 free cash flow forecast falls by US$250 million, while our operating earnings estimate declines by 5%.

Overall, the petroleum arm's share of group earnings falls to 15% in fiscal 2019 from 19% post the sale, with the return on capital employed rising to 16% from 14%.

BHP will be net cash by the end of fiscal 2019, but the company has committed to returning the sale proceeds, which equate to circa 8.6% of market capitalisation.

It is unclear how BHP will return the funds, with the structure likely to be announced when the sale is completed in October.

A special dividend is possible, although Ord Minnett sees a share buyback as more likely due to the lasting benefits of less issued capital, such as EPS and NPV per share accretion.

A share buyback would most likely be via a 60/40 split between the Australia-listed 'Ltd' shares (off-market) and the UK-listed 'Plc' stock (on-market), in line with the issued capital split.

BHP had US$11.4 billion in franking credits available as at 30 June 2017 and we predict a similar amount as at 30 June 2018, so franking credits should not be a limitation in undertaking the off-market 'Ltd' component.

Based on a US$6 billion buyback of the 'Ltd' shares and a US$4 billion buyback of the 'Plc' shares, we calculate an EPS benefit of around 7% and an NPV per share benefit of about 2%.

We rate BHP as Accumulate, with the stock trading below our NPV measure, and offering strong free cash flow and below-average enterprise value to operating earnings multiples.

We are positive on the outlook for the company based on potential changes the new chairman may implement and, with the divestment of the US onshore assets, BHP is now our preferred large-capitalisation diversified miner.

UNIBAIL-RODAMCO-WESTFIELD

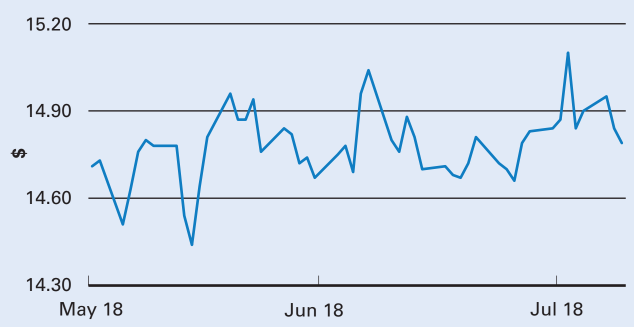
RETAIL THERAPY

Sector: Real Estate Recomm: Buy Risk rating: Medium Share price: $14.79

Year to December	2017A	2018E	2019E
Profit after tax ($m)	1,780	2,460	3,044
Earnings per share ($)	0.89	1.03	1.10
Price/earnings (x)	16.6	14.4	13.5
Dividend ($)	0.80	0.93	0.99
Dividend yield (%)	8.4	6.3	6.7
Franking (%)	-	-	-

Source: Company reports, Ord Minnett Research. Profits are on a normalised basis.

Unibail-Rodamco-Westfield (URW) share price



Source: IRESS

Ord Minnett now has coverage of **Unibail-Rodamco-Westfield** following the merger of Unibail-Rodamco and Westfield in late May.

Unibail is a leading owner and developer of shopping centres across Europe, and its acquisition of Westfield has strengthened its global footprint, providing it with exposure to the US and the UK retail markets. Unibail has great access to capital markets and, in our view, its management team is excellent, leading us to initiate on Unibail with a Buy rating and a $19.00 target price.

Unibail's €62 billion portfolio comprises 102 shopping centres in 27 retail markets, including 56 flagship centres that represent 85% of its total portfolio. The former Westfield assets comprise 29% of the assets, while non-retail assets – office buildings and convention/exhibition centres – comprise 13%. (See Figures 3 and 4 for portfolio splits by market segment and geography.)

Unibail has consistently generated strong growth in earnings per share since 2007, owing to the company's high-quality assets – we see its collection of retail assets as the best-quality portfolio globally – and its expertise in investment and divestment, development, leasing and management of the portfolio.

The company expects the Westfield deal to be accretive to earnings per share from the first full fiscal year following completion.

Noting the limited company guidance with regard to the recent acquisition, we have incorporated the Westfield transaction into our model, and now forecast EPS growth for the combined entity of 8.0% per annum over the coming three years.

This is driven by like-for-like rental growth, development completions, and cost-savings and revenue benefits.

Unibail has delivered a stable and growing dividend over the past 10 years, with a payout ratio of 85–95%. We assume 92.6% in this year and 92.2% in 2019. This is at the high end of 85–95% guidance, but even if the payout is reset to the low end at 85%, the dividend yield is still an attractive 5.7%.

In terms of development, Unibail has outlined a €13 billion development pipeline with target yields on cost of 7%-plus, which should create material value as it is built out over the next seven to eight years.

Figure 3: Portfolio by segment (%)

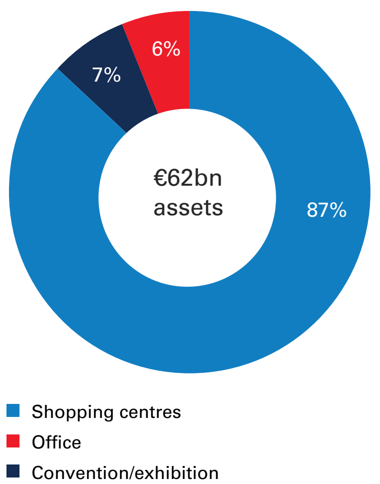
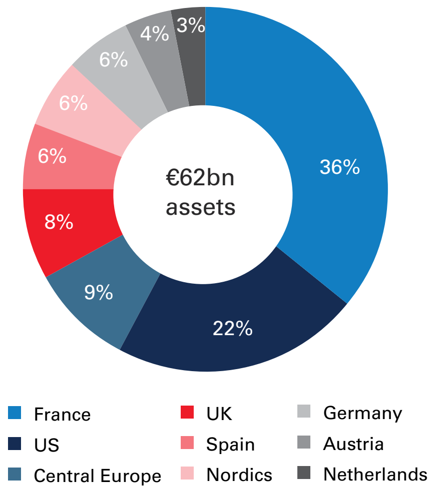


Figure 4: Portfolio by geography (%)



Source: OML Research, company data

AMCOR

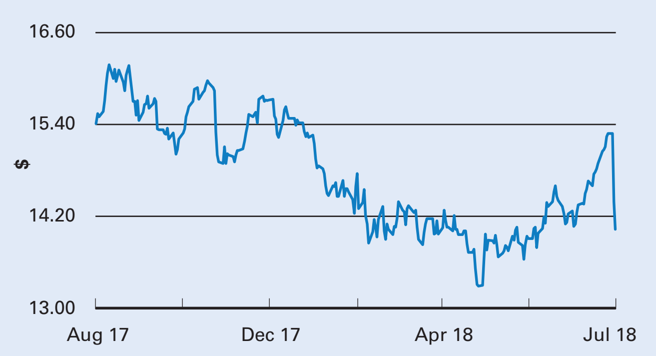
PACKAGE DEAL

Sector: Containers & packaging Recomm: Accumulate Risk rating: Medium Share price: $14.03

Year to June	2017A	2018E	2019E
Profit after tax ($m)	929	939	1,043
Earnings per share ($)	0.80	0.81	0.90
Price/earnings (x)	17.5	17.3	15.6
Dividend ($)	0.57	0.58	0.63
Dividend yield (%)	4.1	4.1	4.5
Franking (%)	-	-	-

Source: Company reports, Ord Minnett Research. Profits are on a normalised basis.

Amcor (AMC) share price



Source: IRESS

Amcor has quickened the pace of its US expansion, making an all-scrip takeover of US rival Bemis Co that values the producer of food packaging at around US$6.5 billion.

The deal, which Ord Minnett views as firmly in line with Amcor's strategy, has been unanimously approved by the boards of both companies and is now subject to regulatory and shareholder approvals, with completion expected in early 2019.

The flexible packaging market in the Americas has consistently been flagged as a focus segment by Amcor management. This deal improves the earnings growth outlook for Amcor, due largely to synergies; provides a significant flexibles platform for Amcor to continue M&A; and still leaves headroom on the balance sheet for further investment.

Under the deal, Amcor will move its primary listing to the New York Stock Exchange (NYSE), but will maintain a listing on the ASX via CHESS depositary interests (CDIs). Existing Amcor shareholders will have the option to receive one NYSE-listed share in the new company or one ASX-listed CDI. The new company is expected to be included in both the S&P 500 Index in the US and the S&P/ASX 200 Index locally.

The scrip ratio is 5.1 Amcor shares for one Bemis share, with Amcor shareholders to own 71% of the 'new Amcor' and Bemis shareholders 29%.

The market capitalisation of the combined entity, which will be the largest producer of flexible packaging in the world, is estimated to be around US$17 billion. Current Amcor chairman Graeme Liebelt and CEO Ron Delia will continue in the same roles in the new company. The new board will have 11 directors – eight from Amcor and three from Bemis.

We estimate a high-single-digit gain to EPS for the 'new Amcor' by the end of fiscal 2022 from the cost savings and revenue benefits. Our forecasts show a minor detraction of 0.2% to EPS in fiscal 2019 before gains of 1.8% in 2020, 5.4% in 2021 and 8.4% in 2022.

Using our published EPS forecast for Amcor and Bemis consensus numbers, we estimate the new company is trading on a fiscal FY19 price-earnings (PE) multiple of 16 times. This is a big discount to Amcor's historical multiple versus the S&P/ASX Industrials Index. If the full US$180 million of synergies is included, this ratio falls to 14 times. Our forecasts show pro-forma PE multiples falling from 15.9 times in fiscal 2019 to 14.5 in 2020, 13.6 in 2021 and 12.7 in 2022.

Figure 5: Portfolio by segment (%)

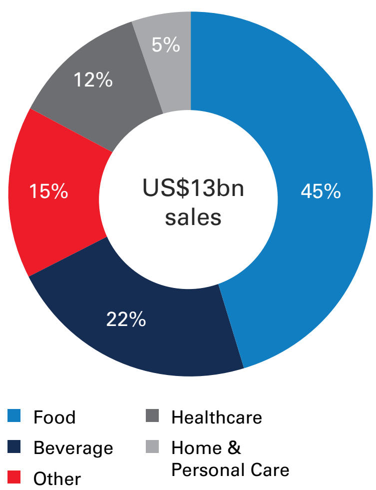
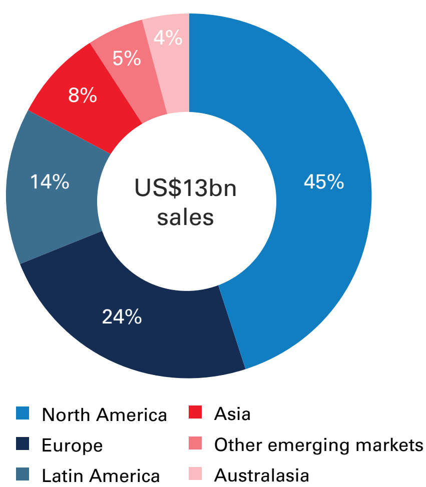


Figure 6: Portfolio by geography (%)



Source: OML Research, company data

RELIANCE WORLDWIDE

SPECIAL GUEST

Sector: Industrials Recomm: Buy Risk rating: Medium Share price: $5.90

Year to June	2017A	2018E	2019E
Profit after tax ($m)	66	86	182
Earnings per share ($)	0.13	0.16	0.23
Price/earnings (x)	47.2	36.6	25.5
Dividend ($)	0.06	0.07	0.10
Dividend yield (%)	1.0	1.2	1.7
Franking (%)	70	40	40

Source: Company reports, Ord Minnett Research. Profits are on a normalised basis.

Reliance Worldwide (RWC) share price

Source: IRESS

Ord Minnett has resumed coverage of **Reliance Worldwide** with an Accumulate rating after the plumbing supplier's purchase of UK engineering company John Guest for $1.22 billion.

The investment fits with its strategy, giving Reliance significant European manufacturing and distribution capabilities.

At an enterprise value-to-operating earnings multiple of 12.4 times, Reliance paid a full price relative to recent deals in the sector, but the British company's historical performance and operating metrics are impressive and imply an uplift to Reliance's margins, returns and cash conversion. We see the deal as highly accretive – including all the targeted synergies, the multiple paid reduces to less than 10.3 times.

John Guest's product portfolio and regional exposure are highly complementary to Reliance's base business. The deal also presents a significant opportunity to cross-sell and provides a broader platform for bolt-on acquisitions.

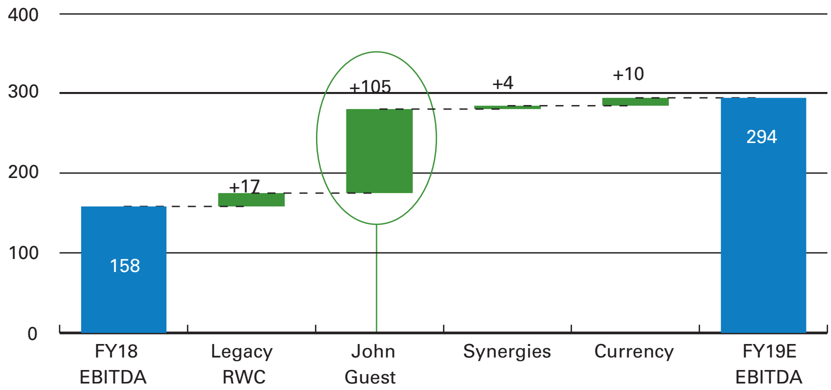
Based on our estimates, Reliance is trading on a fiscal 2019 price-earnings multiple of 26 times and offers a fiscal 2018–21 compound annual growth rate of 25%. We have factored in $20 million of cost savings and revenue benefits for John Guest and a sales benefit for its European operations due to cross-selling opportunities. We see potential upside to our growth estimates, however, if Reliance continues to expand its distribution base, launches new products or completes further acquisitions. See Figure 7 for the bridge to our fiscal 2019 earnings estimate.

Given John Guest's complementary geographic exposure, we see Reliance's sales exposure to US group Home Depot falling to 20% in fiscal 2019 from 26% in 2018. We are alert to the risks of further destocking by the hardware chain and will look for an update from Reliance management at the company's result, which is scheduled for 27 August.

Reliance holds leading positions across its key product categories and has a proven track record of delivering through-the-cycle revenue growth, with future earnings set to be driven by continued penetration of its SharkBite-branded, brass push-to-connect (PTC) fittings and accessories.

We see Reliance offering an attractive investment proposition, with high-quality growth underpinned by its disruptive PTC products, channel expansion strategy and M&A agenda.

Figure 7: Components of fiscal 2019E operating earnings increase ($m)



Source: OML Research, company data

PINNACLE INVESTMENT MGT

REACHING THE TOP

Sector: Diversified financials Recomm: Buy Risk: Higher Price: $6.07

Pinnacle Investment Management is a multi-boutique investor that holds minority equity stakes in seven Australia-based boutiques.

Beyond simply owning equity stakes, Pinnacle offers support via seed funding, both working capital and fund investment; distribution to retail and institutional markets; administration support services, including compliance, finance, legal, responsible entity, technology and fund administration; and operational and governance frameworks.

Pinnacle has been successful historically in fostering growth for its boutiques, with all seven currently profitable and holding $38 billion in combined funds under management as at 30 June 2018.

Ord Minnett has raised its recommendation on Pinnacle to Buy from Hold following its most recent acquisitions of Metrics Credit Partners (MCP) and Omega Global Investors for a total of $48 million.

MCP is an alternative credit manager, specialising in private debt, fixed income and capital markets, that was founded in 2013 and is based in Sydney. Pinnacle has provided third-party distribution assistance to MCP since 2013, including for MCP's listed investment trust in 2017. This strong and existing relationship mitigates some of the usual investment risk.

Omega is a so-called smart beta manager that was founded in 2008 and is based in Melbourne. It develops customised and standardised smart beta products that can include specific factor and/or environmental, social or governance overlays. We expect the distribution support offered by Pinnacle will be instrumental in accelerating Omega's success.

Incorporating the latest funds data, the new acquisitions – and the dilution from the capital raising to fund them – leads us to raise our fiscal 2019 and 2020 EPS forecasts by 13%, while our target price rises to $6.43 from $5.19.

For the full report, please contact your Ord Minnett adviser.

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