

April 2019

ORDS MONTHLY

GLOBAL GO-SLOW CONSUMER CONFIDENCE BOOST

The Australian stock market remains comfortably higher so far in 2019, with the S&P/ASX 200 Index up 9.5% at time of writing, although – as Figure 1 shows – most of the rise came in the first two months of the year.

More recently, markets have been increasingly fretting over a slowdown in global economic growth. Investors searching for certainty are also growing weary of the Brexit saga, not to mention trade talks between Beijing and Washington that appear predicated on the Confucian principle that “it does not matter how slowly you go so long as you do not stop”. Given these factors, it is unsurprising that markets are now largely marking time after a hectic start to the year.

Locally, politicians are jostling for our favour at every opportunity ahead of a federal election in May, with both sides promising more dollars in voters’ pockets – albeit to different demographics.

Whichever party wins the election – and virtually all opinion polls favour the ALP to wrest the government benches from the Coalition – a boost for the recently diffident consumer is assured.

The increasing possibility of cuts to the RBA cash rate is also likely to buoy the outlook for consumers harried by housing price weakness. Stymied also by tighter lending criteria post the banking Royal Commission.

In the Investment Strategy note in this edition of the *Ords Monthly*, we examine this convergence of monetary and fiscal policy, and its impact. See page 2.

Charter Hall Group leads our corporate coverage. The property manager and developer is one of our preferred property trusts and offers strong growth prospects from a diversified portfolio of non-residential real estate and expanding funds management margins. We run the ruler over Charter Hall on page 4.

Westpac has decided to exit its wealth management business, pointing to weak revenue prospects and increasing regulatory headwinds. See page 5 for our view.

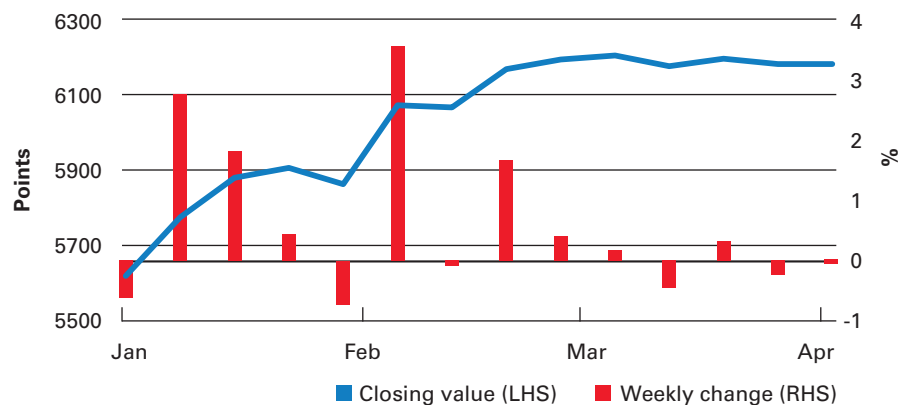
The expanding offshore operations of **SEEK** now contribute almost two-thirds of the recruitment and

education group’s revenue. This geographic diversification, and the exceptional growth on offer in its offshore markets, makes **SEEK** our preference in the online sector. See page 6 for the details.

Local biotech hero **CSL** is still at the top of the global tree in plasma-derived therapies, while its Seqirus influenza vaccine division is scaling up rapidly. We expect **CSL** to post yet another year of solid earnings, as indicated on page 7.

Meanwhile, **Woolworths** delivered both good and bad news – setting a \$1.7 billion share buyback after offloading its petrol business, but booking \$370 million in charges as it deals with its flagging Big W discount department store chain. Page 8 has more.

Figure 1: S&P/ASX 200 Index weekly performance in 2019



Source: Ord Minnett Research, Iress

INVESTMENT STRATEGY

CONVERGENCE

The much-fatigued Australian consumer could find some succour in the second half of 2019 as the paths of fiscal and monetary policy combine to impart some much-needed relief.

A fiscal policy boost (in the form of government spending) is coming, regardless of which party emerges victorious in May's federal election.

The government's recent budget looked as though it could provide the largest fiscal impulse to the economy since the GFC response a decade ago. Meanwhile, in his reply, opposition leader Bill Shorten offered more money for low-income earners but said the Labor Party – favoured by the polls to win the looming election – would reject the second stage of the government's tax plans that would have benefitted middle- and high-income earners.

In any case, tax relief will be a policy centrepiece for both major parties ahead of the election.

On the central bank's cash rate, our economists recently shifted their call to the possibility of interest rate cuts from the Reserve Bank of Australia (RBA).

The banks are unlikely to pass the full extent of any cuts through to borrowers, but we would envisage a reduction in mortgage rates of 35–40 basis points which should provide something of a crutch for the soft housing market.

At the very least, the combination of supportive fiscal and monetary policy should serve to avert the downward pressure on consumption. Our economists expect growth in consumption to recover into the mid-2% range in the first half of calendar 2020.

Despite this coming consumer stimulus, it is difficult to find a retailer that is oversold and trading at cheap multiples, with some consumer-exposed stocks outperforming in 2019 so far.

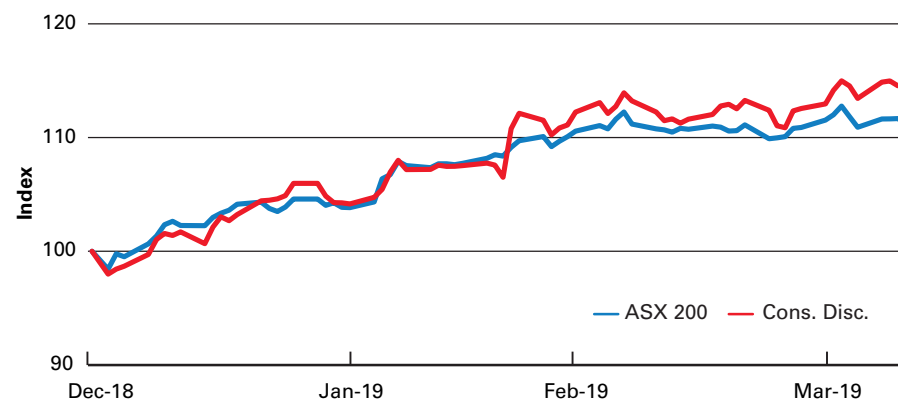
In the housing-exposed retailers, for example, Harvey Norman is up 22% in 2019 on a total return basis, JB Hi-Fi is 15% higher and Wesfarmers is up 11%, versus a rise in the S&P/ASX 200 Accumulation Index of 12%.

In our view, the muted reaction to the budget is due to the market already pricing in a fiscal boost given the long run of poor news flow on consumption. See Figure 2.

Investment Strategy

Convergence	2
Charter Hall Group	
Growth spurt	4
Westpac Banking Corp	
Break-up time	5
SEEK	
On the job	6
CSL	
In good health	7
Woolworths	
Sale fuels buyback	8

Figure 2: Consumer Discretionary vs S&P/ASX 200



Source: Ord Minnett Research, Iress. Accumulation basis.

In this housing-exposed retail group, **JB Hi-Fi** is our preference – the company’s valuation and dividend yield are attractive given its resilient earnings profile and outlook. Management also executes well, with a dynamic approach to category management providing leverage to new products and technologies, while costs are well-managed.

We are negative on **Wesfarmers**, which has moved to the consumer discretionary industry group since the **Coles** spin-off.

In our view, the housing slowdown will drive margin compression in its Bunnings and Kmart businesses, while its industrial divisions also face challenges.

In other discretionary retailers, we prefer **Super Retail Group**. The owner of Super Cheap Auto, Rebel, MacPac and BCF has outperformed the S&P/ASX 200 Accumulation Index by nearly nine percentage points in the year to date.

A key driver has been company-specific, with the MacPac acquisition proving to be less deleterious than expected.

The poor health of the consumer has been most evident in prices of the main retail property trusts, with **Scentre** and **Vicinity Centres** underperforming the market by seven and 14 percentage points, respectively.

Both REITs have endured a downdraft in earnings expectations, and **Woolworths’** recent announcement of the closure of 30 Big W discount department stores will only add to the pressure on the sector.

In fact, domestic retail REITs, along with residential REITs, are our least-preferred property exposure. As outlined in the *Ords Weekly* of 5 April, we prefer diversified property trusts, some selected developers and those with longer weighted average lease expiries.

Another element of policy relief for consumers could come in the form of lower official interest rates from the RBA.

This convergence of RBA and government stimulus has implications for the banks – the Australian market’s largest sector.

The banks have been through a very challenging period with the Royal Commission, as well as a sliding

housing market, dragging the sector down. In the year to date, the financials sector sub-index has underperformed the broader market by seven percentage points.

Domestic interest rates have an obviously significant bearing on the earnings outlook for the Australian banking sector. As a first-order impact, lower interest rates impact net interest margins due to the lower return on free funds and deposit rate compression.

The sector, however, typically reprices its loan book when the cash rate falls, and mortgage rates have increased substantially relative to the RBA’s cash rate since 2008.

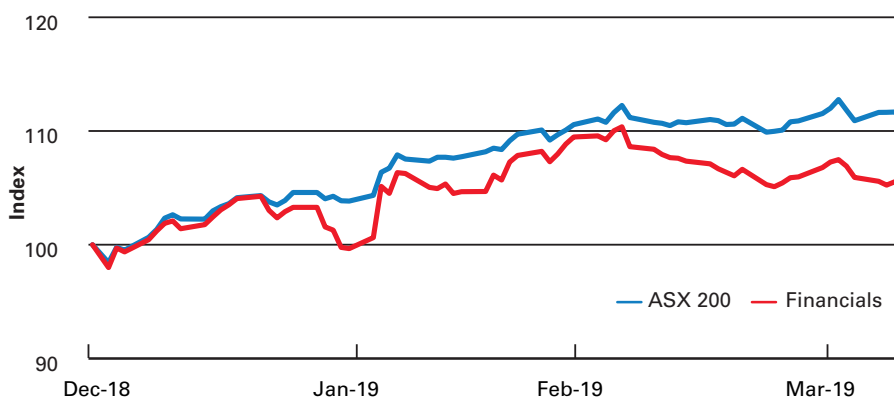
In addition, a lower cash rate could spur a recovery in credit growth, so an easing by the RBA should not be seen as an unambiguous negative for the banks.

“...a lower cash rate could spur a recovery in credit growth.”

Other consumer-exposed stocks that could also benefit from the coming consumption boost include **Star Entertainment** and **Crown Resorts**. A slowdown in VIP business and the effect of the Barangaroo development on the Sydney market have been key factors undermining confidence and earnings expectations, but we would argue that the state of consumer confidence is also having an impact.

We are positive on Star while Crown now appears to be in play, despite Wynn Resorts withdrawing from takeover talks.

Figure 3: Financials vs S&P/ASX 200



Source: Ord Minnett Research, Iress. Accumulation basis.

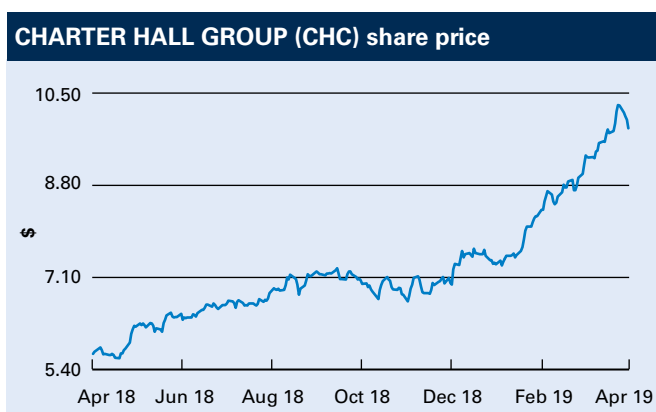
CHARTER HALL GROUP

GROWTH SPURT

Sector: **Real estate** Recomm: **Accumulate** Risk rating: **Medium** Share price: **\$10.12**

Year to June	2018A	2019E	2020E
Profit after tax (\$m)	176	207	329
Earnings per share (\$)	0.38	0.44	0.71
Price/Earnings (x)	26.8	22.8	14.3
Dividend (\$)	0.32	0.348	0.49
Dividend Yield (%)	3.1	3.4	4.8
Franking (%)	-	-	-

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



Source: IRESS

Charter Hall Group is a property group with assets across the office, industrial, retail and education sectors via a range of listed and unlisted funds.

Ord Minnett recently raised its rating on Charter Hall to Accumulate, based on widening margins in its funds management operations, increasing economies of scale as its assets under management grow, and a favourable portfolio composition.

Charter Hall is becoming more capital-efficient and increasingly well-positioned to fund its growth in assets – currently at circa \$28 billion following the Folkestone acquisition – on a ‘capital-light’ basis.

The group had \$115 million of cash at December and we estimate it will generate a further \$140–160 million in the next two years from maturing funds and retained earnings.

This scenario should see Charter Hall positioned with enough cash to sponsor the growth of its funds for the next two to three years.

Over the next three years we expect Charter Hall to increase its assets under management to around \$40–45 billion, implying growth of 40–60%; lift its underlying property funds management margin from to

55% from 43%; and deliver a 40–45% increase in underlying EPS excluding performance fees.

This should ease any concerns about risks to earnings from a tapering off in performance fees, following what we expect to be a record year for such fees in fiscal 2020.

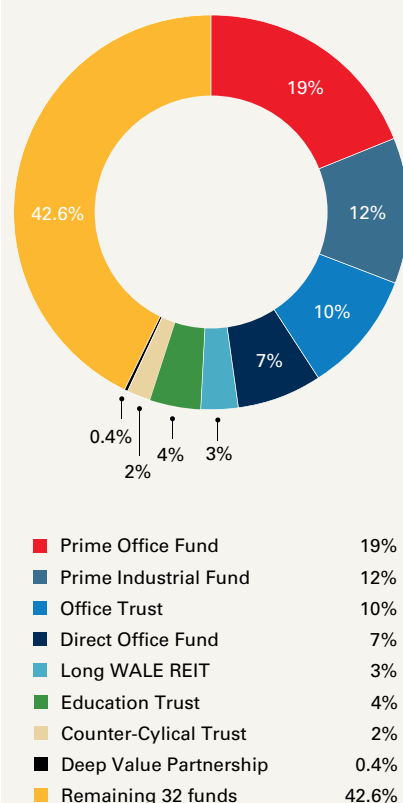
Charter Hall has eight key vehicles – out of a total of around 40 – that we see as likely to drive the vast majority of growth in assets. See Figure 4 for details.

In aggregate, these vehicles comprise around 60% of the platform and equate to \$17 billion. Over the next three years, we expect them to grow by \$12 billion, equating to 80–85% of growth in total group assets.

These growth vehicles are exposed to office, industrial and long weighted-average lease expiry (WALE) sectors, with typically historical internal rates of return, scalable balance sheets and competitive funding costs.

We note fundamentals in the Australian office, industrial and long WALE segments are among the best globally, and transaction markets are likely to get a ‘shot in the arm’ from low long-term bond yields, which typically should reduce funding costs and keep return spreads high.

Figure 4: Assets under management split by fund (%)



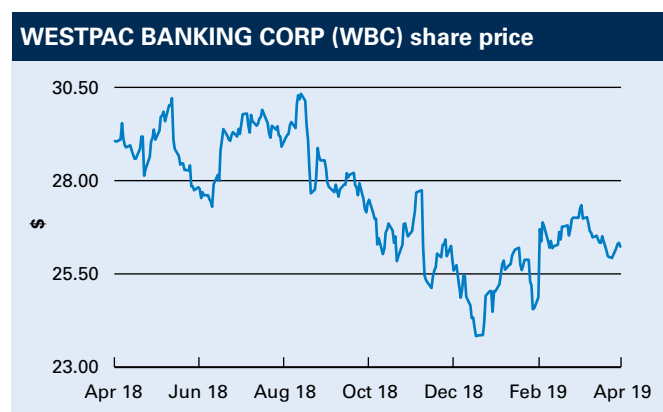
Source: Ord Minnett Research

WESTPAC BANKING CORP

BREAK-UP TIME

Sector: **Banks** Recomm: **Hold** Risk rating: **Medium** Share price: **\$25.57**

Year to September	2018A	2019E	2020E
Profit after tax (\$m)	8,065	7,527	8,362
Earnings per share (\$)	2.29	2.11	2.32
Price/Earnings (x)	11.2	12.1	11.0
Dividend (\$)	1.88	1.88	2.08
Dividend Yield (%)	7.4	7.4	8.1
Franking (%)	100	100	100



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

Source: IRESS

Westpac Banking Corp has moved to exit the wealth management business, citing revenue headwinds and a rising regulatory burden in the wake of the Hayne Royal Commission.

In the reorganisation, existing customers will be transferred to Viridian Advisory, an independent advisory group, on an opt-in basis, with Westpac moving to a referral model under which customers are referred to a panel of advisers, i.e. not just Viridian.

BT Financial Group (BTFG) will no longer exist as a separate division, with its insurance business to be subsumed into the consumer banking unit, and the private wealth, platforms and superannuation operations to be folded into the business banking arm.

In related moves in executive ranks, George Frazis, chief executive of consumer banking, and Brad Cooper, head of BTFG, will leave Westpac. David Lindberg, current head of business banking, will become head of consumer banking, while Alistair Welsh will take over the chief of business banking role in an acting capacity.

Westpac's advice exit appears to be a rational response to structural challenges that have weighed on profitability in recent years – even before customer remediation costs, the advice business was loss-making in fiscal 2017 and fiscal 2018.

Westpac will continue to provide insurance, private wealth, platforms and superannuation products through its main business units and, in our view, is well-positioned in most of these products. The outlook is somewhat uncertain in the insurance business, however, given the 'no hawking' recommendation from the Royal Commission's final report (albeit the scope of any ban is yet to be decided).

The bank did not disclose the proceeds from the transaction as the financial impact will depend on the size of the business that transfers to Viridian.

Management expects the benefits to be spread over fiscal 2019 and fiscal 2020, but we suggest they will be only modest, and dwarfed by separation costs in any case.

Management guided to one-off costs of \$250–300 million in relation to the changes, with some

\$200 million to be booked in the first half of fiscal 2019. We note revenue losses from the restructuring will occur sooner than any cost savings.

Separate to the wealth business restructuring, Westpac also announced further customer remediation charges to be taken in the first half of fiscal 2019.

The bank expects to make a provision for \$260 million on a post-tax basis related to financial advice service fees from its wealth management arm, and the incorrect classification of loans for some consumer and business borrowers. Westpac also reiterated that it needed to take provision for financial advice issues in aligned dealer groups, with the size of these charges uncertain. We note these are issues that we also expect its peers to face.

Combined, we expect these charges to amount to \$550 million, significantly more than our previous allowance of \$100 million, leading us to cut our fiscal 2019 cash earnings forecast by 5.6% to \$7.53 billion.

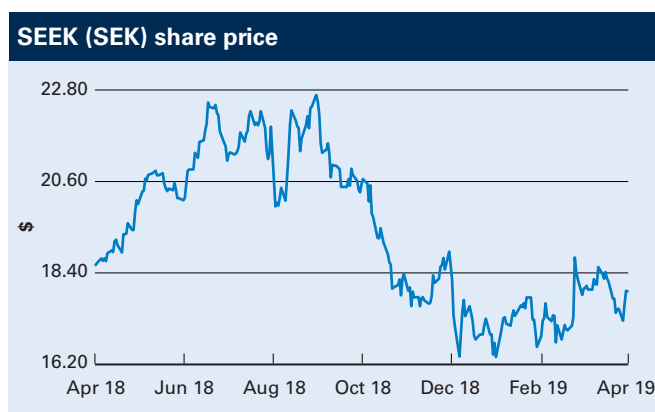
SEEK

ON THE JOB

Sector: **Commercial & prof. services** Recomm: **Accumulate** Risk rating: **High** Share price: **\$17.57**

Year to June	2018A	2019E	2020E
Profit after tax (\$m)	230	233	265
Earnings per share (\$)	0.66	0.66	0.75
Price/Earnings (x)	26.8	26.6	23.4
Dividend (\$)	0.46	0.46	0.51
Dividend Yield (%)	2.6	2.6	2.9
Franking (%)	100	100	100

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



Source: IRESS

SEEK is an online recruitment and education group with operations in Australasia, China and south-east Asia, Brazil and Mexico.

The company's first-half fiscal 2019 earnings and revenue comfortably beat Ord Minnett's estimates. The strong result was achieved despite a softening Australian economic picture, as SEEK's international businesses continued to outperform.

This growing contribution from its international arm leaves SEEK less exposed to the performance of the Australian economy, and is the prime reason we prefer it to its peer Realstate.com.

SEEK's international businesses now contribute 60% of group revenue and 50% of operating earnings, and are poised to become a much greater part of the overall group.

Geographical diversification not only lessens dependence on the Australian economy, but also creates much greater growth potential as its international investments are all in developing markets with very long runways for growth.

The company splits its business into two divisions – SEEK Asia Pacific and Americas (we note former **Commonwealth Bank** CEO Ian Narev was recently hired as head of this business) and SEEK Investments.

The jewel in the SEEK Investments crown is the Zhaopin operation, the No.1 online employment agency in the booming China market.

That said, only around 10% of online employers are Zhaopin customers so far. The number of online employers in China, however, is expected to grow at a compound annual growth rate of more than 20%.

In addition, only about 10% of China's population currently search for jobs online. Given this combination of factors, Ord Minnett sees Zhaopin as still in the early stages of continuing 'hyper growth'.

Zhaopin's revenue has shown an annualised growth rate of 26% over the past seven years, and we expect it to sustain an annualised growth rate of more than 20% for the foreseeable future.

During this phase, we also expect earnings margins to be stable, with room for significant improvement as the business matures.

The key business in the Asia-Pacific and Americas division is the Australasian operation.

Australian employment has improved over the past couple of years, since the jobs recession from the mining slowdown in 2015, but the unemployment rate and underemployment rate could still improve.

We note the official data is more positive than SEEK's job listings data and our own observations.

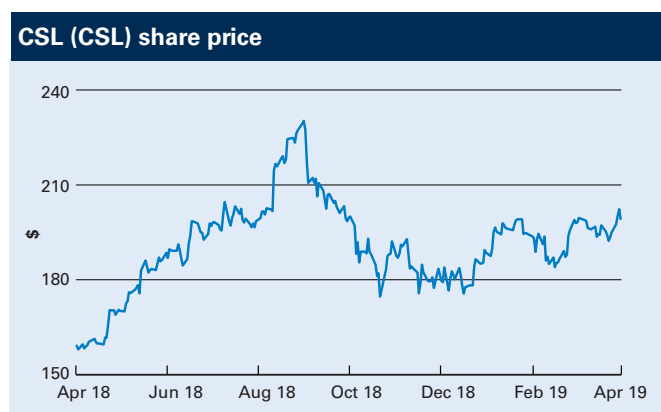
Given a more accommodating monetary stance from the Reserve Bank of Australia, however, we expect further improvement in the jobs market, which should in turn drive further growth in employment classifieds.

CSL

IN GOOD HEALTH

Sector: **Pharmaceuticals** Recomm: **Accumulate** Risk rating: **Medium** Share price: **\$199.00**

Year to June	2018A	2019E	2020E
Profit after tax (\$m)	1,671	1,927	2,230
Earnings per share (\$)	3.68	4.24	4.91
Price/Earnings (x)	54.1	47.0	40.6
Dividend (\$)	2.34	1.95	2.32
Dividend Yield (%)	1.2	1.0	1.2
Franking (%)	-	-	-



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

Source: IRESS

CSL is a world-leading supplier of plasma products and related therapies, and influenza vaccines.

Sales growth from CSL's core plasma business in the first half of fiscal 2019 was weaker than expected, but the company retained its clear market lead in 2018 as the largest supplier of plasma-derived therapies.

Importantly, results and commentary from CSL's leading rivals were consistent, indicating market conditions were robust with demand exceeding supply in some markets and plasma collection again being a key constraint.

Plasma products

CSL comfortably retained its position as the largest supplier of plasma-derived therapies, by both volume and revenue, in 2018. CSL grew its global market share to 44%, versus Spain's Grifols at 29% and 27% for Shire, recently acquired by Japan's Takeda Pharmaceutical for US\$62 billion.

Slowing growth into the end of calendar 2018 was evident for all three major suppliers.

We are inclined to attribute this to a difficult comparable period and tightness in raw material supply, however, given consistent reports of robust demand. This is particularly the case for immunoglobulin, which accounts for more than half of all plasma-derived therapy sales across the major suppliers.

Consistent with its position as the leading supplier of plasma-based therapies, CSL also collects more plasma than its key rivals. Grifols has retained its lead as the owner of the largest number of centres, thanks almost entirely to acquisitions. By our estimates, however, CSL collects almost as many litres of plasma as its two chief competitors combined.

Putting aside M&A activity, CSL is the clear leader in terms of the number of centres it opens and average collections per centre.

We expect the competitors to continue to lift their investment in plasma centres, especially Takeda, but we see little risk to CSL's market-leading position.

Influenza vaccines

The Seqirus vaccine business posted a 3.0-percentage-point lift in market share to 23% during the first half of fiscal 2019, driven largely by product mix. The Seqirus gain came at the expense of key competitor Sanofi, whose share fell to 57%, while GlaxoSmithKline held steady at 20%.

Notably, revenues from standard vaccines were flat on a year ago, but this was offset by strong growth in sales of the modified vaccine for older patients.

We attribute flat revenues from classic vaccines to some price erosion due to geographic mix, i.e. low-priced tender markets and, to a lesser degree, increased competition in developed world markets.

CSL is well-positioned for another year of mid-teens earnings growth, supported by robust demand for its key plasma therapies, while the ramp-up of the influenza business offers another source of earnings growth.

WOOLWORTHS

SALE FUELS BUYBACK

Sector: **Consumer staples** Recomm: **Hold** Risk: **Medium** Price: **\$30.44**

Woolworths (WOW) will return \$1.7 billion to shareholders via an off-market buyback, using the proceeds from the sale of its petrol division to British-based fuel and convenience store chain EG Group.

The buyback will use about \$665 million of the \$2.6 billion in franking credits the retailer had at June 2018.

The buyback announcement was accompanied by \$370 million in one-off charges related to a restructuring of its discount department store chain Big W.

Woolworths will close 30 of its 183 Big W stores over the next three years, and two distribution centres – Monarto in South Australia and Warwick in Queensland – at the end of their leases in fiscal 2021 and 2023, respectively.

The charges comprise \$270 million of one-off costs through the fiscal 2019 profit and loss statement related to lease and other store exit costs;

and a \$100 million write-down of Big W's assets on the balance sheet.

The write-down reflects a more conservative level of expected margin recovery from the department store chain.

We have raised our normalised EPS forecasts by 1% in fiscal 2019 and 3% in fiscal 2020 due to the buyback.

The Australian food turnaround at Woolworths has been very strong, and we expect it to broadly continue. A Big W turnaround is uncertain, although a recovery to long-term positive earnings is more likely following the restructuring, despite the near-term outlook being weaker.

We maintain our Hold recommendation on Woolworths as, in Ord Minnett's view. However, it is trading at an elevated valuation that incorporates a premium for already announced capital management and its market leadership position.

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

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