ORD MINNETT
PRIVATE WEALTH

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ORDS MONTHLY

KEEPING SCORE

EARNINGS MUTE WHITE NOISE

The Australian stock market is heading for a lacklustre performance in the first quarter of 2018, with the S&P/ASX 200 Index down 1.4% at time of writing.

The most-recent trading action in global markets has been dominated by trade-war tensions in the wake of president Donald Trump's tariffs on US imports of steel and aluminium, and a revolving door in the executive wing of the White House.

Locally, the hot-button issues taxing investors have been the royal commission into financial services and a controversial plan by the ALP to abolish franking credit rebates if it wins government.

In the domestic economic picture, Australian December-quarter GDP figures were below expectations – showing an annualised rate of 2.4% versus market expectations for 2.5% – and reaffirmed that the consumer is keeping their hands in their pockets. This outcome consolidates our view that the Reserve Bank of Australia will consider lowering its 3.25% GDP growth forecast for calendar 2018 and will keep interest rates on hold this year.

Other more frequent data suggests there is more growth and momentum around businesses than households, but the consumer drives circa 60% of economic growth, and subdued activity from this segment is still the dominant drag on GDP growth.

Against this backdrop, however, corporate earnings have still impressed, both globally and locally. Specifically, the February reporting season overall proved a solid one in Australia, with positive earnings revisions of 1.4% over the month making it the best season in the past 11 periods.

This performance ratcheted up overall growth expectations for the full year, with our net profit growth projection for fiscal 2018 rising to 9.2%, up from our January estimate of 8.3%.

We examine the reporting season in more detail in our Investment Strategy note starting on page 2.

One of the highlights from reporting season was another high-quality result from CSL, the leading global supplier of plasma and a member of the Ord Minnett blue-chip portfolio for the past eight years. CSL's influenza vaccine arm Seqirus is also starting to deliver and we believe management's guidance is conservative. We discuss CSL's prospects in more detail on page 4.

We recently raised our rating on Woodside Petroleum to Hold from Lighten as, in Ord Minnett's view, the market is not pricing in enough value for the oil and gas group's growth projects. On page 5, we outline our reasoning.

At first glance, the aforementioned tariffs on US imports of steel and

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aluminium looked to be a negative factor for BlueScope Steel, but the subsequent exemption of Australia from the levies leaves the company with a clear cost advantage over some of its main American rivals, particularly in finished products. We discuss our investment thesis on page 6.

At the smaller end of the market, we take a look at People Infrastructure on page 7. The labour hire company has a market-leading safety record and a stable network of more than 10,000 employees, and has exposure to some strong growth sectors – in particular, the National Disability Insurance Scheme, where it is the key staff supplier to the some of the largest not-for-profit disability accommodation service providers.

We also like Viva Energy REIT, with its exposure to the $25-billion service-station market via a high-quality portfolio of Shell and Coles Express-operated assets. We discuss this stock on page 8.

INVESTMENT STRATEGY

DOING THE NUMBERS

The February 2018 results season proved to be a solid report card for corporate Australia, with beats, revisions and stock performance all underpinning a strong outlook. (See Figure 2 for what each sector contributed to the final outcome.)

Earnings revisions were positive, with the 1.4% rise through the course of February making it the best reporting season in the past 11 periods.

As a result of this, overall growth expectations for the full year have been ratcheted up – our net profit growth projection for fiscal 2018 is upgraded to 9.2%, up from the 8.3% rise we flagged in January. (See Figure 1)

Materials and energy sectors will account for the bulk of the growth, with the former contributing 4.0 percentage points to our 9.2% aggregate growth forecast for net profit.

Importantly, the upgrades weren't narrowly confined to a small number of sectors or stocks. Overall, we saw 73% of sectors generating positive revisions, which is the highest rate since February 2013.

In keeping with recent seasons, the themes of rising capital expenditure and escalating cost pressures stood out again in this latest period.

The theme of declining dividend payout ratios, however, looks to have stalled – since August 2017, the S&P/ASX 200 payout ratio has held steady at circa 70%.

- **Capital expenditure**
  The market remains in an upgrade cycle, with most sectors seeing increased spending estimates.

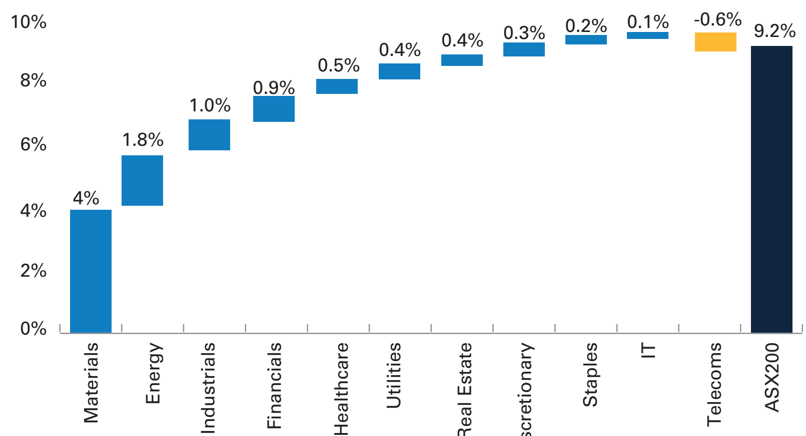
As is to be expected, materials is the largest contributor, with our one-year forward expectation for the sector rising by more than $3 billion since February 2017.

BHP Billiton, where forecasts are up $2.9 billion, accounted for the bulk of the increase.

Meanwhile, expectations for both **Rio Tinto** and **Fortescue Metals** have risen around $300 million.

In materials sub-sectors, such as packaging, numbers have actually been cut, with **Amcor's** expected spending now down $60 million a year ago.

Figure 1: FY18E Net profit bridge for S&P/ASX 200



Source: OML, Bloomberg

- **Costs**
  The persistent pressure of escalating costs was evident across a wide range of companies that reported.

  The load looked particularly weighty in materials, where a majority of companies reported higher-than-expected increases in a range of costs.

  Prime examples of this include **South32** and BHP, while **Oil Search** also surprised with higher cost guidance for calendar 2018. Consensus numbers for these three companies were all scaled back post the results.

- **Payout ratios**
  A slide in dividend payout ratios since October 2015 – when the aggregate ratio stood at 78% after a long ascent from 63% in September 2012 – appears over. This was still the case last reporting season, but a stabilisation now seems to be taking hold around the 70% mark.

  That said, there are wide divergences in payout ratios among sectors, with a handful seeing expansion, such as financials, consumer staples, materials and energy, while a number are still sliding, such as telecoms, utilities and consumer discretionary.

Winners and losers

- **Consumer discretionary**
  Retailing suffered significant falls after soft trends in like-for-like sales growth, as well as some concerns around strategic investments at **Harvey Norman** (dairy JV losses) and **Super Retail** (Macpac acquisition).

- **Telecoms**
  Vocus was the key underperformer after cutting its full-year guidance due to higher marketing and energy hedging expenses, and as its CEO stepped down (its chairman has also departed since then, replaced by veteran telecoms executive Bob Mansfield).

  Telstra delivered results in line with market expectations, but the industry backdrop remains challenging, with average revenue per user continuing to decline in mobile.

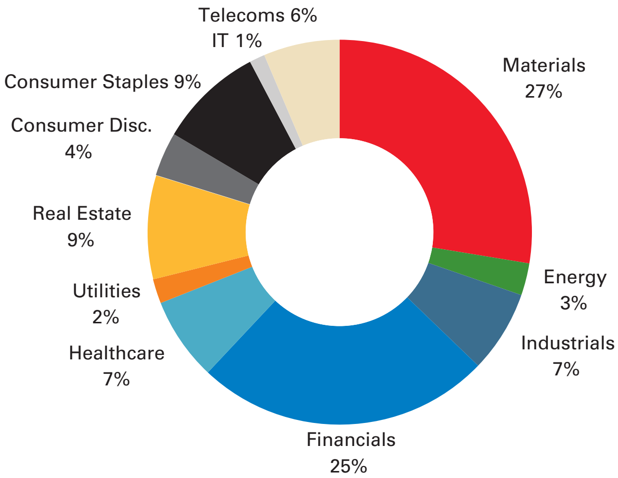
  Telecoms is the only sector not expected to grow earnings in fiscal 2018.

- **Healthcare**
  The sector saw overall upgrades to consensus forecasts, but particularly for **ResMed** and **CSL**, which are reaping the benefits of product launches and market-share gains.

- **Financials**
  Tailwinds from stronger equity markets benefitted names such as **AMP** and **ASX**, while general and health insurers, e.g. IAG and NIB, enjoyed wider margins as premium increases outpaced claims inflation.

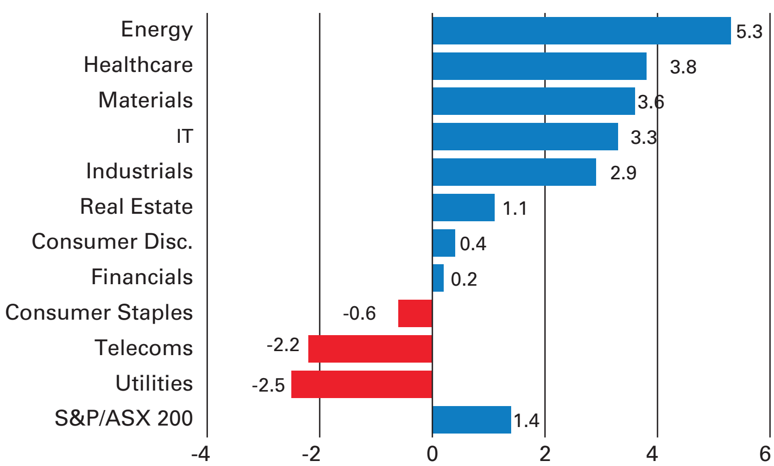
- **Materials**
  Estimates were raised, buoyed by results from **Boral**, Rio Tinto and **Orora**.

Figure 2: First-half FY18 net profit contribution by sector



Source: OML, Bloomberg

Figure 3: FY18 post-result EPS revisions by sector



Source: OML, Bloomberg

CSL

LIQUID GOLD

Sector: Healthcare Recomm: Hold Risk rating: Higher Share price: $163.75

Year to June	2017A	2018E	2019E
Profit after tax ($m)	1,742	2,133	2,442
Earnings per share ($)	3.83	4.72	5.40
Price/Earnings (x)	43.4	35.2	30.7
Dividend ($)	1.77	2.06	1.48
Dividend Yield (%)	1.1	1.2	0.9
Franking (%)	-	-	-

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

CSL (CSL) share price

Source: IRESS

CSL, a leading global plasma supplier and a member of Ord Minnett's core blue chip portfolio since 2010, continues to deliver high-quality results with revenue, earnings and dividend all above our forecasts for the first half of fiscal 2018.

Revenue came in 6% ahead of our forecast, driven by wider margins which, in turn, reflected an improved product and country mix and subdued costs. A 79 cents per share dividend was also well ahead of forecast of 70 cents.

A big lift in earnings by the key Behring plasma division was the highlight, while the Seqirus flu vaccine business also beat our estimates.

Post the result, our full-year earnings estimate for Seqirus has been raised 46%, albeit off a low base, while we have increased our Behring earnings forecast by 5%.

CSL has maintained its breakeven guidance for Seqirus, but we believe it will benefit from lower vaccine returns after a severe northern hemisphere flu season.

Claims of a vaccine shortage have been denied but, in our view, a lift in demand is a predictable response to the worst flu season in years.

For Behring, the earnings contribution from the plasma business in the first half was some 25% ahead of our estimates. This division will bear the brunt of higher costs in the second half, but the strength of the market has still led us to raise our estimate for full-year earnings.

The plasma business will continue to benefit from supply issues affecting competitors, while the sharp lift in margins in the first half reflects the materially higher margins generated by its specialty products and new haemophilia therapies.

Sales of its Haegarda therapy – used to prevent hereditary angioedema attacks – are on track to be significantly higher in the second half, so we expect full-year margins to lift despite rising costs. New treatments such as Afstyla, used for haemophilia A, and Idelvion, for haemophilia B, should also provide upside for sales.

This is in addition to CSL's Hizentra and Privigen treatments, which won approval from the US Food and Drug Administration in 2017 to treat chronic inflammatory demyelinating polyneuropathy, a rare autoimmune disorder that affects the peripheral nerves.

Management explicitly warned costs would be heavily weighted to the second half, especially R&D. This was also the case last year when the second half accounted for only 40% of profits. We suspect, however, that there is an element of management taking the opportunity to invest for the future after another strong first-half performance.

We are confident CSL will report a full-year net profit ahead of guidance, thanks to a maiden profit from Seqirus – given the very difficult flu season – and continued momentum in plasma product sales – especially the high-margin specialty and haemophilia therapies. We believe this will be achieved, despite a material lift in costs during the second half.

WOODSIDE PETROLEUM

LONG-RANGE VIEWPOINT

Sector: Energy Recomm: Hold Risk rating: Higher Share price: $28.60

Year to December	2017A	2018E	2019E
Profit after tax ($m)	1,314	2,001	2,063
Earnings per share ($)	1.56	2.14	2.20
Price/Earnings (x)	18.5	13.5	13.1
Dividend ($)	1.26	1.05	0.60
Dividend Yield (%)	4.4	3.6	2.1
Franking (%)	100	100	100

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

Woodside Petroleum (WPL) share price

Source: IRESS

Ord Minnett recently raised its rating on **Woodside Petroleum** to Hold from Lighten on valuation grounds following the steep slide in its shares. In our view, the market is not pricing in enough value for the company's growth projects.

Since the stock peaked in mid January, Woodside has dived more than 15%, sharply underperforming the 2.2% decline in S&P/ASX 200 Index over the same period. The Woodside fall was driven by sliding Brent prices, as well as the $2.5 billion equity raising in February to fund capital expenditure on its medium- and long-term growth projects.

Woodside's stock price is not factoring in much of its growth portfolio. Approximately 10% of our estimated enterprise value for the company, or US$3 billion, comes from growth projects which we value on a risk-weighted basis. These include small-scale near-term projects, such as Senegal and Myanmar, and larger longer-term projects, such as Scarborough and Browse.

Our net present value measure (excluding unsanctioned projects) is US$18 billion, or $26.54 per share. We estimate the stock includes only US$2.5 billion for these projects, with Woodside paying US$744 million for 50% of Scarborough and US$440 million for 35% of the Senegal assets.

Woodside looks more attractive on a valuation basis – we have also raised our target price to $29.70 from $29.00 – but the risk now is the significant amount of growth capital expenditure likely to occur over the medium to long term.

Woodside is targeting first production from Scarborough by 2025. The development concept for Scarborough involves utilising existing infrastructure at the Pluto LNG plant to meet a market gap the company expects will emerge from the early 2020s.

Meanwhile, a concept plan for the deepwater Senegal project has been chosen, with first oil production expected from the 2021–23 period.

We estimate Woodside's share of capital expenditure, including spending on Myanmar, Senegal, Scarborough and Browse, will amount to US$30 billion between 2018 and 2030 at an average of US$2.3 billion per annum.

We see net debt peaking at US$7.3 billion, or gearing of 25%, in 2025, before falling sharply after that to reach a net cash position by 2019.

Woodside's 2017 results were overshadowed by the Scarborough and Senegal acquisitions, and the large capital raising.

Nevertheless, operating earnings were slightly stronger than Ord Minnett had expected, driven by a good performance on operating costs, with management noting a 9% decline in unit production costs (excluding Wheatstone) on the previous year.

Underlying net profit was 5% below our estimate, with a high effective tax rate due to one-off items.

BLUESCOPE STEEL

COMING UP TRUMPS

Sector: Metals and Mining Recomm: Accumulate Risk rating: Higher Share price: $15.32

Year to June	2017A	2018E	2019E
Profit after tax ($m)	651	720	841
Earnings per share ($)	1.14	1.29	1.51
Price/Earnings (x)	13.7	12.1	10.3
Dividend ($)	0.09	0.12	0.15
Dividend Yield (%)	0.6	0.8	1.0
Franking (%)	100	7	-

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

BlueScope Steel (BSL) share price

Source: IRESS

BlueScope Steel is a global steel products manufacturer with operations predominantly in Australia, New Zealand, North America and the ASEAN region.

The stock has slid more than 6% since 1 March when US president Donald Trump provided details on his long-anticipated plan to introduce a 25% tariff on steel imported into the US and a 10% tariff on aluminium imports. Globally, steel stocks have broadly underperformed, with little distinction between winners and losers.

After the final proclamation was signed by the president, however, Australia was granted an exemption from the penalties, along with Mexico and Canada for an indefinite period as those countries continue talks on the North American Free Trade Agreement (NAFTA).

Australia's exemption follows months of intense lobbying by diplomats and senior politicians, and leverages long-standing trade and security relationships between the two countries.

In fact, we note the imposition of tariffs could well benefit BlueScope's operations in the US. The company produces about 2 million tonnes per annum of hot rolled coil from its North Star facility in Ohio, and has significant leverage to higher US steel prices, which have risen 6.5% since the tariff was foreshadowed on 1 March.

In addition, the shielding of Australia – and therefore BlueScope – from the tariff also provides the company with a cost advantage for its US west-coast Steelscape business which makes finished products for the building industry.

The Washington state-based Steelscape, which also has a plant in California, takes in about 200,000 tonnes of coil from Port Kembla, which is then transformed into a variety of coated and painted products. The exemption from the tariff gives Steelscape a cost advantage given its rivals on the west coast operate almost entirely on imported steel.

Over the past five years, BlueScope has undergone significant restructuring activities, including closing half of its manufacturing capacity in Australia.

The company's first-half result for fiscal 2018 was very strong, leading us to raise our target price to $18.00 from $16.30.

Some in the market viewed the company's outlook commentary for the second half as a little soft, but we believe management was simply trying to remain circumspect in what is otherwise a broadly positive macro-economic environment for steelmakers.

BlueScope's underlying businesses are high-quality and well-managed. We expect share price performance to be driven by steel spreads and management's ability to deliver on margin improvement in the company's operations.

PEOPLE INFRASTRUCTURE

PEOPLE, PLEASE!

Sector: Commercial Services Recomm: Buy Risk rating: Higher Share price: $1.44

Year to June	2017A	2018E	2019E
Profit after tax ($m)	6	8	9
Earnings per share ($)	-	0.12	0.14
Price/Earnings (x)	n/a	12.2	10.2
Dividend ($)	-	0.04	0.08
Dividend Yield (%)	-	2.8	5.4
Franking (%)	-	100	100

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

People Infrastructure (PPE) share price

Source: IRESS

People Infrastructure is a temporary labour and workforce management company, backed by a market-leading safety record and a stable network of more than 10,000 employees.

The company is exposed to some appealing industry drivers, including the rollout of the National Disability Insurance Scheme (NDIS), an increase in infrastructure spending, a recovery in resources industry investment, changes to the childcare funding regime and technological change.

The company, operating primarily under the AWX and Edmen brands, has grown revenue at a compound annual growth rate (CAGR) of 20% between fiscal 2013 and 2017, servicing more than 3,100 clients of varying size.

People Infrastructure's recent result for the first half of fiscal 2018 bettered Ord Minnett's expectations, driven by increased operational efficiencies and some additional back office synergies from the tie-up of Edmen and AWX.

Post the result, we added People Infrastructure to our list of best stock ideas, with the stock now in our small-cap preferred portfolio. It is trading on a fiscal 2019E price-earnings ratio of 10.2 times, offering plenty of value with circa 13% potential upside to our $1.62 target price.

People Infrastructure is currently the only company to handle the entire staffing solution for a range of prominent not-for-profit disability accommodation service providers.

The NDIS will see an annual investment of $22 billion from fiscal 2019. This is expected to result in an annual increase of 31.2% in the number of disability services operators to fiscal 2019, while the number of staff required is expected to grow at a CAGR of 24.4%, according to the National Disability Insurance Agency, the NDIS manager.

This is a compelling structural tailwind for the business, with the industry uniquely placed to depend on casual staffing solutions.

Childcare, which represents 6% of group profit, is also set to benefit from regulatory changes with a $37 billion funding package designed to make childcare more affordable. Childcare was one of the fastest growing professions over the past five years with a CAGR of 5.2%, which is expected to continue.

The fragmented total labour hire market was estimated at $19.7 billion of revenue in fiscal 2017, with People Infrastructure accounting for less than 1% and the top 10 companies accounting for just 37%. This gives the company plenty of opportunities to grow market share via acquisitions.

The ramp-up of the NDIS continues, with the transition of disability accommodation services from the NSW government to the not-for-profit sector yet to begin, although the NDIA has flagged the end of fiscal 2018 for completion. Changes to the childcare funding regime are also slated for the start of fiscal 2019, providing the company with multiple avenues for growth.

VIVA ENERGY REIT

SERVO TIME

Sector: Real estate Recomm: Buy Risk: Medium Price: $2.04

Viva Energy REIT (VVR) provides exposure to the $25 billion service-station market through a high-quality portfolio leased to Viva Energy Australia and operated by Coles Express.

The majority of Viva's 440 service stations operate on triple net leases with a fixed 3% per annum rent review structure and a 14-year weighted average lease expiry. Only around 1.5% of its leases expire before 2026.

The trust is internally managed and costs are kept low, with no performance or transaction fees payable to the manager.

Viva has completed $103.2 million of acquisitions since its initial public offering in 2016, and its latest guidance assumes $50 million of acquisitions in 2018. The trust can source acquisitions either in the direct market or through its relationship with Viva Energy Australia.

Viva is undertaking a capital management program focused on extending the tenor of its debt and diversifying funding sources. It has not ruled out pursuing a security buyback as part of the program, although it would only do so at an appropriate discount to NTA. Currently, Viva is trading at a circa 7% discount to net tangible asset (NTA) value.

The trust's stable net property income growth profile is underpinned by the 3% fixed annual rent reviews, the absence of material lease expiries in the near term, and the potential for earnings growth through acquisitions.

We believe Viva's current valuation is attractive – our price target is $2.30, offering upside of around 13% to its recent trading levels, plus a circa 7% yield – leading us to reiterate our Buy recommendation.

For the full report on Viva Energy REIT, please contact your Ord Minnett adviser.

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