ORD MINNETT
PRIVATE WEALTH

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ORDS MONTHLY

THE SAGA CONTINUES
QUESTIONS TO ANSWER

Equities markets have had another turbulent month, dealing with drone attacks, toing and froing in high-level politics as Washington and Beijing continue their trade spat, an increasingly bitter Brexit process and political breakdown in Hong Kong.

In this edition of the Ords Monthly, we examine the implications of the latest in a long list of challenges to confront markets – the formal impeachment inquiry of US president Donald Trump. See page 2 for our analysis and Figure 2 for how markets have performed in the year to date.

In our corporate coverage, we lead off with Treasury Wine Estates, Australia's largest vintner. The company is focusing on key US and China markets and has been successful in using fast-moving consumer goods industry tactics to achieve its strategic goals. See page 4 for our investment thesis.

Reliance Worldwide designs and manufactures a range of water flow and control products and solutions for the plumbing industry.

The company holds leading positions across key product categories and we see Reliance offering high-quality earnings growth, underpinned by penetration of its core push-to-connect fittings product range. Page 5 has more information.

Nufarm is a producer of crop protection chemicals and products whose performance in recent years has been affected by bad weather across many of the countries in which it operates and a constrained balance sheet.

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Nufarm cannot make it rain in eastern Australia, but it has shored up its vulnerable capital position by selling its South American crop protection and seed treatment operations to its major shareholder, Japan's Sumitomo Chemical Co, for $1.2 billion. The deal removes the risk of a capital raising and produces a less-volatile earnings profile. Our analysis is on page 6.

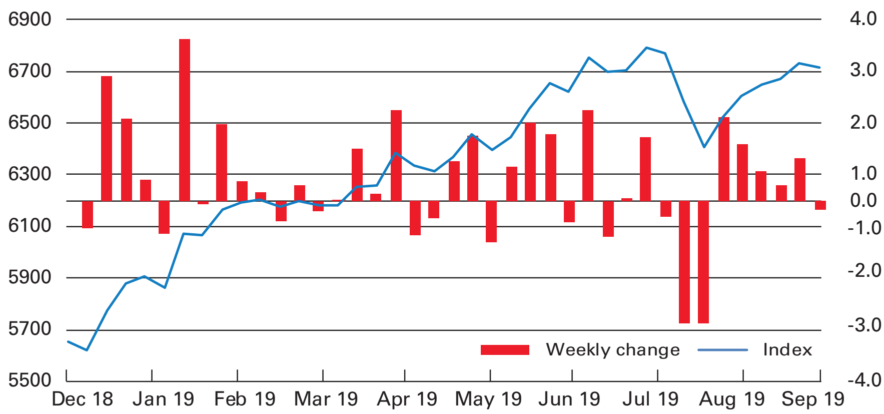
The booming demand for high-quality infant formula has seen Bellamy's Australia receive a $1.5 billion takeover offer from China Mengniu Dairy Co at $13.25 a share.

The bid – unanimously recommended by Bellamy's directors – requires federal government approval, but we expect the Treasurer to approve the takeover. Page 7 has the details.

People Infrastructure recently reported fiscal 2019 results that met expectations across the board.

We see strong earnings growth for the healthcare and IT staffing group, buoyed by contributions from its acquisitions, organic growth and structural tailwinds. See page 8 for more.

Figure 1:S&P/ASX 200 Index weekly performance in 2019 (up to 27 September)



Source: Ord Minnett Research, Iress

INVESTMENT STRATEGY

WEIGHING THE OPTIONS

The threat of impeachment has shadowed US president Donald Trump for most of his term in office. Recently, that threat moved a step closer to becoming reality after the House Speaker Nancy Pelosi announced the House of Representatives ('the House') would move forward with an official impeachment inquiry.

The process is expected to take a number of months, and even if the House decides there is enough evidence to vote for impeachment, the move seems destined for defeat in the Senate, given the upper house is currently controlled by the Republican Party.

US presidential impeachments are rare. Only three presidents have been impeached by the House – Andrew Johnson (1868), Bill Clinton (1998) and Richard Nixon (1974). Of these, Johnson and Clinton were acquitted in the Senate, while Richard Nixon (1974) resigned.

Voter support for impeachment is low, despite a laundry list of allegations against the president, and, in fact, his approval has risen from the lows of January 2018.

Financial market reaction to the latest inquiry has been muted for two reasons:

Firstly, the general sentiment is that a Republican-controlled Senate will block a conviction against one of their own, and secondly, previous experience suggests that political turmoil is secondary to economic conditions at the time of the impeachment proceedings.

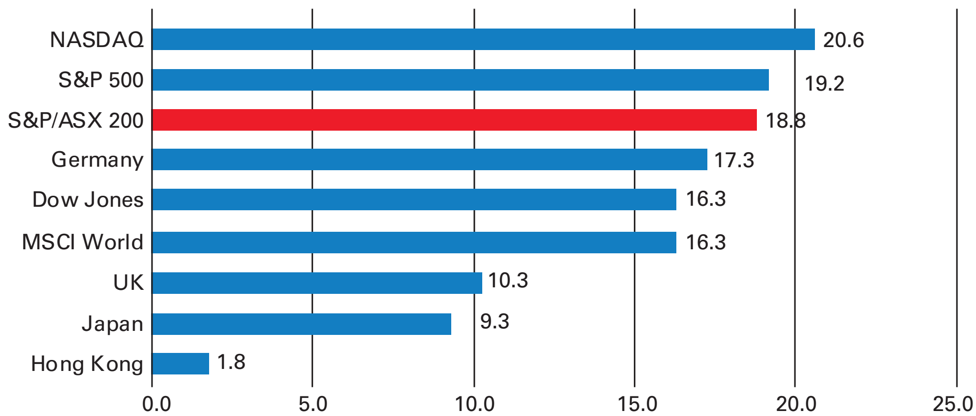
For example, in Nixon's case, the equity market suffered significant declines due to an oil price shock that sent the US economy into stagflation, whereas the market was largely unfazed by Clinton's impeachment, instead lifting on positive momentum in the US economy and a boom in dot-com companies.

Oil prices are not a significant issue at present, the recent whipsawing after the drone attacks on Saudi Arabian processing plants notwithstanding. The proceedings against president Trump do come at a time, however, when equity markets are being challenged by slowing global growth and record levels of policy uncertainty. See Figure 4 on page 3.

Against that backdrop, we analyse the policy areas that could be affected by impeachment proceedings.

Trade – In particular, negotiations with China. An optimistic view would be that the US president turns more conciliatory, desiring a quick

Figure 2: Global markets performance in 2019 (%, in local currency terms)



Source: OML Research. As at 27 September 2019 resolution in a bid to reduce market volatility and improve his re-election chances. Trump's approval ratings are currently near their best levels since he took office.

On the other hand, China may prefer to delay a deal in the hopes that it puts more pressure on the US economy and scuttles his chances of retaining the presidency in the 2020 elections.

It is worth noting that at time of writing, media reports suggest Chinese officials will not put reforms to industrial policy or government subsidies – two of Washington's main demands – up for discussion.

Geopolitical – Similarly, leaders in Iran and North Korea could be emboldened to undermine the US president, further inflaming diplomatic tensions. Oil prices have threatened to jump this year on heightened geopolitical risks, such as the aforementioned attacks on Saudi plants.

Fiscal – US domestic policy has been mired in gridlock for some time given the make-up of Congress.

Even without the overhang of impeachment risks, clashes between the political parties on fiscal policy have regularly threatened to put the US government into shutdown, the last of which occurred early this year.

The US government has instead relied on a series of short-term spending bills, i.e. continuing resolutions, to keep the government and its agencies funded. The current spending bill funds the government until 21 November.

With impeachment inquiries exacerbating the tension between the two parties, it seems unlikely we will see much bipartisan support for fiscal stimulus in the coming months. Instead, the risk of another government shutdown appears higher.

These are the key risks for the US president to navigate. Conversely, there are risks for the Democrats in pushing for the inquiry.

Voters – The electorate – a majority of which oppose impeachment proceedings (see Figure 3) – may blame them for exacerbating instability in the economy and financial markets and attempting to derail Trump's agenda.

Furthermore, if the inquiry finds no evidence of wrongdoing, then it could solidify Trump's chances of retaining the presidency, which leaves the US with the status quo of an impulsive leader.

Despite being unlikely, we should not discount the scenario of the Republican-held Senate voting to convict the president and remove him from office in a bid to consolidate votes and improve Republicans' chances of re-election.

In that instance, current vice president Mike Pence would be elevated to the role of president. Pence's approval ratings are similar to Trump's, but the vice president may not be as polarising a figure to voters as the mercurial president.

Investment strategy

The balance of outcomes from the impeachment scenario does little to allay our concerns, and consequently we maintain our relatively defensive investment strategy.

This portfolio positioning includes overweight positions in cash and bonds, while in equities, we reiterate our preferred investment themes as follows:

Structural leverage – Companies that are less dependent on economic conditions, but instead benefit from structural changes in their industry;

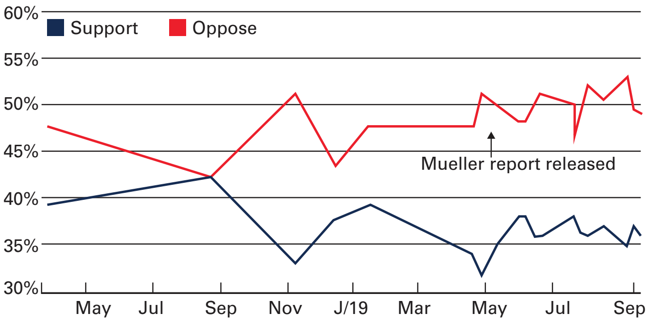
Volatility vigilance – Relatively defensive exposures as a counterweight to market volatility;

Yield leaders – In the expectation that interest rates will fall further; and

Policy tailwinds – Beneficiaries of government policies.

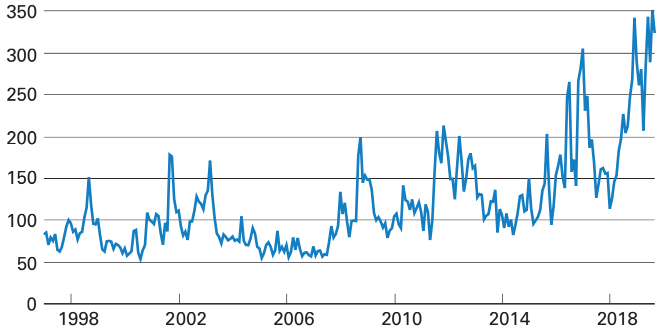
For the complete report on our portfolio positioning and preferred stock exposure, please contact your Ord Minnett adviser.

Figure 3: Voter support for impeachment proceedings



Source: Politico/Morning Consult polls

Figure 4: Index of global economic policy uncertainty



Source: www.policyuncertainty.com

TREASURY WINE ESTATES

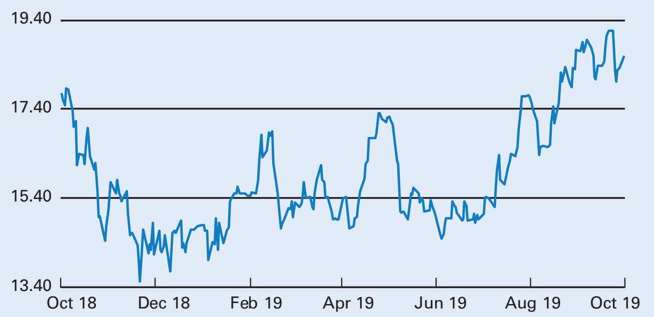
TASTY TIPPLES

Sector: Consumer Staples Recomm: Accumulate Risk rating: Higher Share price: $18.57

Year to June	2019A	2020E	2021E
Profit after tax ($m)	433.8	526.5	668.8
Earnings per share (¢)	60.4	73.2	93.0
Price/earnings (x)	30.7	25.4	20.0
Dividends per share (¢)	38.0	46.0	60.0
Dividend yield (%)	2.0	2.5	3.2
Franking (%)	100	100	100

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

Treasury Wine (TWE) share price



Source: IRESS

Treasury Wine Estates, Australia's largest wine company by revenue and vineyard acreage, has executed its strategy well through using fast-moving consumer goods (FMCG) thinking in the wine industry.

The FMCG strategy includes a focus on fewer brands and premiumisation, leveraging of scale in marketing and innovation, diversifying global supply and optimising distribution networks, i.e. the 'route-to-market'.

The owner of brands such as Penfolds, Wolf Blass and Lindeman's recently hosted an investor day and Ord Minnett outlines its views below:

Group

- The company reiterated fiscal 2020 guidance for growth in earnings before interest, tax and SGARA* (EBITS) of 15–20%, although this would be skewed to the second half due to US route-to-market costs and global business support costs.
- The 2018 vintage is large and high-quality, providing a boost to the outlook for fiscal 2021.
- A spin-off of the commercial business was considered, but not progressed as overall costs have reduced and margins have improved, although Treasury would reconsider a spin-off as part of any future M&A
- Growth in luxury/masstige volumes, revenue and gross profit have exceeded the overall group's growth, indicating positive shift in product mix.

Asia

- Treasury Wine is seeking to grow the overall wine category in China with market share gains of imported wine versus domestic wine, and other alcohol options such as beer and spirits.
- Treasury is seeking a majority of volumes in China via its own warehouse versus a minority currently.
- The Rawson's Retreat range having two partner distributors is having a mixed impact.
- Multi-regional brands BV (French) and Penfolds (French and Californian) are diversifying supply.
- The French acquisition provides Treasury with 'negocian' (merchant) status in China, allowing broader sourcing options.

Americas

- Treasury has set a 25% EBITS margin for this division, on par with the overall group margin. There is now more confidence, however, that this metric will be met via greater availability and distribution, and a positive mix change to its luxury and masstige offerings.
- Progress was made in optimising the route-to-market in the second half of fiscal 2019, with new distributors up 4% in points of distribution overall, with 11% growth for luxury brands.

Australasia and Europe

- Range curation by Endeavour Drinks (Dan Murphys's BWS) should benefit Treasury due to its brands and innovation.
- The Penfolds' Bilyara winery development for luxury wine is expected to have a fast payback.
- Australian commercial cost pressures are likely to weigh on EBITS margin growth in Europe due to the commercial skew.
- Brexit will be managed by providing a separate supply chain to continental Europe rather than through the UK.

* SGARA, or 'self-generating and regenerating assets', is a reference to the impact of accounting standard AASB 141 (Agriculture), which requires changes in the net market value of agricultural assets such as crops to be recognised in revenue accounts.

RELIANCE WORLDWIDE

CRACKING THE PLUMBERS' MARKET

Sector: Industrials Recomm: Accumulate Risk rating: Higher Share price: $4.03

Year to June	2019A	2020E	2021E
Profit after tax ($m)	152.0	160.2	177.3
Earnings per share (¢)	19.2	20.3	22.4
Price/earnings (x)	21.0	19.9	18.0
Dividends per share (¢)	9.0	10.0	11.0
Dividend yield (%)	2.2	2.5	2.7
Franking (%)	100	0	10

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

Reliance Worldwide (RWC) share price

Source: IRESS

Reliance Worldwide designs, manufactures and supplies a range of water flow and control products, and solutions for the plumbing industry.

These are used in behind-the-wall plumbing applications and include fittings, pipes, valves and accessories.

The company holds leading positions across 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 disruptive, SharkBite-branded, brass push-to-connect (PTC) fittings and accessories.

The company recently hosted an investor day at its Cullman facility in Alabama in the US – a key market for the company – and Ord Minnett makes its key observations below.

A key point on the growth outlook for us was that 75% of Reliance's portfolio is expected to grow at a pace above end-market trends.

Reliance has a three-pronged plan to grow its business: 1) the primary objective is to accelerate the growth of its core product range; 2) keep investing in product development to expand its range; and 3) entering new geographic markets, with select countries in Europe, South America and Mexico (with a partnership now in place) highlighted.

Management sees growth of the categories in which it operates at 4–5% in the medium term, albeit fiscal 2020 will clearly be lower than this given weakness in Europe, Middle East and Africa (EMEA) and Australia.

Reliance is aiming for growth above the 4–5% range for 75% of its portfolio. Interestingly, the Fluid Tech (water treatment) and Integrated Installation Solutions (fire-stop systems and hot water heaters under the Holdrite brand) businesses were flagged as growing the fastest and having the highest margins across the portfolio.

We note Reliance sees global addressable markets of $3 billion for Fluid Tech and $5 billion for Holdrite.

Reliance's tools to achieve its growth strategy are; 1) keep expanding the understanding of end-user requirements; 2) expanding its market reach by ensuring its products are widely available for purchase; 3) innovation and product development; and 4) M&A activity.

In the US, Reliance is looking for bolt-on acquisitions – the ideal target would have a disruptive plumbing product range that would benefit from Reliance's distribution platform.

A European acquisition is not an option until the John Guest business is integrated, but over time Reliance would look at companies with local manufacturing and distribution relationships. Building exposure to plumbing and heating in continental Europe is therefore a medium- to longer-term priority.

We see Reliance offering high-quality earnings growth, underpinned by penetration of its core push-to-connect fittings product range. The return on its organic capital expenditure projects remains compelling, and Reliance's plan to continue expanding production capacity in fiscal 2020 is a positive driver.

NUFARM

BLAME IT ON RIO

Sector: Chemicals Recomm: Hold Risk rating: Higher Share price: $5.64

Year to July	2019A	2020E	2021E
Profit after tax ($m)	89.1	104.5	117.4
Earnings per share (¢)	23.5	27.5	30.9
Price/earnings (x)	24.0	20.5	18.3
Dividends per share (¢)	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0
Franking (%)	0	0	0

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

Nufarm (NUF) share price

Source: IRESS

Nufarm is a producer of crop protection chemicals and products whose performance in recent years has been affected by bad weather across many of the countries in which it operates and a constrained balance sheet.

The company cannot fix the weather, but it has moved to shore up its vulnerable capital position by selling its South American crop protection and seed treatment operations to its major shareholder, Japan's Sumitomo Chemical Co, for $1.2 billion.

By selling the Latin American assets, the balance sheet is derisked – gearing as measured by net debt to operating earnings has been cut to an almost immaterial 0.7 times from 3.0 times. The risk of a capital raising has also been removed and the earnings profile of the company is now less volatile.

Fears around Sumitomo's appetite for its Nufarm investment have also been convincingly allayed and the master agreement for product development and commercialisation with the Japanese company has been renewed to 2025. Nufarm management will now focus on cash flow in higher-margin markets.

The sale announcement came with the company's fiscal 2019 results, where Nufarm posted operating earnings of $420.3 million, in line with guidance and slightly above our $417.4 million forecast. A net profit of $89.1 million beat our $81.7 million estimate due to better than expected currency impacts. No final dividend was declared.

To reflect the removal of the Latin America assets – which made up 28% of fiscal 2019 revenue – we have lowered our EPS forecasts by 23% for fiscal 2020 and 22% for fiscal 2021. See Figure 5 for Nufarm's geographic earnings split pre and post sale.

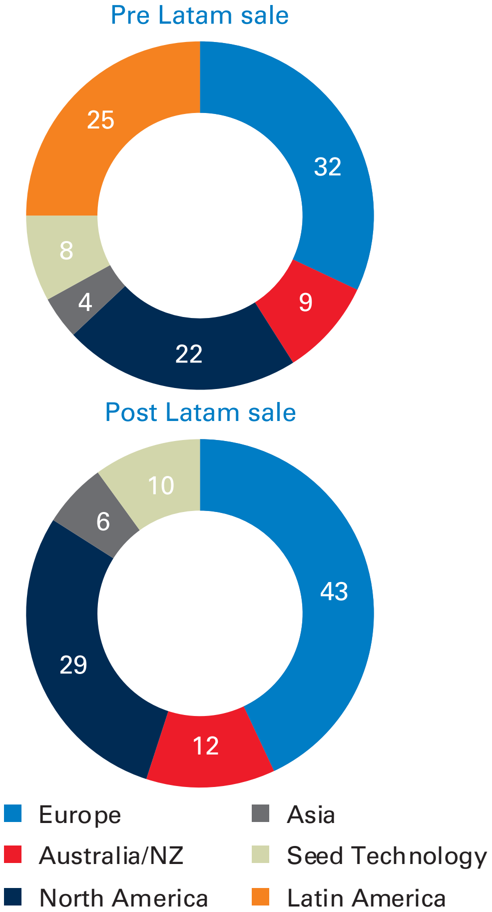
Our earnings estimates remain relatively unchanged otherwise.

If weather conditions improve, Nufarm will likely see consensus earnings upgrades into fiscal 2021. We remain cautious on this prospect, however, given the continued severe drought on the Australian east coast.

On the positive side, cost pressures in Europe – where margins have almost halved – and price pressures in North America – where trading conditions are very competitive – are both likely to abate in the second half of fiscal 2020.

The next focal point will be a timeline for the reinstatement of dividends as the balance sheet is repaired and the management of working capital is improved.

Figure 5: Earnings split by region (%)



BELLAMY'S AUSTRALIA

MENGNIU DYNASTY

Sector: Consumer Staples Recomm: Hold Risk rating: Higher Share price: $13.02

Year to June	2019A	2020E	2021E
Profit after tax ($m)	30.0	34.0	45.0
Earnings per share (¢)	25.0	29.0	38.0
Price/earnings (x)	52.1	44.9	34.3
Dividends per share (¢)	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0
Franking (%)	0	0	0

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

Bellamy's Australia (BAL) share price

Source: IRESS

Bellamy's Australia (BAL) has received a takeover offer from China Mengniu Dairy Co to at $13.25 a share, valuing the infant formula producer at around $1.5 billion.

Bellamy's board of directors unanimously recommended that shareholders vote in favour of the scheme, in the absence of a superior offer.

Foreign Investment Review Board (FIRB) approval is a question, but it is likely to be received.

Ord Minnett sees this proposal as a positive for other Australia and New Zealand listed companies exposed to the China consumer due to potential corporate appeal, although we suggest Bellamy's could be a better competitor in the China infant formula market with China Mengniu in its team.

We have maintained our Hold recommendation on Bellamy's and raised our target price to $13.25 in line with the offer price, assuming no other bidders emerge and FIRB approval is achieved.

The all-cash offer is via a scheme of arrangement at $13.25 per share, made up of an $12.65 cash and a $0.60 fully franked special dividend.

The cash consideration represents a multiple of 30 times Bellamy's normalised operating earnings for fiscal 2019; a 59% premium to its $8.32 stock price just prior to the bid; and a 54% premium to three-month volume-weighted average price of $8.59.

We do not see a competing bid as likely, due to the significant premium to the current share price and Bellamy's board recommendation.

An alternative bidder is also unlikely to emerge given the absence of China regulatory approval, which was a factor limiting Bellamy's appeal as a listed equity investment and, arguably, a takeover target.

We do not see FIRB approval as an issue for the offer. Bellamy's owns no agriculture and the value of its manufacturing facilities lie in the China customs approvals. In addition, most of its product is consumed in China.

Approval from China's State Administration for Market Regulation (SAMR) is yet to be received.

Despite Bellamy's comment that a change in ownership would not help achieve SAMR approval, we suggest the offer from China Mengnui is unlikely to hurt its chances.

For Australasian companies exposed to the China consumer, we see the proposed deal as positive for the share price performance of Bellamy's peers due to potential corporate appeal.

That said, Bellamy's is arguably a better target than its peers due to its size (with a current market capitalisation of $1.461 billion and takeover valued at $1.502 billion), large shareholders looking to sell, and an existing relationship with China Mengniu.

Bellamy's is expected to be a better competitor in the China infant formula market with China Mengniu, provided SAMR approval is ultimately received. This is due mainly to the scale of China Mengniu, and its position should speed up any roll-out while providing some scale advantages.

PEOPLE INFRASTRUCTURE

BUILDING A BUSINESS

Sector: Industrials Recomm: Buy Risk: Higher Price: $3.16

People Infrastructure recently reported fiscal 2019 results that met expectations across the board. The healthcare and IT staffing agency posted net profit of $12.1 million, broadly in line with Ord Minnett's forecast for $11.9 million.

Meanwhile, operating earnings jumped 36.3% on a year ago due to organic growth, margin expansion and contributions from acquisitions.

The coming year provides an opportunity for People Infrastructure to leverage its expertise across healthcare in nursing and disability areas to expand its services and extend its client base.

In doing so, the company will be able to set itself up to benefit from multiple structural tailwinds, including enhanced disability funding, an aging population and an undersupply of nursing staff.

People Infrastructure's IT capability is similarly placed. New technology is continually emerging and system updates are recurring events.

These technologies are often complex and require a high level of specialist expertise to integrate effectively, and the company's Recon and Halcyon Knights acquisitions are beneficiaries of this trend.

The company has been highly acquisitive over the past 18 months, and while the core business has shown good growth since its IPO, acquisitions have been a major contributor.

This will again be a big factor in fiscal 2020, where we estimate businesses not a part of the original group will account for circa 40% of operating earnings.

That said, management have still forecast robust annualised core earnings growth of 10%, driven by solid sustainable growth in revenues and modest operating leverage.

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

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