Earnings Season Insights March 2019

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Shareholders reap the benefits of record distributions

The February/March 2019 recent reporting season was preceded by a relatively brutal confession period, where several meaningful downgrades led to a widespread readjustment in consensus estimates. Consequently, the lower expectations were generally met, although as usual there were still surprises, both positive and negative.

Markets rallied in relief not because results were strong but because they weren't worse than recently trimmed expectations. In fact, excluding resources, industrials struggled to achieve mid-single digit growth. After months of getting beaten up by the revelations emerging from the Hayne royal commission, the heavily weighted major banks bounced. TPG Telecom provided Telstra with a surprise, withdrawing from the mobile market. And another tragic dam disaster in Brazil gave iron ore prices another shot in the arm, lifting market leader BHP and Rio.

Capital management initiatives—special dividends and share buybacks—were a feature. Dividends and distributions for the year ended June 2019 are estimated to total near $85bn, the highest on record. This surge reflects robust cash generation in the resources and energy sectors; the proceeds of asset sales; higher payout ratios; and action to pay out franking credits given the threat to the rebate of surplus credits should there be a change in government in May. These payouts need to be funded and have raised gearing levels, although balance sheet strength remains generally sound.

Consensus earnings per share growth estimates for the June half have been trimmed slightly to around 6%, with commodity-reliant companies continuing to provide meaningful support. Excluding the resources and energy sectors, growth expectations for the remainder of the S&P/ASX 200 are nearer 3%. Expectations for FY20 see a reversal in the drivers, with commodity-related earnings growth stalling and industrials recovering. Banks and financials are likely to continue to struggle in the wake of the Hayne royal commission.

After the surge in capital management initiatives in FY19, where growth in total returns to shareholders easily exceeded growth in earnings, total returns are expected to fall in FY20, mainly driven by the resources sector, although growth in distributions by industrials and financials is likely to be modest and pedestrian. Don't extrapolate FY19 payouts.

For the 200-odd companies under our coverage, the simple average price/fair value is 1.07, with the market capitalisation weighted average 1.08. This suggests the S&P/ASX 200 is moderately overvalued.

Resources and energy stocks continued to produce strong results, robust cash flow and engage in meaningful capital management initiatives. Both BHP and Rio Tinto results were affected by production disruptions but share prices continued to rise with surging iron ore prices after another dam disaster at Vale in Brazil. BHP paid an early special dividend and we anticipate a large final distribution. Rio announced a US$4bn special dividend taking total cash returns declared in 2018 to US$13.5bn. Fortescue Metals completed the iron ore trifecta with a special dividend and both South32 and Whitehaven Coal also paid specials. In the energy sector, Woodside lifted its payout to 100% and Santos declared a strong final dividend.

The major banks reported modest improvement in earnings despite increasingly challenging operating conditions. All face meaningful remediation costs, which will be separate from underlying cash profits. Assets quality remains the feature. Earlier repricing protected net interest margins. Unless there is a call for significantly increased capital, all will comfortably meet APRA's 1 January 2020 requirements.

The regional banks did not fare so well with both Bendigo and Adelaide Bank (BEN) reporting lower earnings and Bank of Queensland (BOQ) downgrading guidance. Funding cost pressures continue unabated and the near-term outlook is sombre. Both report pressure on net interest margin and non-interest income. The fair values of both banks were cut, BEN by 9% and BOQ by 4%. Share prices also retreated.

The usually reliable healthcare sector experienced a mixed reception to announced results. The share prices of the big three global players, CSL, Cochlear and Resmed, retreated by 4%, 8% and 12% respectively in the 24 hours after announcements. Ramsay Healthcare's share price bounced on results after a stressful six months. InvoCare recovered strongly despite a lower result as management announced the improved trading in 4Q18 had continued into early 2019 as market conditions normalised.

The media sector was mixed. In new media, both Domain and SEEK were winners while Carsales.com disappointed. Nine Entertainment was the feature in the traditional media space while Seven West struggled. The gaming sector saw mixed reactions as VIP turnover declined. Star Entertainment's share price moved nicely higher while Crown Resorts slipped by 5.3%.

a2 Milk was the standout in the consumer space with strong results pushing the share price 10% higher. Chinese demand for infant formula grew 45% from 1H18. Blackmores' share price slumped 34% on a soft 1H19 result and a downgrade to FY19 guidance. Sales to Chinese customers fell in 2Q19, reflecting weaker consumer sentiment and changes in the channel mix.

Supermarket operators disappointed with both Coles and Woolworths results underwhelming. Wesfarmers also struggled, but a $1.00 per share special eased the pain.

The share prices of Magellan and Platinum surged for different reasons. Magellan on the back of an excellent result and growth in funds under management, Platinum more relief after expectations had been downgraded.

The REIT sector continued to be led by Goodman, while Charter Hall also added to positive results. Low bond yields and dovish central bank policy continues to push capitalisation rates lower, lifting valuations. Dexus continued to ride the office supply shortages in Sydney and Melbourne.

Building materials suppliers Adelaide Brighton and Boral faced a challenging environment as residential construction activity retreats from peak levels in early 2018.

There were several meaningful changes to our fair value estimates, but fewer upgrades than six months ago. The highlights (a 10% plus increase) and lowlights (a decline of over 10%) are mentioned below along with the drivers of the change.

Strongly Positive

- A2 Milk
- Breville Group
- Computershare
- Domain Holdings
- InvoCare
- IOOF Holdings
- James Hardie
- Magellan Funds
- Mortgage Choice
- Nine Entertainment
- Platinum Asset Mgt
- Ramsay Healthcare
- SEEK Limited
- Star Entertainment
- Vocus Group
- Wesfarmers

Strongly Negative

- AMP Limited
- Bank of Queensland
- Bendigo and Adelaide Bank
- Blackmores
- Carsales.com
- Cochlear
- Crown Resorts
- G8 Education
- Lendlease
- Resmed Inc
- Seven West Media
- Woolworths

Fair value upgrades

- **Breville Group** (BRG) +10%
  Stronger than expected performance in Germany and Australia, along with a higher likelihood of successful expansion into other European regions including Switzerland and Benelux.
- **Charter Hall Group** (CHC) +13%
  Raised growth assumptions for funds under management following a 22% increase in 1H19 to $28.4bn.
- **Goodman Group** (GMG) +10%
  Higher medium-term performance fee expectations; raised rate of development completions; and a faster rate of growth in external assets under management.

Those with "honourable" mentions, with an increase between 5% and 10% included: Atlas Arteria, Fortescue Metals, GPT, Independence Group, IRESS, Mirvac and Treasury Wine Estates.

Fair value downgrades

- **Blackmores** (BKL) -22%
  Downgrade of FY19 NPAT by 16%; longer-term volume growth assumptions driving operating leverage pared; and reduction in long run margin expectations in relation to China-facing revenue.
- **Challenger** (CFG) -14%
  While the long-term investment case remains intact, we expect the headwinds facing annuity sales into Japan will persevere and combine with margin pressure to drag on earnings.
- **Lendlease** (LLC) -12%
  High separation costs of around $500m and net outflows of $500m to complete impaired projects to exit the Engineering and Services business and reduced assumptions in Australian development more than offset improved expectation in UK and US development.
- **Mayne Pharma** (MYX) -19%
  Reduced margin assumptions and an increase in the weighted average cost of capital to reflect the high uncertainty we see in the business.
- **McMillan Shakespeare** (MMS) -14%
  Regulatory and macro headwinds in the core group remuneration services division and merger uncertainty combine to drive valuation lower.
- **Pact Group** (PGH) -14%
  Reduced earnings estimates; the possibility of an imminent equity raise to be completed at a discount to fair value; and lost market share in the Australian rigids business we had not previously anticipated.
- **Unibail-Rodamco-Westfield** (URW) -10%
  We are far less optimistic than management for rent growth across the retail portfolio and have cut our rental growth outlook for all the retail assets. Given retail spending across Europe and the U.S. has been vastly buoyed by stimulatory interest rate settings, the eventual move up in interest rates will hurt household disposable income and discretionary retail spend.

Other companies with a "dishonourable" mention, with downgrades between 5% and 10% included: Aveo Group, Coles Group, Oohmedia and Vicinity Centres. Companies whose fair value has been progressively downgraded in the fallout from the Hayne inquiry include AMP, IOOF, Mortgage Choice and FlexiGroup.

Key

Fair Value
↑ Increase
→ No change
↓ Decrease

Price/Fair Value
Discount (undervalued)
Premium (overvalued)

Initial Market Reaction (IMR)
Strongly positive (price increase over 5%);
Positive (price increase between 3% and 5%);
Neutral (plus/minus zero to 3%);
Negative (price fall between 3% and 5%);
Strongly negative (price fall over 5%).

All Price/Fair Value calculations based on close price Wed 6 March 2019

ANZ Bank ANZ	
Fair Value ($)	29.00 →
Price/Fair Value	0.96
IMR	Neutral

Commonwealth Bank CBA	
Fair Value ($)	80.00 →
Price/Fair Value	0.93
IMR	Neutral

The **Initial Market Reaction (IMR)** rating monitors the share price reaction to results in the 24 hours after the announcement. Five categories are included—Strongly Positive (price increase over 5%); Positive (price increase between 3% and 5%); Negative (price fall between 3% and 5%); Strongly Negative (price fall over 5%); Neutral (plus/minus zero to 3%). This provides some insight as to whether expectations were met, exceeded, or disappointed. In many cases, the market action was more to do with future guidance than the reported results. We invest in the future, not the past.

Banks

Australia & New Zealand Banking Group's (ANZ) (wide moat) 1Q19 update focused on capital, funding, lending growth and asset quality, with no news on earnings. Credit quality is stable with a loan loss expense of just $156m, representing a very low annualised loss rate of 10 basis points. Capital levels remain at peer highs with a common equity Tier 1 (CET1) capital ratio of 11.3%. The pro forma capital ratio of 11.6% is well ahead of APRA's 10.5% required by 1 January 2020. Funding and liquidity settings remain strong. The on-market share buyback continues and is designed to partially offset the steady and orderly build-up in capital. The trading update was broadly in line with our expectations, underpinning our $29 per share valuation. A key negative is home loan growth continues to slow. Factors are tighter credit conditions, higher regulatory mortgage risk weights and very competitive operating conditions particularly for high-quality owner-occupier home loans. But the upside is ANZ's willingness to refocus on growing the residential loan book to at least the system growth rate. No change to our FY19 forecasts, with cash earnings of $6.7bn, just below $6.8bn consensus, and total fully franked dividends of $1.61 per share based on a 67% dividend payout ratio. We forecast the payout to trend lower over time to the top end of ANZ's medium-term target of 60%–65% of cash earnings by end FY23. Our FY19 group loan growth forecast remains at 3.5% and at similar annual levels out to end FY23 on the back of modest GDP growth, good employment growth, solid population growth, low interest rates and eventually less stringent underwriting standards. Net interest margins (NIM) were not specified but must be under pressure as funding costs remain elevated with short-term and long-term wholesale funding costs increasing in leading up to the end of calendar 2018. Wholesale interest spreads have retreated somewhat in recent weeks with the key 90-day bank bill swap rate back below 2.00%, currently sitting around 1.95%. Despite modestly higher wholesale funding costs we maintain our forecast net interest margin at 1.90% reflecting upside due to the September 2018 variable home loan repricing. The update did not refer to revenue and expense trends and we make no changes to our FY19 forecasts. Despite an annualised 1Q19 loan loss rate of just 10 basis points, we maintain our FY19 loan loss rate forecast of 12 basis points with loan arrears rates ticking up with pockets of loan stress. If achieved, the loan loss rate would equal the lowest for 13 years. IMR Neutral.

Commonwealth Bank of Australia's (CBA) (wide moat) 1H19 result was messy and slightly below our expectations. Cash earnings from continuing operations of $4.7bn increased 2% on 1H18. Cash earnings including discontinued operations rose 2% to $4.8bn, modestly below our $4.9bn expectation. The unchanged $2.00 per share dividend was broadly in line with expectations with the payout ratio increasing marginally to 75%. Return on equity (ROE) of 13.8% is a little low, but still not a bad outcome, considering the larger capital base and modest profit increase. We liked the solid volume growth good outcomes for home loans, transaction deposits and business loans, offset by weakness in net interest margins (NIMs). Non-interest income softened due to lower commissions, weaker trading performance and lower insurance income. We reduce our FY19 cash earnings by $200m to exclude the full-year impact of discontinued operations. We now forecast a FY19 cash profit of $9.7bn, with the $4.33 per share fully franked dividend unchanged. Our $80 fair value estimate and wide moat rating are unchanged. Despite the softer outlook, we remain confident in the long-term earnings outlook for Australia's biggest bank. The performance highlights the challenges facing the major banks, primarily slowing loan growth, a weakening housing sector, pressure on NIMs, elevated remediation costs, and relatively soft ROEs. However, we have allowed for these headwinds in our forecasts and continue to see slow and steady improvements in operating performance and earnings. We expect the orderly correction in Australia's housing market to continue for the next year at least, but we believe the strength of CBA's brand will underpin good growth in home loan volumes supported by the bank's large branch network and online capability. The balance sheet remains strong with the common equity Tier 1 (CET1) capital ratio increasing to 10.8% up from 10.1% at June 30, 2018, boosted by the sale of the NZ life insurance business, positive 27 basis points, and good organic capital generation, positive 66 basis points. The internationally comparable CET1 ratio of

National Australia Bank NAB	
Fair Value ($)	30.00
Price/Fair Value	0.85
IMR	Neutral

Westpac Banking Corp WBC	
Fair Value ($)	33.00
Price/Fair Value	0.83
IMR	Neutral

Macquarie Group MQG	
Fair Value ($)	135.00
Price/Fair Value	0.96
IMR	Neutral

16.5% places the bank comfortably in the top quartile of global peers. IMR Neutral.

National Australia Bank (NAB) (wide moat) released a reasonably impressive 1Q19 trading update. The unaudited cash profit of $1.65bn is in line with our expectation and our we retain our full-year forecast profit of $6.6bn. The profit is modestly higher than the average of the two previous quarters, up 2%, and 3% below 1Q18. Good volume growth offset by weaker net interest margins and lower markets and treasury income resulted in broadly stable revenue. Asset quality was strong with the ratio of 90-plus day arrears and gross impaired assets to gross loans broadly stable at just 0.72%. Despite high household debt level, weak wages growth, and soft economic conditions there are no signs yet of any deterioration in loan quality. Loan losses declined for the fourth consecutive quarter to just $193m. This was a strong outcome considering an additional $62m was recognised for drought-related provisions. The annualised loss rate 13 basis points was close to our FY19 forecast of 14 basis points. No change to our FY19 bad debt expense of $804m. The balance sheet remains in good shape with leverage, funding and liquidity measures above regulatory minimum requirements. The common equity Tier 1 CET1) capital ratio of 10% declined from 10.2% at end September 2018 due to the declaration of the FY18 final dividend detracting a net 48 basis points of CET1 capital. We expect NAB to achieve APRA's 10.5% CET1 benchmark in an orderly manner by the 1 January 2020 deadline from organic capital generation and offering a 1.5% discount on the dividend DRP in calendar 2019. As expected, net interest margins (NIMs) were not specified, but declined on 2H18 quarterly average of 1.84% due to pressures in housing lending and lower markets and treasury income. This is consistent with CBA's 1H19. Margins should improve during the remainder of FY19 due to the eventual repricing of variable home loan rates by 15 basis points in January. Based on the $70m million "cost" in delaying the repricing approximately four months, we see a potential uplift of $190m million for FY19. We maintain our full-year margin forecast of 1.86%, in line with FY18. Expenses were well managed declining 3% on the quarterly average for 2H18 due to improved productivity and lower RC and marketing spend. Despite the strong quarterly performance operating expenses could increase more than expected due to ongoing customer remediation costs and regulatory compliance investigations. The resignations of the chairman and CEO grabbed investor attention. IMR Neutral.

Westpac Banking Corporation's (WBC) (wide moat) 1Q19 trading update confirmed it is making good progress despite increasingly challenging operating conditions. The unaudited cash profit of $2.04bn was up a healthy 7% on the average of the previous two quarters of $1.91bn. Excluding 2H18 remediation costs of $281m, the 1Q19 cash NPAT was broadly stable on the average of the two previous quarters. The unaudited 1Q19 statutory NPAT was $1.95bn. The quarterly profit was modestly lower than our FY19 quarterly cash profit run rate of $2.08bn, but we make no changes to our full-year cash NPAT forecast of $8.3bn and fully franked dividend of $1.90 per share. Our $33 fair value estimate is unchanged. Highlights included higher net interest margins (NIM) due to home loan repricing in September, offset by weaker margins in Treasury and Markets. Group NIM fell sharply in 2H18 to 2.07% and we reduce our FY19 forecast from 2.12% to 2.10%. Balance sheet settings remain sound with the common equity Tier 1 (CET1) ratio easing from 10.6% to 10.4% in 1Q19 due to the payment of the FY18 final dividend, accounting for 69 basis points of decline. Organic capital generation was solid, with a positive 47 basis points of CET1 capital. Funding and liquidity levels remain above regulatory minimums. Operating expenses were lower due to a small business divestment and the nonrepeat of costs from the customer remediation program. Additional customer remediation costs are expected in 2Q19. We maintain our full-year forecast for a 3% increase in operating expenses and a cost/income ratio of 43.4%. WBC remains well positioned to achieve APRA's 10.5% "unquestionably strong" requirement effective 1 January 2020. The loan book is well provisioned and remains in good shape. The ratio of group stressed assets to total committed exposures were broadly stable with no new impaired individual loans over $10m. The loan impairment charge of $204m for the quarter was modestly higher than previous quarters in FY18 but below levels incurred in FY17. IMR Neutral.

Macquarie Group's (MQG) (narrow moat) 3Q19 trading update held no surprises and we retain our positive view and $135 fair value estimate. Guidance was reiterated with management expecting an increase in NPAT of up to 15% from FY18's $2.56bn. Guidance is subject to the usual challenges including market conditions, currency movements, and potential regulatory and tax uncertainties. Our forecast is for growth of 17% to $3bn, ahead of guidance and analyst consensus estimates of $2.95bn. Despite guidance, we see risk

Bendigo and Adelaide Bank BEN	
Fair Value ($)	10.50 ↓
Price/Fair Value	0.94
IMR	Strongly Negative

AMP Limited AMP	
Fair Value ($)	2.40 ↓
Price/Fair Value	0.99
IMR	Strongly Negative

to the upside. MQG's long-term commitment and investment in the renewable energy sector will accelerate and within the next decade will likely be a powerful contributor to group profits. The diversified global financial services business continues to benefit from structural growth opportunities with strong performances from the two market facing businesses outweighed by softer results from the three non-market-facing businesses. Management advised the market-facing businesses of Macquarie Capital and Commodities and Global Markets delivered strong—but unspecified contributions with year-to-date profits up significantly. The contribution from the non-market-facing businesses was up on 3Q18, but down on year to date due to lower performance fees in Macquarie Asset Management offset by asset sales in Corporate and Asset Finance and strong continued growth in Banking and Financial Services. As expected, balance sheet settings remain sound with surplus capital of $4bn up strongly from $3.4bn at 2Q close. Macquarie Bank common equity Tier 1 (CET1) ratio of 10.8%, based on APRA definitions, and 13.6% on a globally harmonised basis, exceed APRA's January 2020 benchmark of 10.5%. Balance sheet leverage, liquidity and funding all comfortably exceeded regulatory minimums. We forecast the FY19 dividend increasing to $6.20 per share, 45% franked, based on a 70% payout, in the middle of the 60%–80% target range. We like the globally diversified business model, low earnings volatility, high focus on risk management, strong returns on equity and quality management. Balance sheet strength, high capital ratios, diversified funding, and dividend sustainability attract. Key risks include weaker capital markets activity, lower profits on asset disposal, increased impairments and lower performance fees. Our positive long-term view is intact with EPS forecast to grow an average of 8% per year for the next five years. IMR Neutral.

Bendigo and Adelaide Bank's (BEN) (no moat) below-expectation 1H19 profit clearly reflects the challenging operating environment currently facing smaller banks. BEN continues to struggle against the major banks with their strong market positions, favorable mortgage capital requirements, scale, and competitive advantages—particularly around funding costs, operating expenses, and regulatory spend. BEN's return on equity (ROE) continues to disappoint, with a 39-basis-point decline from 8.3% in 1H18 to 7.9%. The 35 cents per share fully franked dividend leaves our FY19 forecast dividend of 70 cents unchanged. Adjusting for the weaker outlook results in a cut in our fair value estimate from $11.50 to $10.50. Weak revenue and higher than anticipated expense growth crimped group profitability with little respite on the horizon as the domestic economic environment softens. Earnings were weaker on both a cash and statutory basis, and we expect their corresponding growth rates to remain subdued in the near term. Cash earnings of $220m were down $5.5m, or 2% on 1H18. We have pared our earnings assumptions through our forecast period to reflect management's more cautious outlook and continuing challenges. We lower our FY19 earnings forecast from $466m to $430m. Expenses grew by 4.2% to $464m, largely due to higher staff and regulatory costs. Net interest margins (NIMs) fell three basis points through the period to 1.95% and this will remain challenged near term as front-book lending discounts persist. Although this was in line with our expectations, we have adjusted our NIM assumptions to trend toward 1.90% by FY23. The cost/income ratio increased from 54.2% in 1H18 to 57.3%, although only 3 basis points higher than 2H18. This was higher than anticipated and we subsequently increase our assumptions through our forecast period as we now believe it will be difficult for management to hit its 55%–56% cost/income target in the near term. One bright spot was the continued strength in asset quality. Loan losses were a low eight basis points annualised, well down on the long-term trend of approximately 11 basis points. We continue to use 11 basis points as our through-the-cycle loan loss rate assumption. Importantly, residential loan arrears continue to trend down, or improve, to around 0.5% of the portfolio. The capital position remains strong and above peers. Supporting this was organic capital generation and lower risk weighted assets. The common equity Tier 1 (CET1) ratio of 8.76% continues to trend up and BEN already comfortably meets APRA's January 2020 benchmark of 8.5% for standardised banks. IMR Strongly Negative.

Life, General and Health Insurance

AMP Limited's (AMP) (narrow moat) 2018 results show it continued to suffer elevated fund outflows from its core Australian wealth management business in 4Q18. Underlying NPAT fell 35% from $1.04bn to $680m supported by solid performances from AMP Caplial and AMP Bank. We expect AMP Bank's stellar run of earnings growth will end in 2019 due to disruptions to its key mortgage broker distributional channel and management's new guidance of higher compliance costs in the business. Moreover, the royal commission's final

Insurance Australia Group IAG	
Fair Value ($)	7.50 →
Price/Fair Value	1.04
IMR	Positive

report also identified several instances where AMP and its leaders may have broken civil and criminal laws, and we believe there is a high likelihood of further court action. We also think there is the prospect of additional license requirements. Together, these issues have prompted us to further reduce our fair value estimate from $2.60 to $2.40 per share. We expect the issues facing the company will take several years to address. While Australian Wealth Management's (AMW) underlying NPAT fell only 7.2% to $363m, this hides the true impact of the royal commission, and we forecast a more precipitous fall to $175m in 2019. The 2018 results only partly account for the lower repricing of its MySuper products and other price reductions that occurred in 2018. It also does not account for the $85m loss due to distribution fees and products being transferred as part of the sale to Resolution Life or extra compliance costs of $15m. AMP indicates if these items were included, the underlying NPAT would have fallen to $203m. We believe this figure is itself overstated as it does not capture the full extent of fund outflows from AWM which accelerated sharply in 2H18. Fund outflows from AWM became more evident in 2H18. There were net cash outflows of $1.715bn from its core retail super platforms in 2018, accelerating from already elevated levels in 4Q. We estimate 4Q18 outflows were $986m compared with 3Q's $708m and compares to fund inflows of $164m 1Q18 before AMP's first disastrous appearance before the royal commission. Annual inflows between 2013 and 2017 were between $1.5bn and $3.4bn. Corporate super outflows for 2018 totalled $806m. Total FUM from retail and corporate superannuation platforms fell from $121bn in 2017 to $115.6bn. Including external platforms, total FUM fell from $130.4bn to $123.2bn. AMP Bank's underlying NPAT increased by 5.7% to $148m, but we forecast earnings to fall to $134m in 2019. The bank relies on the mortgage broker channel along with its financial advisors to originate its banking products. Both these distributional channels will be disrupted in the near term. Compliance-related costs will increase by $10m in 2019. On a more positive note, we expect AMP Capital to continue to be the earnings growth driver of its retained businesses. AMP Capital's underlying NPAT grew by 7.5%, driven by continued strong fund inflows from sources external to AMP's business. We expect underlying NPAT of $179m in 2019. Higher management fee margins earned on external-sourced funds, which are focussed on infrastructure and property asset management, resulted in management fees increasing by 16.2% to $309m, compensating for more moderate growth in fees on internally sourced funds. The lower 14 cent dividend reflects weaker performannce and a deteriorating capital position. Surplus capital fell in the six months from $1.8bn to $1.65bn at end December. AMP reconfirmed it proposes to return most of the net cash proceeds of the sale to Resolution Life to shareholders. IMR Strongly Negative.

Insurance Group of Australia's (IAG) (no moat) 1H19 performance was heavily affected by severe hail storms in December 2018, reducing the reported insurance margin to 13.7%. Despite the increase in natural hazard costs for FY19, our positive view is intact with the company supported by a strong capital base, robust long-term profitability, and a positive business outlook. Despite the sharp increase in natural peril costs, we like the underlying performance and make no change to our $7.50 fair value estimate. Previously announced storm claims costs drove a 33% reduction in the insurance profit to $496m with the reported insurance margin down 420 basis points to 13.7%. Cash earnings fell 49% to $319m, with the 14% decline in the fully franked dividend to 12 cents per share supported by a higher payout. We liked the 4% increase in top line insurance premium income and the 70 basis points increase in underlying insurance margin to an impressive 16.2%. Top line revenue growth was due to premium increases and a positive New Zealand exchange rate. Volume growth was largely flat over the period. Capital is well above internal targets and regulatory requirements with limited material operational demand for capital. Due to high natural peril costs and lower than expected investment returns, we reduce our FY19 forecast cash profit from $1bn to $921m. Our outer-year earnings forecasts are broadly unchanged. Despite the spike in the 1H19 payout ratio to 88%, the full-year guidance target range of 60%–80% is retained. Our FY19 forecast dividend of 37 cents, including the previously announced 5.5 cents special dividend, is intact. We estimate a franking rate of 85% for the 2H19 dividend and subsequent dividends. The impressive execution of strategy continues to support our confidence in IAG achieving its medium-term targets. Expanded reinsurance and quota share arrangements are working to reduce natural disaster claims volatility and we expect further moderation going forward. Management's 3–5 year through-the-cycle financial targets are unchanged including a 15% ROE, sustainable and attractive dividends, top quartile total shareholder returns, and compound EPS growth around 10%. IMR Positive.

QBE Insurance Group QBE	
Fair Value ($)	12.50
Price/Fair Value	1.01
IMR	Positive

Suncorp SUN	
Fair Value ($)	14.50
Price/Fair Value	0.94
IMR	Negative

Medibank Private MPL	
Fair Value ($)	2.95
Price/Fair Value	0.96
IMR	Neutral

QBE Insurance Group's (QBE) (no moat) 2018 cash profit was modestly below our forecast due to softer investment returns, but the strong underlying performance impressed. Earnings quality sets the foundation for good growth expected in 2019 and 2020. Management is applying the basics of running an insurance company—consistently good decision-making on underwriting, pricing, and claims. The insurance result was in line with guidance with combined operating ratio (COR) of 95.7% within the 95–97% target. Investment returns were soft, but not surprising considering increased uncertainty in global equity markets in late 2018. Importantly, management delivered on its operational goals in 2018 including a significant improvement in COR, remediation of the underperforming Asian operations, cost reductions, asset sales, and portfolio exits. The net cost of catastrophe claims reduced significantly from US$1.2bn in 2017 to US$523m. Our cash earnings forecasts for 2019 are broadly unchanged at US$952m as is our $12.50 fair value estimate. The 2018 cash profit of US$715m was a substantial recovery from the US$262m cash loss in 2017. Underwriting losses in 2017 were the worst year on record for the global insurance industry. Despite a slightly softer than expected 2018 cash profit, the final dividend surprised on the high side at 28 cents per share (cps) 60% franked. The 2018 dividend of 50 cps exceeded our 46 cps forecast. From the start of calendar 2020, management is guiding for franking of only 10% as the proportion of international income increases. The 2018 dividend payout of 70% of cash profit was modestly higher than the target of up to 65%, but reflects the positive outlook, stronger balance sheet, and modest business growth. Our longer-term payout forecast averages 60%. The core business is doing well, and we expect further progress in 2019. Guidance for 2019 is a COR of 94.5%–96.5% and investment returns of 3.00%–3.50%. The cash return on equity for 2018 of 8% was a significant improvement on 2017 but remains subpar and below our 9% cost of equity. The adjusted insurance margin of 7.3% still needs to be managed higher, and we forecast further improvement to 9% in 2019 and an average of 10.5% over our five-year forecast period. IMR Positive.

Suncorp's (SUN) (no moat) sharp fall in 1H19 earnings was forewarned with the Sydney storm update in early January, but we were disappointed with the outlook for additional regulatory costs in 2H19, and higher natural hazard allowance and extra reinsurance costs in FY20. The Sydney hailstorm in December 2018 was the main culprit for the 13% decline in 1H19 cash profit to $413m compared to 1H18. Lower investment earnings and a doubling of regulatory spend were partially offset by increased reserve releases. Despite the cash NPAT and dividend being broadly in line with market expectations, share price weakness on the day is to do with the softer outlook for the diversified financial services group. The benefits of the diversified business structure stood out, with the particularly weak Australian general insurance result, NPAT down 43% from 1H18 to $133m, partially offset by a solid banking performance, NPAT broadly stable at $183m, and a strong New Zealand NPAT, up 82% to $111m. Our FY19 earnings forecasts are modestly lower as the additional regulatory spend is partially offset by better than expected business improvement program (BIP) benefits. We reduce our FY20 earnings forecast by $122m to $1.2bn to reflect headwinds of regulatory spend, increased natural peril allowance and higher reinsurance costs, partially offset by a better than expected likely outcome from the BIP. Longer-term forecasts are broadly unchanged. Looking ahead we expect a strong recovery in 2H19 earnings and higher natural peril allowances and reinsurance in FY20 should reduce volatility in earnings going forward. Despite headwinds, management's medium-term targets are unchanged, with 10% return on equity, 12% underlying insurance trading margin and 60–80% dividend payout standing out. Balance sheet settings are strong with the bank common equity Tier 1 (CET1) capital ratio of 9.16%, including $434m in surplus regulatory capital. The downside of surplus capital and lower profits is a disappointing ROE of just 6% annualised, based on cash earnings, being well below our 9% allocated cost of equity. A fully franked dividend of 26 cents per share declined on 1H18 but was a high 81% payout, above the target of about 70%. Management confirmed the planned capital return of approximately $600m resulting from the yet to complete sale of the Australian life business to TAL Dai-ichi Life Australia. Completion is due late February but could be delayed subject to final regulatory approval. The $600m planned capital return will include a small special dividend to take advantage of surplus franking credits. IMR Negative.

Medibank Private's (MPL) (narrow moat) strong underlying performance for 1H19 was offset by a sharp drop in investment income, with NPAT of $208m down 15% on 1H18 but up 4% on 2H18. Core businesses continue to deliver sound results with a small net increase in policyholder numbers,

NIB Holdings NHF	
Fair Value ($)	6.20 →
Price/Fair Value	0.95
IMR	Neutral

Magellan Financial Group MFG	
Fair Value ($)	29.00 →
Price/Fair Value	1.23
IMR	Strongly Positive

improved health insurance operating profit of $282m, and a strong uplift in Medibank Health operating profit to $29m. Despite lower investment income, we expect a rebound in 2H19 in line with stronger global and domestic equity markets. We reduce our FY19 NPAT forecast from $455m to $430m, reflecting lower-than-expected investment returns. Our $2.95 per share fair value estimate is unchanged as forecast earnings in outer years is broadly intact. Robust net health insurance margins of 8.7% were underpinned by a good expense performance with the MER down modestly to 8.5%. Solid momentum supports a bright outlook for MPL's private health insurance business, but the potential for a change in government could limit premium increases to a maximum of 2% over the next few years. Interestingly, management noted its willingness to consider buying a smaller private health insurer in a stressed operating environment. Recent approval for a 3.30% average increase across all Medibank and ahm insurance products is effective 1 April. Management highlighted possible unintended consequences of Labor's policy to limit premium increases to a maximum of 2% for two years from April 2020 could potentially put smaller not-for-profit health insurers under financial stress as some in this cohort already operate on very slim insurance underwriting margins. MPL's net insurance underwriting margin is 8.7% and the industry average is about 5%. The industry regulator, APRA, would likely force consolidation of funds making underwriting losses. The dividend of 5.7 cents per share is up 3.6% on 1H18 based on a 67% payout of the underlying EPS of 8.5 cents per share. Full year payout ratio guidance remains at the top end of the 70%–80% range. Despite our lower FY19 forecast NPAT we maintain our 13 cents per share fully franked forecast dividend. Management confirmed the outlook for FY19, with private health insurance market volumes expected to remain flat. Medibank Insurance delivered a $536m pretax operating profit in FY18, and we forecast a modestly higher result for FY19. In the past the Medibank Private brand has struggled to retain policyholders, but the insurer is targeting a flat outcome in policyholders in FY19 compared with a 2.2% decline in FY18 and a 4.1% in FY17. If achieved this will be a good outcome. Utilisation growth rates for both hospital and ancillary are expected to remain subdued through FY19. IMR Neutral.

NIB Holdings' (NHF) (narrow moat) delivered a solid 1H19 performance with reported NPAT up 5% on 1H18 to $74m, in line with our expectations. But the make-up of the result surprised. A strong insurance underwriting result was partially offset by a weak performance from the travel insurance business and a sharp fall in investment returns. We were impressed with the modest FY19 guidance upgrade for consolidated group underlying operating profit of at least $195m from at least $190m previously. Our FY19 underlying operating profit forecast is $196m, and if achieved, will be 6% higher than FY18. At current levels, NHF is trading 8% below our valuation, at around 20 times forecast FY19 earnings. We forecast EPS to grow an average of 9% per year until FY23. Our FY19 forecast incorporates lower health insurance claims expenses partially offset by lower World Nomads net operating profit. We slash our investment return forecast from $32m to $19m with our forecast reported NPAT forecast falling from $140m to $133m. Our FY19 fully franked dividend forecast is flat at 20 cents per share with a 69% payout toward the top of the 60%–70% target range. Solid top line revenue growth and weak claims inflation drove the strong performance from the Australian resident health insurance business with underlying profit up 33% to $88m on the back of an impressive net margin of 8.8%, well up on 7.3% in 1H18. The performance benefited from a full six months contribution from the GU Health acquisition compared with two months contribution in 1H18. The international inbound students and workers private health insurance business performed strongly with double-digit top line and earnings growth underpinned by strong policyholder growth and the GU acquisition. The underlying operating profit increased 16% to $18m with net margins steady at 33%. The international inbound business continues to impress, and we expect further solid growth going forward. IMR Neutral.

Wealth Managers

Magellan Financial Group (MFG) (narrow moat) announced impressive 1H19 results, delivered against a backdrop of turbulent markets. Underlying NPAT increased by 62% from 1H18 to $176.3m driven by increased funds under management (FUM). Over the six months, spot FUM increased to a high of nearly $75bn before dipping to $70.8bn by the end of December as higher volatility gripped global markets. Even so, we were encouraged inflows remained strong despite volatility. Adverse market conditions saw market returns fully offset by cash distributions, but this was more than offset by inflows totaling $1.4bn, all of which demonstrates MFG's appeal to investors by virtue of its strong brand and record of outperformance. Average FUM grew to $72.1bn, up from $53.6bn in 1H18. Both

Perpetual PPT	
Fair Value ($)	37.20 ↑
Price/Fair Value	1.09
IMR	Neutral

Platinum Asset Mgmt PTM	
Fair Value ($)	5.50 →
Price/Fair Value	0.98
IMR	Strongly Positive

underlying EPS and dividends grew above market expectations, increasing to 99.8 cents and 73.8 cents per share, respectively. The global asset manager continues to perform in line with our expectations. We have adjusted some of our earnings forecasts but retain our fair value estimate of $29. MFG continues to grow its share of money managed for institutional clients. This increased from $50.3bn at end June to $51.8bn, accounting for close to 75% of the total FUM pool. The asset manager's institutional client base grew marginally in its concentration, but we still view the overall client pool to be well diversified given the top 30 institutional clients contribute less than 40% of total management and services fee revenue. The remaining FUM are managed for retail clients, which fell marginally to $19bn. Central to MFG's favourable results were positive fund inflows from both its institutional and retail client base even in the face of difficult market conditions. Encouragingly, inflows from institutional investors totalled $886m, whereas retail clients contributed an additional $475m. Both were down from 1H18, however, we note this was delivered amid a period of lacklustre market returns globally. We expect total FUM to increase by an average of 8.8% per year towards $106bn by FY23. Even as volatility spooked global markets, flagship strategies delivered upper-quartile investment returns well ahead of their benchmarks. As always, higher FUM balances helped pave the way for higher management fees, with base management fees up by 28% from 1H18 to $225.8m. Average base management fee margins were slightly down to 63 basis points, but this was due to a mix shift towards institutional FUM. We believe there is no reason for MFG to lose hold of its current fee margins anytime soon. Strongly Positive.

Perpetual's (PPT) (narrow moat) 2H19 earnings should improve from the disappointing 1H19 results recorded in both the Investments and Private divisions. Our longer-term forecasts have not materially changed, but a major rebound in Australia's equity market from its precipitous fall in the December quarter sees a moderate uplift in narrow-moat Perpetual's (PPT) fair value estimate from $36.30 to $37.20 per share. We expect profit before tax (PBT) of the core Investments' division to fall by about 14% in FY19 after a 20% slide in 1H19 from 1H18. However, we think this sharp fall overstates the true decline in performance. Part of the fall is due to an accounting change (AASB 9) which requires fair value changes to now go through the profit-and-loss statement instead of below the line through comprehensive income. The unrealised fair value loss in 1H19 was $10.1m could be reversed in 2H19 if market hold up. A more pressing concern is the continuing net fund outflows. Net cash outflows in the Investments' division were $1.3bn, mainly from institutional clients. We continue to believe PPT will be unable to address these fund outflows in the near term as investors move into passive alternatives. PPT's poor medium-term performance exacerbated fund outflows. We expect Private's impressive earnings growth rate in FY17 and FY18 to stall and forecast FY19 PBT to fall by about 1%. We believe the erosion of trust for financial advisers from the misconduct revealed by the royal commission will continue to indirectly impact its Private business. On a more positive note, we forecast Corporate Trust to continue its impressive earnings growth in FY19. We expect PBT to increase by about 7%, following an impressive 13% increase in 1H19. While we expect continued earnings growth in we don't expect the 1H growth rate to repeat in 2H as capital flows into infrastructure and property funds stabilised from strong growth rates toward the end of the half. Additionally, we expect a general slowing in systemwide credit growth to also impact earnings in 2H19. PPT could acquire growth, which management confirms is a part of its new strategy. The strong balance sheet, with gearing of 11.6% at end December is well below its target of 30%. IMR Neutral.

Platinum Asset Management's (PTM) (narrow moat) 1H19 results were, while underwhelming, in line with recent guidance. Underlying NPAT was down 38% on 1H18 to $65.2m as closing funds under management (FUM) fell to $24.1bn from $25.7bn in June. Positive net inflows of around $700m weren't enough to plug the $2.2bn hole created by investment underperformance over the half year. Nevertheless, our $5.50 fair value estimate remains, underpinned by the Asia region growth story, a difficult to replicate value-based strategy and a strong brand. A key highlight was renewed momentum in net inflows. In contrast to major competitor Magellan Financial Group, the majority of PTM's FUM are managed for retail clients, who collectively account for around 75% of total FUM. Not surprisingly, net inflows were skewed towards the earlier part of 1H19 where PTM was still benefiting from FY18's strong performance. Net flows totalled $689m but 88% of these came in 1Q19 and December experienced net outflows. Momentum was strong in PTM's retail flagship products with both the Platinum

ASX Limited ASX	
Fair Value ($)	52.00 →
Price/Fair Value	1.35
IMR	Neutral

Challenger CGF	
Fair Value ($)	9.25 ↓
Price/Fair Value	0.91
IMR	Neutral

International Fund and Platinum Asia Fund contributing $503m and the ASX-quoted funds collectively amassing over $160m. Given the decline in recent investment performance, we expect little to no net inflows over 2H19. Operating expenses were well-contained falling 7.5% from 1H18 to $38m. Looking ahead, we expect PTM to increasingly spend on staff retention to maintain investment outperformance and business development initiatives to enhance distribution and brand presence. Accordingly, we believe costs will continue to trend up over the long term, with our assumptions reflective of this. Of course, the perfect tonic is increasing FUM and improved performance. At the heart of our investment thesis are our assumptions on future returns, which we believe will be the core driver of FUM. We have assumed a "through the cycle" market return of around 9% per year over the forecast period. Our research indicates emerging markets and international-developed equities, which has an outsize influence on PTM's core strategies, will outperform US equities over the next 10 years due to more attractive relative valuation. We do not discount the potential instability in PPT's FUM given the eroding trust in vertically integrated advisor groups post the royal commission, but we believe FUM growth should regain traction once the asset manager's investment strategy plays out over time. Nevertheless, we assume zero net inflows throughout the forecast period given the extreme volatility of PTM flows historically. We expect total FUM to increase by an average of 7% per year, after distributions, towards $36bn by FY23, driven by investment performance. IMR Strongly Positive.

Other Financials

ASX Limited's (ASX) (wide moat) 1H19 NPAT increased 6.8% to $246.1m, broadly in line with our expectations, although net interest income was much stronger than we expected. Dividend increased 6.7% to $1.144 fully franked, on a 90% payout ratio. We maintained our fair value estimate at $52.00 per share. We continue to forecast mid-single-digit annual underlying EPS growth over the next decade, as was achieved over the past decade. The result was the first to incorporate the new AASB 15 accounting standard which reduced Listings revenue by about 12% and group revenue by 3%. This meant the result was not comparable with 1H18 and management provided like-for-like growth rates to better illustrate the underlying performance of the business. Net interest growth of 51% was much higher than our 5% full-year forecast and the average annual increase of 5% over the past 10 years. Management attributed the increase to the 16% increase in collateral balances, relating to growth in open futures positions, and an increase in investment spreads. We increase our full-year interest forecast but don't expect the strong growth to be sustained in later years. The result was solid across the divisions, with like-for-like group revenue up 6.5% but EBITDA rising just 2.1% due to expenses growth of 9.4%, relating to reinvestment in the business. Management maintained their 9% full-year expenses growth guidance which is in line with our forecast. We expect expenses growth to fall to mid-single-digit rates from FY21 and management confirmed this was also their expectation. Divisional revenue growth rates were reasonably consistent with the mid-single-digit rates achieved in prior recent periods and with our forecasts. Capital expenditure guidance of $70m to $75m was maintained and is also in line with our forecast. ASX remains extremely strong with no debt, $7.3bn in participants' margin commitments, and $1.1bn in ASX-owned cash, of which $202m is free to use. Although expenses growth and capital expenditures will be relatively high in FY19, we are comfortable regarding the sustainability of fully franked dividends. IMR Neutral.

Challenger's (CGF) (no moat) lower-than-expected annuity sales along with continuing margin pressure were the key takeaways from its poor 1H19 results. Lower annuity sales were due to disruptions caused by the Financial Services Royal Commission to its core financial adviser distributional channel. In addition, Australia's low interest rates relative to the US led to a preference by Japanese investors for US$ annuities over A$ annuities and weighed more-than-expected on A$ annuity sales into Japan. Although we believe CGF's long-term investment case remains intact, we now expect these headwinds to persevere over the next few years and combine with continuing margin pressures to be a drag on earnings. This has prompted a reduction in fair value estimate from $10.80 to $9.25 per share. We now forecast normalised FY19 NPBT of $547m, at the lower-end of company guidance of $545m–$565m. This leads to a NPAT forecast of $402m, slightly higher than our previous $399m forecast with a lower effective tax rate. However, the main change to our forecast is in the outer years, with normalised NPAT in FY20 of $402m, down from the previous forecast of $435m. This is primarily driven by lower expected annuity sales and continuing margin pressure. In aggregate, total annuity and other life sales for

Computershare CPU	
Fair Value ($)	19.40 ↑
Price/Fair Value	0.90
IMR	Strongly Positive

Genworth Australia GMA	
Fair Value ($)	2.70 →
Price/Fair Value	0.91
IMR	Positive

1H19 were down 17.6% on 1H18, with sales slowing markedly in 2Q19. The impact on cash operating earnings was further exacerbated by ongoing margin pressure. Lower margins were driven by lower-than-expected distributions from an absolute return fund and the repositioning of its investment portfolio to lower returning high-grade fixed income assets. We expect continuing margin pressure in 2H19 as CGF continues to reduce allocation to its property portfolio. Despite these near-term issues, we still expect CGF to benefit from the longer-term trend of a larger allocation of annuities in retirement portfolios. We believe the allocation to annuities will continue to be supported by the general direction of public policy which we think will focus more attention on the retirement income phase of superannuation. However, we expect public policy in this area to be delayed given the upcoming federal election. We also believe legislators will more likely focus on implementing the royal commission recommendations. Consequently, we do not expect the company to benefit from a boost in annuity sales in the near-term from a change in public policy. On a more positive note, the company continues to maintain a strong balance sheet. IMR Neutral.

Computershare's (CPU) (narrow moat) 1H19 result was strong but only slightly ahead of our expectations. Although statutory NPAT rose by 52%, CPU frequently reports a range of nonrecurring items, meaning the 15% increase in underlying NPAT is a more accurate reflection of the underlying performance. Although we expected strong margin income growth, we were surprised by the 21% jump in client-owned cash balances and the US$10m in EBITDA from the corporate and technology division. However, we have maintained our long-term low-single-digit annual growth forecast for client-owned cash balances as management expects the jump to reverse in 2H19. We previously assumed the corporate and technology division would become a cost centre following the divisional loss in FY18. However, the 1H19 result is more indicative of long-term divisional earnings. We increase our divisional earnings forecasts accordingly, which constitute around 3% of group EBITDA, in addition to lowering our A$/US exchange rate to 0.71. Combined, these changes cause a 2% increase in our fair value estimate to $19.40 per share. The result was driven by a 58% increase in margin income, which offset earnings weakness elsewhere. The US$38m, or 13%, increase in group EBITDA comprised a US$46m increase in margin and a US$8m fall in other earnings. Although revenue growth was flat, the higher proportion of higher-margin revenue from margin income caused the group EBITDA margin to increase from 26% to 29%, which is broadly in line with our investment thesis. The register maintenance division, which makes up about 44% of group EBITDA, delivered a mixed result with margin income-related revenue increasing 59% but other revenue flat on 1H18. This is largely in line with our investment thesis the registry business is reasonably mature and likely to generate low-single-digit revenue growth, excluding margin income, in the long term. The U.S. mortgage servicing business, which constitutes around 25% of group EBITDA, continues to grow in line with our expectations. The value of mortgages serviced, also known as unpaid principal balance (UPB) increased 30% to US$93bn and is rapidly approaching management's long-held target of US$100bn. However, management confirmed UPB would continue to grow beyond the target, which is in line with our expectations. The U.K. mortgage servicing business, which we estimate constitutes 5%–10% of group EBITDA, also performed in line with our expectations. The 13% fall in UPB reflects the amortisation of the closed UKAR mortgage book, which is in line with our forecasts. The performance of the employee share plan division, which makes up around 10% of group EBITDA, was a little weaker than we expected but not sufficiently so to change our forecasts at this stage. IMR Strongly Positive.

Genworth Mortgage Insurance Australia's (GMA) (no moat) 2018 results were in line with our expectations. Moderating Australian housing conditions and an October 2017 earnings curve review led to a 24% decline in net earned premiums (NEP) and a 51.9% loss ratio, tracking our forecast for a 25% decline and 53% loss ratio. Excluding the impact of the curve review, NEP fell 4.3% in 2018, reflecting challenging end-market conditions, although underlying NPAT of $93.9m matched our projection. We maintain our $2.70 per share fair value estimate. Downside risks remain. We expect further credit standard tightening by major bank customers and the impact of stronger macro prudential regulation, particularly following the recent royal commission, and forecast low single-digit near-term NEP growth. Our forecast 4% growth for FY19 NEP is at the high end of management's range of between negative 5% and positive 5%, while our assumed loss ratio of 50% is at the mid-point of management's 45% to 55% estimate. But further negative follow-on effects from Australia's housing moderation, such as a spill-over

IOOF Holdings IFL	
Fair Value ($)	5.60 ↑
Price/Fair Value	1.16
IMR	Strongly Positive

IRESS IRE	
Fair Value ($)	11.80 ↑
Price/Fair Value	1.08
IMR	Strongly Positive

Mortgage Choice MOC	
Fair Value ($)	1.10 →
Price/Fair Value	0.81
IMR	Strongly Positive

into the broader economy due to lower household wealth, could drive our valuation downward by nearly 50%. The company announced an additional $100m of buybacks, with a portion subject to shareholder approval at the 9 May AGM. So long as the market price remains below our fair value estimate, we recommend voting for this repurchase. The balance sheet supports this endeavour. GMA finished the year with more than $3.2bn in cash and investments, and its regulatory capital base is 1.94 times its prescribed capital amount (PCA) coverage ratio, which continues to be well above its target PCA coverage ratio of 1.32–1.44 times. IMR Positive.

IOOF Holdings' (IFL) (narrow moat) 1H19 result highlights the importance of completing the ANZ Bank Pensions and Investments funds (P&I) acquisition to ensure near-term earnings growth. Better-than-expected fund flows into portfolio and estate administration business prompt an increase in our fair value estimate from $5.00 to $5.60 per share but with a very high uncertainty rating. Underlying NPAT of $100.1m was 5.8% higher than 1H18 but this hides the true like-for-like performance as it includes about $15m from the partly completed P&I acquisition. Excluding this contribution, like-for-like NPAT is about 9.9% lower. Our fair value estimate of $5.60 and earnings forecasts are based on our base-case view the P&I funds will not be transferred to IFL. There continues to be very high uncertainty over IFL's future sustainable earnings not only because of the unpredictability on whether the P&I funds transfer will occur but also because management indicates it is too early to tell what ongoing costs and margin pressures may be given the several ongoing reviews it is conducting in response to the royal commission. Subject to these caveats, we expect IFL's fair value estimate could approach $8.00 per share if the P&I funds transfer is in fact approved. If the P&I transaction does not proceed, management indicates a capital management program including a share buyback will be initiated. We believe this is the most likely outcome. In this circumstance, we expect IFL to redeem its $800m debt note and use the proceeds to repay most of its circa $417m borrowings and use the remainder to institute an $400m share buyback. However, the extent of any share buyback is also dependent on results of the many reviews it is undertaking, the negotiations with regulators, and the broader regulatory and economic environment. On a positive note, management indicated it is not seeing significant outflows from its retail superannuation funds into industry funds. Unlike competitor AMP Ltd which experienced an elevated level of fund outflows from its retail superannuation platforms in the December 2018 quarter, IFL reported fund inflows of about $273m. However, IFL did experience elevated levels of fund outflows from its advice business of $471m in the December 2018 quarter, not including the circa $17bn fund inflows from the ANZ Bank-aligned dealer group. This compares with inflows of $525m in the same quarter in 2017. We also expect further margin pressures prompted by lower pricing in response to the findings of the royal commission as well as competition from third party administrators. IMR Strongly Positive.

IRESS (IRE) (narrow moat) reported a reassuring 2018 result in line with our expectations. Both revenue and NPAT were within 1% of our forecasts, but we were encouraged by the performance and outlook for the Australian wealth management and U.K. lending divisions, which compose 31% and 7% of segment profit, respectively. We slightly increase revenue growth forecasts, but our 2019 group segment profit forecast of $151m is largely unchanged and remains in line with management's guidance of $146m to $153m. The bulk of the 7% increase in our fair value estimate to $11.80 per share is due to the roll forward of our financial model. IRE is well placed to manage key short-term risks, including the potential consequences of Brexit in the U.K. and the royal commission fallout in Australia. The U.K businesses compose about one third of group profit, but clients are largely domestically focused and unlikely to experience a material direct impact from Brexit. IRE performed well in 2018, with all six divisions reporting revenue growth and a respectable group revenue growth rate of 8%, or 6% on a constant currency (CC) basis. Importantly, the group EBITDA margin expanded, albeit very slightly to 27.4%. This is significant as the EBITDA margin contracted in each of the previous seven years as management reinvested and repositioned the portfolio. Similarly, underlying EPS growth of 7.6% was one of the strongest results in the past decade and provides further evidence the business is evolving as we expect. This partly reflects management's strategic decision to transition away the structurally weak financial markets division, which represented 68% of group profit a decade ago but just 25% in 2018. The balance sheet remains in good shape and credit metrics remain very strong, with a net debt to EBITDA ratio of just 0.6. IMR Strongly Positive.

Mortgage Choice (MOC) (no moat) is battling challenges on multiple fronts with 1H19 cash profit

Steadfast Group SDF	
Fair Value ($)	3.00 →
Price/Fair Value	1.06
IMR	Positive

Link Administration LNK	
Fair Value ($)	8.90 →
Price/Fair Value	0.86
IMR	Neutral

down 43% from 1H18 to just $7.1m. Despite overwhelming negativity, the result was better than expected and we are modestly more confident in the long-term outlook for the embattled mortgage broker. Management is doing everything it can to deal with the challenges and continues to set the business for an eventual upturn in mortgage growth and resolution of structural industry changes. But it will take 12–18 months before industry, political and regulatory issues settle, and the business can start growing again. The better-than-expected profit prompts an increase in our FY19 cash NPAT forecast from $12.9m to $14.1m, and toward the bottom of the $14m–$15m guidance range. The three cents per share (cps) fully franked dividend was well below the 4.50 cents we expected. The payout was cut from 90% in 1H18 to 53%. Despite the profit uplift, we cut our forecast FY19 dividend from 9.5 to 6.5 cps based on a revised 55% payout, previously 93%. The sharp fall profit is partly due to weaker demand for residential loan finance, a softer property market and tougher lending underwriting standards. A minor positive is despite a 15% fall in loan approval values and 12% decline in settlement values, MOC's total loan book increased 1% on 1H18 to $54.5bn. A higher average loan life offset the lower settlement volumes, but if the trend continues for softer settlement volumes, the loan book will start to shrink. Balance sheet settings are sound, with net assets of $82.7m, $4m in debt and the reduced dividend payout to 53% will add to cash reserves. Despite 1H19 net operating cashflow of $6.7m, the $11.3m payment of the final FY18 dividend drained cash, necessitating a new $4m debt facility. IMR Strongly Positive.

Steadfast Group (SDF) (no moat) maintained FY19 earnings guidance following a strong 1H19 result. Our positive view is intact and at current prices, the stock is trading close to our $3.00 per share fair value estimate. Underlying cash NPAT increased an impressive 17% to $50m, just ahead of our $48m expectation. The fully franked dividend of 3.2 cents per share (cps) was in line, increasing 14% on 1H18 based on 50% payout of underlying cash NPAT. Including $12m in amortisation expense, EPS increased 12% to 4.8 cps. We like the strong pricing and volume growth and expect similar outcomes for several years. Our FY19 cash NPAT forecast of $113m excludes amortisation expense. Adjusting for amortisation of $25m, our underlying NPAT is $88m, the midpoint of unchanged guidance of $85m–$90m. Our underlying EBITA forecast of $193m is close to the midpoint of guidance of $190m–$200m. 1H is seasonally weaker than 2H with a split near 45/55. We expect a 2H19 underlying cash NPAT of $63m to achieve our unchanged FY19 cash NPAT forecast of $113m. We like the strong cash flow, good organic growth in both the broker and underwriting businesses and the ongoing acquisition growth strategy. Revenue growth was strong at 23% with EBITA growth of 21% a highlight. A net $94m was spent on small bolt-on broker and underwriting agency businesses. Broker EBITA margins were steady at 29% and underwriting margins increased from 44% to 46%. Our FY19 dividend forecast of 8.5 cents per share is based on a 60% payout of cash profits. Despite the relatively low 2.8% dividend yield or 4.0% including franking, the broker offers attractive earnings growth options. We forecast EPS growth to average 8% annually for FY20–FY23. Material acquisitions remain a medium-term catalyst, but we don't expect any in 2H19. Lower-risk, smaller bolt-on acquisitions continue to feature, typically independent brokers already accessing the SDF network. Despite expected strong top line growth there are lot of moving parts to the expanding group, which translates into high execution risk. SDF has done well combining organic growth with targeted acquisitions since listing in 2013. However, acquisition risk is always a concern, and overpaying for assets could result in potential future asset writedowns to the detriment of shareholders. But this is not our base case as we are confident management and the board will continue to apply appropriate care in investing shareholder's funds in its long-term inorganic growth strategy. IMR Positive.

Information Technology

Link Administration's (LNK) (narrow moat) 1H19 results were broadly in line with our expectations, and we have maintained our fair value estimate at $8.90 per share. Management's outlook was vague but positive nonetheless, and cost synergy guidance was maintained, albeit skewed to 2H. We believe the decline in share price was caused by a combination of ongoing uncertainty about Brexit and Australian superannuation regulation, in addition to various slightly weak aspects of the result. However, the long-term outlook for the group is little changed and, importantly, the UK Link Asset Services business is performing in line with expectations, and financial leverage is falling to comfortable levels. Despite a soft 1H19 performance and regulatory uncertainty, we continue to believe LNK's Australian fund administration business, which accounts for around 30% of group EBITDA, has good prospects. Investors have been concerned about the division since the federal government proposed changes to

MYOB Group MYO	
Fair Value ($)	3.40 →
Price/Fair Value	1.00
IMR	Neutral

Aveo Group AOG	
Fair Value ($)	2.10 ↓
Price/Fair Value	1.01
IMR	Positive

superannuation legislation with the release of the 2017–18 budget. Uncertainty has also increased after the release of the Productivity Commission's review of superannuation and the royal commission into the financial-services sector. A lack of unpleasant surprises from LAS is reassuring considering the number of Australian companies that have destroyed shareholder value via similar large acquisitions in the U.K. in recent years. Considering Brexit uncertainty, the business is generating respectable mid-single-digit underlying revenue growth, albeit in line with our expectations. The sale of the CPCS division, which accounts for about 25% of LAS, is a sensible move that exits a relatively low-quality business at a 16% profit on the 2017 acquisition cost and reduces financial leverage of the group. The recent decision to increase the investment in PEXA to 44% is a smart move enhancing the earnings growth outlook and diversification. Management provided operating performance data showing the strong growth being generated by the business and which has exceeded internal forecasts. However, we have maintained our valuation of PEXA, which is still at a relatively early stage of its business cycle. IMR Neutral.

MYOB Group's (MYO) (narrow moat) 2018 result was in line with our expectations but overshadowed by KKR's likely acquisition of the company. Group EBITDA was within 1% of our forecast, implying no growth on the prior year, although group revenue growth of 7% was respectable and sustainable. Weak profit growth is consistent with management's long-held plan to transition the company to cloud based products via its Connected Practice strategy. This involves reinvesting profits into the cloud platform and increasing sales and marketing expenditures. In the short to medium term, the strategy will impact profits but should significantly benefit long-term growth and underpin the company's competitive position. We continue to believe the KKR acquisition is highly likely to proceed and have largely maintained our earnings forecasts and MYO's fair value estimate at the offer price of $3.40 per share. MYO was permitted to seek alternative offers but as none have emerged, making it more certain the KKR offer will proceed. Although KKR is willing to sell its 19.9% shareholding into a higher offer, we expect most potential financial bidders will be reluctant to buy from such a sophisticated investor that has already conducted due diligence on the company. MYO plans to release its Scheme Booklet in mid- to late-March 2019 with the Scheme meeting expected in mid- to late-April 2019. We will provide our recommendation on the offer following the release of the Scheme booklet. Under the Scheme Implementation Agreement with KKR, MYO is unable to declare a dividend. IMR Neutral.

Real Estate Investment Trusts

Aveo Group (AOG) (no moat) reported 1H19 underlying profit of $12m compared with $36m in 1H18. Development was the major detractor, with earnings falling by $10m and profits booked from the divestment of noncore assets falling $20m. In many respects, the financial result is a mere side-show, overshadowed by a potential part or even full sale of the business being progressed by AOG's investment bankers. Indicative and nonbinding offers were received from multiple parties in January and a more detailed due diligence is expected to take a few months given the complexity of assessing 93 Australian villages, five US villages, a development pipeline of over 5,000 units, plus five aged care facilities. Management wouldn't comment on specifics other than to advise there is interest from Australian and international investors. At this point, the most logical outcome is for an investor to make an offer to acquire the entire business via a scheme of arrangement. There is no guarantee a transaction will arise given the considerable uncertainty around long-term cash generation prospects of existing assets and pipeline initiatives. This is amply illustrated by AOG's security price sitting at less than 50% of the net tangible asset backing of $3.83 per security. The interplay intentions of major shareholder Mulpha International, which has a 24.4% stake—and growing—add further complexity to a potential transaction. We further reduce our medium-term sales earnings and distribution expectations, incorporating the softer housing market. We trim expectations for deferred management fees for outgoing residents. Our fair value estimate for no-moat-rated AOG declines from $2.30 to $2.10. The target to sell 1,150 new and used units for FY19 was reiterated. But even with the seasonally stronger 2H, this looks unachievable given there were only 332 settlements in 1H19. According to management, the retirement living industry is at a cyclical low, with Sydney particularly soft. Customer surveys point to stable demand, but elderly residents are deferring settlement due to a reluctance to sell their dwellings, that in most instances comprise the bulk of their saving, in a weak housing market. Management didn't provide earnings guidance for FY19 due to uncertainty around margins and volumes of settlements on legacy units. AOG also couldn't commit to a figure

BWP Trust BWP	
Fair Value ($)	3.30 →
Price/Fair Value	1.13
IMR	Neutral

Dexus Property Group DXS	
Fair Value ($)	10.30 ↑
Price/Fair Value	1.22
IMR	Neutral

Goodman Group GMG	
Fair Value ($)	11.20 ↑
Price/Fair Value	1.17
IMR	Postive

for the number of units it will deliver in FY20 due to uncertainty around sales and levels of unsold stock. Further, it currently seems to be more value accretive to buy-back than add to the current base of unsold inventory. We now forecast an approximate 50% decline in FY19 underlying NPAT to $64m. We forecast distributions of five cents implying a 45% payout ratio. IMR Positive.

BWP Trust (BWP) (narrow moat) reported 4% growth in 1H19 NPAT excluding revaluation gains to $58.8m. The result was flattered by an accounting change and lower interest rates, which helped offset the departure of Bunnings from properties in the prior year. Without the accounting change, adjusted NPAT would have been flat. Distributions increased 1.7% to 8.93 cents per unit and guidance is for 2H distributions to continue growing at the same pace, potentially supported by profits from the sale of assets. Our forecasts are largely unchanged, and we maintain our $3.30 per unit fair value estimate. Like-for-like rental growth was broadly in line with expectations at 2.5% for the year to December, underpinned by fixed and CPI-linked rental increases over most of the portfolio. Market rent reviews disappointed. Two properties' belated rent reviews were resolved—Artarmon and Fyshwick. BWP agreed to no change in rents in Artarmon for three years, while Fyshwick sees no rise for one year, a poor outcome. At least Bunnings agreed to extend the Fyshwick lease by two years to December 2024. Seven market rent reviews from FY18 and 1H19 are still being negotiated. We expect moderately better outcomes. Occupancy remains high at 99.1% but a relatively short-weighted average lease expiry of 4.3 years suggests ongoing vacancy risk. Despite this risk, BWP's property values increased by $23m after redeveloping a couple of properties recently vacated by Bunnings and as cap rates continue to fall. Bunnings-occupied properties have typically been selling on cap rates around 5.5% since late 2015, compared with BWP's 6.4% weighted average cap rate. This suggests there's still upside to BWP's property values reflected in the unit price currently at a 27% premium to net tangible asset backing of $2.89 per unit. IMR Neutral.

Dexus Property Group (DXS) (narrow moat) reported 1H19 earnings on a funds from operations (FFO) basis of 31.3 cents per security (cps) up 3.6% on 1H18. Growth in Sydney office rents have far exceeded expectations as low levels of vacancies have put the balance of power in lease negotiations firmly in favour of the landlord. Management stated they have not seen evidence of prospective tenants being deterred by significant increases in rent. In fact, DXS advised effective rents (face rents adjusted for tenant incentives) for newly negotiated leases in Sydney in 1H19 increased by 18% over prior rates. Management estimated rents across their Sydney office portfolio are currently 8% below market rates on average. Much of this under-renting will be captured as 19% of DXS' office portfolio will be renegotiated in the Sydney market in the 2.5 years to June 2021. We've assumed Sydney office rents increase by approximately 10% over this period. We forecast office rents to increase slightly in Melbourne and decline for leases renewed in Perth and Brisbane over the next three years. The strong outlook for Sydney office rents and improved growth prospects in DXS' fund management activities is behind the 5% increase in our fair value estimate from $9.80 to $10.30. DXS reiterated FY19 guidance for FFO per security growth of circa 3% underpinned by office like-for-like growth of 4–5%, industrial like-for-like growth of 2.5–3.5%, post-tax trading profits of $35–40m and maintenance and leasing costs of $155–165m. The guided distribution growth of 5% to 50.2 cps implies a yield of just 4.3% at current levels. Aside from the solid growth in Sydney office rents, the next major positive is the momentum in growing the funds management platform. Funds under management (FUM) have increased from $5.6bn in 2012 to $15bn currently. A large part of the growth is attributable to rising property values, with the balance a result of internal developments and acquisitions. IMR Neutral.

Goodman Group (GMG) (narrow moat) has upgraded FY19 earnings guidance from growth of 7% to 9.5%. The raised guidance is mostly due to a step up in performance fees as the returns for wholesale investors in GMG managed funds were materially above benchmark, a major catalyst being ultra-loose monetary policies and falling bond yields. After years of tight reins on its development business, GMG has said the high demand supports a more aggressive stance and development work in progress will exceed $4bn after hovering around $3.5bn in recent years. The faster rate of development will have a multiplier effect on earnings, increasing development fees, but also accelerating the growth rate in external funds under management, GMG's highest return on equity activity. We make multiple forecast revisions, which include higher medium-term performance fee expectations underpinned by across-the-board outperformance of GMG management funds. Raised rate of development completions, feeding

GPT Group GPT	
Fair Value ($)	5.40 ↑
Price/Fair Value	1.14
IMR	Neutral

Mirvac Group MGR	
Fair Value ($)	2.25 ↑
Price/Fair Value	1.18
IMR	Positive

into higher development earnings but more importantly a faster rate of growth in external assets under management. Our fair value estimate for narrow-moat-rated GMG increases 10% from $10.20 to $11.20. One of GMG's better conceived strategies was the decision to have development occur within funds rather than on balance sheet. GMG initially suffered through lower development profits on the sale of assets to its funds. However, it is now being amply compensated in numerous ways. First, GMG receives modest fees for providing development services to the funds; and second, it has been able to shrink its balance sheet as developments now occur off rather than on-balance sheet. Most importantly, the enabling of GMG managed funds to acquire assets at cost, often a discount of 20% to market value, has materially boosted the returns metrics of each fund. This in turn has flowed into higher performance fees. GMG is reaping the rewards of this at present, with the $39.6bn of external funds achieving average returns around 15%, materially above the industry return benchmark of circa 10%. Returns comprise rents and higher asset values, which have been driven by low global bond yields. The focus in recent years has been to operate at the pointy end of the industrial development spectrum. The strategic preference is on inner city sites of major cities where development approval is costly and protracted. GMG is one of a very few industrial developers with the balance sheet, risk appetite and patience to acquire sites where time between site acquisition and first rent generation is often around five years. GMG can accommodate this as many of the investors are sovereign wealth funds whose investment horizon is in decades rather than years. Development in inner city sites is currently generating superior returns as e-commerce firms are prepared to pay significant rental premiums to operate from sites that offer strategic benefits in terms of faster delivery times. IMR Positive.

GPT Group (GPT) (narrow moat) reported 2018 earnings on a funds from operations (FFO) basis of 31.84 cents per security (cps), up 3.5% and consistent with guidance. The $5.9bn office portfolio was the main driver, delivering 5.8% like-for-like income growth and to a lesser extent, the $1.9bn industrial portfolio, where like-for-like rental growth was 2.8%. The $6.2bn retail portfolio achieve hard-fought growth of 2.2% as sales in numerous malls were impacted by competitor expansions nearby. We lift the rental growth outlook and valuations attributable to the office and industrial portfolio and trim rental outlook and valuations for the retail assets. Our fair value estimate for narrow-moat-rated GPT increases 6% to $5.40. Guidance is for growth in 2019 FFO and distributions of 4%. This doesn't seem a stretch given rents for the office portfolio contain an annual rental ratchet of 3.9% and rents for the 5% of leases expected to be extended should jump by around 8%. Further, while the office portfolio recorded a closing occupancy of 97% (including signed leases) the average office occupancy for 2018 was only 93%, providing scope for upside from higher average occupancy. GPT will also generate higher fund management earnings, as the fee base for 2019 increases by 5% to $12.6bn. The major strategic change is GPT's revised target weighting to office, retail and industrial of 40%, 40% and 20%, respectively. The changes equate to a 10% reduced weighting to retail shopping centres and a 5% increased weighting to both office and industrial. GPT had been gradually moving away from the old target weighting, so no surprise here. We are not particularly optimistic about GPT's focus on growing its industrial portfolio by $150m–$200m annually. Industrial is very much the "in-favour" sector. Valuations have spiked over the past two to three years as discount rates fall and rents start to rise as growth in online retail has triggered supply shortage in Australia's major east coast cities. We don't see GPT has any competitive advantage in logistics ownership or management. GPT booked material noncash revaluations of $911m or 50cps, which provided a source of collateral to enable GPT to make $690m of acquisitions and have gearing increase to 26.3%. We view leverage settings as reasonable. IMR Neutral.

Mirvac Group (MGR) (no moat) reported 1H19 operational earnings of $290m or 7.85 cents per security (cps), up 27% on 1H18, nearly entirely attributable to an $87m lift in pretax development earnings. Guided growth in FY19 EPS tightened slightly from 2%–4% to 3%–4%. The major business activities of office ownership and development are performing better than expected. Office rents have continued their upward trajectory, supported by acute supply shortage in both Sydney and Melbourne. We slightly raise profit expectations for the pipeline of commercial office and industrial facilities as MGR has made good progress on de-risking developments through tenant pre-commitments. Our fair value estimate increases 7% to $2.25. The fall in long-term bond yields has added support to asset values and hence medium-term profits from the developments progressing through construction and planning. We raise our

Scentre Group SCG	
Fair Value ($)	3.85 →
Price/Fair Value	1.03
IMR	Neutral

Stockland Group SGP	
Fair Value ($)	4.00 ↓
Price/Fair Value	0.92
IMR	Neutral

rental growth assumptions for the office portfolio, which represents 49% of balance sheet assets. Our view is supported by the sustained low vacancy in the Sydney office market. MGR advised Australia-wide office leases struck in 1H19, faced rent jumping 6% for renewed leases and 19% for new leases. Upfront incentives paid to tenants were 16% on average, compared with 22% for the year to June 2018. We like the business strategy to focus capital on the larger Australian east coast cities. We agree the larger economic hubs benefit from superior population growth and hence a deeper pool of tenant demand. Overall, we believe this, combined with a focus on newer high amenity premises, will result in superior long-term occupancy and hence lower-risk cash flows. We think MGR's strategy on focusing on the major cities of Melbourne, Sydney and Brisbane and apparent discipline in acquiring sites support long-term shareholder value creation. IMR Positive.

Scentre Group (SCG) (narrow moat) reported 2018 earnings on a funds from operations (FFO) basis of 24.24 cents per security (cps) up 3.9% and in line with guidance from a year ago of 4% growth. Guidance is for growth in comparable net operating income of 2.5%, FFO growth of 3%, and distribution growth of 2% to 22.6 cps. We make minor revisions to our forecasts to account for the timing of the delivery of $810m of redevelopments in 2H18. Our forecasts align with guidance. There was nothing in the result or outlook that significantly impacted our view and we leave our fair value unchanged at $3.85. Like retail landlords across the globe, SCG is facing fast-evolving consumer spending patterns. The common thread is more sales—and especially discretionary retail—are going through online channels, hurting the high-margin specialty retail categories of apparel and jewellery. Further, younger consumers especially are less inclined to visit the mall preferring instead to spend more time on screens. The landlords' challenge is to redevelop or remix the mall in a way to attract more customers or get those who visit the malls to stay longer, trying to increase the spend per visit and hence lift mall sales and support rents. SCG is no different to peers, elevating entertainment and dining, but this comes at a cost and needs a corresponding lift in foot traffic to support a significant increase in restaurant area. We think SCG is making the best of its opportunities, but it is hard to swim against such a strong tide. We forecast SCG to generate ongoing rental growth, but at a far slower rate than the landlord has been able to previously achieve given the changing consumer spending behaviour. Key assumptions that underpin our $3.85 fair value are rents to grow at a compound annual growth rate of 2.2% over the next decade and SCG invest 0.55% of the value of its malls annually into tenant incentives and maintenance capital expenditures. We assume this level of lease incentive enables the landlord to maintain occupancy around the 99% level. We also forecast annual investment in expansionary capital expenditures of $360m annually generating a stabilised yield on cost of 7%. Notwithstanding the challenges in retail, SCG, which has a high weighting to discretionary retail categories has been generating respectable sales performance. Should the Australian or New Zealand economies face a period of economic contraction, we would expect a sharp-pull back in discretionary retail spending, hurting sales in SCG's malls more than the retail REITs whose tenant register is predominantly nondiscretionary retailers. IMR Neutral.

Stockland Group's (SGP) (narrow moat) 1H19 earnings on a funds from operations (FFO) basis of 16.8 cents per security (cps) were down on the 18.0 cps in 1H18 and consistent with expectations. The decline was mostly due to a fall in residential settlements to 2,096 lots compared with 3,159 in 1H18. Management is guiding for over 6,000 settlements for FY19, underpinning stronger 2H19 earnings. We continue to forecast FY19 FFO growth of 4.4%, below guidance which was trimmed to growth of approximately 5% from 5%–7% previously. Guidance was reiterated for distributions of 27.6 cps. After a five-year run of strong earnings growth, it is fair to say most of SGP's businesses are facing tougher operating conditions, the only solidly performing divisions are office and industrial which comprise 5% and 17%, respectively, of pre-overhead EBIT. Overall, the retail performance weakened more than expected. Comparable retail sales deteriorated further growing just 1.4% in 12 months. This is impacting the rental growth trajectory, with rents up just 0.2% on renewed leases and falling 2.6% for new leases. Incentives paid to secure new tenants picked up from 13.1% to 14.5% and the tenant retention rate eased to 63% from 65% a year ago. These metrics are compelling arguments for SGP to reduce its exposure to retail. We trim retail rental growth expectations and factor in earnings dilution from selling additional higher-yielding malls. Corresponding with weakness in Australian dwelling prices, we've also cut earnings growth expectation for the retirement living business. Our fair value estimate declines from $4.15 to $4.00. Corresponding with the upped retail divestment programme, the retail

Vicinity Centres VCX	
Fair Value ($)	2.60 ↓
Price/Fair Value	0.97
IMR	Neutral

Ansell ANN	
Fair Value ($)	27.00 →
Price/Fair Value	0.93
IMR	Neutral

development pipeline has been cut by 50%. SGP is far from immune to the decline in Australian house and apartment prices. However, we think the impact will be less than for many peers, especially smaller operators. IMR Neutral.

Vicinity Centres' (VCX) (narrow moat) 1H19 was worse than expected, with most malls across the portfolio reporting sluggish sales and rent performance. New management is trying to extract value, but it will be difficult as trading conditions are changing far faster than the three to five years it takes for a landlord to revise its in-mall offering. A case in point is the fanfare surrounding the opening of Victoria's Secret's first full-line Australian store in Chadstone (Vicinity's 50%-owned premium mall in Melbourne), a stark contrast to its home market in the U.S. where the brand is struggling to attract shoppers. We expected VCX to offload around $1.9bn of its weakest malls by June 2019, but to date only $670m have been sold. Management expressed optimism in selling the remaining assets post June 2019, but it seems they'll need to discount further as there is a wave of vendors trying to sell and few cashed-up buyers. We push out the settlement date for the 12 assets flagged for sale back a year and assume VCX will need to take a haircut of 10% to its original price expectations. The fast evolution in consumer spending patterns has seen VCX and other landlords scramble to remix to more contemporary categories such as medical and beauty services and dining. The challenge is these categories are labour-intensive and hence have less operational leverage than legacy categories such as fashion. Revisions to asset sales timing and price expectations plus reduced rental growth expectation results in a 9% reduction in our fair value estimate from $2.85 to $2.60. Trading data revealed a very mixed outcome across mall types. The best performing assets include the recently revitalised Chadstone (21% of portfolio to be retained) and DFOs, (12% of portfolio to be retained) where specialty and mini-major sales were up 12% and 7%, respectively. The remaining premium CBD and "high potential" malls achieved comparable sales growth of just 1.3%. This level of sales growth makes it hard to raise rents and reduces the upside from revitalisation. IMR Neutral.

Healthcare

Ansell (ANN) (narrow moat) reported 1H19 adjusted NPAT of US$64m, a 1% increase on 1H18. Earnings were constrained by higher raw material costs (primarily Nitrile), while uncertainty in the European automotive market impacted demand for protective gloves. However, the company is reaping the benefits of its ongoing transformation program and management now expects to exceed the original cost savings target. The unfranked dividend of US$ 20.75 cents per share was up a 1% increase on last year. We maintain our $27 per share fair value estimate. Despite the soft start to the year the outlook remains positive. Management increased the FY19 EPS guidance range from US$1.00–US$1.12 to US$1.06–US$1.12. This is ahead of our previous projections and, as such, we increase our EPS forecast by 9% to US$1.08. The uplift reflects the expectation of a stronger second half, which will be supported by increased selling prices, reduced raw materials cost in addition to the cost savings from the transformation program. Management raised the annual target savings to US$35m by FY20, up from the original target of US$30m. Over the next five years, we forecast EPS to grow at a high-single-digit pace on average, although a meaningful portion of this will come in the form of margin expansion. We expect the company to generate organic revenue growth of 3.5% per year on average, towards the lower end of management's targeted 3%–5% range. We forecast the group EBITDA margin to increase by two percentage points to 18% over the five years ending FY23, mainly reflecting ongoing transformation cost benefits, pricing, and favourable product mix shift. Healthcare sales grew by 4%, although a small portion of this reflects the recently acquired Digitcare. The sales growth was supported by improving trends in the surgical business, along with strong performances in life science and single use business. Underlying EBIT fell by 8% to US$48m (51% of group) due to higher raw material costs, along with less favourable mix shift, neither of which we expect to persist over the long term. We forecast earnings improvement in the second half, as price increases start to flow through, while the sales mix shifts towards higher margin product. Industrial sales were broadly flat, affected by slowdown in European market demand from challenges in the automotive sector, along softness in Russia, Turkey, and Brazil. However, these headwinds moderated towards the end of the half, and we continue to expect revenue growth in the low- to-mid-single-digit range on average over the next five years. Within the division, the U.S. performed strongly, growing by 6%, helping to offset the weakness in Europe. The EBIT result was more positive, rising by 18% to US$45m (49% of group) mainly due to an improved product mix and cost savings, which should continue in the near term. IMR Neutral.

Cochlear COH	
Fair Value ($)	180.00 →
Price/Fair Value	0.99
IMR	Strongly Negative

CSL Limited CSL	
Fair Value ($)	212.00 ↑
Price/Fair Value	0.93
IMR	Negative

Cochlear's (COH) (wide moat) 1H19 result disappointed, sending the shares down 8% on the day. We think it was a case of reality not meeting lofty market expectations. NPAT grew a seemingly impressive 14% to $128m versus 1H18. However, the result flattered to deceive. It benefited from a lower U.S. tax rate and favourable currency movements. At the pretax line, profit was up a still impressive 10%, but the revenue line was more telling. It grew at 11%, but in constant currency (CC) terms, growth was just 6%. Demand for implants was the major source of weakness with volumes up just 5% and revenue flat. Emerging market units grew 15% but developed markets were soft. Management cited increased competition and health budget constraints. Services revenue was a positive, up 21% in CC terms. This segment captures demand for upgrades from the existing user base. The high switching cost for users with Cochlear implants is a key underpinning of our wide moat rating. Sound processor upgrades were key to the growth. We like the upgrade story based on the existing pool of implants, but continued growth in the number of implants is important to expand the pool for future upgrades. The smallest segment is acoustics at 13% of total sales revenue. Here, revenue was flat and product innovation will be key to regaining momentum. Despite the softer result, we maintain our $180 per share fair value estimate. While acknowledging the apparent disappointment, COH's revenue growth has varied widely in the past. When sales have flatlined in COH's history, typically between major launches and innovations, the shares have generally over-reacted. FY19 guidance remains for NPAT to grow 8% to 12% to $265m to $275m million. Our $271m forecast is near the middle of this range. This strong apparent profit growth is flattered somewhat by the lower A$ versus the US$ and EUR and the lower U.S. tax rate. Management expects the services division to be the key revenue growth driver for FY19, as it was for 1H19. Importantly, emerging market growth should remain strong. However, COH cautions growth rates can be variable. For investors focused on the attractive long-term revenue drivers for COH and believing as we do in the company's competitive advantages, occasional sluggish revenue growth can provide attractive opportunities to invest. Product innovation will be key to COH regaining sales growth momentum. In the longer term, we are confident the company's competitive advantages will support its market-leading position. IMR Strongly Negative.

CSL Limited's (CSL) (narrow moat) 1H19 result met our expectations, but the profit mix was slightly different with the turnaround in vaccines a highlight. NPAT increased 6.8% to US$1.16bn, driven by 8.6% higher revenue versus 1H18. Modest compression in the EBITDA margin from 39% to 38.2% reflected higher selling, administration, marketing and research and development costs. CSL is increasing sales and marketing expenditure to support the commercialisation of recent core product launches. Unfavourable currency moves detracted by US$35m. On a constant currency (CC) basis, NPAT was up 10%. We maintain our FY19 NPAT forecast of US$1.93bn. CSL's vaccines division, Seqirus, is tracking slightly better than expected. But for CSL Behring, there were a couple of patches of weakness in albumin and haemophilia. Sales for both product groups declined modestly versus 1H18, however CSL is on-track overall and management expects strong demand growth for its core products to continue. Guidance remains for NPAT of US$1.88bn to US$1.95bn on a CC basis with management expecting results at the upper end of the range, consistent with our forecast. Our fair value estimate increases modestly from $207 to $212 per share, adjusting for the time value of money. Shares are moderately undervalued, trading at a 12% discount. We continue to like CSL's medium-term growth prospects, driven by the commercialisation of the five major new products launched in the past two years. We see further upside from increasing penetration of existing markets, entering new markets and broadening the range of applications. Longer-term, the commitment to research and development (R&D) is key. It should sustain product innovation and support the intangibles-based competitive advantage CSL enjoys in its core CSL Behring division. The Seqirus division continues its turn around and, if anything, is tracking slightly better than we expected. Innovations with CSL's higher-priced quadrivalent flucelvax and fluad vaccines underpinned the strong result. 1H19 EBIT increased 65% from UD$185 in 1H18 to US$304m. Fluad sales more than doubled while data shows flucelvax was more effective than standard egg-based vaccines in preventing influenza-like illness in the 2017/18 US flu season. CSL is investing in manufacturing and distribution capacity to support the strong demand. CSL's unchanged strategy of focusing on five key areas in the application of its intellectual property appeals. Those key areas are immunology, haematology, transplant, respiratory and cardiovascular. R&D is key to continued innovation which currently sees five potential new products in human trials. Management's dedication to R&D is exemplified by its commitment to invest 10% to 11% of revenue annually. IMR Negative.

Healthscope HSO	
Fair Value ($)	2.50 →
Price/Fair Value	0.98
IMR	Neutral

Healius Limited HLS	
Fair Value ($)	3.50 →
Price/Fair Value	0.80
IMR	Neutral

InvoCare IVC	
Fair Value ($)	16.00 →
Price/Fair Value	0.91
IMR	Strongly Positive

Healthscope's (HSP) (narrow moat) 1H19 result was somewhat academic considering the high probability the company will be acquired by Brookfield and that a trading update was provided only two weeks ago. Nevertheless, the result was in line with our expectations and we have maintained our earnings forecasts and fair value estimate at Brookfield's Scheme of Arrangement offer price of $2.50 per share. Revenue of $1.2bn was broadly in line with our full-year forecast of $2.5bn, as was EBITDA of $198m, versus our FY19 forecast of $413m. Management also maintained FY19 EBITDA growth guidance at 10%, which is consistent with our forecasts. As was flagged previously, the Northern Beaches Hospital (NBH) continues to ramp up as expected and will increase group revenue by around 10% by FY21. The balance sheet was stretched during construction of the NBH but leverage is reducing following the NSW Government State Capital Payment and the opening of the hospital. We continue to expect the Scheme Meeting to be held in May or June which is conveniently after AustralianSuper's agreement with BGH ends. This is important as it enables AustralianSuper, Healthscope's second-largest shareholder, to vote in favour of the Scheme which requires the support of over 75% of HSO's shareholders for it to become unconditional. This support may be required if BGH, which owns 19% of HSO, opposes the offer. Brookfield intends to make an off-market takeover offer of $2.40 per share should it fail to exceed the 75% support required but exceeds 50.1%. IMR Neutral.

Healius Limited (HLS) (no moat) reported underlying NPAT of $39m for 1H19, down 10% from 1H18. The weak performance reflected soft market conditions across all divisions, mostly driven by the benign winter flu season. However, we do not expect these conditions to continue and expect volumes to eventually revert toward the historical norm. 2H19 should improve, as efficiency initiatives in pathology and imaging contribute an approximate $10m EBIT uplift. The fully franked 3.8 cents per share dividend, represents an approximate 60% payout ratio we believe can be sustained through the cycle. Management expects FY19 underlying NPAT of between $93m and $98m, slightly below our previous forecast. We trim our FY19 NPAT estimate by approximately 6% to $96m, although our long-term thesis is intact, and we maintain our $3.50 per share fair value estimate. The long-term outlook for HLS' services remains positive, and we forecast high-single-digit EPS growth over the four years from FY20, underpinned by the growing and ageing population, advancements in medical technology, and rising cancer survival rates. Pathology's revenue rose by 3%, reflecting solid fee growth and increases in specialties, although this was offset by softer volumes, which grew by a modest 2%. This volume softness is temporary, in our opinion, and we expect improvement over the remainder of the year, and over the long term we continue to forecast growth of around 4%–5% per year. Disappointingly, EBIT declined by 15% due to softer volume and less favourable mix along with the loss of the bowel screening contracts and higher labour costs. In response to the challenging short-term market conditions, the company is undertaking productivity programs that are expected to deliver savings over the next year helping margins to recover by around 150 basis points to approximately 14% within the next three years. Medical centre EBIT declined by 2%, reflecting doctor departures and a less-favourable mix shift. We forecast improving earnings in the coming years, on the back of a strong pipeline of new doctors and an increasing number of general practitioners, along with cost savings through the transformation program Project Leapfrog. This initiative is aimed at increasing utilisation of the medical centre footprint, by improving appointment management, self-check in kiosks, and online capabilities, which would enable patients to join the queue remotely. Imaging was the strongest-performing division, though it remains the smallest earnings contributor. Within the division, revenue and EBITDA grew by 9% and 13%, respectively, on the back of ongoing strength in CT and MRI modalities, despite the general market softness. This segment should also benefit from ongoing productivity initiatives, along with increased IT investment. IMR Neutral.

InvoCare (IVC) (wide moat) reported a soft, albeit well flagged 2018 result. Operating EBITDA declined by 4% to $119m, in line with our estimates. Underlying NPAT of $50m was below our forecast although this was mainly attributable to higher depreciation and interest expense on the back of the refurbishment program and large number of acquisitions. As cautioned earlier in the year, case numbers were soft, in addition to temporary closures while renovations took place. Given the softer earnings, the final dividend was cut from 27.5 to 19.5 cents fully franked. This resulted in 2018 dividend falling 20% to 37 cents, below our 40 cents forecast. While cutting dividends is not an optimal outcome, we agree with the decision to preserve the balance sheet health as a priority, and we

Ramsay Health Care RHC	
Fair Value ($)	65.00
Price/Fair Value	0.98
IMR	Strongly Positive

ResMed Inc. RMD	
Fair Value ($)	14.20
Price/Fair Value	1.02
IMR	Strongly Negative

continue to forecast an 80% payout ratio going forward, in line with the long-term average. Despite cutting our FY19 NPAT forecast by 7% to $55m, we remain confident in IVC's long-term earnings outlook and maintain our $16.00 per share fair value estimate. Pleasingly, the company flagged improved trading in the Australian funeral business in 4Q18, and early January 2019, signalling a normalisation of market conditions. While the annual death rate can fluctuate, the 3% decline experienced in 2018, driven by the mild winter weather and benign flu season, is abnormally low, and the largest decline in almost 30 years. The probability of two consecutive years of declining deaths is extremely low, and we continue to forecast 2% annual growth on average over the next five years. Beyond this the outlook is even more positive, with the ABS forecasting 240,000 deaths per year by 2034, compared with approximately 160,000 in 2018, supported by ageing demographics. We forecast the top line to grow at around 6% per year on average over the next five years, supported by: (1) a resumption of 1%–2% growth in the number of deaths, (2) a return to around 3% per year pricing increases, which should be achievable as the new shops open and industry volumes grow which should stabilise competitor behaviour, and (3) incremental market share gains. The main question remains whether the Protect and Grow 2020 initiative will deliver the earnings uplift to justify the cumulative $200m outlaid. We believe it will and are encouraged by the strong growth demonstrated by refurbished sites. As revenue resumes growing, operating leverage and efficiency gains should help EBITDA margins to improve from the current 25% back above 26% within the next three years. The soft volume and revenue saw 2018 EBITDA margins contract by around 100 basis points. IMR Strongly Positive.

Ramsay Health Care's (RHC) (narrow moat) 1H19 result was in line with both our expectations and management guidance. We maintain our earnings forecasts and $65 fair value estimate. The share price has risen 16% over the past four months, and at the current price of AUD 64.64, the stock is now fairly-valued. The price and fair value imply a FY20 P/E multiple of 21 and dividend yield of 2.4%, or 3.5% including franking credits. Although RHC is expanding its overseas operations, we expect the dividend will remain fully-franked near term due to the magnitude of the franking balance. Although revenue and EBITDA increased by 15% and 10%, respectively, growth was significantly boosted by the acquisition of Capio. Without Capio, revenue and EBITDA grew by 8% and 7%, respectively, driven by a relatively strong performance from the core Australian business. Management continues to expect recently acquired Capio to be EPS-accretive within two to three years and maintains FY19 EPS growth guidance of "up to 2%", and EBITDA growth of between 10% and 12%. All expectations are broadly consistent with our forecasts. The Australian business accounted for 68% of 1H19 group EBITDA and performed relatively well in a tough environment. Revenue growth of 5% was broadly in line with our full-year forecast of 6%, while EBITDA growth of 6% was above our 4% full-year forecast. Despite an uncertain legislative outlook and falling private healthcare affordability, RHC grew admissions and market share thanks to the quality of its hospital portfolio. Longer term, we continue to believe the business is well placed to benefit from population growth and an ageing population. We expect the division to fall to about 60% of group EBITDA by FY21 following the integration of Capio. The French business, which represented 27% of 1H19 group EBITDA, was boosted by the $1.9bn acquisition of Capio with revenue and EBITDA growing by 26% and 19%, respectively. Excluding Capio, revenue and EBITDA growth were 3% and 5%, respectively. It's also worth remembering RHC only owns 51% of the French business. Capio appears to be performing broadly in line with our expectations. The acquisition makes strategic sense, giving access to new markets while adding modest scale to existing operations in France. Capio will diversify regulatory and business risk as it operates in the Nordic countries (Sweden, Denmark, Norway) and France and Germany. Aside from Capio, the French business performed satisfactorily, with modest revenue growth and margin expansion in an uncertain regulatory environment. RHC is in reasonable financial shape, but we caution RHC has sizable operating lease obligations. However, on a "look through" basis, which excludes nonrecourse debt within the 51%-owned French business, the net debt/EBITDA ratio is 2.1, which we think is manageable given the defensive nature of the business. Much of the debt does not mature until 2022, so we don't believe the group faces a material near-term refinancing risk at this stage. IMR Strongly Positive.

ResMed Inc. (RMD) (narrow moat) 2Q19 results were below expectation. Strong momentum in mask sales continued, while device sales, particularly outside the Americas, disappointed. Although the strong sales growth in the small software-as-a-

Sonic Healthcare SHL	
Fair Value ($)	25.50 ↑
Price/Fair Value	0.96
IMR	Neutral

BHP Billiton BHP	
Fair Value ($)	25.50 →
Price/Fair Value	1.48
IMR	Neutral

service business was impressive, RMD's earnings and moat are underpinned by its core sleep apnoea business, which enjoys switching costs and a commanding market share. With little change in the A$/US$ exchange rate, our fair value estimate for the Australian CDI remains $14.20. The core devices business was sluggish, growing just 3% on 2Q18 on a constant-currency basis. In U.S., Canada, and Latin America devices, sales growth of 7% was offset by declining revenue in the Rest of the World markets, with France and Japan particularly challenged following digital health upgrade systems. Year-to-date sales growth in the segment of 8% tracks our unchanged estimate of 8% sales growth in FY19. Longer term, we expect RMD can expand the devices business at a high-single-digit compound annual growth rate over the five years to 2023 as it increases its share of an unpenetrated and hence growing market. The masks business increased revenue 10% on 2Q18 on a constant-currency basis. The favourable shift in product mix, along with manufacturing efficiencies, allowed RMD to enjoy a 70-basis-point expansion in gross margin from 58.2% in 1Q19 to 58.9%. We continue to expect masks to grow at a low-double-digit CAGR over the five years to FY23. Recent acquisitions of MatrixCare and Propeller Health for US$975m pushed net debt to US$1.05bn, with RMD suspending its share buyback. Nevertheless, the levels of debt remain comfortable. A US$0.37 of dividend per share was declared. IMR Strongly Negative.

Sonic Healthcare's (SHL) (narrow moat) positive outlook on the potentially "company transformative" Aurora Diagnostics acquisition was hard to ignore when management released 1H19 results. We make minor upward adjustments to earnings assumptions due to upgraded guidance provided on the back of this acquisition, which increases our fair value estimate 6% to $25.50. The 33 cents per share dividend is marginally higher than 1H18's 32 cents of 1H18. Top line group revenue growth was healthy, albeit in line with previous guidance, but lower margin contract wins resulted in slightly lower growth rates across operating earnings. On a constant currency (CC) basis, group revenue was up 4.8% on 1H18 to $2.8bn. This flowed through to underlying EBITDA growth of 3.4% to $467m and NPAT growth of 2.6% to $214m. This largely reflected the pickup of lower margin revenue contracts, such as National Health Service in the UK, as well as consumable cost increases and some slightly weaker underlying pricing. Among other factors, SHL's targeting of both high-margin private and low-margin nonprivate contracts globally makes group margin estimation difficult, so we assume a relatively steady state through our forecast period. Management went to great lengths to highlight the potential company transformative nature of the Aurora Diagnostics acquisition, giving a potential taster with earnings guidance hiked as a result—albeit not markedly different from previous guidance. Specifically, FY19 underlying EBITDA growth was upgraded to 6%–8%, on a CC basis, which compares with pre-Aurora Diagnostics acquisition guidance of 3%–5%. The revised EBITDA guidance moves forecast FY19 EBITDA to a midpoint of just over $1.02bn on a CC basis. Strong organic growth within Australia and the US laid the foundations for this result. Australian Pathology revenue displayed an encouraging 6% organic growth. We accordingly upgrade our earnings growth assumptions in this segment. The US also displayed healthy top line revenue growth of 6%, on a CC basis. Similarly, we adjust our earnings growth assumptions slightly upwards to reflect the more optimistic US outlook, which includes the Aurora Diagnostics-driven earnings upgrade. Germany, on the other hand, experienced flat organic revenue growth, which management attributed to the European heat wave and regulatory changes. Our less optimistic growth outlook in Germany leaves our growth assumptions unchanged, tracking at 3.0% per year through our forecast period. Keep in mind, Germany has grown enormously in recent years to become SHL's third-largest division. IMR Neutral.

Materials

BHP Billiton's (BHP) (no moat) 1H19 adjusted NPAT of US$4bn was in line with 1H18. Adjusted earnings per share were also flat versus a year ago at US$0.76. BHP's shares have risen with the Vale disaster and the subsequent rise in the iron ore price. Higher commodity prices and increased investor risk appetite have also helped. There may be more upside in iron ore than we have factored in, but there is also a risk that further production disruptions could frustrate BHP's efficiency efforts. For now, we maintain our $25.50 per share fair value estimate. Higher near-term prices are likely to incentivise an eventual supply response. We can see additional iron ore supply coming from Vale as it eventually recovers, Anglo American in Brazil, and Samarco once it restarts, though the timing of these events is uncertain. More broadly, we still expect China's steel demand to decline and for scrap to account for a greater proportion of supply. Our FY19 adjusted earnings forecast falls modestly to US$2.20 per share. We lower our expectations for copper production slightly, with Escondida tracking

Fortescue Metals Group FMG	
Fair Value ($)	4.50 ↑
Price/Fair Value	1.47
IMR	Strongly Positive

Rio Tinto RIO	
Fair Value ($)	55.00 →
Price/Fair Value	1.76
IMR	Neutral

towards the lower end of guidance. The effective tax rate of 36% was also higher than we expected, and we raise our full-year forecast. Regardless, a much stronger second half will be needed to hit our earnings forecast. There's potential for near-term upside though from high iron ore prices if sustained. If the second half averages US$85 per tonne, versus our US$65 per tonne forecast, adjusted earnings would rise by 14% or US$0.31 per share. EBIT of US$7.3bn was in line with 1H18 but EBITDA declined 10% to US$10.1bn. At the divisional level, underlying EBITDA increased 38% for petroleum to US$2.3bn, coal by 17% to US$1.8bn and iron ore by 1% to US$4.3bn compared with 1H18. Copper was the laggard with EBITDA falling 40% to US$1.9bn. The better petroleum performance primarily reflected higher prices, but the division also delivered solidly on production and unit costs. Coal benefited from higher coking coal prices and volumes. Productivity in iron ore offset the slight reduction in the average realised price. The weaker copper EBITDA primarily reflected the lower average copper price. Costs and volumes also detracted though with the decline in grade at Escondida and several outages impacting. BHP remains in strong financial shape. Free cash flow of US$7.6bn benefited from US$6.9bn of proceeds from the sale of U.S. onshore shale. This represents the bulk of the expected aftertax payments of about US$10.7bn. Cash from the sale was returned via the off-market buyback and the US$1.00 per share special dividend. The US$0.55 per share fully franked dividend may have disappointed. However, with BHP's capital allocation strategy clear and the near-term call on cash flow for capital expenditure relatively modest, we think a large final dividend is probable. We forecast FY19 dividends of US$2.80 per share, including the US$1.00 special. Net debt of US$9.9bn is below the stated target range of US$10 to US$15bn and dividends appear the logical outlet for excess cash. IMR Neutral.

Fortescue Metals Group's (FMG) (no moat) 1H19 NPAT declined 5% to US$644m versus 1H18. However, that comparison masks a significant sequential lift. Adjusted profit was up 66% against 2H18, reflecting lower product discounts. The better realised iron ore price saw EBITDA margin expand 24% to US$21 per metric ton versus 2H18. Unit costs were challenged, a function of lower volumes. We expect unit costs to improve with much stronger volumes expected in 2H19. But we've lifted our overall near- and medium-term cost assumptions with 1H19's actuals. We raise our fair value estimate from $4.20 to $4.50 per share. The increase reflects higher near- and medium-term earnings. A faster-than-expected convergence in iron ore price discounts for FMG's lower grade product, compared with the benchmark 62% index, is the primary driver. At its worst in 2018, FMG's ore received an approximate 50% discount relative to the 62% index. This has subsequently shrunk to around 15%, slightly better than our unchanged 17% long-term assumption. Reduced discounts for lower grade ore reflect a renewed focus on raw material input costs for steel makers. Lower steel maker margins have again seen those companies focus on minimising unit costs through lower cost inputs, rather than maximising steel volumes with higher grade raw materials. We consequently lower our assumed discounts for FMG's ore relative to the 62% benchmark. In FY19, it's now 30% versus 35% previously and 40% in FY18. For FY20 to FY22, we now assume an average 21% discount down from 25% previously. A modest increase in near- to medium-term unit costs is a partial offset, but longer term, we still expect incremental cost efficiencies through innovations such as automation. As a result of the cost and price discount changes, we raise our earnings forecasts by 15% to US$0.58 per share in FY19 and by 18% to US$0.52 per share in FY20. Dividends were a feature with a 19 cents per share ordinary and an 11 cents per share special, both fully franked. This was up from 11 cents per share in 1H18. The increased payout reflected the much stronger financial position and the improved outlook given the higher iron ore price and lower discounts. Net debt sits at US$3bn, down from US$3.3bn a year ago. EBIT interest cover is a comfortable 7.9 and annualised net debt/EBITDA sits at 0.9. We see scope for further modest debt reduction, but a relatively limited call for capital investment from the core business. Rather than undertaking another round of large-scale investment, FMG remains focused on extracting efficiencies and volumes from the current asset base. In addition, exploits outside iron ore are long-dated and limited to early stage exploration. These are relatively modest investments. Therefore, we expect excess cash to most likely be returned to shareholders.
IMR Strongly Positive.

Rio Tinto's (RIO) (no moat) Dividends dominated Rio Tinto's 2018 result, the company paying a US$2.43 per share special dividend with the proceeds from asset sales. Most of this was from the exit from coal. A final dividend US$1.80 per share took the 2018 pay out to US$5.50 including the special dividend. RIO's financial position is very

Iluka Resources ILU	
Fair Value ($)	10.50 →
Price/Fair Value	0.86
IMR	Neutral

South32 Limited S32	
Fair Value ($)	2.80 →
Price/Fair Value	1.39
IMR	Positive

strong with net cash of US$0.3bn at end 2018. On an adjusted basis, net debt is US$8bn after including the upcoming dividend and tax payments and the remaining share buyback. Adjusted NPAT of US$8.8bn was slightly ahead of 2017's US$8.6bn. Underlying EBITDA declined from US$17.4bn to US$17.2bn, excluding the earnings from the discontinued coal operations. The 3% lower iron ore price was the primary driver of the 2% decline in iron ore EBITDA to US$11.3bn. Aluminium EBITDA declined 10% to US$3.1bn with higher costs more than offsetting the benefit of higher prices. Higher copper production was the primary driver of a 46% increase in EBITDA for copper and diamonds. Productivity gains via volumes and cost efficiencies were generally offset by inflation. RIO aims to gain further productivity benefits of US$0.6bn in 2019, though we expect a large portion of the benefits to be offset by slowly rising industry inflation. Peers are also engaging on similar productivity-based initiatives. We retain our $55 per share fair value estimate and the shares remain overvalued. Commodity prices, particularly for steel making materials, are elevated. Our expectation China is unlikely to continue to support excessive investment activity through ever-increasing debt is the key reason for overvaluation. Lower fixed asset investment (FAI) in China is likely to have an outsize impact on demand for steel and iron ore. Iron ore accounts for about 65% of RIO's earnings. Lower FAI should also slow demand growth for copper and aluminium, which account for most of non-iron ore earnings. IMR Neutral.

Iluka Resources' (ILU) (no moat) 2018 adjusted NPAT more than tripled to $304m versus 2017's $96m. It was a strong result and better than our $254m forecast with non-production related costs less and revenue better than expected. The impressive uplift was driven by higher prices, which added $265m to NPAT. The realised zircon price rose 41% to $1,321 per tonne and rutile 21% to $952 per tonne. Higher unit costs and lower sales volumes were partial offsets, detracting $56m from net profit. Despite the stronger-than-expected result, we maintain our $10.50 per share fair value estimate. Guidance for 2019 volumes and costs was weaker than we expected. Management is focused on stabilising operations and delivering consistent performance at Sierra Rutile after an unreliable and strike affected 2018. We suspect there may be a touch of conservatism in the guidance for rutile output and unit costs in Sierra Leone. Regardless, the outlook is weaker in the near term. We lower our 2019 forecast by 16% to $349m or 83 cents per share. Like many of its mining peers, ILU is in strong financial shape. The balance sheet now has modest net cash versus about $180m net debt a year ago. The improvement reflected a 51% increase in net operating cash flow to $627m driven by higher prices and a modest drawdown of inventories. Lower inventories contributed $86m to cash flow. ILU also paid very little cash tax in the period, but this timing issue will resolve in 2019. The final dividend of 19 cents per share fully franked brought the 2018 payout to 29 cents, down marginally on 2017's 31 cents per share payout. Dividends in 2017 were abnormally high, with the outlook for market conditions and prices set to improve and capital expenditure requirements low at the time. ILU is now in period of elevated capital expenditure, which necessitates a lower dividend payout. ILU expects to invest $330m in 2019, primarily to complete the Cataby mine and Sierra Rutile expansions at Gangema and Lanti. All major developments are on schedule and budget. The feasibility study for the Sembehun deposit in Sierra Leone is also due this year. Early works for the development looks likely to start in 2019. IMR Neutral.

South32 Limited (S32) (no moat) delivered solid 1H19 results with 18% growth in adjusted NPAT to US$642m versus 1H18. The performance was largely driven by record production in Australia Manganese and higher commodity prices. Underlying EBIT grew 28% to US$925m, with higher prices adding US$223m and volumes US$216m versus a year ago. Production guidance is unchanged, and output is tracking in line with our expectations. In its updated guidance, management generally lowered unit costs to reflect favourable currency changes. FY19 capital expenditure guidance was also modestly reduced. However, lower costs are not enough to alter our $2.80 per share fair value estimate. The balance sheet is in good shape with about US$700m net cash, however, capital management is still a focus. S32 declared a 1H19 dividend of US$ 5.1 cents per share and special dividend of US$ 1.7 cents per share, both fully franked and broadly in line with 1H18. S32 returned US$511m to shareholders in the half through dividends and buy-backs. Of the company's US$1bn capital management program, US$127m remains to be returned to shareholders by 10 April. S32 remains overvalued. Commodity prices remain the key driver of shareholder returns. Many of the company's key commodities trade well above our estimated long-term marginal cost, namely manganese, alumina, and metallurgical coal,

Oil Search OSH	
Fair Value ($)	6.60 →
Price/Fair Value	1.24
IMR	Neutral

Santos STO	
Fair Value ($)	7.85 →
Price/Fair Value	0.91
IMR	Neutral

suggesting earnings are above sustainable levels. Further, continual expenditures are needed to offset depletion and the cyclical and capital-intensive nature of the industry adds risk. Buoyant commodity and share prices do not reflect our view China's economic growth will shift toward less commodity consuming activities, which will drive down prices. IMR Positive.

Energy

Oil Search's (OSH) (no moat) reported a 13% increase in 2018 NPAT to US$341m, in line with our expectations. 2018 dividend was US$ 10.5 cents per share near expectation. We marginally reduce our 2019 EPS forecast from 31 to 30 cents following updated guidance for exploration and evaluation expenditure of US$235m–US$285m, higher than we previously anticipated. Our 2019 production forecast is unchanged at 29.6 million barrels of oil equivalent (mmboe) near the midpoint of 28.0–31.5 mmboe guidance. This is a 20% increase on 2018's earthquake-impacted performance, and back to prior years' levels. Our US$13.20/boe unit operating cost assumption is also at the midpoint of 2019 guidance, excluding administration expense. Our unchanged $6.60 fair value estimate equates to a 2023 EV/EBITDA multiple of 7.8, excluding $1.40 for Elk/Antelope resources and 35 cents for Alaska Slope. Existing producing PNG assets comprise $3.25 or approximately 50% our fair value estimate after allocating the full $2.60 in group net debt. Our assumption for expansion at PNG LNG contributes $1.60 or 25% of fair value. We credit full value for OSH's 8.0Mtpa expansion aspirations via three new 2.7Mtpa trains at PNG LNG. These will double PNG LNG's capacity by 2023 and increase group production by 80% from a non-earthquake-impacted 29.5 mmboe base to over 53 mmboe. We consequently forecast 15.5% five-year EBITDA CAGR to US$2.1bn by 2023. This is marginally ahead of OSH's 2024 target, assuming they will do better. We assume an unchanged midcycle Brent crude price of US$60 per barrel and an A$/US$ exchange rate of 0.72. Our fair value ascribes above-average risk to equity and incorporates a 3.0% sovereign risk premium for PNG. Removing the premium would increase our fair value by 35% to $8.90, somewhat above the share price, though only to 3-star or Hold territory. Also, apparently not considered by the market is net debt, or if considered, then chiefly the positive side of the ledger. Net debt of a hefty US$2.8bn was down 12% from US$3.2bn levels at end June 2018, but net debt/EBITDA is still high at 2.8 and the company heading into capital expenditures for PNG LNG expansion. We don't anticipate net debt/EBITDA falling below 1.0 until 2025, after peaking at 3.5 in 2021. IMR Neutral.

Santos' (STO) (no moat) 2018 result held no real surprises. Including a month's Quadrant earnings for the first time, the company reported underlying 2018 NPAT up 116% to US$727m, well ahead of our US$585m expectations. However, this includes a US$146m favourable foreign exchange gain which if excluded brings the result back to near in line with forecast. Net operating cash flow up 44% to US$1.6bn was only marginally ahead of our US$1.5bn expectations. The fully franked US$ 6.2 cent 2H dividend took 2018 dividends to US$ 9.7 cents on a modest 28% payout. This was ahead of our US$ 7.8 cent target. We make no change to our $7.85 fair value estimate. STO had an excellent year and is in great shape to deliver earnings growth going forward. The company is driving costs lower, despite higher energy prices, in a turnaround that began three years ago. All its assets are free cash flow-positive at less than US$40 per barrel oil prices and the target for 2019 is a free cash flow breakeven at less than US$35 per barrel. That's despite 2019 guidance for US$1.1bn in capital expenditure, up sharply from 2018's US$759m. The average free cash flow break-even in 2018 was just US$31.80. Those creditably low costs were achieved despite both planned and unplanned shut-downs, including PNG earthquake. Management still targets production growth to greater than 100 mmboe by 2025 versus 58.9 mmboe in 2018. Our model fully credits that being achieved. Pleasingly, STO says it can fund that growth, in addition to pay dividends, out of free cash flow at a long-term US$65/bbl oil price. Unchanged 2019 production guidance is for 71–78 mmboe, capturing a significant boost from a full year of Quadrant. We sit at the high end of the range, confident given the recent strong record. Our comfort to credit such production levels is supported by growth projects and favourable activity on STO's part. Upstream unit production costs came in at US$8.17 per boe in 2018 and guidance for 2019 is for an improved US$7.50–US$8.00 per boe. Cooper Basin unit production costs were down 12% to US$8.17/boe. STO is drilling an increasing proportion of horizontal wells to lower unit production costs. Equity gas production continues to build at GLNG and Quadrant integration synergies are advancing. Quadrant delivers high margin gas production with CPI linked contracts. In conjunction with growth projects including PNG LNG expansion and Barossa backfill to Darwin LNG, we see little reason to doubt production expansion to 100 mmboe. That doesn't

Woodside Petroleum WPL	
Fair Value ($)	46.50
Price/Fair Value	0.77
IMR	Neutral

Newcrest Mining NCM	
Fair Value ($)	23.00
Price/Fair Value	1.06
IMR	Neutral

include appraisal of the exciting Dorado oil discovery which came with Quadrant, nor ultimate expansion potential at GLNG. Appraisal of the Dorado discovery is planned for 2019 to be followed by a look-alike target at Roc South. Net debt of US$3.6bn reflects the US$2.15bn purchase of Quadrant. Somewhat elevated net debt/EBITDA of just over 2.0 is manageable and we expect it back to 1.0 levels by as soon as 2022. IMR Neutral.

Woodside Petroleum (WPL) (no moat) reported a strong 50% increase in underlying NPAT to US$1.42bn, 6% below our more bullish US$1.5bn expectation. Net operating cashflow of US$2.74bn, however, was in line with expectations. The modest NPAT miss was due to slightly higher than expected unit operating costs, which on our measure came in at US$12.75 per barrel of oil equivalent (boe), versus the US$12.25 per boe we anticipated. We see no material consequence going forward and our longer-term assumptions stand; including 40%-plus production growth to 130 million barrels of oil equivalent (mmboe) by 2024, a midcycle Brent crude price of US$60 per barrel, and midcycle operating costs of US$10.30 per boe. These support a healthy 4.5% 5-year EBITDA CAGR to US$4.7bn by 2023 versus 2018's US$3.8bn. The key driver of assumed production growth is the Pluto/ Scarborough LNG expansion. Our fair value already fully credits $5.00 per share for a second Pluto LNG train. The surprise was payment of an outsize US$ 91 cents final dividend versus our US$ 81 cents forecast. The 100% payout ratio is well ahead of the unchanged policy of paying out 80% of underlying earnings and brings the 2018 dividend and payout ratio to US$1.44 and 93%, respectively. WPL justified the higher payout on stronger than originally budgeted production and oil prices, but also because its large franking balance is at risk from potential regulatory changes with the federal election looming. We applaud the move, which speaks to the quality of management though not to the point of shifting our Standard stewardship rating. The growth strategy looks to be increasingly well aligned with market conditions. It points to growing demand for long-term gas contracts, including a 40% increase in Chinese LNG demand. Asian growth is being driven by clean air policies and urbanisation while European growth is driven by rising carbon prices and declining domestic supply. WPL notes 230Mtpa of additional LNG supply will be required by 2030. This is in broad step with our own views. WPL is preparing for final investment decisions on its Pluto Train 2 and Browse gas projects in 2020. The balance sheet remains strong, net debt of US$2.4bn down from US$3bn at end June 2018 and US$4.7bn this time last year. Net debt/EBITDA is just 0.65, positioning WPL appropriately for upcoming capital expenditures. However, even maintaining the 80% payout ratio, we still only project peak net debt/ EBITDA of just 1.5 in 2022 and rapid return to sub-1.0 levels by as soon as 2024. Current debt facilities have a favourable five-year average duration of which the drawn fraction has even higher 6.5-year average duration. Cost of debt is a competitive 3.9%. IMR Neutral.

Gold

Newcrest Mining's (NCM) (no moat) 1H19 adjusted NPAT doubled to US$237m versus 1H18. The result was stronger than our US$226m forecast, the difference unrealised foreign exchange gains. Stripping out these gains, NPAT was as expected. A strong improvement in production volumes at Cadia and lower unit costs at Lihir underpinned the result. Gold output was up 6% and copper 33%, while group all-in-sustaining costs declined 13% to US$747 per ounce. Higher profit came despite a headwind from lower prices. NCM's realised gold and copper prices were down 5% and 7%, respectively. With the result as expected, our $23 per share fair value estimate is unchanged. Management reaffirmed FY19 guidance for production and operating costs. Guidance is to produce 2.35 to 2.60 million ounces of gold and 100,000 to 110,000 tonnes of copper. The guidance midpoints represent a 5.5% uplift in gold and 35% rise in gold production versus FY18. As we had already forecast, management now says capital expenditure will be towards the bottom of the guidance range, in part helped by favourable currency moves. Lihir and Cadia remain the long-life engines. Incremental expansions at Lihir remain on track with the company expecting to achieve annualised processing plant throughput of 15 million tonnes (mt) per year from mid-2019. We continue to see long-term upside to Lihir's production volumes and unit costs, underpinned by the large, long-life orebody and technological innovation. The study for the planned expansion of Cadia to process 33 mt of ore per year is expected to complete in late 2019. It's a valuable, low-capital cost option to partly offset the planned grade decline. The primary focus on organic growth, as exemplified by the expansions of Lihir and Cadia, has been key to the improved financial results. We see a longer-runway there through the application of technology to the company's large resource base. Successful greenfield exploration is a major reason

Aurizon AZJ	
Fair Value ($)	3.80
Price/Fair Value	1.22
IMR	Neutral

Monadelphous MND	
Fair Value ($)	10.50
Price/Fair Value	1.71
IMR	Positive

why NCM has the long-life orebodies and development options it enjoys today. We also think partnering with junior explorers at an early stage makes sense. The strategy importantly minimises the entry cost while allowing NCM to leverage its exploration expertise. Key will be to quickly and efficiently distinguish the valuable joint ventures from the chaff. IMR Neutral.

Mining Services

Aurizon's (AZJ) (narrow moat) 1H19 earnings have been hit hard after implementation of new, lower regulated tariffs in the network division. Group underlying EBIT fell 16% to $406m and NPAT fell 19% to $227m. Dividend was cut 19% to 11.4 cents per share, based on a 100% payout ratio. Earnings are tracking below our prior forecast, but this just reflects timing of tariff implementation. We downgrade our FY19 earnings forecasts, but our longer-term forecasts are largely unchanged. We keep our $3.80 fair value estimate and consider the stock marginally overvalued. AZJ has a tough outlook and is not a preferred investment. The company has a narrow economic moat, but competitive advantages are weakening due to tough regulation and increasing competition. There is a risk AZJ may raise equity in 2019 to get gearing back to target levels. The above-rail haulage division—comprising coal and bulk—is tracking in line with expectations, and full-year EBIT guidance of $390m to $430m is unchanged. EBIT in the coal haulage business fell 6% to $210m. Volumes were down 1%, with strikes and bad weather mainly to blame, while operating costs rose 8% due to increased maintenance and higher operating costs to support new contracts. The 2H should see improvement in volumes as new contracts start, with FY19 guidance for 215 to 225 million tonnes reconfirmed. Bulk haulage EBIT fell 30% to $14m after Cleveland-Cliffs Inc ceased iron ore mining in Australia and terminated its haulage contract. Grain volumes were also down as the drought continues without respite. 2H19 earnings will be even worse on the full period impact of the Cliffs termination and closure of one of Mt Gibson's iron ore mines. Longer-term performance should improve on cost-out initiatives and new contracts. The turnaround of the bulk business has a long way to go—1H19 EBIT margin was just 5%. To put in perspective, EBIT margin was 34% in the coal haulage business. The network division was the worst performer, with EBIT down 18% to $203m after the regulator cut tariffs. The regulatory environment is tough, and we don't believe allowed returns adequately compensate the rail network for substantial longer-term risks stemming from its complete reliance on the coal industry. Unfortunately, AZJ has limited ability to dispute regulatory decisions. Maintenance-dominated capital expenditure is guided to $480m–$520m in FY19 and around $500m in FY20. On the surface, the financial position appears sound with forecast FY19 net debt/EBITDA of 2.4 times. However, gearing is above management's 40% target ratio at 42.4% and heading in the wrong direction. Management is currently reviewing the capital structure, often a precursor to an equity raise. It wouldn't be ideal for an equity raise after buying back shares in FY18 and having a 100% dividend payout ratio. Nonetheless, an equity raise of a few hundred million dollars wouldn't surprise. IMR Neutral.

Monadelphous (MND) (no moat) reported an 18% decline in 1H19 NPAT to $31m, close to our $32m expectation. Revenue of $830.5m was slightly higher than anticipated and down 5% on 1H18. But EBITDA margin was softer than expected, down from 7% to 6.5%. There was a significant increase in maintenance revenue, up 25% on 1H18 to $503m as on-and off-shore oil and gas maintenance contracts ramped-up; and margins on maintenance are often lower than for new construction. The engineering construction segment, however, recorded a sharp 30% decline in revenue to $332m, with the Ichthys onshore LNG facilities finished. Ichthys' run-off is forecast to result in lower construction revenue in FY19 and 10% less group revenue. Our little changed FY19 group revenue forecast of $1.61bn is in line with this guidance. Our $10.50 fair value is unchanged. MND has secured $770m of new contracts in FY19 to date. This is less than the 1H19 revenue required to be replaced. Despite this, we stick with our optimistic enough 4.8% 5-year EBITDA CAGR forecast of $150m by FY23. Management says the resources sector continues to strengthen, with energy to follow. It expects opportunities to generate significant new construction revenue in FY20 and beyond. The sentiment is in line with our own, which anticipates an increase in sustaining capital works in the resources sector following an unsustainable period of deferment. But we continue to be less optimistic than the market. MND retains a healthy $166m net cash position, although it declined for the past three halves from $228m at end FY17. Maintaining a high dividend payout ratio largely accounts for the decline, and the as expected 25 cents 1H19 dividend equates to another $33m outgoing. Assuming maintenance of the 80% payout going

CIMIC Group CIM	
Fair Value ($)	34.50 →
Price/Fair Value	1.46
IMR	Neutral

Downer EDI DOW	
Fair Value ($)	5.70 →
Price/Fair Value	1.34
IMR	Negative

Lendlease LLC	
Fair Value ($)	15.20 ↓
Price/Fair Value	0.88
IMR	Strongly Negative

forward, our forecasts don't envisage a change in trend to the declining net cash position, though the fall is modest to a still healthy $145m by FY23. We think it advisable for contractors to retain a net cash position, given the ever-present danger of a contract turning sour. IMR Positive.

Engineering & Construction

CIMIC Group (CIM) (no moat) reported an 11% increase in underlying 2018 NPAT to $781m, marginally ahead of our $761m forecast, and at the top end of guidance. The modest beat reflects slightly better than anticipated revenue growth from all three major segments including construction, mining and services. Higher than anticipated net interest charge was only a partial offset. Net finance costs increased mainly due to a reduction in interest from shareholder loans to BIC Contracting and an increase in the general level of bonding to support growth. We make no change to our $34.50 per share fair value estimate. NPAT guidance for 2019 is set at $790m–$840m subject to market conditions, which would equate to an increase of between 1.2% and 7.6%. Our forecast is unchanged at a guidance high-end $840m or $2.59 per share. CIM has announced several large contract wins. These have been coming at a combined average magnitude of approximately $600m per week, triple a five-year historical average nearer $200m. An increase was anticipated and necessary in support of our revenue growth assumptions, but the pace we think supports guidance high-end growth. Our 2020 EPS forecast is $2.72. The full-year DPS of $1.56 increased by 16% and equates to a moderate fully franked 3.4% yield at the current $45.90 share price. We project DPS to increase at a five-year CAGR of 2.8% to $1.79 by 2023. That would equate to a nominal yield of 3.9% at the current share price, but just 2.5% in real terms and less compelling. IMR Neutral.

Downer EDI (DOW) (no moat) reported a just 2% increase in underlying 1H19 NPAT to $115m, 14% below our $134m forecast. But its underlying FY19 NPAT guidance is unchanged, suggesting a significantly stronger 2H than we'd envisaged. We trim our underlying FY19 NPAT forecast by 3% to a guidance-equalling $291m or 49 cents per share, but our fair value is unchanged at $5.70 per share. one year's earnings does not a fair value make. At $7.30, we think the market credits a too-high midcycle EBITDA margin nearer 9%. That and/or revenue growth we just don't see. We clearly see less net revenue growth potential in focus areas than the market does. For example, we believe government infrastructure spending is nearing peak. The as-expected 1H19 DPS of 14 cents increased by 8% and equates to a moderate annualised fully franked 3.8% yield at the current $7.30 share price. We project DPS to increase at a five-year CAGR of 6.5% to 37 cents by 2023. That would equate to a nominal yield of 5.0% at the current share price, but just 3.2% in real terms and less compelling. DOW's strategic focus on services has reduced earnings contribution from construction-related activities to just 17% of group. Urban services businesses of transport, utilities and facilities (Spotless) leverage DOW to population increases, government outsourcing, and technology. Work-in-hand favourably increased by 3.5% to $43.5bn. The gains were substantially in transport services including rail, though visibility is clouded by yet more changes to segment reporting. Chiefly the rail segment is now being included as part of the transport segment, among several lesser reshuffles. But as a function of annualised 1H revenue, work-in-hand represents a modest decline to 3.4 years from 3.5 six months ago. 1H19 revenue grew by 9% to $6.3bn. Net operating cash flow was solid, up 11% to $340m, though not sufficiently to stop net debt from climbing marginally to $931m. While this is still modest leverage of just 7%, net debt/EBITDA of 1.2, or 2.1 if operating leases are included, a company operating in the contracting space probably shouldn't have any net debt at all given the industry's vagaries. For instance, Cimic with its net cash position is in a far stronger position. We don't project DOW to be net debt-free until very late this decade, a legacy of FY17's $1.3bn Spotless acquisition. Weighted average debt duration is relatively short at just 3.8 years. IMR Negative.

Lendlease (LLC) (no moat) reported 1H19 earnings of $16m, down from $426m in 1H18 due to foreshadowed $500m of anticipated losses on multiple engineering projects. Leading on from this, LLC has decided to exit its Engineering and Services businesses and over the next six months work out the optimal approach to sell or separate engineering from the broader business. This is quite a back flip, as management had previously flagged the engineering business benefited from competitive advantages and was essential to its integrated model. Management's indicative pretax separation costs of $450m–$550m are materially above what we would have expected. We estimate only $100m of this relates to ordinary separation costs related to staff, technology, and bankers. We speculate the balance of $350m–$450m relates to

News Corporation NWS	
Fair Value ($)	21.50
Price/Fair Value	0.88
IMR	Neutral

Nine Entertainment NEC	
Fair Value ($)	2.00
Price/Fair Value	0.85
IMR	Strongly Positive

"concluding customer contracts," a euphemism for warranties LLC will need to provide on further underperforming or high-risk projects. We adjust our forecasts to assume the Australian Engineering and Services business is exited in June 2020. The high separation costs, net outflows of $500m to complete previously impaired projects, and an estimated $300m reduction in net working capital underpin our view of a net loss on exiting the business. We also cut our growth assumptions in Australian development but raise growth expectations for development in the U.S. and U.K. to reflect recently secured large and long-tailed urban regeneration projects in the U.K. and escalation in development activity in the U.S. We also slightly reduce LLC's weighted average cost of capital from 9.4% to 9.2% to account for a slightly lower level of risk going forward. Our fair value estimate for no-moat LLC declines to $15.20. We continue to view the fund management operations as the most attractive part of the broader business. External assets under management were up by over 20% in the past year to $34bn. Further strong growth, albeit at a slower rate, is assured, underpinned by a commercial pipeline that will see $6.1bn of office building complete over the 3.5 years to June 2022 in Melbourne, Sydney, and Singapore. A major positive of the business is urban regeneration, where contracts with councils support an attractive return on equity and modest risk. IMR Strongly Negative.

Traditional Media (Print & Television)

News Corporation's (NWS) (no moat) 13% lift in 2Q19 normalised EBITDA to US$374m belied subdued performances in key units. Normalised NPAT, fell 18% to US$103m or EPS of US$ 18 cents, with a dividend of US$ 10 cents unfranked. We maintain our US$15.30 fair value estimate (A$21.50), albeit we trim our near-term EBITDA forecasts by 2% on average. We see the gap between our fair value and market price closing as the market becomes more comfortable with the potential of the digital-centric divisions (digital real estate, books) to hold the fort, while the structurally-challenged divisions (news and information, subscription video services) transition to more digital-led models. While consolidation of 65%-owned Foxtel's earnings drove the headline lift, the pay TV operator's underlying EBITDA more than halved to US$54m. The near-term cost of transitioning to a hybrid model took its toll, with a fall in traditional set-top-box subscribers and the costs incurred to stem this trend (content, marketing) and to launch new products (Foxtel Now, Kayo) exerting pressure. The volatility in news and information services earnings also continued, with normalised EBITDA down 15% to US$120m, mainly driven by weak UK advertising. To cap it off, the mere 2% rise in digital real estate EBITDA to US$121m was the lowest quarterly growth in three years, hampered by soft trading conditions in both US and Australia. The book division is continuing its renaissance, posting another 13% increase in EBITDA to US$88m, the sixth consecutive quarter of growth. Of the two structurally uncertain units, investor concern appears to be increasingly focused on the subscription video services, particularly the Foxtel pay TV business. Foxtel's EBITDA has slumped from US$932m in FY13 (EBITDA margin of 29.3%) to US$406m in FY18 (EBITDA margin of 17.8%). Our current forecasts for Foxtel are certainly not heroic, projecting an average annual EBITDA decline of 4% over the next five years, with margin settling at 17.0%. As for the news and information unit, digitisation is progressing well. Nowhere is this more evident than in Dow Jones and The Wall Street Journal (WSJ), where digital advertising and subscription revenues are offsetting print advertising revenue decline. IMR Neutral.

Nine Entertainment's (NEC) (no moat) 1H19 result was affected by the noise and impact created by the Fairfax merger. Reported 1H19 group NPAT was down 1% to $172m, inclusive of seven months contribution from Fairfax assets. Excluding the assets to be sold, "continuing business" group EBITDA lifted 6% to $252m while NPAT increased 5% to $126m, equating to EPS of 7.4 cents, also up 5%. The five cents dividend represents a payout of 68%. But we highlight three key points from the result, all of which support our unchanged $2.00 fair value estimate for the enlarged group. First, FY19 earnings guidance is reassuring. The projected 10% minimum uplift in group EBITDA (on a continuing business basis) to $420m is broadly in line with our expectations, if we exclude likely earnings from the to-be-sold businesses of around $65m from our $481m EBITDA forecast. Management's willingness to provide guidance while integrating the Fairfax engenders confidence. Second, the weakness in the result was primarily from businesses earmarked to be sold, with Fairfax's regional/community and New Zealand newspaper EBITDA down 37% year-on-year to $38m. The crown jewel of the Fairfax stable, 59.4%-owned Domain is holding up well in a weak listing market via astute yield management, the Metro Media publishing units are performing better than expected (EBITDA up 58% to $40m) and profitability is imminent for the now wholly-owned

Seven West Media SWM	
Fair Value ($)	0.68 ↓
Price/Fair Value	0.79
IMR	Strongly Negative

Carsales.com CAR	
Fair Value ($)	14.50 →
Price/Fair Value	0.89
IMR	Strongly Negative

Stan whose subscriber growth is impressive. Third, the core TV unit is improving to be a reliable earnings and cash flow anchor for the no moat-rated group. The 6% fall in TV EBITDA to $161m (64% of group earnings) was commendable given the weak advertising market, supported by the 160-basis point rise in margin to 28.6%. Fundamentals remain solid, with continuing rise in Nine's ratings/revenue share and declining costs. The unchanged fully franked DPS of five cents was perhaps the only disappointment, shy of our six cents estimate. However, with an underleveraged balance sheet and expected proceeds from the asset sales program, the potential for higher dividends or capital management is high. Despite this, we wind back our DPS forecast by an average of 11% over the next three years, given the 10 cents annual base the board appears to have set for FY19. The progress of extracting synergies from the Fairfax merger is on track, with management reiterating the timetable for their realisation. Indeed, the projected $65m synergy to be achieved by the end of FY20 is slightly above our $62m estimate, not counting the potential longer-term upside from rationalising Nine and Fairfax's newsroom/news-gathering resources. IMR Strongly Positive.

Seven West Media's (SWM) (no moat) 1H19 result was weaker-than-expected across the board. We cut our fair value estimate by 3% to 68 cents per share. Benefits of a 200-basis point lift in TV revenue share to 38.4% were effectively wiped out by the 5% fall in the wider metropolitan TV advertising market. Adjusted for the extra trading week in 1H18, this led to a flat underlying TV EBIT of $142m, a subdued outcome in the context of a stellar, cricket-fuelled ratings period (primetime ratings share up 170 basis points). The combined 23% slump in print media EBIT to $13m added to the woes, with the magazine profits back on the downhill slope. It is little wonder FY19 EBIT guidance was shaved from 5% to 10% to 0% to 5%. And its delivery critically hinges on achieving cost reduction of $30m to $40m, some $10m above the previous target. We reduce our forward operating earnings forecasts by an average of 3%, with FY19 EBIT estimate now pegged at $236m. While at the low end of the revised guidance range, the practice of conservative forecasting relative to management projection has served us well in the past and we believe will continue to do so in the future. Compositionally, more than two thirds of our $15m FY19 group EBIT estimate downgrade stemmed from cuts to newspaper and magazine forecasts. This was after a horror 1H19, where newspapers EBIT fell 17% to $9m and magazine EBIT crashed 35% to $4m. With the combined earnings from these two units now accounting for less than 10% of the group total, we are beginning to ponder whether all the management resources and time being spent in restructuring these print media assets are worth the effort. Trading at 5.5 times our FY19 EPS estimate and 5.2 times EBITDA, we believe both the cyclical and structural headwinds are more than reflected in the current stock price. What is not reflected is the still solid free cash generation of $47m in 1H19 up from $16m in 1H18, and the improving balance sheet. Indeed, net debt/EBITDA is on track to fall to 2.0 times on our estimates by the end FY19, with management sticking to a sub-2 times target. IMR Strongly Negative.

New Media

Carsales.com (CAR) (narrow moat) reported a weak 1H19 result but we maintain our fair value estimate at $14.50 per share. We think the market valuation is overlooking three key positive attributes of the company. First, the international portfolio of businesses is growing nicely and as expected. On an underlying basis, the portfolio increased revenue by 21% and still has massive growth potential. Revenue from international businesses comprised 20% of 1H19 group revenue, up from 13% in 1H18, with international EBITDA increasing to 15% of the group from 9%. This is an encouraging trend which we expect to continue and underpin earnings-growth rates for the group. Second, we think the market is also overlooking the potential of other domestic portfolio businesses, such as the finance and tyresales.com. Although finance profits collapsed, reflecting operating leverage to some degree which means a reversal is likely to be equally as impactful. Importantly, CAR's competitive position in Australian online automotive classified advertising remains extremely strong and will continue to generate an increasing number of finance leads. The diversification into adjacent areas including tyresales.com creates exposure to a huge market and leverages the strong core business. Although tyresales.com relatively small, management claims revenue growth remains strong. Third, the strength of the competitive position, and associated network effect, in the core online automotive classified advertising business should not be underestimated. CAR has dominated this segment for many years despite attempts by much larger competitors, such as Facebook and eBay, to disrupt its position. The company is sensibly increasing switching costs and economies of scale via diversification which should at least

Domain Group DHG	
Fair Value ($)	2.80 →
Price/Fair Value	0.93
IMR	Negative

REA Group REA	
Fair Value ($)	62.00 ↑
Price/Fair Value	1.32
IMR	Negative

maintain existing competitive position and economic moat. Key performance indicators such as audience size and inventory remained strong in 1H19. We don't believe CAR is facing structural problems and consider weakness to be cyclical and fixable. The weakest area appears to be the finance business, which experienced a 72% fall in EBITDA. This was driven by a combination of a weak real estate market, and the associated wealth effect, credit tightening following the royal commission, and weak new cars. However, the depreciating nature of cars means we expect new car sales and the finance business to eventually recover. IMR Strongly Negative.

Domain Group's (DHG) (narrow moat) shareholders breathed a sigh of relief following the 1H19 result which showed the company continues to grow sales of premium real estate listings and remains a serious competitor for REA Group. Despite a 12% fall in EBIT, the result was broadly in line with our forecast, which we downgraded last October following management's weak trading update. We have largely maintained our earnings forecasts, and our $2.80 fair value estimate is unchanged. Amid the backdrop of lower listings, most pronounced in the key Sydney and Melbourne markets, group revenue was slightly better than flat, at $184m. The 7% lift in digital revenue to $150m offset a 24% slide in the struggling print business. The core residential business, representing most of the digital business and approximately 50% of group consolidated revenue, grew by 9% to $94m as increasing premium of new listings as a proportion of total listings expands yield per listing. The print business' decline of 24% is in line with our forecast of a 25% fall in revenue for the full year. While still profitable, the print business remains a drag on operating profit, and the victim of year-on-year revenue declines. DHG continues to strip costs from the besieged segment, lifting print EBITDA margin from 24.4% in 1H18 to 28.8%. However, we believe print margins have peaked and forecast divisional revenue to continue to decline at a CAGR of 15% over the next decade. DHG boasts a combined digital and print audience of 7.2 million, which management claims is 72% of REA's audience, but it has a degree of subjectivity. The acquisition of Fairfax by Nine represents an opportunity for DHG to extend its reach to Nine's digital audience of nearly 9 million. With the gap in total listing on each competitor's platform now effectively closed, DHG is likely to emerge a more significant competitor. With a FY19 EV/sales of 11.2, REA trades at a significant premium to DHG on 4.5. With just $121m in net debt at end December, the balance sheet remains in good shape. Net debt/ EBITDA ratio of 2.3 and EBIT/interest coverage ratio of 8.2 are comfortable, and the company operates a capital-light business model. The dividend of two cents per share, fully franked was 50% lower than 1H18 due to the goodwill impairment. We expect the DHG to comfortably continue paying franked dividends and improve its balance sheet metrics over the coming years. IMR Strongly Positive.

REA Group's (REA) (narrow moat) continues to defy the worst Australian real estate downturn in decades, with its 19% increase in 1H19 EBITDA slightly exceeding our expectations. We increase our fair value estimate by 5% to $62 per share, reflecting higher earnings forecasts and the time value of money impact on our financial model. Our forecasts imply underlying EPS will grow at a CAGR of 11% over the next decade. We were surprised the stock fell 5% after the strong result, with revenue up 16% in Australia despite real estate listings falling 3% nationally and by 10% in Sydney. We expect share price weakness was caused by management's guidance for weaker revenue growth in 2H19 due to the Federal and New South Wales elections. In addition, the noncore businesses didn't perform particularly well, with the Asian division incurring a significant impairment. However, guidance is broadly in line with our expectations and negative short-term factors don't materially impact our DCF-based fair value. REA remains in a strong competitive position and even increased its average monthly traffic lead over Domain in recent months from 2.8 to 3.0 times. Our primary concern is REA remains dependent upon its core Australian listings business, which represents 95% of group EBITDA, and effectively increasing listing prices rather than listings. Domain is also likely to be a stronger competitor in future, following the appointment of its new CEO last year and the acquisition of Fairfax by Nine. The financial division is also struggling due to the weak Australian property market and the consequences of the royal commission. Although divisional revenue grew by 12%, like-for-like revenue growth excluding the Smartline acquisition was flat and is likely to remain so for the remainder of the year. The investment in Move is also performing worse than expected with revenue growth of 11% versus our full-year forecast of 17% despite the additional benefit of the Opcity acquisition. This isn't a big issue from the perspective of our fair value as Move is a very small part of the group and has been loss making for some time. However, we expected

SEEK SEK	
Fair Value ($)	19.00 ↑
Price/Fair Value	0.95
IMR	Strongly Positive

Coles Group COL	
Fair Value ($)	12.30 →
Price/Fair Value	0.93
IMR	Negative

stronger revenue growth at this stage of the business' development and the performance raises questions around this and other investments which have been made. The media and data businesses also delivered a rather disappointing result despite its 19% revenue growth but is relatively small contributor to the group. From a cash flow and balance sheet perspective REA remains in great shape. We expect REA to be debt-free by FY21. IMR Negative

SEEK (SEK) (narrow moat) reported a slightly stronger 1H19 result than we expected, with revenue up 19% against our 16% forecast. Full-year revenue growth guidance of 16% to 20% was maintained, versus our now revised forecast of 21%, and EBITDA growth guidance of 5% to 8%, versus our 4.4% forecast. But management now expects reported NPAT to be slightly below FY18, rather than "broadly similar." These changes aren't material to our valuation. We make several small adjustments to our earnings forecasts and increase our fair value estimate by 2% to $19.00 per share. The main surprise was the performance of the Chinese business Zhaopin, which accounts for some 42% of group revenue and which generated local currency revenue growth of 39%. We previously assumed the division would achieve 22% revenue growth in FY19 but have increased growth to 40%. This strong growth rate reflects management's strategic decision to reinvest profits to accelerate revenue growth, with the EBITDA margin falling from 22% in 1H18 to 18%. This reduced local currency EBITDA growth to 13% and our forecast has increased from 7% to 15%. SEK owns 61% of Zhaopin. The other notable aspect was the continued weakness in the South American businesses in Mexico and Brazil. They account for just 4% and 2% of group revenue, respectively. We have cut our full-year forecasts accordingly but continue to expect improvement from FY20. Seek Asia, which accounts for 11% of group revenue excluding Zhaopin, performed well but broadly in line with our expectations. The division grew revenue by 11% in constant currency terms or 18% in A$ terms. We maintain our 13% growth rate in A$ terms. Unsurprisingly, strong revenue growth reflects organic user growth in Hong Kong, Singapore, Indonesia, and Thailand and growing penetration of depth products. SEK has successfully diversified from its highly profitable core Australian businesses, which represented 29% of group revenue in 1H19. Revenue growth of 13% was slightly lower than our previous 15% full-year forecast, which we've slightly reduced. Like other online classified advertising platforms in Australia, most of SEK's revenue growth is coming from sales of "depth" products, or selling more appealing advertisements to existing clients, with muted growth from increasing volumes. The EBITDA margin of 62% is relatively strong but reflects the maturity of the business. We expect SEK's other businesses to gradually increase margins, which underpins our group margin expansion forecast from 29% in FY19 to 36% over the next decade. Management's decision to reinvest in the business and sacrifice short-term profits for long-term growth has attracted investor criticism. FY19 looks likely to be the third consecutive year of reasonably flat earnings growth, implying a statutory NPAT based EPS CAGR of negative 1% over the period. Considering the company trades on a relatively high multiple due to its growth attributes, this represents a dichotomy to some investors. However, we think revenue growth is a more relevant metric for SEK, and on this basis, the three-year CAGR is 18%. We are comfortable with management's decision to prioritise revenue growth over profits in the short to medium term as the company operates in markets where network effects are the main source of competitive advantage, but usually only achieved by the leading provider. IMR Strongly Positive.

Retailers

Coles Group's (COL) (no moat) food sales growth nearly evaporated in 2Q19, after the successful "Little-Shop" campaign funnelled customers to its stores and away from Woolworths in 1Q19. This tracks our expectations for food sales growth to significantly slow, and our sales and NPAT estimates for COL are virtually unchanged. We maintain our fair value estimate of $12.30. Supermarket like-for-like sales grew 1.5% in 2Q19, down from 5.1% growth in 1Q19. So far, momentum has not returned in 2H19. Supermarket headline sales increased 3.6% in the half, just shy of the overall Australian food retailing market at 4.2%. COL supermarkets underperformed and lost market share in New South Wales, where the flagging appeal to customers of ageing stores exceeded the positive impact of strong online sales growth. The sales growth wasn't enough to offset the cost pressures from higher wage and energy costs, and the one-off labour expenses related to discontinuing single use plastic bags. Food EBIT margins declined slightly by 12 basis points. We maintain our FY19 forecasts of headline sales growth of 2.6% and flat EBIT margin of 3.9%. The liquor segment took market share. We estimate New Year's Eve-adjusted headline sales growth was 1.8% in 1H, ahead of the Australian

JB Hi-Fi JBH	
Fair Value ($)	24.50 →
Price/Fair Value	0.93
IMR	Neutral

Harvey Norman HVN	
Fair Value ($)	3.40 →
Price/Fair Value	1.12
IMR	Neutral

liquor retailing market at 1.3%. The sales growth was lower than our previous full-year estimate of 4.2%, and we reduce our FY19 headline sales growth expectations to 1.8%. Nonetheless, we expect liquor sales growth to rebound to 4% over the following five years, fuelled by population growth and price inflation. EBIT margins improved by 29 basis points, due to a higher margin product mix and operating efficiency gains. In response to poor results, management announced a "strategic refresh" broadly focusing on improving the online platform, refurbishing existing stores and rolling out new formats, driving supply chain efficiencies, and bolstering customer confidence by moving more products to Every Day Low Pricing, and away from promotions. The board reconfirmed target dividend payout of 80–90% of earnings from 28 November 2018 to 30 June 2019. IMR Negative.

JB Hi-Fi (JBH) (no moat) successfully navigated a tough retail environment in 1H19, but we see cyclical headwinds persisting for the remainder of the year. NPAT increased 5.5% to $160.1m while EBIT was 4.8% higher at $236.6m. Dividend increased 5.8% to 91 cents per share fully franked. FY19 guidance of underlying NPAT is $237m–$245m, versus our revised estimate of $248m, which we trimmed by 2%. Headline sales guidance of $7.1bn for FY19 was reiterated, and we lowered our sales estimate by 2% to converge. Long term, we continue to expect JBH to defend its market share against new online competitors, with smaller store-networks losing out to JBH as well as Amazon and friends. We maintain our $24.50 fair value estimate, with marginally lower forecast sales offset by the time value of money impact. Headline sales growth of 4.2% was below our prior FY19 estimate of 5.8%. Nevertheless, total sales growth of 4.1% in Australia easily outperformed growth in the addressable market which was virtually flat. JBH continued to act as a consolidator in the bricks-and-mortar channel. However, the group is still under-indexed in the online channel, with only 6% of Australian sales sold online, versus the current online penetration of 9% of total Australian retailing, and high-teens in the consumer electronics and home appliances market. The group achieved positive comparable sales growth in all three segments, but growth slowed in January 2019. JBH Australia and The Good Guys generated 96.8% of group sales and 99.6% of 1H19 EBIT. The small New Zealand segment displayed the strongest like-for-like growth at 12.6% and returned a small profit. Online sales grew by 21% and we calculate it accounted for about 33% of JBH Australia's like-for-like sales growth. We forecast group sales in ecommerce to continue outperforming the bricks-and-mortar channel over the next decade. Hence, we see little potential to materially expand the group's footprint beyond the current 316 stores. On the upside, sales growth could be greater than our estimate of 3.7% annually over the next decade. Revenue could be bolstered were competitive intensity to abate and consumer demand strengthen, or JBH to take a larger slice of the online market without cannibalising sales from its physical store network. Also, JBH could further improve The Good Guys' operations by expanding and diversifying ranging to higher-margin products. In 1H19, group EBIT margins were up four basis points on headline sales growth of 4.2%. We estimate FY19 EBIT margins to increase 10 basis points to 5.2%. IMR Neutral.

Harvey Norman Holdings' (HVN) (no moat) 1H19 sales and profit growth tracked below our full-year expectations, and we slightly downgrade our near-term outlook. The 1H129 dividend was steady at 12 cents per share fully franked. After a slow first half in the core Australian franchising operation, we expect 2H19 to be challenging as consumers grapple with relatively sluggish wage growth, a weakening housing market, and associated negative wealth effect as well as uncertainty around the upcoming May federal election. Overseas, the smaller company-owned operations fared much better, but sales growth was still below our too-optimistic expectations. Looking past the current year, we continue to see fierce competition limiting market share gains in Australia. We also expect competition to stifle EBIT margin expansion, with franchising operating margins already down 20 basis points in 1H19. Our long-term sales and underlying NPAT growth estimates are virtually unchanged, with both growing at a compound rate of 3% per year. Our fair value estimate is unchanged at $3.40. There is potential upside to our sales growth forecast, if the overseas success with the flagship store strategy, can be replicated in Australia. Fading consumer sentiment is not the only headache for Australian retailers. A more long-lasting structural challenge is the migration of consumers to the online channel. HVN's low online sales penetration remains a key concern of ours, which we estimate at only 3%, half that of JB Hi-Fi. The Australian franchising operations account for about 50% of the group operating profit. After signs of improving sales momentum into November 2018, sales growth slowed toward the end of the calendar year. Headline sales fell 1.7%, with like-for-like sales

Wesfarmers WES	
Fair Value ($)	28.00 ↓
Price/Fair Value	1.22
IMR	Strongly Positive

Woolworths WOW	
Fair Value ($)	24.50 →
Price/Fair Value	1.23
IMR	Stronglhy Negative

declining by 0.6%. We estimate HVN's addressable market was flat in 1H19, and the decline in sales indicates a loss of market share. In contrast, JB Hi-Fi, grew its Australian sales by 4% in the period. JB Hi-Fi's strong online sales growth of over 20% accounted for about one third of its like-for-like sales growth, and we see HVN's weaker online platform as a source of its relative underperformance. We lower our full-year headline sales growth estimate from flat to a decline of 2%. The overseas segment was the bright spot, generating about 25% of the group pretax profits in 1H19 but nevertheless below expectations. Headline sales increased by 12%, below our 17% forecast. The strong overseas sales growth was supported by flagship stores opened in all seven overseas countries over the past three years, increasing brand awareness and thus boosting sales at other existing stores. The sales increase resulted in EBIT margin expansion, and profits before tax increased by 25%. We had expected stronger headline sales and hence greater leverage, resulting in profits rising by 34% for the full year. We scale back our FY19 estimate in line with 1H19's performance. Our longer-term forecasts are not materially higher, with annual overseas profits only 3% higher over the next decade. IMR Neutral.

Wesfarmers (WES) (wide moat) declared a $1.00 special dividend on top of a Coles-inflated $1.00 1H19 dividend, both fully franked. The return of excess funds and franking credits is sensible, especially against the backdrop of potential changes to franking rules after the May federal election. Underlying sales growth at WES' largest profit contributor, Bunnings, is decelerating. Management had already flagged the weakness in its department stores segment in January. Growth in operating profit at the group's largest segments was in line with our full-year estimates. The smaller industrials segment's EBIT beat our forecast, and we increase the full-year contribution by $50m. However, the impact on our fair value estimate is immaterial and we maintain it at $29. It will revert to $28 on the ex-dividend date of the special on 26 February. Bunnings' like-for-like sales growth slowed to 4% in 1H19, from about 6% in 2H18, and 9% in 1H18. We expect the days of high-single-digit comparable sales growth are over, as we expect it to be increasingly difficult for Bunnings to drive above-market sales growth by adding new products and expanding its range. Our like-for-like growth forecasts are unchanged at 4% for FY19, and average 3% longer term. Cyclically soft consumer sentiment is a challenge for all retailers, including Bunnings. But were the weakness in housing prices to be prolonged and construction and renovating activity slow further, the impact could be more severe for hardware retailers. Management expects the moderate 1H19 trading conditions to continue for the remainder of FY19. Bunnings represents 55% of group EBIT from continuing operations, and EBIT increased by 7.9% on the previous half, tracking our unchanged FY19 forecast of 7.8%. A decline of 3.8% in operating profit at the second-largest business segment, Kmart Group, was also broadly in line with our unchanged estimate of a 3.5% decline in FY19 EBIT. The Kmart Group, consisting of discount department store chains Kmart and Target, accounts for 22% of group EBIT from continuing operations. The industrials division and stationery retailer Officeworks reported stronger than expected results, the former helped by delays in commissioning Orica's Burrup ammonium nitrate plant. Adjusting for capitalised lease commitments, we estimate the net debt of A$7.1bn billion, or $8.2bn billion after the payment of the special dividend. However, at an adjusted net debt/EBITDA of 1.4 the balance sheet remains conservatively geared. IMR Strongly Positive.

Woolworths (WOW) (narrow moat) delivered a weaker than expected 1H19 result. In line with our thesis, a material profitability expansion in the core Australian food business proved evasive, with EBIT margins increasing by a mere eight basis points. We were surprised by the slow-down in the liquor and hotels segments' sales growth and EBIT margins, together accounting for 18% of the group's operating profits, although we expect these metrics to rebound. In all, our long-term forecasts for the business are largely unchanged, and our fair value estimate of $24.50 stands. Australian groceries account for almost 66% of the group's sales and operating profit. The current share price of $28.69 implies a 50-basis point margin expansion to 5.2% for the food segment. We continue to view this as an unlikely outcome given the raft of cyclical, but most notably ongoing structural challenges, which we expect to drive EBIT margins lower. Our FY19 forecast of 4.5% food EBIT margin is unchanged, equating to a year-on-year decline of 20 basis points, with higher wages weighing on second-half profitability. WOW is grappling with intense competition from its key competitor Coles, along with Aldi, and soon Kaufland, in the discount channel, and online from Amazon. We anticipate cost efficiencies generated to be mostly passed on to customers. Supporting our view, WOW reduced average food prices by 1% in 1H19. We see EBIT margins constrained at 4% long term. For now, we

Breville Group BRG	
Fair Value ($)	11.00 ↑
Price/Fair Value	1.49
IMR	Strongly Positive

Domino's Pizza Enterprises DMP	
Fair Value ($)	53.00 →
Price/Fair Value	0.80
IMR	Negative

leave our sales growth estimates—on a 52-week basis—for the Australian food segment unchanged at 2.7%. In 1H19 we estimate headlines sales grew by 2.5% after adjusting for New Year's Eve. Over the next decade, we forecast WOW to maintain its market share and grow Australian grocery sales by 4% on average. For liquor, New Zealand food and hotels, we trim our sales growth expectations in line with adjusted 1H19 sales growth figures of 2.5%, 1.9% and 0.5%. We expect the Australian liquor retailing market to rebound from growth of only 1.3% to 4% over the next five years, fuelled by population growth and price inflation. The hotel segment cycled strong sales growth in 1H18. Our long-term sales growth forecast of 2% per year for the pubs business is unchanged. Capital management is on the horizon, with the return of $1.7bn from the sale of the petrol business. Management mentioned an off-market buy back as a possibility. At current share prices, a buy back would be value-dilutive to our fair value estimate. The weakest link remained the loss-making Big W. Our forecast of a significant rationalisation of the store footprint is unchanged. We expect some 34% of the current stores to close over the next decade. IMR Strongly Negative.

Small Retailers

Breville Group (BRG) (narrow moat) reported a 20% increase in NPAT to $44m on 1H18. The comparable period was impacted by a tax adjustment, which if excluded would have seen NPAT increase by 15%, a strong result, nonetheless. The dividend increased 12% to 18.5 cents per share, 60% franked. Management guided to FY19 EBIT growth of slightly higher than 11%, assuming no adverse change in economic conditions, slightly lower than our 12.6% forecast. We increase our fair value estimate from $10 to $11 per share reflecting: (1) continued strong performance in Germany and Australia; (2) a higher likelihood of successful expansion into additional European regions Switzerland and Benelux; and (3) time value of money. We lift our EPS estimates by around 4% on average over the next five years and expect BRG to sustain low-double-digit growth. Despite raising our fair value estimate, we continue to believe the stock remains overvalued at current prices. To produce a valuation closer to the current stock price, we would need to project average EPS growth of around 20% per year, which is more akin to our bull-case scenario. While the company has a formidable record, we believe this level of growth is unachievable, especially against the backdrop of a softening global economy, and formidable competition in Europe. The global product segment continues to perform strongly, growing revenue by 15%, 9% on a constant currency (CC) basis. This reflects double-digit growth in Australia, the U.S., the U.K., along with positive early results from the expansion into Germany and Austria. The company expects FY19 global product growth to be consistent with the last two years at the low-double-digit mark, and we envisage this pace being maintained for at least the next five years. However, the ongoing investment into new product development and marketing will keep the division's EBITDA margins capped at around 17% on average over the coming years. Within the global product segment, Europe remains the strongest performer growing revenue by 40% (32% on a CC basis), albeit off a small base. This reflected double-digit growth in the U.K. under the Sage brand, along with the hugely successful expansion into Germany and Austria. The expansion into these new regions has been more positive than we expected and is already running an impressive 3.5 years ahead of the U.K. expansion which launched in 1H14. Over the next year, BRG will launch into Benelux and Switzerland, which are approximately 150% of the size of Australia and New Zealand in both population and GDP, which significantly grows the addressable market. Given the exceptional record of expanding into North America and Europe, we project a similar trajectory for these new regions. Despite a challenging macro environment in both Australia and the U.K., BRG continues to deliver double-digit revenue growth. This implies new products are resonating with customers, and taking market share in the process, especially in the growing health food categories. BRG continues to increase its investment into marketing and research and development, which should help defend its brand strength and maintain product quality. IMR Strongly Positive.

Domino's Pizza Enterprises (DOM) (no moat) same-store sales growth of 3.3% in 1H19 beat the 2.9% announced at the trading update in November. The positive sales momentum continued early in 2H19, with like-for-like sales up again and tracking at 4.0%. However, sales growth remains at the bottom end of the targeted 3%–6%, held back by a maturing core Australian market, but also in France. We forecast FY19 same-store sales growth for the group at 3.2% and a slight increase from our previous estimate of 3.0%. Management guidance is for the mid to lower end of the 3%–6% range. Our lower EBITDA margin and store addition estimates for FY19, result in a decline to our underlying EBIT estimate of 8% from $250m to $229m. This is in line with management's guidance for EBIT at the lower

Super Retail Group SUL	
Fair Value ($)	7.50 →
Price/Fair Value	0.97 ●
IMR	Neutral ○

Ainsworth Game Tech AGI	
Fair Value ($)	1.20 →
Price/Fair Value	0.70 ●
IMR	Neutral ○

end of the $227m–$247m range. Weak French sales growth dragged down the European segment, which otherwise performed relatively strongly. However, our key concern rests with lower-than-expected EBITDA margins in Australia and New Zealand, as well as in Europe. We reduce our EBITDA margin forecast for Europe in the near term and Australia longer term. But these negatives are offset by higher expected sales growth and margins for Japan, and the impact of the time value of money on our DCF valuation. Our fair value estimate is unchanged at $53. The poor performance in France, led to only 2.3% same-store sales growth in Europe, below the global target of 3%–6% and resulted in operational deleverage, as costs grew faster than sales. We expect the French and European business to rebound towards the back end of FY19, as new regional management gets its feet under the desk and a contract with an aggregator is signed for France. The Japanese market was the standout, with relatively strong 4.8% like-for-like sales growth against Europe and Australia at 2.3% and 3.5%, respectively. However, the Japanese growth rate is also noticeable against its past performance, as like-for-like sales are virtually flat from four years ago. This growth, together with ongoing unwinding of the percentage of company-owned stores resulted in EBITDA margins expanding. We remain cautious on the outlook for Japan, given the demographic headwinds. From FY21, we now expect EBITDA margins to tick up by 50 basis points a year, up to 41.6% in FY28, which is 140 basis points lower than our prior estimate. This is well short of management's aspirational target of 45%. In fact, upside does exist to our Australian EBITDA margin forecast from unwinding of the corporate store count in the medium term, as seen in Japan. However, this is dependent on improving franchisee profitability at the store level, which slightly deteriorated in 1H19 on 1H18. IMR Negative.

Super Retail Group (SUL) (no moat) reported a mixed 1H19 performance across the three business segments which leaves our estimates virtually unchanged. We maintain our $7.50 fair value estimate. 1H19 sales growth in the highest-margin auto segment fell short of our previous estimate but was offset by stronger-than-forecast sales in outdoor and sporting. In 2H19, we expect consumer spending to remain constrained by relatively sluggish wage growth, a weakening housing market, particularly in New South Wales and Victoria, and uncertainty around the upcoming federal election. We expect these headwinds to affect all three businesses and maintain our estimate for 5.4% full-year revenue growth versus 6.0% reported for 1H19. Outdoor sales were bolstered by a full contribution from Macpac, but the second half will partially cycle the sales contributions from the acquisition, which completed 31 March 2018. The auto segment represented 42% of group EBIT from operations and delivered comparable sales growth of 1.8%, tracking below our prior full-year estimate of 4.2%. Year-to-date divisional comparable sales growth was slightly better at 2.2%. As such, we lower our FY19 forecast to 2.2% but maintain our average sales growth forecast at 4.0% over the next 10 years. EBIT margin was flat, mainly due to increased depreciation and amortisation costs. We forecast FY19 EBIT margins to remain at around current levels of 11.6%. Sporting goods accounts for 40% of EBIT and delivered comparable sales growth of 3.2%, above our previous full-year forecast of 2.5%, driven by transaction growth and an increase in units per transaction. We lift our sales growth to 4.3% for the full year. However, we continue to forecast medium- to long-term sales growth to be challenged by ongoing fierce competition from new entrants JD Sports and Decathlon as well as online players. We maintain our average sales growth forecast of 2.3% from FY20. We expect FY19 EBIT margins of 9.4%, relatively flat year on year, but gradually decline to 8% longer term. Outdoor's strong revenue growth of 16.5% was driven by the Macpac acquisition. The core BCF outdoor chain increased total sales by 2.2% and gained market share. However, market share gains were achieved at the cost of lower prices, with EBIT margins falling 180 basis points and EBIT down 23% to $15m. We expect EBIT margins including Macpac to recover by 70 basis points by FY20 and stabilise at 6.7% longer term. IMR Neutral.

Gaming & Leisure

Ainsworth Game Technology (AGI) (narrow moat) reported a weak 1H19 adjusted profit before tax (PBT) down 45% on 1H18 to of $9m, albeit marginally ahead of the $8m guidance. Unsurprisingly, the main challenge faced was intense competition in the Australian market, which led to an approximate halving of unit volume and revenue, along with margin compression. There were, however, a few positives, the most noteworthy being: 1) strong international revenue growth which nearly doubled on 1H18 and now accounts for 83% of group, up from 76%; 2) a 6% increase in units on participation (leased machines); and 3) a step up in design and development

Crown Resorts CWN	
Fair Value ($)	15.00 →
Price/Fair Value	0.78
IMR	Strongly Negative

expenditure (D&D) both in percentage and dollar terms. The dividend was suspended, which is disappointing, but prudent given the recent lacklustre performance and should facilitate a higher level of reinvestment. We still expect a stronger 2H18 but cut our FY19 PBT forecast from $26m to $22m, to reflect the weakness in the domestic market and higher D&D expenditure. Management guided to improved profitability in 2H19 on a sequential basis, on the back of strong international momentum and new product releases in Australia. However, the language appears less optimistic than previous guidance for a minimum 75% PBT growth in 2H19 from 1H19. However, our midcycle earnings forecasts are broadly unchanged, as is our $1.20 per share fair value estimate. Australia remains the most challenging market, with volume and revenue both halving, reflecting the intense competition. While we don't expect a material change in the competitive landscape, we expect new product launches in 2H19, and the additional D&D spend to support a domestic market share at around 8%. We project a 30% decline in FY19 volume and beyond to improve at a modest pace. We forecast the segment's EBIT margin to improve by around 3% to 28% over the next five years, as revenue improve modestly and AGI benefits from high operating leverage. North America performed reasonably well, with revenue and EBIT growing by 40% and 47%, respectively. This reflected strong outright sales of the "Quick Spin" product family on the A640 cabinet. Disappointingly, however, the gaming operations installed base shrunk by 23%, as customers opted to purchase top performing titles outright. Our preference would be to see the installed base growing strongly, as this revenue tends to be more resilient and higher margin. Latin America's earnings were flat on 1H18, although the game operations installed base grew by 37%, offset by a 10% decline in outright sales. On balance, we view this as a positive outcome, which should add to earnings stability. Strong cash conversion kept the balance sheet in reasonable shape, despite the earnings weakness, with leverage (debt/EBITDA) at a modest 0.88 times. A final dividend of one cent per share is possible. IMR Neutral.

Crown Resorts' (CWN) (narrow moat) 1H19 normalised NPAT grew by an underwhelming 1% to $194m. Group normalised EBITDA declined by 7% to $419m, with the softness mainly reflecting a surprisingly sharp drop in VIP turnover during November and December, along with softer main-floor gaming, and higher labour costs. The 30 cents per share dividend (60% franked) was in line with the recently introduced policy. We anticipate a similar dividend in 2H19. We cut our FY19 NPAT forecast by 8% to $388m, to capture the challenging near-term outlook, however, many of the challenges faced by the company are cyclical in nature. VIP which weighed on revenue is notoriously volatile, and we are reluctant to extrapolate two months of poor performance. Additionally, we attribute the reduced average spend per customer (and consequential soft main-floor gaming revenue) to softening consumer environment, and negative wealth effect resulting from declining residential property prices, both of which we expect to eventually stabilise. Accordingly, our long-term assumptions are broadly unchanged, and we maintain our $15 per share fair value estimate. We project 6% EPS growth on average over the next three years, prior to the opening of Crown Sydney which in our view is underappreciated by the market. The performance was mixed at the Melbourne property, which represents around 75% of group earnings, where revenue and EBITDA fell by 1% and 3%, respectively. Main floor gaming grew by 2%, which is in line with our expectations, although (within the segment) gaming machines continue to disappoint, growing revenue by 1%, whereas table games were stronger growing at a healthy 3%. Visitation numbers were positive, although the average spend per customer was lower than in recent years, which weighed on total turnover. We do not see any structural reason for this softness, and we continue to forecast main floor gaming should grow at around 4% per year over the long run. VIP was the main source of pain, with both Australian resorts underperforming and falling short of our expectations. Turnover fell by 12% to $20bn, despite management flagging turnover rose by 13% the first four months of FY19, implying an extremely weak November and December. The reversal highlights volatility, with a small number of players able to significantly move the dial. Visitation numbers were solid although the average spend was lower, which we attribute to slowing Chinese economic growth, and tighter junket liquidity. The Sydney facility is progressing on schedule for completion in the June half of 2021. Management reiterated the total gross project cost of $2.2bn billion ($1.4bn net of apartment sales) and confirmed apartment sales are progressing well. The balance sheet is in pristine condition, currently operating in a net cash position. Moreover, we maintain our bullish outlook on Sydney, with a superior location and high-end focus, we forecast CWN to take just over half of Star Sydney's VIP

The Star Ent Group SGR	
Fair Value ($)	4.80 →
Price/Fair Value	0.93
IMR	Strongly Positive

Tabcorp TAH	
Fair Value ($)	4.50 →
Price/Fair Value	1.04
IMR	Negative

market while concurrently growing the domestic market. IMR Strongly Negative.

The Star Entertainment Group (SGR) (no moat) reported a mixed 1H19 result, with NPAT down 2% to $124m from 1H18. At the current pace the company is tracking below our expectations, and we have cut our FY19 NPAT forecast by 3% to $260m. Domestic gaming performed extremely well, with both slots and tables delivering strong growth at Sydney and Queensland venues, exceeding our expectations. However, this was largely overshadowed by the disappointing 33% decline in VIP turnover, a trend which we forecast to continue into 2H19. The dividend of 10.5 cents per share, fully franked, increased 40% from 7.5 cents in 1H18, in line with our estimates. Despite trimming our FY19 earnings, our long-term projections are broadly unchanged. Additionally, we maintain our $4.80 per share fair value estimate. Sydney's domestic gaming floor performed exceptionally well, despite the softening consumer environment. Slot revenue grew by 10% on 1H18, exceeding our expectations on the back of strong visitation and market share gains. While this growth should continue into the second half, the pace of growth is unsustainable, and over the long run, we continue to expect mid-single-digit growth on average. Table revenue grew by a healthy 5%, most of which came through the private gaming rooms. Sydney's EBITDA margin improved by two basis points to just over 23%. The strength in domestic gaming was offset by a sharp drop in international VIP revenue. VIP turnover fell by 33% to $21bn, despite flat front money. In a similar scenario to rival Crown Resorts, the company experienced strong visitation, although a lower average spend per VIP customer. While we attribute a portion of this to the slowing economic growth in China, management also blamed the unusually high win rate, at 1.62%, compared with the 1.35% normalised rate, the highest it's been in the last five years, consequently punters cashed in their chips earlier than usual. Sydney felt the brunt of this where VIP turnover halved to $14bn, whereas Queensland VIP turnover almost doubled, albeit off a much smaller base, reflecting the return on the recent refurbishment and expansion projects. International VIP is cycling a very strong comparable period heading into the second half, and likely to continue struggle over the remainder of the year. Queensland delivered a record normalised EBITDA of $107m, supported by gaming and nongaming revenue. New assets were successfully commissioned during 1H19 which attracted new customers to the venue and contributed to a solid 12% increase in visitation. Queensland EBITDA should grow at a mid-single digit pace until FY23 when the new Treasury casino comes online, at which point we expect earnings to jump to the low 20% range over the first three years of ramp up. IMR Strongly Positive.

Tabcorp (TAH) (narrow moat) reported a 1H19 underlying NPAT of $211m, more than double 1H18. This rapid growth mainly reflected a full six-month contribution from recently acquired Tatts. Had the Tatts acquisition been in place for the full comparable period, revenue and EBITDA would have increased by 6% and 9%, respectively, a more modest, but positive result, nonetheless. Lotteries was the standout performer, reflecting strong digital growth and new game initiatives, boosted by a favourable jackpot sequence. Additionally, management flagged a higher cost savings target, as the merger integration with Tatts is progressing better than expected. The dividend of 11 cents per share, fully franked, was in line with our forecasts. Our $4.50 per share fair value estimate is unchanged, as the stronger performance in lotteries, and additional cost synergies are offset by a more challenging wagering outlook. Lotteries grew revenue by a staggering 20% on a pro forma basis, exceeding our expectations. Some of the strength in lottery is sustainable, and attributable to increased investment in game offerings and digital. However, we believe the majority was driven by a more favourable jackpot sequence, with an unprecedented six jackpots at or above $50m in the half. We are reluctant to extrapolate this growth and remind investors of FY17 when Tatts was faced with an unfavourable jackpot sequence which hurt performance. Accordingly, we have increased our FY19 lottery revenue forecast to capture the near-term uplift, although our long-term revenue growth forecasts are lifted by around 1% on average over the next five years to 6%, reflecting structural improvements. Lotteries and Keno now represent around half group earnings and remain TAH's most attractive and defensive businesses. Offsetting the strength in lotteries was a softer than expected result from the wagering division. Turnover growth of 2% was broadly in line with our expectations, as digital turnover continues to grow at a low-double-digit percentage rate, at the expense of traditional bricks-and-mortar wagering. Digital presently accounts for just over 40% of wagering turnover and, on our expectations, will surpass retail channel wagering in size within the next three years. However, overall wagering revenue declined by 3%, falling short of our

APA Group APA	
Fair Value ($)	8.50 ↑
Price/Fair Value	1.15
IMR	Neutral

Auckland Int'l Airport AIA	
Fair Value ($)	7.10 ↑
Price/Fair Value	1.02
IMR	Neutral

projections. This reflects an increase in generosities (rebates and incentives) and lower fixed odds yields, which was driven by operators in the industry aggressively pursuing market share ahead of the introduction of wagering point of consumption taxes. These initiatives are required to entice and retain customers amid tough competition, and accordingly, we have lowered our wagering revenue growth forecasts to fall slightly in FY19 and grow by 3% per year on average over the next five years. IMR Negative.

Utilities & Infrastructure

APA Group's (APA) (narrow moat) 1H19 EBITDA increased 4.3% to $788m, with growth coming roughly 50:50 from new assets and tariff increases. Management expects full-year EBITDA to be towards the top of guidance of $1.55bn to $1.575bn, broadly in line with our prior expectations. This represents a slowing of growth to around 3.5% for the full year. We make minor changes to our earnings forecasts and upgrade our fair value estimate 2% to $8.50 per security. Completion of substantial new projects, including solar farms, gas pipelines and a gas processing plant, should drive stronger EBITDA growth in FY20 and we forecast 7% growth. Operating cash flow fell 4% to 39.8 cents per security on higher tax payments and dilution from last year's equity raising. These aren't major issues—tax payments will lead to more franking on distributions while equity dilution will be offset once new growth projects come online shortly. Tax payments should steadily increase holding back distribution growth but adding franking credits. In the core energy infrastructure division, EBITDA rose 6% to $789m. Queensland was the best performing state, with EBITDA up 8% to $512m, followed by New South Wales and Western Australia, which both rose 5% to $75m and $123m, respectively. The main negative was Victoria and South Australia, which saw EBITDA fall 4% to $69m on lower regulated tariffs. The small asset management and energy investments divisions both recorded moderate growth. Corporate costs rose 50% to $42m due to a payout to retiring CEO Mick McCormack and costs relating to the attempted takeover by CK Infrastructure. The balance sheet remains sound, with gearing of 66.5% considered reasonable given APA's highly defensive earnings. Over the past six months, gearing rose 110 basis points as the company invests in substantial growth projects, which should add $215m to revenue per year starting in FY20. Gearing remains comfortably within management's target range of 65%–68%. With the CK Infrastructure takeover distraction in the rear-view mirror, management is once again focused on finding an acquisition in the U.S. It's looking for a business in gas transmission or distribution, with a platform for growth. We would expect a sizable acquisition, likely needing another equity raising. Overall, we are not enamoured with this strategy given inflated infrastructure prices globally, risks from entering a new market and timing with the long-standing managing director retiring this year. But APA has a good record of accretive growth, so we're not too concerned. IMR Neutral.

Auckland International Airport's (AIA) (wide moat) 1H19 results were in line our full-year projections, with underlying NPAT up 3% to NZ$137m. Traffic growth moderated but retail revenue climbed rapidly on the back of newly opened stores and restaurants. Profitability should expand markedly in 2H19 and the company remains on track to hit unchanged full-year NPAT guidance of NZ$265m to NZ$275m. We forecast NZ$275m, representing growth of 5% on FY18. While some regulatory risk has crept into the outlook given the airport's decision to cut aeronautical pricing following pushback from New Zealand's Commerce Commission (ComCom) we maintain our NZ$7.40 per share fair value estimate, while our ASX-listed share valuation lifts 3% to $7.10 due to a stronger $NZ. Passenger traffic grew 4.1% in 1H19, as international and transit movements climbed 3.5%, while domestic traffic grew 4% versus 1H18. These results are broadly in line with our full-year forecast for 3% domestic and 3.9% international gains, suggesting some moderation in domestic traffic in the second half, combined with less-pronounced declines in transit passengers, which fell 5.2% as new routes directly from Melbourne to San Francisco and Santiago overflew Auckland. We also expect slowing revenue growth in 2H from the 11.5% rate posted in 1H19. A major driver was a 25% increase in retail revenue following the recent opening of new retail floorspace, including several luxury stores in the international terminal. Retail sales per passenger leapt nearly 20%, but we see this slowing to 8% in the full year. Nonetheless, we anticipate retail spending per passenger continuing to climb well ahead of inflation, averaging roughly 6% over the next five years. EBITDA margins slipped 40 basis points from 1H18 and our forecast for a slight improvement in FY19. Nonetheless, management maintained its outlook for costs to climb only by single digits in the full year, despite operating expenses increasing 14% over in 1H19.

Sydney Airport SYD	
Fair Value ($)	7.30 →
Price/Fair Value	0.98 ●
IMR	Neutral ○

Transurban TCL	
Fair Value ($)	11.00 →
Price/Fair Value	1.13 ●
IMR	Neutral ○

This suggests 2H19 EBITDA margins should improve by more than a percentage point, keeping AIA on-track to hit our projections. We continue to expect further profitability expansion over the long term as the airport leverages its fixed cost base, with EBITDA margins climbing to the high-70% range over the next 10 years. Free cash flow will also be better as capital expenditure plans are delayed. AIA cut capex plans from NZ$450m–NZ$550m to NZ$280m–NZ$$330m. Management noted its cumulative capital spending plan through FY22 remains intact, and we have no changes to our long-term assumptions as a result. The balance sheet can comfortably meet these plans. The airport finished the period with net debt/EBITDA of 3.9 times. While we expect this metric to climb back above 4.0, we believe risk remains low given EBITDA/interest cover of more than 5 times, on average, over the next five years. The company holds an A- credit rating from S&P—a solid investment-grade profile. IMR Neutral.

Sydney Airport's (SYD) (narrow moat) 2018 results were in line with our expectations keeping the company on track for solid, albeit slowing, bottom-line growth going forward. Total passenger traffic increased 2.5% in the year, driven by 4.7% international and 1.2% domestic traffic growth. Alongside higher per-passenger rates and the positive mix shift of greater international traffic regulated aeronautical revenue increased 7.6% versus 2017, while upgrades to retail facilities and higher leasing rates drove a 7.2% improvement in unregulated retail revenue. Total revenue climbed 6.8% to $1.59bn, nearly identical to our projection. We are encouraged by good cost control, which boosted EBITDA at a higher 7.2% rate, to $1.28bn, again on target with our estimate. However, we expect slowing growth in passenger traffic, revenue, and EBITDA in 2019. Management's initial outlook for the year supports our view, with an expected 4% increase in 2019 distribution to 39 cents per security (cps) versus the nearly 9% growth to 37.5 cents in 2018. We maintain our $7.30 fair value estimate. We expect international traffic growth to decelerate to 3.6% in 2019, owing to a slowing of airline capacity growth, but forecast aeronautical revenue gains remaining north of 6% due to rising per-passenger charges. Similarly, we anticipate rising per-passenger retail spending. The metric climbed 4.6% in 2018, and we project 4% growth in 2019 and an average of 3.5% over the next four years as the airport benefits from rising international passenger mix, annual escalators on its leasing rates, and expanded retail offerings in domestic terminal 3, where SYD will gain control of commercial activity in July 2019. We also expect improving property revenue over the next several years given a planned additional hotel in 2021, following 7.5% top-line gains in 2019. We expect distributions to grow at a much slower pace in future. Management noted it expects to begin paying cash taxes in 2022, following the usage of its tax loss benefits. This timing is slightly accelerated from our assumed 2023. As such, we see distributions growing at only a 3.4% annual rate through 2028. Cash available for distribution will likely increase at a slightly faster pace, though, as management plans to smooth the payout amount into 2022. The regulatory environment for SYD remains favourable. The major risk facing SYD remains its highly geared balance sheet, although metrics generally improved in 2018. Net debt/EBITDA decreased slightly to 6.6 from 6.7 in 2017, and there are no maturities in 2019. Average maturity is roughly six years. We see servicing costs rising over time as interest rates move to a more-normalised level but expect SYD to cover its interest payments two to three times with EBITDA over the next 10 years. IMR Neutral.

Transurban's (TCL) (wide moat) 1H19 underlying proportionate EBITDA increased 10% to $1bn, in line with expectations. Key drivers were solid traffic volume growth in most markets, toll increases and three acquisitions. Unchanged distribution guidance points to 59 cents per security in FY19, with mid-single-digit growth in 2020. Distributions will need to be supported by debt in coming years—what management refers to as a capital release—due to equity dilution from recent raisings, but this isn't a major concern. Free cash flows will improve as new development projects complete; TCL has nine projects completing over the next five years. We make minor changes to earnings forecasts, mainly increasing depreciation and interest expense, which were both above expectations in the half. We maintain our $11.00 per security fair value estimate. The Sydney road network saw proportionate revenue and EBITDA increase 8% to $527m and $400m respectively. Key drivers were 2.1% growth in traffic volumes and acquisition of the 25.5% stake in WestConnex and an additional 15.4% stake in the M5. Excluding the acquisitions, toll revenue grew 3%. WestConnex comprises several road projects, with the M4 the only operating section at present. The next project to complete will be new tunnels extending the M4 east, followed by an extension to the M5 in 18 months. Work has commenced on the M4–M5 link,

AGL Energy AGL	
Fair Value ($)	21.00 →
Price/Fair Value	1.03
IMR	Negative

Origin Energy ORG	
Fair Value ($)	7.80 ↑
Price/Fair Value	0.95
IMR	Neutral

which should complete in FY23, followed by a couple of smaller projects. The slightly delayed NorthConnex tunnel, linking the M2 to the Newcastle Freeway, should open in 2020. Combined with potential new roads being considered by the state government, including a western harbour tunnel, a link between the Princes Highway and the M5, upgrades around Sydney Airport and a northern beaches link, Sydney's road network should undergo profound change in the next 10 years. In Melbourne, toll EBITDA grew 5.4% to $362m on 4.6% growth in traffic volumes and toll increases, partly offset by lower fee income from nonpaying motorists after changing fee arrangements in the wake of a public backlash. Traffic growth benefited from recent upgrades to state-owned feeder routes. Looking forward, growth is likely to slow before the West Gate Tunnel project completes in 2022. Brisbane was an underperformer, with EBITDA up just 2.4% to $146m. The main negatives were subdued traffic volume growth of 0.3% because of disruption from works on Gateway and Logan motorways, as well as similar fee changes to Melbourne. Traffic volumes should rebound in coming months, leading to a better performance in FY20. North America performed relatively well with EBITDA of $96m, up 8.5% excluding the A25 acquisition in Montreal. The 395 express lanes are 50% complete and scheduled to open in FY20. Additional extensions are likely in this congested region. The A25 has been integrated, and back office systems are being enhanced. The balance sheet is relatively sound, though credit metrics deteriorated over the past year. Gearing increased 60 basis points to 35.8% and funds from operations/debt fell 30 basis points to 8.6%. While high, gearing is reasonable considering TCL's highly defensive and growing earnings. Risk is well managed with a long average debt maturity of around nine years, while almost all debt is hedged for interest rates and currency. IMR Neutral.

AGL Energy's (AGL) (narrow moat) 1H19 underlying NPAT rose 10% to $537m, mainly on stronger wholesale electricity prices. Despite this, management believes earnings are tracking towards the middle of the full-year NPAT guidance range of $970m to $1.07bn, which implies no growth from last year. 2H19 headwinds include lower gas sales volumes, lower average retail prices, and higher fuel costs. We make minor changes to incorporate the result and increase our FY19 NPAT forecast 1% to $1.027bn. We also marginally upgrade medium-term earnings forecasts to reflect higher electricity futures prices and marginally reduce the discount rate used in our valuation to reflect a higher expected debt weighting. These changes see our fair value estimate increase 5% to $21 per share. The electricity portfolio was the star performer with operating income up 8% to $955m. The main positives were higher prices for large business customers following increased wholesale electricity prices, as well as lower costs because of the falling price of the renewable energy credit AGL is obliged to buy. These factors more than offset the negatives, which included lower average retail prices as most remaining customers were put on discounted rates in the aftermath of last year's government and media attacks. The gas portfolio also performed well, with gross margin income increasing 5% to $411m, mainly on higher prices for retail and wholesale customers. The main negatives were lower sales volumes to retail and business customers, and sharply higher gas purchase costs. Gas purchase costs should continue rising as contract prices catch up to high market prices, implying over 40% upside. However, this also suggests further upside to prices charged to customers, particularly business and wholesale customers on multiyear contracts. The balance sheet remains strong. Management previously suggested a return capital to investors via a share buyback if it didn't find an acquisition or other use for surplus capital. However, AGL appears happy to maintain firepower while it waits for growth opportunities. IMR Negative.

Origin Energy's (ORG) (no moat) reported a good 1H19 result with underlying EBITDA up 20% to $1.7bn and underlying NPAT up 53% to $592m, mainly on stronger LNG export prices and lower interest expense. Dividends were reinstated, with 10 cents per share fully franked paid and management guiding to the same in 2H19. There is plenty of upside to the expected FY19 payout ratio around 33%, as financial health improves. EBITDA in the utility business, known as energy markets, was flat, while integrated gas EBITDA jumped 43%. Headwinds will intensify in 2H, and FY19 profit growth is unlikely to be as strong. We increase our earnings forecasts for the integrated gas division on the recent improvement in the oil price and a faster than expected improvement in domestic gas prices. Our fair value estimate increases 4% to $7.80 per share. Energy markets EBITDA rose 2% to $852m as lower electricity earnings were offset by sharply high gas earnings. FY19 guidance of $1.5bn to $1.6bn is unchanged. Electricity gross profit fell 7% to $719m on lower volumes and lower average

Spark Infrastructure SKI	
Fair Value ($)	2.40 →
Price/Fair Value	0.95
IMR	Neutral

Telstra TLS	
Fair Value ($)	4.40 →
Price/Fair Value	0.72
IMR	Neutral

retail prices. Downward pressure on retail prices stems from measures to help alleviate concerns from the 2018 government electricity price review. Electricity earnings should fall further in 2H19 on price relief measures, nonrepeat of renewable energy credit trading gains and continued intense competition. Focus is on reducing costs to serve customers and improve customer experience by investing in IT and digital platforms. Gas gross profit increased 24% to $398m on higher prices for large business customers. These customers sit on multiyear contracts, so there's a lag in pushing through higher wholesale gas prices. Additionally, gas earnings benefited from diverting gas from its own power stations and instead selling the gas to wholesale customers. Guidance is for 2H19 earnings to be flat on 2H18. The integrated gas division, mainly consisting of the 37.5% stake in the APLNG export business, was again the star performer, with EBITDA up 43% to $900m, mainly driven by a 40% increase in realised LNG prices, which are linked to oil prices with a few months lag. Earnings also benefited from higher average prices for domestic gas sales, though prices received remain well below spot prices because of long-term, low-priced contracts. We expect further upside to earnings as these domestic gas contracts end over the longer term. Costs rose on higher royalties, gas purchases, and price hedging. APLNG's FY1919 distribution breakeven guidance is broadly unchanged at US$39 to US$42 per barrel of oil, while Brent oil prices sit today around US$66 per barrel. This suggests strong free cash flows at APLNG, and dividends paid to ORG will continue despite the sharp fall in oil prices late last year. IMR Neutral.

Spark Infrastructure (SKI) (no moat) posted a solid 2018 result, with proportional EBITDA up 5% to $825m. Distributions of 16 cents per security (cps) were comfortably covered by look-through operating cash flow of 19.5 cps. The result was in line with our expectations. We make minor adjustments to our earnings forecasts and remain comfortable with our $2.40 fair value estimate. There is no change to our opinion SKI lacks an economic moat, as heavy-handed regulation offsets monopoly benefits. This is becoming more evident as the regulator turns the screws trying to improve utility bill affordability. The main issue for SKI is the sustainability of distributions. The company was recently forced to cut forecast distributions to 15 cents per share for 2019 following an adverse tax ruling. There could be further downside after the next round of regulatory resets, which will incorporate lower return settings and allowances to cover tax. Management suggests these unfavourable changes will shave $60m–$75m per year from revenue on a proportional basis from 2021. To put it in perspective, this could reduce free cash flows by around four cents per security, all else being equal. With reduced cash flows and a related deterioration in credit metrics, combined with ongoing reinvestment needs at the underlying companies, we doubt SKI will be able to maintain distributions at current levels. We now factor in distributions falling to around 13 cps in 2021, though even this requires a more aggressive distribution payout ratio than the company has used in the past. Financial health remains sound for now, but ongoing regulatory attacks will weaken credit metrics after the next round of regulatory resets. Management is highly focused on maintaining current credit ratings, suggesting it won't try to prop up distributions from 2021 with debt. EBITDA of Victoria Power Networks (VPN) increased 6% to $830m on regulated tariff increases and cost-out initiatives. This trend should continue until the next regulatory reset in December 2020, with tariffs increasing at mid-single-digit rates in January 2019 and 2020. After the 2020 regulatory reset, tariffs are likely to fall due to increasingly tough regulatory conditions. South Australia Power Networks (SAPN) underperformed with EBITDA flat at $656m as regulated tariff increases and cost-out initiatives were offset by lower unregulated revenue and higher emergency response costs. Nonetheless, the near-term outlook is positive as earnings should benefit from a 2.7% tariff increase in July 2018 and a similar increase in July 2019, combined with ongoing cost-reduction measures. SAPN's next regulatory reset is in mid-2020, and it should also be tough. TransGrid's EBITDA increased 13% to $669m as new renewable energy connections drove a strong increase in unregulated revenue. Regulated tariff increases and cost savings also helped. RAB increased just 1% to $6.4bn, but unregulated assets, such as new renewable energy connection lines, swelled 21% to $431m. Having just undergone a regulatory reset, TransGrid's earnings should grow solidly until June 2023. IMR Neutral.

Telecommunications

Telstra (TLS) (narrow moat) 1H19 reported NPAT, fell 28% year on year to $1.23bn, impacted mainly by $328m in restructuring charges related to the T22 transformation program. On an underlying basis, NPAT declined 26% to $1.55bn. Underlying EBITDA was down 15% to $4.676bn. It is possible

Vocus Group VOC	
Fair Value ($)	3.00 ↑
Price/Fair Value	1.23
IMR	Strongly Positive

the 1H19 fully franked DPS of eight cents disappointed, down from 11 cents in 1H18, given consensus expectation was a half to one cent higher. However, we are comfortable with the board's decision to stay conservative with a payout ratio of 77%. Indeed, the dividend was higher than our 7.5 cents forecast, and it would have been more of a concern if TLS went back to agonising over this issue, having just taken off the dividend shackles to combat the enormous competitive, structural and company-transformation challenges. The composition of this dividend was five cents from underlying earnings (payout of 84% versus policy of 70 to 90%) and three cents from net one-off receipts from the NBN (payout of 68% versus policy of 75%). As such, we saw little in the result to warrant a change in our forecasts or the $4.40 fair value estimate. This is particularly as all the FY19 guidance metrics were reiterated, with projected normalised EBITDA guidance of $8.7bn to $9.4bn in line with our unchanged $9bn estimate. The mobile division was the standout performer. While 1H19 EBITDA was down 6% to $1.9bn, it is tracking above our full year expectation of an 8% fall, with TLS competing aggressively and successfully for customers in the important post-paid segment. The importance of the 239,000 increase in post-paid mobile subscribers in 1H19 cannot be over-emphasised. Granted, the cost of this gain was felt in the 2% fall in post-paid average revenue per user and manifested in the 6% decline in EBITDA. However, these outcomes for the narrow moat-rated group's most important division (41% of group normalised EBITDA) were still moderately above expectations. Critically, increasing subscribers provides an importance base for monetisation and establishing first-mover advantage, as TLS transitions to 5G. Recurring NBN receipts also increased 28% to $345m, while Global Connectivity lifted EBITDA by 15% to $155m. The Data and IP division also fared better than expected, with EBITDA down just 6% to $782m, tracking better than our full year forecast of an also 8% fall. On the negative side, the fixed-line businesses continued to slide, with EBITDA down another 29% to $866m. This was compounded by a 66% slump in Network Application Services (NAS) EBITDA to $39m, hit by a reduction in NBN commercial works and a fall in other one-off revenues in the managed data networks space. Net debt/EBITDA of 1.7, is still within the board's comfort zone of 1.3 to 1.8. This was despite free cash flow coming in at $627m, down from $1.716bn a year ago—a well-telegraphed fall owing to lower earnings, bringing forward of capital expenditures, working capital movements and restructuring cash costs. However, management reiterated FY19 free cash flow guidance range of $3.1bn to $3.6bn. IMR Neutral.

Vocus Group's (VOC) (narrow moat) 7% fall in 1H19 underlying EBITDA to $176m was a reality check on the transformation progress under the revamped management team. While building blocks are being put in place (strategic focus, culture, cost discipline), there is no denying the tough market dynamics. The core network services unit saw just a 3% lift in EBITDA to $167m, a slowdown from the 15% achieved in FY18. The combined Australian consumer and business EBITDA fell 17% to $79m, hurt by the challenging NBN economics and structural headwinds on legacy revenues. None of this was a shock and we retain our FY19 underlying EBITDA estimate of $358m, down 2% on FY18, and within management's reaffirmed guidance of $350m–$370m. Indeed, all our forecasts are intact, albeit our fair value estimate has nudged up 3% to $3.00, adjusted for time value of money. However, market enthusiasm for the three-year turnaround program has driven shares in the narrow moat-rated group to more than 20% above our intrinsic assessment. We were guilty of such exuberant expectations with respect to previous management regime's recovery aspirations, but we have learnt our lesson. Over 40% of VOC's revenue (consumer, business) remains hostage to adverse external factors, and only so much costs can be taken out. While the Network Services division is the crown jewel, it does not operate in a competitive vacuum as evidenced by continuing industry price erosion. Steady growth in New Zealand, with 1H19 EBITDA up 10% to NZ$31m, is encouraging but it accounts for just 10% of group EBITDA before unallocated costs. In any case, we expect group EBITDA to reach $412m in FY21, up 15% from our forecast FY19 base of $358m (effectively flat over three years). We believe this adequately factors in the recovery potential under the rejuvenated senior management team. Normalised underlying NPAT, excluding significant items, fell 29% to $49m dragged down by the 7% decline in underlying EBITDA (or 10% inclusive of long-term incentive employee expense), and higher depreciation and amortisation and net finance costs, mostly the impact of the commencement of Australia Singapore Cable project. The dividend was passed, and we do not expect a resumption until FY21 when net debt/EBITDA is forecast to drop to 2.2, down from the onerous 3.1 at end December.
IMR Strongly Positive.

Amcor AMC	
Fair Value ($)	14.60 →
Price/Fair Value	1.01
IMR	Neutral

ARB Corporation ARB	
Fair Value ($)	15.00 →
Price/Fair Value	1.18
IMR	Neutral

Industrials

Amcor's (AMC) (narrow moat) 1H19 result was than we had anticipated driven by weak flexibles volumes in developed markets. Constant currency sales were accordingly soft at 4.3%. Resurgent volumes in the rigid segment were pleasing, however, and provided some offset. We trim our full-year flexibles volume expectations and now expect FY19 top-line growth of 5.8% to US$9.86bn, down from prior expectations of 6.2%. Nonetheless, with our full-year operating income forecast largely unimpacted at US$1.125bn and our medium-term expectations unchanged, we retain our fair value estimate of $14.60 per share. While Asian flexibles volumes grew strongly, flat volumes in Europe and the Americas offset and saw flexibles sales grow at 2.9% on a constant currency basis. We reduce our FY19 flexibles segment volume forecast from 2.4% to 1.3% and now expect segment top-line growth of 5.4% to US$6.88bn, down from our prior growth forecast of 6.4%. However, segment 1H19 margins of 12.4% are tracking largely in line with our unchanged full-year forecast. In contrast, we upgrade our full-year rigid segment volumes forecast from 1.5% to 2.6% to reflect resurgent rigid beverage volumes in 1H19. Favourable sales mix and volumes contributed to strong top-line growth of 7.6% on a constant currency basis. Pleasingly, beverage volumes rebounded strongly from a poor showing in 1H18 where a wet summer saw North American volumes fall 7.4%. FY19 rigid sales are now expected to grow by 6.8% to US$2.98bn, versus prior forecast growth of 5.7%. 1H19 segment EBIT margin of 10.6% trails our full-year forecast, but we continue to expect segment EBIT margin of 11.4% for FY19. The balance sheet continues to look extended at net debt/EBITDA of 2.8 times at end December and we expect net debt/EBITDA of 2.9 times post Bemis deal completion. While leverage will reduce relatively quickly toward AMC's through the cycle target of 2.25 to 2.75 times, current leverage is manageable with interest covered around 6 times in FY19. Management informed the market in late January of the delay to the anticipated closing date of the Bemis transaction. Minimal further detail was provided with the earnings release and AMC continues to expect completion in the June quarter. The transaction remains subject to antitrust approvals in Europe, the U.S. and Brazil, while all other necessary clearances have completed. We continue to ascribe a 100% probability of deal completion and expect US$126m in synergy realisation. Therefore, the deal remains set to add A$1.14 per share in value for shareholders, in our view. IMR Neutral.

ARB Corporation (ARB) (narrow moat) reported 1H19 revenue of $218m and pretax profit of $38m, growth of 6% and 5%, respectively. The dividend of 18.5 cents per share fully franked was an 6% increase on 1H18. Sales to original equipment manufacturers (OEMS) grew the fastest at almost 22%, reflecting new contracts commenced during the year, although this was offset by softness in the core Australian market. Management highlighted a continuation of sales growth in early 2H19, although cautioned unstable economic conditions remain in some of ARB's key markets. At the current pace ARB is tracking marginally below our expectations. Accordingly, we trim our FY19 EPS estimate by around 4% to 43 cents. However, our long-term projections and $15 per share fair value estimate are unchanged. The Australian region (over 80% of group sales) grew revenue by a modest 4%, below our 6% forecast. The domestic softness is a reflection on a subdued domestic consumer environment and slower new vehicle sales, both of which we attribute to the negative wealth effect from declining housing prices. However, the impact on ARB has been limited, as the company's primary target categories are medium and large sport utility vehicles (SUVs) and four-wheel-drive utilities, both of which have outperformed the broader new vehicle sales market. However, we believe the softness is cyclical, and our long-term projections are broadly unchanged. We continue to expect ARB to generate mid-single-digit sales growth in the core Australian market, underpinned by ongoing expansion into new product categories, a resumption of 1%–2% per year growth in new vehicle sales, incremental market share gains, and inflationary price increases. We forecast Australian operating margins to remain around 20% for the foreseeable future, broadly in line with historic averages. Price increases and strict cost control will help offset higher energy and steel prices, along with the weaker A$ which impacts Thai baht denominated operating costs. The company's brand power underpins its ability to justify a price premium over competitors and continue passing through rising input costs. Exports grew at a moderate 7%, albeit slightly below our expectation, and disappointing compared with the 14% per year growth generated over the past five years, although the share of group revenue remains relatively small. Management has demonstrated its commitment to growing exports by establishing and growing offshore sales and servicing capabilities while increasing warehousing and distribution capacity. The company's penetration of the US, Europe, and Middle East is negligible, with considerable room to

Brambles BXB	
Fair Value ($)	11.20 →
Price/Fair Value	1.06
IMR	Neutral

Qantas Airways QAN	
Fair Value ($)	5.00 →
Price/Fair Value	1.13
IMR	Neutral

grow, and we project offshore revenue growth in the low- to mid-teens percentage range for the foreseeable future. IMR Neutral.

Brambles (BXB) (wide moat) enjoyed 5% volume growth in 1H19 versus 1H18 owing to good underlying U.S. economic conditions, share gains in Europe, and improved results in Asia-Pacific. Along with 2% contribution from price, revenue increased 7% on a constant-currency (CC) basis, tracking our full-year forecast. However, negative currency translation drove reported sales growth of only 3%, while continuing cost pressure in transport and lumber expenses led to operating income falling 3% to US$504m. The resulting fall in margin—about 100 basis points to 17.7%—trails our prior forecast for flat full-year profitability, and management's outlook for underlying profit to only modestly grow this year is a bit worse than we had expected. We lower our near-term projections as result, but we think the longer-term opportunity for margin expansion remains, owing to further pricing actions, more-modest cost inflation, and investments in automation and other cost savings. We maintain our $11.20 per share fair value estimate. The CHEP Americas segment suffered the largest profitability degradation, but we see several signs that should lead to improved results past FY19. Despite 5% contribution from higher prices, underlying operating profit fell 11% versus 1H18 due to inflation in transport and lumber costs, with margin contraction from 17.3% to 14.7%. Nonetheless, we are encouraged by 2% volume growth, confirming management's estimate competitors have remained disciplined on price. The European business similarly continues to fight inflationary cost pressures, but profitability declines were far less pronounced given better-structured pricing mechanisms in the region's contracts. Margins declined a modest 70 basis points to 24.4% versus 1H18, tracking our 25% full-year forecast. However, we caution that near-term economic risk remains paramount. While encouraged by 5% volume growth through market share gains, like-for-like volume gains were a slower 1%, with management cautioning weaker economic conditions have impacted the business. And the uncertainty of Brexit could weigh on near-term revenue and cash flow, with key risks including access to timber supply, changes to customer demand patterns, and labour shortages. IMR Neutral.

Qantas Airways (QAN) (no moat) reported a 20% fall 1H19 in underlying profit before tax of $780m. Unsurprisingly, the main driver of the decline was the $416m increase in fuel cost from 1H18. The company was able to pass through some of the higher fuel price, as evidenced by the 6% increase in average unit revenue, although it was unable to fully offset the 10% growth in unit cost (including fuel) over the year. The 12 cents per share fully franked dividend was up from seven cents in 1H18 was ahead of our expectations. We increase our full-year projection from 19 to 24 cents per share. We lifted our FY19 EPS estimate by around 3% to 62 cents, to reflect a lower than expected fuel bill of $3.9bn, compared with our previous estimate of $4.1bn, strong forward bookings (up 7%) and improved utilisation. However, our long-term estimates are broadly unchanged, and we project low-single-digit EPS growth on average over the next five years. We continue to forecast low-single-digit revenue growth in Qantas International over the next five years underpinned by low- to mid-single-digit capacity growth, which will be partially impacted by softening unit revenue as fuel prices continue to decline. We maintain our $5.00 per share fair value estimate. Despite a challenging consumer environment, the domestic business performed relatively well, with revenue up 6%. EBIT grew by a modest 1%, as the company was able to recover most of the higher fuel costs through higher pricing. We were pleased to see utilisation at 80%, reflecting disciplined capacity management. Unit revenue should continue to grow in the second half, albeit at a slower pace than in the first half. Management guided to flat capacity in the second half, which translates to minus 1% for the full year, which we have factored into our assumptions. The international business, which is notoriously volatile and highly competitive, endured a challenging half with a 60% fall in underlying EBIT to $90m, despite the 5% increase in unit revenue. This weakness reflected an $219m jump in fuel cost, in addition to less favourable currency movements, higher commissions and cost of doing business. However, on a more positive note, management indicated the competitive environment seems to have stabilised, with a moderate 4% additional competitor capacity in the first half. Jetstar's performance was mixed, with strong demand for its key long-haul markets including Bali, Japan, Thailand, and Vietnam, offset by higher fuel bill. Revenue grew by 5%, on the back of strong unit revenue, improved load factor, and an 11% increase in average revenue per domestic seat, all of which helped but were unable to fully offset the higher fuel bill which dragged EBIT down 20% and operating margin down almost 4 percentage points to 12%. IMR Neutral.

Qube Holdings QUB	
Fair Value ($)	2.62 ↑
Price/Fair Value	1.02
IMR	Neutral

a2 Milk A2M	
Fair Value ($)	13.60 ↑
Price/Fair Value	1.04
IMR	Strongly Positive

Qube Holdings (QUB) (narrow moat) reported a pleasing 1H19 result, with solid volume growth in ports and bulk and Patrick driving underlying NPAT of $65m, 20% ahead of 1H18, and slightly outpacing our prior expectations. Management retained guidance of "solid" adjusted NPAT growth in FY19, albeit not as strong as the 1H performance. We upgrade our forecasts marginally and increase our fair value estimate by 3% to $2.62 per share. Our long-term estimates, however, are largely unchanged and QUB's prospects remain attractive. The vertically integrated logistics company enjoys cost advantages over competitors, and the Moorebank facility should further entrench its advantage. The operating division, which includes the former logistics and ports and bulk divisions, grew underlying EBITA 5% to $82m. Volume upticks in ports and bulk, which is exposed to the recovering resources industry, drove the increase, offsetting a flat half for Logistics. This remains in line with our full-year forecast of around $171m. We forecast an EBITDA CAGR of 8% over the next five years as solid growth in containerised freight volumes is partly offset by intense competition keeping pressure on prices, limiting margin expansion. Underlying EBITA in infrastructure and property of $21m is in line with our full-year forecast of $40m. The Moorebank project appears on track to begin operating—albeit in a limited capacity—in early FY20. We are optimistic on the long-term potential of the Moorebank Logistics Park and expect it to drive substantial cost efficiencies for tenants importing large volumes of containers through Port Botany. The Patrick container business enjoyed increased volumes and market share gains in 1H19. Further productivity gains helped drive the 15% increase in QUB's share of Patrick's underlying NPAT before amortisation to $19m, which tracks our unchanged forecast of $37m. The outlook remains positive, with no contract losses in the half. We continue to forecast annual increases in container volumes of a little more than 3% over the next five years, combined with an uptick in pricing, driving a 6% CAGR of Patrick's underlying earnings over the same period. The 2.8 cents per share dividend was 4% higher than 1H18 in addition to a one cent per share special dividend, both fully franked. While this is above QUB's payout ratio of 50% to 60% of underlying earnings per share, the dividend policy is currently under review to allow for more flexibility. With net debt of $1.07bn, the current leverage ratio of 28% is below the target 30% to 40% range.
IMR Neutral.

Consumer Staples

a2 Milk Company's (A2M) (narrow moat) 1H19 result was in line with our longer-term forecasts. But the near-term outlook exceeds our expectations. Revenue from infant formula, the key product in this geography, grew 45% versus 1H18 as the company continued to rapidly expand distribution and gain market share. This improvement outpaces our prior full-year forecast for 27% growth. Moreover, despite management confirming our expectation for increased marketing expenses to drive lower 2H margins, full-year profitability will likely prove slightly better than we previously forecast. A2M estimates consolidated FY19 revenue will grow in line with 1H19's 41%, with EBITDA margins increasing from 30.7% in 1H18 to 31%–32%, compared with our prior forecast for 26% top-line growth and flat margins. We lift our FY19 EBITDA projections from NZ$354m to NZ$404m. But we've already incorporated continued market share and margin expansion into our long-term results. As such, our fair value estimate increases 4% to NZ$14.20, a greater 5% to A$13.60 given a strengthening NZ$. A key piece of our thesis is market share gains for a2 Platinum infant formula in China, and the company has not disappointed. Management notes value market share ticked up from 5.1% at end FY18 to 5.7%, nearly hitting our previous full-year target of 5.9%. We are encouraged by strong execution across several selling channels despite operating in a competitive market, including minimal disruption from China's new e-commerce laws, further expansion into the country's mother and baby stores—to 12,500 from 10,000 only a few months ago. We still see market share climbing to 15% in China over the next 10 years, but now expect this achievement on slightly faster trajectory, reaching 6.7% in FY19. Faster infant formula sales growth has an outsize effect on A2M's bottom line. The product made up nearly 81% of revenue in 1H19, up from 78% in 1H18, and formula's high-margin profile helped to boost EBITDA margins from 32.7% in 1H18 to 35.5% from 32.7%. We expect increased marketing efforts to drive down this profitability in 2H19, but management now projects FY19 EBITDA margins of 31% to 32% versus a prior outlook for broadly flat performance. We had already forecast margins climbing to 34% over the next decade, which remains unchanged, but we now project EBITDA will reach 31% of sales in FY19, up from about 30% previously. The one concern we have in the 1H19 results is poor cash conversion. Free cash flow of NZ$110.5m was only 72.4% of NZ$152.7m NPAT, compared with 117% in 1H18 and an average of

Blackmores Limited BKL	
Fair Value ($)	105.00 ↓
Price/Fair Value	0.89
IMR	Strongly Negative

Coca-Cola Amatil CCL	
Fair Value ($)	8.90 →
Price/Fair Value	0.95
IMR	Neutral

about 97% over the past several years. Nonetheless, we attribute this largely to timing issues around receivables and inventory and continue to forecast 98% cash conversion for the full year. Moreover, A2M's balance sheet remains strong, with no debt and NZ$288m in cash on hand.
IMR Strongly Positive.

Blackmores Limited (BKL) (narrow moat) reported a soft 1H19 result and downgraded full-year guidance. Despite strong growth in volumes, which translated to an 11% increase in revenue to $319m, NPAT was flat at $34m reflecting increased costs from higher raw material prices, higher rebates in China relating to stock clearance and the changing channel mix, increased marketing spend particularly in China, and higher operating costs as the company ramps up capability in Asia. While some issues may be temporary, there is risk margins are being eroded by increasing competition, weaker consumer sentiment and strong distribution partners. Dividend was steady at $1.50 per share fully franked. Management cited an even softer start to 2H19 in China and expects 2H profit to be lower than 1H's $34m. We downgrade our FY19 NPAT forecast 16% to $63m and assume longer-term volume growth won't generate the operating leverage we had previously thought. Our fair value estimate falls 22% to $105 per share. The stock now screens as marginally undervalued. Australian and New Zealand sales rose 19% to $144m. This was driven by underlying growth of around 6% and the increasing trend of Australian retailers exporting Blackmores products to China. EBIT increased 28% to $33m, representing a margin of 23.1%, compared with 21.5% in 1H18. We see this as a good result in an increasingly competitive market, helped by new product launches and online sales growth. Conversely, China revenue fell 11% to $65m and EBIT nearly halved to $12m, with a greater percentage of sales to China were transacted through Australian retailers, benefiting the ANZ segment. Combining China with ANZ to look through the impact of indirect sales, we revenue increased 8% while EBIT fell 4%, showing volumes continue to grow solidly but margins are pressured. Other Asia performed well with revenue up 34% to $53m and EBIT increasing from $1.2m to $4.6m, driven by strong volume growth in Korea, Taiwan, and Hong Kong. EBIT margin expanded from 3.1% in 1H18 to 8.6% but still well below ANZ margins. We continue to expect margins in this division to improve as BKL gains scale in these markets. BioCeuticals revenue increased 7% to $57m and EBIT rose 8% to $8.5m, with the margin remaining relatively flat at 15%. This business faces headwinds from April 2019 as private health insurance rebates will no longer be available for a range of natural therapies including treatment from naturopaths. Pleasingly, financial leverage remains conservative, allowing BKL to debt-fund organic expansion and bolt-on acquisitions, while maintaining a relatively high-dividend payout ratio. We forecast net debt/EBITDA of just 0.4 times in FY19. IMR Strongly Negative.

Coca-Cola Amatil's (CCL) (narrow moat) 2018 results highlighted areas of both challenges and successes. The core Australian beverages business remained pressured by headwinds from container deposit schemes (CDS), competitive pricing responses in water, and ongoing investments to drive growth. We're encouraged these investments and price cuts appear to be generating positive volume response and market share gains but expect the Australian business to again face falling EBIT in 2019 as further sales, marketing, and pricing actions are taken. As a result, despite continued growth in New Zealand and CCL's alcohol and coffee division, we see operating margins slipping from 13.2% in 2018 to 12.8%, to an EBIT of $621m versus 2018's $635m. Nonetheless, we believe this year will be the final year of transition for Australian beverages. While we don't see this segment reaching the same levels of high-teens EBIT margins enjoyed in the past, we agree with management CCL will grow its earnings per share at a mid-single-digit rate annually starting in 2020. We maintain our $8.90 per share fair value. We expect CCL can stem the top-line challenges in Australian beverages over the long run but results in 2019 will remain choppy due to the further advent of CDS across most Australian states. Price increases due to CDS resulted in lower volumes at a faster clip than we previously anticipated. In NSW volumes declined 3.4%, compared with a smaller 0.4% slide in the rest of Australia. In all, beverage volume across the country fell 1.3% in 2018, with a 0.6% increase in average price per case. We anticipate revenue declines will continue in 2019. Encouragingly, volume share improved across both sparkling and still beverages, with recent launches such as No Sugar helping to drive gains in brand Coca-Cola in 2H18, and improved performance in dairy and energy drinks. While we still project falling volumes in sparkling drinks over the long run, we expect performance in other key categories can lead to a slimmer 0.3% total volume annual decline. New Zealand's success remains a stark opposite. Together with Fiji, this geography grew revenue

Treasury Wine Estates TWE	
Fair Value ($)	12.30 ↑
Price/Fair Value	1.25
IMR	Neutral

Adelaide Brighton ABC	
Fair Value ($)	5.00 →
Price/Fair Value	0.94
IMR	Negative

6.9% on volume gains of 6.1%, building market share across all categories. This outpaced our expectations, and while we expect some moderation in volume improvement going forward given similar secular health-related challenges as other developed economies globally, we're confident in CCL's ability to drive low-single-digit revenue growth. Profitability also remained solid, with EBIT margins widening by about 10 basis points to 18.9%. We expect similar annual improvement going forward. CCL's primary emerging market exposure and longer-term growth opportunity remains Indonesia but continued to struggle. Although volumes ticked up by 1%, challenging product mix and currency translation headwinds drove top-line results down by 2.1%, EBIT margins slipped from 9.1% to 8.7% due to cost pressures and additional marketing investments. We remain optimistic on the long-term potential and comfortable with our 10% segment EBIT margin forecast, which includes the higher-margin Papua New Guinea business. IMR Neutral.

Treasury Wine Estates' (TWE) (no moat) H19 results keep it on-track to meet our near-term projections. Performance was solid, with good execution on distribution changes in the U.S. and continued market premiumisation in China leading to strong top-line growth of 16% versus 1H18. Alongside this improved top line, TWE enjoyed further profitability expansion. Earnings before interest, taxes, and expenses associated with the valuation of self-generating and regenerating assets (EBITS) grew 19% to $338.3m and a 22.4% margin versus 21.9% in 1H18. Management reiterated FY19 guidance of roughly 25% EBITS growth, tracking our forecast, albeit on a slightly higher revenue base than we anticipated, mitigated by some increased near-term costs associated with changes to altered U.S. strategy. We lift our fair value estimate from $11.70 to $12.30 to account for these changes and the time value of money, but our long-term expectations are largely unchanged. The core of our thesis is the blistering pace of EBITS growth TWE has enjoyed will not continue over the longer term. Principally, we see more limited upside from a mix shift toward higher-margin luxury wine away from lower-margin commercial products, given the company's already strong inroads in doing so. Highlighting this point, management offered an early outlook into FY20, forecasting 15% to 20% EBITS growth, bracketing our 18.3% projection. Asia remains the primary growth engine, and with less than 5% market share in China, the company's runway remains long, in our opinion. Revenue in the segment grew 32% versus 1H18, as TWE further expanded its distribution in the region and concentrated on high-priced luxury and masstige wines. This strategy led to total volume rising just 1.6%, but average revenue per case jumping more than 30% as luxury and masstige wines grew volume more than 20%. We expect some softening of price increases as TWE continues to expand its offerings of midrange products, but nonetheless still expect revenue growth to average more than 25% over the next four years reflecting volume share gains. Moreover, given the focus on high-priced wines, the Asian segment's margins remain TWE's highest, near 39%, which we expect to continue. The business in the Americas also appears to be back on track following some short-term hiccups associated with the route-to-market change-over. Revenue grew 20%, as the company captured greater pricing per case as a direct distributor in some regions under the new selling model, although EBITS margin fell from 19.9% in 1H18 to 18.5%. As such, near term margins will be a bit lower than we anticipated, but we make no changes to long term forecasts, and see margins rebounding to nearly 24% within the next several years. Like its model in Asia, TWE is self-distributing 25% of its business in the U.S., which offers many of the same benefits regarding product discipline and marketing controls. Together, the Americas and Asia segments made up nearly 72% of 1H19 EBITS and we expect this contribution to rise to more than 80% over the next five years. The balance sheet should support these investments. TWE believes it can complete any planned French M&A in the normal course of doing business, without a need to raise additional capital. IMR Neutral.

Building & Construction Materials

Adelaide Brighton's (ABC) (narrow moat) 2018 NPAT of $191m held no surprises. But cautious guidance and an underwhelming 2018 final dividend led investors to question whether the substantial pipeline of Australian infrastructure projects can offset declining demand from residential construction. Management is guiding to flat volumes across cement, concrete, and aggregates in 2019. While the market reacted negatively, guidance largely tracks our expectations for a minor decline in construction material demand in 2019 before growth returns once more in 2020. We marginally upgrade our five-year sales CAGR to from 4.8% to 5.3% due to expected positive mix shift. But with midcycle EBIT margins lowered by 1% to 15% due to rising energy costs, our fair value estimate of $5.00 per share remains unchanged.

Boral BLD	
Fair Value ($)	5.80 →
Price/Fair Value	0.85
IMR	Neutral

James Hardie JHX	
Fair Value ($)	21.20 →
Price/Fair Value	0.87
IMR	Strongly Positive

The Cement, Lime & Aggregates (CLC&A) segment, which accounts for 97% of earnings, experienced a more adverse mix shift than we expected in 2018. Significant volumes of low-value aggregates to early stage infrastructure projects continued through 2H18, while a greater proportion of cement sales into more competitive east coast markets also contributed to the negative mix effect. CLC&A margins correspondingly declined from 20.5% in 2017 to 19.8%. While cement volumes were in line with our 1% forecast, concrete and aggregates volumes were surprisingly strong, up 14% and 10%, respectively, and provided for segment top-line growth of 4.4% despite the negative impact of sales mix. We expect mix shift to reverse course over the coming two years, while price increases act to largely offset rising input costs. Nonetheless, we see segment EBIT margins of 17.5% at midcycle, around 1% lower than prior estimates due to rising energy costs that may not be fully recovered. We forecast a five-year sales CAGR of 6.1% for the CLC&A segment, with volumes to deliver around 2% of this growth as infrastructure projects pick up the slack from waning demand in residential construction. Remaining top-line growth will be delivered from positive movement in price and mix shift. Nearer term, we forecast segment top-line growth of 3.9% in 2019, delivered entirely from price increases with neither volumes nor mix shift to positively contribute. In fact, volumes are expected to recede by a marginal 0.3% in 2019 before returning to 1.4% growth in 2020 as demand from infrastructure projects gathers steam. Mix shift is expected to be neutral in 2019 before sales of higher value aggregates increase to infrastructure projects as they progress toward completion and recovery of cement volumes in South and Western Australia yield positive mix shift in 2020. Return of capital remains an option in the absence of value accretive downstream M&A targets. Earnings quality was again robust in 2018, with net income well supported by operating cash flow. Specifically, net income (before depreciation) was 92% operating cash flow backed, up slightly on 89% in 2017. IMR Negative.

Boral's (BLD) (no moat) 1H19 results were affected by delays to Australian infrastructure projects and adverse US weather. While announced EBITDA of $485m was expected, pricing in the Australian businesses and volumes in its US fly ash businesses were soft and lead us to trim our FY19 EBITDA forecast by 2.5% to $1.09bn, including Boral USG join venture profits. Nonetheless, we continue to see medium-term top-line growth given a robust infrastructure pipeline in Australia and a supportive residential and infrastructure backdrop in the US. We retain our valuation of $5.80 per share. While we reduce our FY19 expectations for Australia segment price increases, we expect positive skew in volumes to the second half to drive 2.8% segment sales growth. Australia segment prices increased 1%–3% in 1H19, comparing unfavourably with our full-year expectations for 3.5%, and were insufficient to offset input cost inflation. Segment EBIT margins thus declined from 10.8% in 1H18 to 9.2%. Meanwhile, infrastructure project delays saw 1H19 concrete volumes fall, offsetting growth in aggregate, cement, and asphalt. We expect better volumes in the second half. Segment EBITDA of $638m is now forecast to be largely flat year on year, before returning to growth again in FY20. Shrinkage in 1H19 fly ash volumes leads us to trim our full-year North America segment EBITDA forecast is by 2.5% to $382m. While strong volumes in the North America roofing business delivered segment revenue growth of 3% in US$ terms, weather impacted volumes elsewhere. Fly ash volumes retreated 6% and we now forecast flat volumes for FY19, down on a prior 4.3% growth assumption. Nonetheless, delivery of the previously guided US$25m in full-year Headwaters synergies remains on track. We continue to expect segment EBIT for USG Boral of $192m, a largely flat result year on year. USG Boral volumes were significantly affected by a market downturn in Korea, which offset growth in Australia, Indonesia, Vietnam, and India. Segment EBIT of $84m was 26% lower than a year earlier despite translational gains from a lower A$. BLD continues to engage with Knauf regarding options for the joint venture following the completion of Knauf's acquisition of USG. While BLD asserts it will only take full ownership of USG Boral once more should it be value accretive for shareholders, our continued preference is for capital be allocated elsewhere given the lack of economic moat in the plasterboard business. While not identifying specific assets, management reaffirmed further assets remain earmarked for sale. Further divestments would provide flexibility for BLD to return capital to shareholders. We believe businesses on the chopping block would include remaining high-fixed-cost, highly cyclical businesses such as the US Brick joint venture. IMR Neutral.

James Hardie (JHX) (narrow moat) delivered a solid 3Q19 result in the face of weak US housing starts. Our full-year adjusted NPAT forecast remains largely unchanged at US$301m and sits just below the midpoint of management's upgraded guidance range of US$295m to US$315m. Our fair value estimate of $21.20 per share is also unchanged. While US housing starts for December are currently unavailable, we estimate North American market index growth was negative 0.75% to negative 1% in 3Q. Despite this, JHX delivered 1% volume growth in North America, thus delivering 1% to 2% above market index growth (PDG). While below management's near-term target of 3%–5% annual PDG, it largely tracks our expectations. We continue to expect North American volumes to grow 4.1% in FY19. North American pricing and margins are also tracking our full-year expectations. Average pricing in the first nine months of FY19 was 3% higher year on year. EBIT margins of 22.9% also largely track our full-year expectations for 22.3%. Our North American volume forecast of 4.1% is unchanged. We factor 3.5% growth in market volumes and 0.6% PDG for FY19. However, with November US single family starts down significantly on the prior year, falling 13.1% on a seasonally adjusted basis, a strong finish will be required in terms of 4Q housing starts given 3Q softness. 4Q housing starts will need to average around the 930,000 on a seasonally-adjusted basis to achieve this market growth rate. Management express their confidence the 3Q housing market easing was transitory, however, providing some comfort. JHX points to a continuation of accommodative macroeconomic conditions including an unemployment rate near 50-year lows and accommodative monetary policy settings. The new CEO recommitted to the group's pre-existing long-term goals. As such, the so-called 35/90 target remains in place in North America under which JHX aims to take fibre cement exterior siding to 35% category share and maintain their 90% market share at the same time. Management are targeting annual above-market index growth in the vicinity of 6% to achieve this.

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