MORNINGSTAR®

Earnings Season Insights September 2018

One-stop shop for over 90 results

Peter Warnes
Head of Equities
Research

Contact Details
Tel: 1800 03 44 55
Email: help.au@morningstar.com

Level 3,
International Tower 1,
100 Barangaroo Avenue,
Barangaroo, NSW 2000

www.morningstar.com.au

© Copyright warning: Our newsletter is available to paid subscribers only and no reproduction is permitted. If you work for an organisation that would like to take out multiple subscriptions to any of our products, our customer service department will be happy to advise you of the discounts available or site licenses.

Dividends rise, FY19 guidance downbeat

Results for the 2017/18 financial year generally met expectations, with earnings growth of the S&P/ASX 200 up around 9% over 2016/17, against expectations around 7%. The weighted average was a little lower, held back by banks and telecommunications. Resources and energy companies continued to perform strongly with earnings up over 20%, while the rest of the market averaged growth around 5%.

But dividend growth was pleasing, just exceeding earnings growth and underpinning the market, with the S&P/ASX 200 Accumulation index adding 2% from 26 July to 31 August and touching an all-time high on 30 August. Solid balance sheets and restrained growth capital expenditure allowed directors to allocate more free cash flow to shareholders via dividends and share buy-backs.

While results were positive, top line or revenue growth underwhelmed, reflecting the lack of inflationary pressures and difficulty raising prices in an increasingly competitive environment. Guidance for 2018/19 was downbeat with management citing increasing cost pressures starting to impact operating margins. Rising energy and imported raw material costs are unlikely to abate in the near-term and analyst earnings downgrades were quite prevalent.

The Gaming and Leisure sector was a feature with Crown Resorts, Star Entertainment and Tabcorp recording strongly positive market reactions. Despite subdued household consumption, retailers performed relatively well as a group as did new media with Carsales.com, Domain and REA Group reporting better-than-expected results. Consumer Staples including Blackmores, Coca-Cola Amatil and Treasury Wines Estates beat expectations, while Wesfarmers and Woolworths were solid. In the smaller retail space both Breville and Super Retail Group beat expectations.

CSL's blockbuster result stood out in the healthcare space while both Ramsay Health Care and InvoCare's FY19 guidance disappointed. REITs were solid, with Goodman Group the standout.

Resource majors BHP Billiton and Rio Tinto reported strong earnings, free cash flow and record dividends, but these were well anticipated. South32 surprised positively. Both Woodside Petroleum and Santos benefitted from stronger oil prices, while the latter's acquisition of Quadrant Energy and return to paying a dividend provided added stimulus to its share price.

Disappointments included building materials companies Adelaide Brighton and James Hardie while Boral surprised positively. In the financials space both Challenger and Insurance Australia Group missed consensus expectations. On the other hand, QBE Insurance pleased after a long period of underperformance.

There was an increased number of strongly positive and negative surprises over previous years. Strongly-rating surprises are measured by an initial market reaction (IMR) where the share price movement exceeds 5% within 24 hours of the announcement.

There were several meaningful changes to our fair value estimates. The highlights (a 10% plus increase) and lowlights (a reduction of over 5%) are mentioned below along with the drivers of the change.

Investors please note: Any Morningstar ratings/recommendations contained in this report are based on the full research report available at www.morningstar.com.au.
© 2018 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates nor their content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice has been prepared by Morningstar Australasia Pty Ltd ABN: 95 090 665 544, AFSL: 240892 (a subsidiary of Morningstar, Inc.), without reference to your objectives, financial situation or needs. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782. Past performance does not necessarily indicate a financial product's future performance. Refer to our Financial Services Guide (FSG) for more information at www.morningstar.com.au/fsg.pdf.

Strongly Positive

- Aveo Group
- Brambles
- Breville
- Blackmores
- Boral Limited
- Carsales.com
- Crown Resorts
- CSL Limited
- Goodman Group
- IRESS Limited
- Link Administration
- Magellan Funds
- NIB Holdings
- QBE Insurance
- Qube Holdings
- South32 Limited
- Santos Limited
- Star Entertainment
- Super Retail
- Tabcorp
- Telstra Corp
- Vocus Group

Strongly Negative

- Adelaide Brighton
- Ansell Limited
- Caltex Australia
- Challenger
- Domino's Pizza
- G8 Education
- Iluka Resources
- Insurance Australia
- InvoCare
- James Hardie
- Netwealth
- News Corporation
- Origin Energy
- Pact Group
- Primary Health
- Ramsay Healthcare
- SEEK Limited

Fair value upgrades

- **Flexigroup** (FXL) +40%
  Better-than-expected FY18 results and an improved outlook as past investments begin to gain traction.
- **Qantas** (QAN) +25%
  Stellar FY18 result. Stronger operating margins reflecting ongoing transformation benefits and lower long-term fuel price. Increasingly more confident in management's ability to extract cost efficiencies and increase prices.
- **Ryman Healthcare** (RYM) +20%
  Increased confidence in development prospects in the company's Australian operations driving faster medium-term earnings growth.
- **Goodman Group** (GMG) +14.6%
  Upgrades to our forecasts for management fees, development margins and rents as management puts customers first.
- **Nine Entertainment** (NEC) +13.3%
  Quality FY18 result highlighting the powerful benefits of operating leverage. Strong FY19 guidance on the back of operating momentum.
- **New Hope Corporation** (NHC) +12.5%
  Meaningful increases in forecast Newcastle export thermal coal prices for near-term and mid-cycle partially offset by an assumption of commensurately higher future costs.
- **Suncorp Group** (SUN) +11.5%
  Better-than-expected FY18 result together with increasing confidence in the ability of management to deliver ambitious benefits from the business improvement program. Higher interest rates in future will also boost investment returns.
- **Treasury Wine Estates** (TWE) +11.4%
  Better long-term profitability from Australian operations, slightly better pricing in Asia and lower tax rate.
- **Breville Group** (BRG) +11%
  Strong FY18 results expectations of stronger sales growth in the Americas and Rest of the World and sustained margin improvement in the distribution segment.

Others with a "honourable" mention with an increase between 5% and 10% included: Boral, Star Entertainment, Blackmores, Cochlear, Trade Me, ResMed Inc, IRESS, Dexus, Santos, Crown Resorts, JB Hi Fi, Sonic Healthcare, Qube, Seven West Media and Lendlease.

Fair value downgrades:

- **Pact Group** (PGH) –17%
  Soft FY18 result with Australian operations 19% below expectation as higher resin and energy costs and lost volume in rigid packaging hit margins. Competitive pressures and powerful customers to keep margins contained.
- **Monash IVF** (MVF) –15.5%
  Reduced margin expectations over the next four years and lower IVF volumes in the near-term after the departure of a high-profile fertility specialist.
- **Primary Health Care** (PRY) –12.5%
  Uncertainty over future direction after the surprise $250m capital issue to fund a day-hospital network, new initiatives aimed at improving operational capacity at existing medical centres and upgrading pathology infrastructure.
- **G8 Education** (GEM) –12.5%
  Weaker-than-expected 1H18 result with oversupply of childcare centres hits occupancy rates, revenue and profit. Negative operating leverage hurts margins. Over the longer-term we now assume a less pronounced margin recovery.
- **Fletcher Building** (FBU) –10.5%
  After a challenging year, we revise our near-term margin expectations. Longer-term we assume a slower-than-previously expected recovery in margin as revenue growth slows.
- **Orora Limited** (ORA) –7.7%
  We question whether the focus on greater scale in US distribution can be achieved in a value-accretive manner. Future revenue growth expectations have been pared along with lower volume expectations.
- **AMP Limited** (AMP) –7.7%
  Ramifications from the Hayne royal commission are far reaching and will impact how the business operates in future. New management will have to reset the business model and the possibility of a break-up of the vertically integrated model cannot be over looked.
- **Ramsay Health Care** (RHC) –7.3%
  Disappointing FY19 guidance of "up to 2%" growth in EPS citing lower hospital volumes in Australia due to reduced private health care participation, ongoing challenges in the UK and a neutral outlook in France were well below our previous assumptions of double digit growth.

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%).

ANZ Bank ANZ	
Fair Value ($)	30.00 →
Price/Fair Value	0.95 ●
IMR	Neutral

Commonwealth Bank CBA	
Fair Value ($)	83.00 →
Price/Fair Value	0.87 ●
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%); Strongly negative (price fall over 5%); Negative (price fall between 3% and 5%); Neutral—plus/minus zero to 3%. This provides some insight as to whether expectations were met, exceeded, or disappointed.

Banks

Australia & New Zealand Banking Group's (ANZ) (wide moat) 3Q18 update focused on capital, funding, asset growth and asset quality, with no news on earnings. The four operating drivers of loan growth, net interest margins (NIM), expense growth and bad debts are broadly in line with our expectations, underpinning our $30 per share valuation. We like the strong capital position, stable risk-weighted assets and sound asset quality. ANZ also has quite a low level of lending to higher risk residential investors and interest-only borrowers. A key takeaway from the update is the bank's credit 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. Australian home loans in grew at a very subdued 0.38 times the system growth rate in 3Q18. Despite softer loan growth, ANZ is steadily progressing corporate initiatives. These include disposing of non-core assets, growing capital levels, building the profitable Australian and New Zealand businesses, and most importantly, continuing to benefit from improved asset quality. The on-market share buyback program was recently doubled to $3bn and to date approximately $1.5bn has been completed. The lower-than-expected 3Q18 bad debt expense and ongoing pressure on NIMs results in minor changes to our FY18 cash profit forecasts. We reduce our bad debt expense forecast from $1bn to $800m which partially offsets a minor decline in 2H18 NIM from 1.93% to 1.91%. The net effect lifts FY18 cash profit forecast modestly to $6.88bn. Our FY18 fully franked dividend forecast of $1.60 per share is unchanged on a dividend payout of 67% trending towards the bank's medium-term target of 60%–65% of cash earnings by end FY22. Capital, liquidity, and funding ratios remain strong and well above regulatory minimums. The common equity Tier 1 (CET1) capital ratio increased to a very strong 11.07%. The capital ratio is equivalent to approximately 11.5% on a pro forma basis when announced asset sales settle and the additional $1.5bn share buyback announced in June 2018 are included. The bank has already met APRA's "unquestionably strong" benchmark capital ratio of 10.5% required by January 2020. IMR Neutral.

Commonwealth Bank of Australia's (CBA) (wide moat) FY18 result was messy. But the underlying cash profit from continuing operations—excluding the one-off AUSTRAC penalty—increased a solid 3.7% to $10bn. The $2.31 per share final dividend increased marginally from a year ago, taking FY18 fully franked dividends to $4.31, based on a 75% payout excluding one-offs. A slightly higher divided is a vote of confidence in the outlook from the Board. Net interest margins (NIM), underlying operating expenses, loan quality, underlying returns on equity, pro forma capital levels and modest dividend growth stood out and support our positive view and unchanged $83 fair value estimate. At current prices, the stock is undervalued, trading 10% below our valuation. Despite FY18 being CBA's "annus horribilis", the underlying business continues to perform well. For the year ahead, we expect a modest increase in cash NPAT, dividend, and return on equity (ROE). But the planned demerger of the wealth management and mortgage broking company, known as "NewCo" will reduce annualised NPAT by at least $500m per year from FY20, all else equal. We forecast a FY19 cash NPAT of $10.2bn with EPS growth a modest 1.5%. We expect margins to soften to a 2.13%–2.14% range, loan growth of 4.3%, and loan losses to increase modestly to 0.16%. If achieved, we think this will be as good outcome considering the challenges experienced in FY18. Management is expecting home loan system growth to ease from 5.6% for FY18 to approximately 4% by end FY19. Modestly lower than forecast loan growth does not have much of an impact on our valuation. We forecast an average annual 1.5% increase in dividend to end FY23 including NewCo. We expect the dividend payout to steadily decline, levelling at around 73% by FY23, toward the bottom of the bank's wide 70%–80% target range. At this stage we have not demerged NewCo from in our forecasts or valuation. NewCo is expected to demerge by the end of 2019. The common equity Tier 1 (CET1) capital ratio of 10.1% increases to an impressive 10.7% on a pro forma basis, modestly above APRA's 10.5% benchmark required by January 2020. The underlying ROE declined from 15.6% in FY17 to 15.3% but remains best in peer group. Including one-offs, the ROE from continuing operations declined 160 basis points to a still-respectable 14.1%. IMR Neutral.

National Australia Bank NAB	
Fair Value ($)	32.00 →
Price/Fair Value	0.86 ●
IMR	Neutral ○

Westpac WBC	
Fair Value ($)	35.00 →
Price/Fair Value	0.79 ●
IMR	Neutral ○

Macquarie Group MQG	
Fair Value ($)	130.00 →
Price/Fair Value	0.97 ●
IMR	Neutral ○

National Australia Bank's (NAB) (wide moat) 3Q18 unaudited cash profit of $1.65bn was broadly in line with our expectations, coming in 1% lower than the average of the two previous quarters and 3% lower than 3Q17. Profits fell due to higher operating expenses, softer net interest margins (NIM) and modestly higher bad debts. There was nothing in the update to change our long-term positive view and our $32 fair value estimate is unchanged. Our FY18 cash profit forecast of $6.45bn and fully franked dividend of $1.98 per share is intact. Our FY18 forecast dividend payout ratio is a high 85%, but strong asset quality, modest loan growth and a benign outlook support the high payout. We forecast the payout ratio to trend lower but remain above the bank's medium-term target of 70–75% of cash earnings. The stock is currently trading at an attractive dividend yield of 7%, or 10% on a grossed-up basis. Loan growth and NIMs were unspecified, but revenue increased 1% on the average of the two previous quarters on the back of good growth in SME lending within business and private banking. A strong performance from New Zealand operations supported modest revenue growth. NIMs declined slightly due to elevated short-term wholesale funding costs and ongoing intense competition in the home lending segment, particularly for residential owner-occupier loans. NIM for the six months ended March 31, 2018 was 1.87% and we maintain our full-year forecast at the same level. As expected, expenses increased 3% due to higher compliance costs, investment spend, and increased depreciation and amortisation. We are forecasting negative "jaws" for FY18 with expenses expected to increase at a greater rate than income delivering an increase, or deterioration, in the forecast cost/income ratio from 42.7% in FY17 to 45.5%. Balance sheet and asset quality remain strong. The quarterly loan loss charge increased 9% to a still very low $203m, including a $25m charge for additional collective provisions for forward-looking adjustments. The year-to-date annualised loan loss rate of 0.13% is in line with our full-year forecast. NAB continues to impress with historically low bad debts. Longer term, we forecast the loss rate to steadily increase to 0.21% by end FY22. Capital levels are sound with the CET1 ratio at 8.7%. IMR Neutral.

Westpac Banking Corporation's (WBC) (wide moat) 3Q18 update covering capital, funding, and asset quality. Despite weaker margins, the update was in line with our expectations, underpinning our unchanged $35 fair value estimate. Lower net interest margins (NIM) surprised, but we make no changes to our FY18 forecast cash profit of $8.4bn and fully franked dividend of $1.88 cents per share (cps). Prior to the update, consensus estimates were for a cash profit of $8.5bn and $1.89cps dividend. The bank continues to leverage strong east coast economic conditions, with 73% of new home loans in the June quarter settled in New South Wales and Victoria. NIMs declined 11 basis points from 2.17% in 1H18 to 2.06% due primarily to the sharp increase in short-term wholesale funding. Despite the surprisingly soft outcome, our FY18 margin forecast of 2.13% is unchanged as short-term wholesale funding costs have eased a little since June. We are not sure if short-term funding costs will continue to fall, but if they remain elevated for long, we expect the bank and major bank peers, to increase variable home loan rates to offset the higher funding costs. We like the strong capital position, modest risk-weighted asset (RWA) growth, sound asset quality, and slowdown in higher-risk residential lending to investors and interest-only borrowers. The 0.1% decline in the common equity Tier 1 (CET1) ratio to 10.4% reflected the 0.70% net of dividend reinvestment, substantially offset by 3Q earnings, converting preference share conversion, RWAs, movements, and other capital changes. WBC's internationally comparable capital ratio was a globally top quartile 16.0%. WBC estimates the impact of regulatory model changes during 4Q18 will add approximately $11.5bn in RWA, representing about 0.30% reduction in the CET1 capital ratio. Most importantly asset quality remains strong despite widespread focus on stressed household budgets. We maintain our FY18 loan loss forecast of 0.13%, in line with the historically low outcome for FY17. IMR Neutral.

Macquarie Group's (MQG) (narrow moat) 1Q19 trading update confirmed the five operating groups are performing in line with expectations. The positive high-level trading update did not surprise. Unspecified 1Q19 operating earnings are up on 1Q18 and FY19 guidance for group profit to be "broadly in line" with the $2.56bn of FY18 was confirmed. Our positive view on Australia's largest global asset manager and investment bank is intact and at the current stock price, the stock is fairly-valued, trading 6% below our $130 fair value estimate. Our higher than guidance FY19 forecast is $2.7bn and if achieved will be 6% higher than FY18. We forecast a solid EPS growth rate of 6.7% for FY19 following a strong 15.4% increase in FY18. Our $5.60 per share dividend, 45% franked, is 7% higher than FY18. Our forecast dividend is based on a 70% payout, mid-range of the 60–80% target. Looking

Bendigo and Adelaide Bank BEN	
Fair Value ($)	11.50 →
Price/Fair Value	0.93 ●
IMR	Neutral

AMP Limited AMP	
Fair Value ($)	3.60 →
Price/Fair Value	0.90 ●
IMR	Positive

ahead we forecast impressive returns on equity around 17% per year and an attractive dividend stream for the next five years at least. Earnings are down on the seasonally strong March quarter, but the group continues to benefit from robust global investment market conditions and good demand for infrastructure and energy assets. MQG's most profitable division, the non-market facing business of Macquarie Asset Management continues to perform well with strong, (but unspecified) base and performance fees featuring. Macquarie Asset Management's assets under management (AUM) increased an impressive 8% 1Q19 to $534bn, largely due the acquisition of previously announced GLL Real Estate Partners in Germany and ValueInvest, as well as infrastructure asset acquisitions, and favourable market and FX movements. Macquarie Infrastructure and Real Assets (MIRA) increased equity under management an impressive 18% to $102bn, well above FY19 estimate of $94bn. Unspecified performance fees again featured, and we estimate a total of $577m for FY19. CEO Nicholas Moore will retire in November and be replaced by the highly qualified 30-year Macquarie veteran and head of Macquarie Asset Management for the past 10 years, Shemara Wikramanayake. IMR Neutral.

Bendigo and Adelaide Bank's (BEN) (no moat) in-line FY18 result was boosted by a healthy lift in net interest margin (NIM). Underlying cash earnings of $445m represented a 6.5% increase on FY17 and came in slightly under our $452m forecast, while the fully franked final dividend of 35 cents per share was as expected and took FY18 dividends to 70 cents fully franked. We retain our $11.50 fair value estimate. Profitability remains healthy, reflected in an increase in NIM but offset by below-system growth in total lending. NIM was up an impressive 12 basis points (bp) to 1.96%, driven by an 11-bp pickup in retail deposit pricing. However, there was wholesale deposit pricing pressure in 2H18 which we expect to continue. The repricing of the mortgage book in late July 2018 will support NIMs in FY19, although front book discounts will act as a NIM headwind. We adjust our NIM assumptions upwards from 1.85% for our forecast period to 1.94%, still lower than current levels, on our expectation of continued challenges from higher funding costs. While revenue growth remains a challenge for the industry, cost management remains a key focus. A 50-basis-point improvement in the cost/income ratio to 55.6% was encouraging, although as management guided, it is unlikely to see any major improvement in the near term, given increased costs of compliance and regulation. We adjust our cost/income ratio assumption from 58% in FY19 to 56% trending towards 55% over the duration of our 2019–23 forecast period. Asset quality remains high, supported by low bad and doubtful debt charges and low loan arrears rates. The capital position remains strong, evidenced by a 35-bp increase in the common equity Tier 1 (CET1) capital ratio to 8.62%, driven by organic capital growth. BEN satisfies APRA's "unquestionably strong" benchmark CET1 capital ratio of 7.5%. BEN's funding profile remains healthy, although its heavy reliance on customer deposits could be a potential issue in the event of intensifying deposit pricing competition, as well as a need by savers to access those deposits at a higher-than-anticipated rate. IMR Neutral.

Life, General and Health Insurance

AMP Limited's (AMP) (narrow moat) 1H18 underlying NPAT of $495m was in line with guidance. The 50% franked 10 cents per share dividend was lower than the payout target range of 70%–90% of underlying NPAT. However, AMP reconfirmed the 2018 dividend at the lower end of the payout range, and we still forecast a full-year dividend of 23 cents. Our $3.60 per share fair value estimate is unchanged. Core wealth management segment's underlying NPAT of $204m was moderately better than expected, with higher revenue from SMSF administration and equity investments in advisor businesses offsetting continuing gross margin pressure. However, the key driver of the performance was strong operating cost management, which we expect will be difficult to replicate due to higher compliance-related costs following the Royal Commission. The results were also the first chance to gauge the fund flow impact from the fallout of Commission hearings. Notably, wealth management incurred $873m net cash outflows, compared with cash inflows of $1.02bn in 1H17. Funds flows worsened in 2Q with 1H numbers only capturing two months of the fallout following the Royal Commission, and 1H17 inflows were inflated from changes in superannuation contribution limits coming into effect. The 1H net outflows were compensated by market performance and other movements totalling $2.5bn, leading to a small increase in FUM. 2H18 fund flows will likely provide a better gauge of the sustainable impact of the Royal Commission on its wealth management business. AMP's other growth segments of AMP Capital and AMP Bank had mixed results relative to our expectations, with AMP Capital's underlying NPAT growing slightly from $92m to $94m, below

Insurance Australia Group IAG	
Fair Value ($)	7.50 ↑
Price/Fair Value	0.97
IMR	Strongly Negative

QBE Insurance Group QBE	
Fair Value ($)	12.50 ↑
Price/Fair Value	0.87
IMR	Strongly Positive

Suncorp SUN	
Fair Value ($)	14.50 ↑
Price/Fair Value	1.00
IMR	Positive

our expectations but AMP Bank performing better than expected with underlying NPAT increasing from $65m in 1H17 to $78m, primarily driven by higher net interest margins offsetting lower loan growth, although loan growth was above system growth. IMR Positive.

Insurance Australia Group (IAG) (no moat) FY18 cash NPAT of $1.03bn fell just short of our forecast and consensus but was up 4.4% on FY17. Gross written premium (GWP) growth of just 1.8% was in line with guidance of "low-single digits," but on an underlying basis increased 4% year on year due primarily to broad based rate increases. Reported insurance margins surged from 14.5% in FY17 to 18.3% and modestly exceeded guidance of 16%–18%. The underlying insurance margin of 14.1% improved on 12.4% a year ago. We increase our fair value estimate 3% to $7.50 after rolling our financial model. Strong profitability, a robust capital position and a positive outlook enabled the board to declare a fully franked final dividend of 20 cents per share (cps) taking FY18 dividends to 34 cps, based on a 78% payout. Despite the solid year-on-year performance, a much softer 2H was concerning. A negative was confirmation surplus franking credits continue to decline with guidance for a reduction in the franking rate with franking expected to be in the 70%–100% range. We estimate a franking rate of 85% for the 2H19 dividend declared in August 2019 and subsequent dividends. While claims cost inflation remains a concern, premium rate increases, and higher-than-expected reserve releases supported a good insurance margin outcome. We expect further underlying improvement in earnings in FY19 with management guiding for GWP growth of 2%–4% and a reported insurance margin in the 16%–18% range. Despite the margin guidance range below the 18.3% achieved in FY18, we think a margin around 18% in FY19 would be a good outcome and is in line with our forecasts. The business optimisation project is progressing well and is on track to deliver net benefits of approximately $100m in FY19. Exiting FY19, management guides to net run rate benefits of $250m. We had previously incorporated these savings in our forecast and consequently our FY19 cash NPAT forecast of $1.14bn is broadly unchanged. Management's three to five year through-the-cycle targets are unchanged with a return on equity (ROE) of 15%, sustainable and attractive dividends, top quartile total shareholder returns, and compound EPS growth around 10%. IMR Strongly Negative.

QBE Insurance Group's (QBE) (no moat) 1H18 cash profits were up a modest 3% to US$385m and in line with expectations. Underlying fundamentals continue to improve, and we expect further good progress with legacy issues over the next year. The 8% tax rate was below our FY18 forecast of 18%. We increase our FY18 adjusted cash NPAT forecast from US$743m to US$775m on a lower tax rate of 14%. Longer term our tax rate forecast is in line with management guidance of the low 20% range. The dividend was steady at 22 cents per share (cps) 30% franked, in line with expectations. The 59% payout is within the target of up to 65% of cash profit. We lift our FY18 forecast from 45 to 46cps. Our longer-term payout forecast averages 60%. Fortuitously, in addition to internal operational improvements, the group is benefiting from an improving external environment, with increasing premium rates, higher interest rates and improving global economic conditions. Our US$ earnings forecasts from 2019 are broadly unchanged, but our fair value estimate increases 4% to $12.50 due to lower A$/US$ exchange rate. Business improvement is moving in the right direction with the adjusted combined operating ratio (COR) of 95.8% within the FY18 guidance range. Despite a decline in insurance margin from 10.1% to 8.2%, the fall was due to lower investment returns and a decline in prior-year reserve releases, not underlying business shortcomings. Investment return guidance was softened to 2.25%–2.75% from 2.5%–3.0% previously. Insurance premium rates increased by an average 4.6% against 1% in 1H17 with the rate of increase accelerating and all divisions benefiting. Customer retention remains high despite the premium price increases. Balance sheet settings improved with key capital ratios increasing following a tough natural peril experience in 2017. The PCA multiple of 1.74 times is mid-range of QBE's target. Gearing improved with the debt/equity ratio easing from 40.8% at 31 December 2017 but is still above medium-term target of 25%–35%. Return on equity improved from 6.6% to 8.2% on cash NPAT but remains subpar and below our 9% cost of equity assumption. IMR Strongly Positive.

Suncorp (SUN) (no moat) delivered on the early stages of its ambitious business improvement program (BIP) with a better than expected FY18 cash NPAT of $1.1bn. Profit was modestly higher than our $1.066b forecast and well above consensus of $1.04bn, though 5% lower than FY17. We have been too negative on the outlook for the BIP and have increased expected benefits in FY19 and beyond. Our FY19 cash NPAT forecast increases

Medibank Private MPL	
Fair Value ($)	3.10 →
Price/Fair Value	0.93
IMR	Neutral

NIB Holdings NHF	
Fair Value ($)	6.20 →
Price/Fair Value	0.99
IMR	Strongly Positive

from $1.15bn to $1.25bn, with higher increases in later forecast years. Longer term, we forecast improved revenue growth, increased cost outs, higher interest rates boosting future investment returns and capital returns with our fair value estimate increasing by 12% to $14.50 per share. FY18 highlights were a strong 2H in the Australian and New Zealand general insurance businesses, impressive balance sheet settings, surplus capital and the eight cents per share (cps) special dividend. The final ordinary dividend of 40 cps took total ordinary fully franked dividends to 73 cps, based on an 86% payout, well above the 60%–80% target range. The total payout for FY18 was a high 95.2% and collectively, ordinary and special dividends were 11% higher than FY17 dividends. Improved underlying claims performance and natural hazards below allowance by $36m in Australia impressed. Reserve releases of $319m represented 3.8% of net earned premium (NEP), well above the 1.5% long-term trend. Net benefits from the business improvement program delivered $40m in FY18, exceeding plan by $30m. Top line revenue growth was a soft 2.4%. Disappointments included a modest decline in the year on year Australian general insurance profit to $681m, a 190-basis point decline in the group general underlying insurance margin to 10.6%, a 5% decline in the banking profit to $389m. FY19 guidance was maintained. SUN announced a non-binding agreement for the sale of the life business to TAL Dai-Ichi (TAL) for $725m and will enter into a 20-year distribution agreement with TAL. The sale is expected to complete before the end of 2018 with approximately $600m of the net sale proceeds, representing about 46 cps, to be returned to shareholders in FY19. IMR Positive.

Medibank Private's (MPL) (narrow moat) FY18 result was softer-than-expected, but our positive view is intact. Good progress in improving the underlying business impressed with the health insurance operating profit up 8% to $536m and the health services business, known as Medibank Health, operating profit up 33% to $47m. The group NPAT margin of 6.4% was modestly below our 6.8% forecast. Lower-than-expected investment income, a higher tax rate, and higher other expenses contributed to the 1% decline in FY18 group NPAT to $445m, about 5% below our forecast and 3% below consensus. The final dividend was a modest disappointment at 7.2 cents per share (cps) taking FY18 dividends to 12.7cps, below our forecast 13cps, but still 6% higher than FY17. We maintain our $3.10 fair value estimate. Our FY19 NPAT forecast of $461m is lower than our previous forecast of $476m, with modest declines in outer years. Despite the challenges, the health insurance margin of 8.5% impressed and is broadly in line with our five-year average. The health insurance performance was in line with expectations with gross margin of 17.3% compared with our forecast of 17.1%. The underwriting expense ratio of 8.8% was broadly in line with our 8.7% and the insurance operating margin of 8.5% was marginally higher than our 8.4%. The outlook statement was typically vague with management targeting modest market share gains, despite the insurer expecting flat overall private health insurance volumes to persist. Hospital utilisation growth is set to remain subdued, but ancillary utilisation growth is expected to slow. Management expenses are targeted to increase modestly above the $557m of FY18. Importantly, for the first time in a decade, MPL's market share increased in 2H18. We estimate the market share was 26.85% at 30 June. MPL increased net policyholder numbers by 0.3% and longer term we forecast growth to gradually recover, averaging 2.8% in the next five years. The growth strategy is on track and the outlook is good. MPL remains well-positioned to deliver meaningful business improvements, which will underpin future earnings growth. But we acknowledge, private health insurance affordability is a major threat and continues to constrain industry wide policyholder growth. Political risks are increasing with the federal opposition party proposing to restrict the annual increase in private health insurance premiums to 2% for two years. The average industry premium rate increase was 3.95% for 2018. IMR Neutral.

NIB Holdings' (NHF) (narrow moat) FY18 underlying operating profit increased an impressive 20% to $184.8m in line with recently upgraded guidance. The final fully franked dividend of 11 cents per share (cps) took FY18 dividend to 20cps, up 5% on FY17 and one cent below forecast. FY18 NPAT increased 11% to $133.5m on the back of a strong performance from the key Australian operations and the nine-month contribution from GU Health. Despite the strong performance and the year-end roll forward of our valuation model, our fair value estimate is unchanged at $6.20 due to a modestly softer short-term outlook than previously expected. The softer guidance results in a broadly flat FY19 NPAT forecast of $135m, about 8% lower than our previous estimate. Return on equity impressed at 26%, but we forecast an average of 24% each year over the next five years due the higher capital base. Negatives included weaker than expected FY19

Magellan Financial Group MFG	
Fair Value ($)	28.00 ↑
Price/Fair Value	0.99
IMR	Strongly Positive

Perpetual PPT	
Fair Value ($)	44.50 ↑
Price/Fair Value	0.93
IMR	Neutral

guidance, increased uncertainty around future regulatory capital requirements, higher spend on marketing, technology, and underwriting expenses, and a modestly softer outlook for dividend growth. FY19's underlying operating profit guidance is at least $180m, about 3% below FY18. We expect fiscal 2019 to be a "consolidation year", but forecast EPS growth to average 11% from FY20–23. We expect the "partners" distribution strategy to contribute meaningfully to net policyholder growth and profitability. The current benign insurance claims environment should continue for several years as high average household debt levels, weak wages growth and tighter household discretionary spending weigh on the rate of growth in claims, particularly claims for elective surgery in private hospitals. Affordability remains a key issue with recent APRA statistics pointing to the continued decline in private hospital membership.
IMR Strongly Positive (pre-announcement)

Wealth Managers

Magellan Financial Group (MFG) (narrow moat) reported a strong FY18 result driven by increased funds under management (FUM) and a subsequent 8% increase in NPAT to $212m. The FY18 dividend was increased by 57% to $1.35 per share, which was well above market expectations and a higher payout ratio. Encouraged by strong FUM growth and continued investment outperformance, we increase our fair value estimate to $28. A healthy combination of organic fund flows, investment performance and acquisitions were the backbone of the result, with average FUM up 29% over the year to $59bn and year-end FUM up 37% to $69.5bn. Excluding the growth from investment performance, $4.4bn of new money flowed into MFG's funds, representing a 10% increase year on year with $2.5bn from institutional and $1.9bn from higher-margin retail investors. Within these flows, $1.6bn is attributed to the IPO of Magellan Global Trust. The acquisition of Airlie in February added a further $6.3bn to total FUM. We expect total FUM to increase approximately 7% per year towards $98bn by end 2023, which supports MFG's healthy earnings profile. In addition to healthy flows, strong investment performance contributed $8.5bn to FUM. MFG raked in $40m in performance fees, almost twice FY17 highlighting the manager's continued outperformance of its benchmarks. The strong growth in FUM supported earnings, with top line revenue growth outpacing operating expense growth. Not surprisingly, management fees were the main revenue driver, up 27% to $381m, while operating expenses, excluding one-offs, were up 20%. In line with these movements, the cost to income ratio fell approximately 200 basis points to 22.7%. The standout feature was the revised dividend policy with the payout ratio increasing 20% to a range of 90%–95% of the funds management business NPAT. This highlights the strength of Magellan's balance sheet and signals a high degree of confidence in their ability to continue generating free cash flow. We increase our expected payout ratio to 92.5% going forward, seeing total dividends per share increase to $1.57 in FY19 and representing a forward dividend yield of 5.6%. IMR Strongly Positive.

Perpetual's (PPT) (narrow moat) FY18 NPAT of $139m was consistent with our forecast of $138.7m. As expected, earnings growth was generated by the private segment, accounting for 23% of profit before tax (PBT) and the corporate trust segment (21% of PBT), with the investments division (56% of group PBT) impacted by fund outflows and higher employee costs. The final dividend of $1.40 took FY18 dividends to $2.75 per share fully franked. The results underscore the importance of PPT's diversification strategy, with the private segment PBT growing by 13.9% and corporate trust by 16.4%. These segments offset 3.4% lower PBT in its core investments division, leading to group underlying NPAT growth of 1.5%. We forecast FY19 group underlying NPAT of $136m, with continued but lower expected earnings growth in both private and corporate trust businesses unlikely to offset further expected lower earnings in the investments division. However, we believe PPT will maintain its dividend at $2.75 per share. PPT confirmed new CEO Rob Adams will commence on 24 September. The gearing ratio (corporate debt divided by corporate debt and equity) of 11.6% is well below the target gearing of 30%. This provides the new CEO with the opportunity to use the balance sheet to acquire earnings growth, which we otherwise would expect to grow by a CAGR in the low single digits in the next five years. We expect the core investments division to continue facing the structural headwinds as investors move to passive investment styles together the in-housing of asset management by major institutional superfunds. This has been recently compounded by poor short-term performance, with only 40% of PPT's funds ranking in the first and second quartile over a one-year period, although 92% have reached this ranking over a 10-year period. Notably, its core Australian equities strategies experienced net fund outflows of 12.5% in FY18, primarily driven by the loss of two major mandates. While we do not expect this level

Platinum Asset Mgmt PTM	
Fair Value ($)	6.40 →
Price/Fair Value	0.81
IMR	Negative

ASX Limited ASX	
Fair Value ($)	49.00 ↑
Price/Fair Value	1.32
IMR	Neutral

Challenger CGF	
Fair Value ($)	12.60 ↓
Price/Fair Value	0.82
IMR	Strongly Negative

of outflows to repeat in FY19, we nevertheless expect continued net outflows and margin pressures in the next five years to impact earnings. IMR Neutral.

Platinum Asset Management (PTM) (narrow moat) reported in-line FY18 results, albeit characterised by a weaker 2H across flows and profitability. NPAT of $189m was up 2% on FY17 and slightly above our $184m forecast, although 2H was down 15% on 2H17. The strong 1H18 outperformance attracted staff performance bonuses, which were a key driver behind the weaker 2H result. A dividend of 16 cents took the FY18 dividend to 32 cents per share fully franked up 7% on the year. Our fair value estimate is unchanged at $6.40. FY18 was a mixed bag for profitability, as investment outperformance attracted high performance fees as well as high performance bonuses, while management fees adjusted downwards for the first full year since they were introduced. Nevertheless, revenue was up 5.9% to $353.3m, comprising $328.7m in management fees, up 5.2%, and $21.9m in performance fees, up from $1.6m in FY17. Meanwhile, fees for the retail-focused Platinum Trust Funds and Platinum Global Fund, which represent 66% of total funds under management (FUM) fell 15 basis points to 1.35% effective July 3, 2017. While the year-on-year revenue increase was positive, despite lower fees, it was heavily skewed towards 1H, as 2H delivered a 2% reduction in fee revenue. FY18's average management fee 18 was down 17 basis points to 116 basis points across retail and institutional clients, with management adamant there is no intention to further reduce these numbers in the near term. Although we welcome this level of conviction when it comes to pricing, generally this isn't a decision entirely within the company's control, so we still expect a downward trending average base fee over the long term. The recent outperformance did not come cheap, only highlighting the competitive forces at play for retaining staff. Staff remuneration expense was up 43.8% to $49.2m. FY18 net inflows of $1bn compared with net outflows $3.6bn in FY17 and investment performance contributed a further $3.5bn. Year-end FUM was $25.7bn, up 13% year-on-year but down 5% since December 2017. FY18 highlights the risks and strengths associated with investing in asset managers. The industry continues to face challenges, including the trend away from active and to passive investing. Underperformance and fee compression continue to threaten profitability, with additional pressures coming in the form of higher salary expenses to retain key personnel. However, we see long-term outperformance as difficult to replicate, supporting the strong brand and underlining competitive advantages. IMR Negative.

Other Financials

ASX Limited's (ASX) (wide moat) FY18 result was a little stronger than we expected, with the 8% revenue growth rate ahead of our 6% forecast. The FY18 underlying EPS growth of 7% was higher than our 5% forecast. The key driver of the result was the listing and issuer services division, which accounts for 26% of group revenue. A 46% lift in capital raisings pushed revenue 15% higher and well ahead of our 9% forecast. However, we don't believe the current cyclical strength in capital markets reflects a structural growth trend for ASX, and we still forecast mid-single-digit revenue and underlying EBITDA CAGR over the next decade. We increase our fair value estimate by 2% to $49 per share. The key challenge facing ASX is to increase its earnings growth prospects beyond the mid-single-digit EPS growth generated by its Australian listed securities businesses. The information and technical services businesses, which comprises 20% of group revenue, also performed well, delivering revenue growth of 9.7%, but in line with our 10% forecast. We also increasingly believe ASX's network effect means its customers are a reasonably captive audience for these services, and we now forecast revenue CAGR of 6% over the next decade, up from 5% previously. Revenue of the cash-equities-related businesses—including cash equities trading, cash equities clearing, and cash equities settlement—was flat and weaker than our 2% forecast reflecting a fall in trading activity and competition from block trading. However, we believe this largely reflects the cyclical nature of the business, and as with the listings business, we expect the weak growth from cash equities to return to mid-single-digit growth from FY19. The balance sheet remains bulletproof with no debt, $8.5bn in participants margin commitments, and $1.1bn in ASX-owned cash. Although expenses growth and capital expenditures will increase in FY19, we are extremely comfortable regarding the sustainability of fully franked dividends. IMR Neutral.

Challenger's (CGF) (no moat) FY18 results disappointed and we trim our fair value from $13.10 to $12.60 per share. Normalised NPAT, of $406m was 5% below our forecast and at the lower end of guided net profit before tax (NPBT) growth of 8%–12%. Lower investment yields on policyholder

Computershare CPU	
Fair Value ($)	13.70 ↑
Price/Fair Value	1.41
IMR	Positive

Genworth Australia GMA	
Fair Value ($)	2.80 →
Price/Fair Value	0.93
IMR	Neutral

IOOF Holdings IFL	
Fair Value ($)	9.80 ↓
Price/Fair Value	0.82
IMR	Neutral

funds in its core annuities business and a higher effective tax rate were the primary drivers of the lower-than-expected results. Nevertheless, the final dividend of 18 cents per share was in line with our forecast and takes FY18 dividends to 35.5 cents per share fully franked. Our forecast FY19 normalised NPAT is reduced from $453.3m to $432.6m and is at the lower end of the company's guidance of normalised NPBT growth of 8%–12%.
While we expected normalised cash operating earnings (COE) margins to contract in FY18, the size of the fall was somewhat concerning, particularly in 2H. COE margins fell 36 basis points (bp), higher than our forecast contraction of 27bp. Margin compression was due to lower interest rates and asset returns and lower other income, primarily due to a one-off life risk fee and income from its insurance linked securities being lower than expected. Margin pressure is also due to continued product diversification, including a higher proportion of lower-margin institutional Guaranteed Index Return and Index Plus products, as well as Japanese annuities. The normalised NPAT was also affected by a higher effective tax rate, increasing 2% to 25.8%. The higher tax rate was primarily driven by interest payments on Challenger Notes not being tax-deductible, a lower proportion of offshore earnings, and a reduction in the level of franked dividends received. CGF also continues to strengthen its distributional reach by announcing a new relationship with fast-growing specialty platform provider Hub 24. We expect these factors, in combination with its strategy to increase the tenor of annuities sold, will drive strong growth in assets under management, compensating for continued margin contraction. The business has also proven scalable, progressively reducing its cost/income ratio and increasing operating margins. Notably, operating margins have increased from 65.4% in FY16 to 67.3% in FY18, despite COE margin pressures. We forecast this to continue, with operating margins expected to expand to 68.2% in FY23 despite continued COE margin contraction. The balance sheet is sound, with the life company's excess capital above APRA's prescribed capital amount, totalling $1.3bn, representing a PCA ratio of 1.53 times, with the target range of 1.3 times–1.6 times. IMR Strongly Negative.

Computershare's (CPU) (narrow moat) FY18 result was in line with our forecasts. However, we have made several minor adjustments which increases our fair value estimate 3% to $13.70 per share. Management provided FY19 underlying constant currency (CC) EPS growth of "around 10%", a little stronger than our 8.5% forecast. Although CPU increased underlying EPS by 16% in FY18, and the 14% increase in CC EPS exceeded management's guidance, we believe these growth rates are stronger than the company can sustain, and we maintain our mid-single-digit underlying EPS compound annual growth rate over the next decade. Margin income continues to be an important component of CPU's earnings; it grew to 29% of group EBITDA in FY18 from 25% in FY17. This likely reflects a strategic decision to maximise exposure to rising interest rates, which we consider to be sensible. The FY18 result also benefitted from an upswing in corporate actions, which we don't consider sustainable. To put this into perspective, of the US$82m increase in group EBITDA, we estimate around half was attributable to the growth in the corporate and class action businesses, with the remainder largely due to the mortgage services business. FY18 was the first year the business services division, constituting 39% of group revenue, overtook register maintenance, at 31% of group revenue, as the largest division in the group. This reflects management's strategy of aggressively expanding the mortgage services business. The mortgage services business continues to be the main "organic" growth driver of the group. Pleasingly, the mortgage servicing EBITDA margin increased from 15% in FY17 to 20%. CPU remains in good shape with net debt down 10% to US$980m. The net debt/EBITDA ratio of 1.6 and will increase to around 2.0 following the Equatex acquisition, within management's target range of 1.75–2.25. The defensive nature of CPU's businesses should prevent shocks that could undermine credit metrics. IMR Positive.

Genworth Mortgage Insurance Australia's (GMA) (no moat) fair value estimate of $2.80 is unchanged following in-line 1H18 results. We still forecast FT18 underlying NPAT of $100m after $50.3m in 1H. We also continue to forecast ordinary and special dividends totalling 24.5 cents per share in FY18 after an ordinary dividend of eight cents and a special dividend of four cents were declared. GMA's strong regulatory capital position allows it to maintain a high dividend payout ratio and continue with the on-market share-buyback program that commenced in May. FY18 guidance is unchanged. We believe the strong balance sheet and lack of major investment opportunities will provide scope for further capital initiatives. IMR Positive.

IOOF Holdings (IFL) (narrow moat) delivered an FY18 underlying NPAT of $191.4m, moderately above our $188.8m forecast. Strong operating cost

IRESS IRE	
Fair Value ($)	11.00 ↑
Price/Fair Value	1.18
IMR	Strongly Positive

Mortgage Choice MOC	
Fair Value ($)	1.70 →
Price/Fair Value	0.83
IMR	Neutral

management offset upward gross margin pressure. A final dividend of 27 cents per share took FY18 dividends to 54 cents slightly above our 53 cents forecast. However, we reduce our fair value estimate moderately from $10.30 to $9.80 per share, in the expectation future operating cost improvements will be unable to offset stronger expected gross margin pressures. We believe fee-reduction pressures in IFL's key platform and advice businesses and its investment management business will be part of the fallout from the Royal Commission. Pendal Group's recent platform fee reduction is likely to be the precursor of what's to come. Beyond increasing margin pressures, the latest round of Royal Commission may also test the robustness of IFL's corporate governance, risk management, and compliance processes. We forecast FY19 underlying NPAT to increase moderately to $202m, benefiting from the ANZ Wealth acquisition for part of the year, with the full-year contribution seeing underlying NPAT accelerate to $233m million in FY20. IFL also announced it had settled the claim against its subsidiary Australian Executor Trustees by paying $44.25m, but its cross-claim against their insurers is continuing. Management also suggested regulatory issues like the potential abolishment of grandfather commissions and the ban on superfund exit fees, among others, were not individually or collectively material to the company. The potential separation of IFL's vertically integrated business remains a genuine risk. IMR Neutral.

IRESS' (IRE) (narrow moat) 1H18 result was stronger than expected. Group revenue growth of 8.4% versus 1H17 was stronger than our full-year growth forecast of 7.1%, but constant-currency growth was lower at 6.3%. Similarly, the contribution margin grew by 8.3%, ahead of our 7.0% forecast, but 6.5% on a constant-currency basis. We increase our FY18 EBITDA forecast by 5% to $129m to reflect the stronger-than-expected first-half revenue growth and lower-than-expected cost growth. This implies EBITDA growth of 11% versus FY17, which exceeds management guidance. We also adjust longer-term forecasts, with EBITDA increasing by a similar amount in future years. Combined with a 2% boost from the time value of money, our fair value estimate has increased by 8% to $11.00 per share. Individual divisions produced mixed results with revenue from the Asia-Pacific financial markets division, which comprises 20% of the group, falling by 3%. We still forecast long-term annual growth of just 1%, owing to the structural pressures facing the sector. However, the Australia and New Zealand (ANZ) and UK wealth management divisions continue to benefit from increasing regulatory requirements and delivered respectable revenue growth of 9% and 6%, respectively, in line with our long-term forecasts. The biggest surprise came from the UK lending division, which comprises just 7% of group revenue but grew by 31% on a constant-currency basis as the division implemented new projects and transitioned to a subscription model. We increase our long-term annual growth forecasts for this division from 5% to 9%. The capital-light business model continues to enable strong cash flows, sustainable dividends, and relatively low financial leverage, which we expect to continue. Debt metrics are extremely comfortable with a net debt/ EBITDA ratio of 1.5 and EBIT/interest expense cover of 19. We expect strong cash flow generation to drive improvement in these metrics over the coming years. IMR Strongly Positive.

Mortgage Choice's (MOC) (no moat) FY18 cash profit NPAT increased 3% to $23.4m on FY17 and was driven by a 1.5% increase in net commission income to $60m and a 1.4% decline in operational expenses to $35m. The final fully franked dividend of nine cents took FY18 dividends to 18 cents per share, 3% higher than FY17 based on a 96% payout. Our fair value is unchanged at $1.70 per share. MOC is at the cross roads and has reset the business model to cope with a rapidly changing operating environment. We maintain our FY19 cash NPAT forecast of $16.6m and dividend of 13 cents per share, underpinned by the newly introduced franchise payout and reduced operating expenses, broadly in line with guidance. We continue to forecast a subdued medium-term outlook for MOC and expect no growth in EPS in FY20 and FY21, before some modest improvement in FY22 and FY23 on the back a stabilisation in the new lending volumes and increased contribution from trail commission as average loan lengthens. Despite the far-reaching negative publicity consumer demand for mortgage brokers continues to grow with industry statistics pointing to an increasing broker market share with a record-high 55.3% of home loans originated in the March quarter 2018. Increasing loan complexity and tougher lending standards are driving more and more borrowers to the services of mortgage brokers. The core mortgage broking business reported FY18 cash profits of $22.75m up 4% on FY17, representing 97% of group profit. The mortgage broking business was complemented by strong profit growth of 7.5% in the smaller

Steadfast Group SDF	
Fair Value ($)	3.00 →
Price/Fair Value	0.94
IMR	Neutral

Link Administration LNK	
Fair Value ($)	8.50 ↑
Price/Fair Value	0.89
IMR	Strongly Positive

MYOB Group MYO	
Fair Value ($)	3.82 →
Price/Fair Value	0.77
IMR	Neutral

financial planning division. Despite the small contribution to group earnings, the 38% increase in funds under advice and 15% increase in insurance premiums in force impressed. We like the diversification strategy but acknowledge it will take several years to generate a meaningful profit contribution. IMR Neutral.

Steadfast Group's (SDF) (no moat) FY18 cash earnings of $97.3m was 3.5% below our forecast, but still up a healthy 11.6% on FY17. The final dividend of 4.7 cents took FY18 dividends to 7.5 cents per share fully franked, up 6.8% based on a 79% payout. Despite a modest fully franked dividend yield around 3%, SDF offers attractive earnings growth upside due to a strong underlying growth profile. Our fair value is unchanged at $3.00. Following the FY18 performance, we trim forecasts to reflect higher amortisation and tax rate assumptions. Our FY19 underlying EBITA forecasts of $190m and underlying NPAT of $86m sit in the middle of the guidance range. Our positive long-term view is unchanged, based on resilient revenue and earnings due to SDF's high proportion of long-standing small- to midsize enterprise customers, high renewal rates, and high customer switching costs. We expect EPS growth to average an impressive 9.4% per year over the next five years based on solid revenue growth from the existing businesses, the recent acquisitions, the unisonSteadfast business, and other equity broker investments. Additionally, significant investment in technology drives rapid improvement in productivity. The combination of good top line revenue growth and a more efficient cost base will deliver forecast net margin improvement and consequently EPS growth. Solid performance of the equity investments in brokers and underwriting agencies, and improved insurance pricing continues to support earnings growth with gross written premium (GWP) reaching a record $5.3bn in FY18. The approximate $300m or 6% increase in network broker GWP compared with a year ago was sourced 3% from organic growth, 1% from new equity brokers, and 2% from additional authorised representatives. The underwriting agency group increased its GWP by an outstanding 18% from $777m in FY17 to $914m, driven by price, volume and acquisition growth. Property and business lines were particularly strong, and we expect more of the same over the next two years at least. The underwriting agency group is the largest group in Australasia with 25 agencies. IMR Neutral.

Information Technology

Link Administration's (LNK) (narrow moat) FY18 result was its first to include earnings from Capita Asset Services (CAS) which was acquired for $1.5bn in November 2017 and since been renamed Link Asset Services (LAS). The 54% increase in revenue was mainly due to the contribution from LAS and was in line with our forecasts. Without LAS, revenue rose by just 2%, also in line with our forecast and was affected by various factors such as client losses and the repricing of the Superpartners contract. However, the 57% increase in underlying NPAT was much stronger than our 43% forecast, reflecting better-than-expected LAS margins and progress with cost-saving initiatives in the rest of the business. We expect the 7% share price rise following the result was largely due to good progress being made with the integration of LAS. It has been nearly a year since LNK acquired LAS and things appear to be progressing even better than expected, which is likely to be increasingly recognised in the share price. We largely maintain our revenue forecasts but increase our EBITDA margin forecasts to around 29% and increased the debt weighting in our weighted average cost of capital, to reflect the increasing likelihood of further acquisitions. These changes have driven a 5% increase in our fair value estimate to $8.50. The balance sheet is in reasonable shape despite the 90% increase in net debt to $557m, caused by the LAS acquisition. Although the LAS acquisition was significant, debt metrics remain comfortable with a net debt/EBITDA ratio of 1.7, which falls to 1.5 if we assume a full year's contribution of earnings from LAS. This is at the bottom of management's target range of 1.5–2.5. The share price has been volatile in recent months, due to the proposed changes to superannuation legislation included in the federal budget. The Royal Commission also casts a shadow on the superannuation industry, but we don't see an obvious negative for LNK at this stage, and it's possible the company could benefit from increased regulation. The acquisition of LAS reduces the relevance of the Australian Fund Administration division to the group, which will fall to 33% of group EBITDA in FY19 from 54% in FY17. We expect the division to generate low-single-digit annual revenue growth and mid-single-digit annual EBITDA growth over the next decade. IMR Strongly Positive.

MYOB Group's (MYO) (narrow moat) 1H18 result was in line with our expectations, and we maintain our earnings forecasts and $3.82 fair value estimate. At the current market price of

Aveo Group AOG	
Fair Value ($)	2.80
Price/Fair Value	0.80
IMR	Strongly Positive

BWP Trust BWP	
Fair Value ($)	2.85
Price/Fair Value	1.18
IMR	Neutral

$3.05, we still believe the shares are undervalued. We forecast an EPS CAGR of 8% over the next decade, underpinned by steady subscriber and average revenue per user (ARPU) growth. Revenue growth of 7% was broadly in line with our full-year forecast of 9% and management's guidance of between 8% and 10%. MYO is increasing its reinvestment over the next two years. Following the failure of the Reckon acquisition earlier this year, management outlined a plan to increase sales and marketing costs by $30m per year, or around 37%, and make a one-off $50m incremental investment into software development, versus research and development (R&D) spending of $68m in FY17. We are perfectly comfortable with this strategy and forecast a drop in EBITDA margin to 41% in 2018 before it rebounds gradually to 45% in FY21. The small and midsize enterprise (SME) division, which accounts 62% of group revenue and increased revenue by 7%, remains the growth engine of the group. Total fee-paying customers grew by 5% in line with our full-year growth forecast. The growth comprises two offsetting trends of growing cloud customers, which rose 32% to 340,000, and declining desktop customers, which fell by 15% to 291,000. We expect both rates gradually moderate over the next decade, but the existing fee-paying and non-fee-paying desktop customers should provide plenty of leads to help build a strong cloud customer base. Management maintained guidance for one million subscribers by 2020, which looks optimistic, but we suspect may be achieved with the inclusion of low-priced practice subscribers, which reached 152,000. We forecast 707,000 by the end of 2020, but this figure excludes practice subscribers, meaning our forecast is roughly in line with guidance once adjusted. Although the practice management division, which accounts for 20% of group revenue, delivered only 1% revenue growth, this was broadly in line with our expectations. We are comfortable with this division treading water for now, as it's an important strategic asset supporting the SME business. Increased software development investment should enable revenue to grow by our forecast 3% annual growth rate in the longer term. The enterprise solutions division, representing 15% of group revenue, provides a key differentiator to Xero as it serves midsize companies MYO can retain as they grow. However, the 10% revenue growth was broadly in line with our high-single-digit full-year and longer-term forecasts, which are unchanged. IMR Neutral.

Real Estate Investment Trusts

Aveo Group (AOG) (no moat) reported FY18 underlying earnings of 22 cents per security (cps), slightly above June guidance of 21.4cps. The business has yet to fully recover from negative press 14 months ago. Newly completed units are taking longer to sell, resulting in a large build-up of unsold inventory totalling $347m, compared with $135m a year ago. The sales rate of units upon resident departure is 7.5%, well down on the long-term average of 10%–11%. This is behind the fall in portfolio occupancy over the past year from 93% to 90%. We think AOG has troughed and operations will improve from this point, but it's likely to take some time. AOG has introduced a variation on its standard contract providing increased options for residents, but the deferred management fees (DMF) are still viewed as elevated and may need to be revisited to accelerate sales. Positives from the result include the continued uptrend in DMF and capital gains for each resold unit, which increased by 6.5% to $104,400. We see AOG taking a further two years to shake off the negative press and reposition to capitalise on the significant opportunity to provide high-quality housing for the elderly. Our fair value estimate for no-moat AOG is unchanged at $2.80. FY19 earnings guidance is 20.4cps. Major swing factors are the sales rate of legacy residential land lots and the time taken for incoming residents to settle. Settlement is currently taking longer partly due to lower auction clearance rates. A strategic review will assess all options. Given the very favourable demographic tailwinds across Australia, AOG regards a faster and high rate of development as the most accretive use of capital. Consequently, advisors are likely to focus on avenues to introduce strategic investors to accelerate the number of units developed or potentially a share buyback. IMR Strongly Positive.

BWP Trust's (BWP) (narrow moat) FY18 distributable income from operations, excluding capital profits, of $113.2m was 0.7% ahead of our estimate, due to lower-than-expected management fees and higher rental income. Distributions of 17.81 cents per unit met guidance and our estimates. We maintain our fair value estimate of $2.85, with units screening as overvalued at the current price of $3.25. Management guided to FY19 distribution growth similar to the 1.7% in FY18, and we expect distributions to increase by 2% to 18.17 cents per unit. Our fair value estimate implies a yield of 6.3%. The key short-term risk to our rental income estimates is lower-than-expected

Dexus Property Group DXS	
Fair Value ($)	9.80 ↑
Price/Fair Value	1.10
IMR	Neutral

Folkestone Education Trust FET	
Fair Value ($)	3.20 →
Price/Fair Value	0.88
IMR	Neutral

occupancy, if it takes longer to release or sell vacant properties. We expect an average occupancy rate of 97.5% in FY19, compared with 98.8% as at June 2018. From FY20, we forecast occupancy to return to 100%, as most upcoming vacancies will be addressed by then. The balance sheet remains strong. Gearing of 19.3% at year-end FY18 was slightly higher than our 18.3% estimate, but still lower than the 20.4% in FY17 and below management's target range of 20%–30%. Despite a shrinking property portfolio and declining rental income, distributions can be maintained with any shortfall topped up by capital profits. Also, the balance sheet provides firepower should any external growth opportunities arise. IMR Neutral.

Dexus Property Group's (DXS) (narrow moat) FY18 funds from operations (FFO) of 60.7 cents per security (cps) was up 3% on FY17. Adjusted funds from operations (AFFO) which is after maintenance and lease incentive costs, increased 5% to 47.7cps, aligning with growth in distributions. DXS estimates rents across its office portfolio are currently 8% below market rates in Sydney and Melbourne. Assuming office demand remains solid, this will see large rent increases for the east coast leases expiring over the next two to three years. Following raised office rental growth expectations, our fair value estimate for narrow-moat DXS increases from $9.10 to $9.80 per security. Guidance is for FFO to grow 3% in FY19. Lower leasing and maintenance costs result in guided AFFO growth of 5%, with distributions to rise in step. We forecast distributions of 50.2cps. At a headline level, gearing remains conservative at 24.1% on a look-through basis, although this metric has been flattered by high asset values. The weighted average capitalisation rate used for valuing the office portfolio is 5.37% and 6.4% for the industrial portfolio. Interest coverage is robust at 4.9 times, providing strong cash flow coverage when borrowing costs eventually move to more neutral settings. Net debt/EBITDA for the year to June 2018 was 4.2 times, a slight deterioration on the 3.8 times in FY17. Net debt/EBITDA, incentives and maintenance costs was 5.3 times. Both are expected to remain at current levels for the next two years while DXS deploys capital to the development opportunities. The Sydney CBD, Sydney Metro, and Melbourne CBD office markets—representing 59%, 11%, and 8% respectively of DXS' office portfolio—continue to overshoot expectations. Tenant demand is robust and new supply muted, a very favourable combination causing rents to surge. Vacancies in both the Sydney and Melbourne CBDs are around 4%, and barring an unforeseen event, they will likely remain below 5% until 2021 when there is a pickup in new supply. We've assumed effective market rents decline for three years from 2022, when new supply comes on stream and landlords are compelled to cut rents to lease vacant space. Performance for the industrial portfolio is respectable, with occupancy high at 98% and effective rents rising 3% in FY18. Industrial property has favourable demand underpinnings from growth in online retail, but a surge in supply is dampening rents in some corridors. DXS isn't immune, with the rents across the industrial portfolio now slightly above market rates, tempering medium-term rent growth to approximately 2%. IMR Neutral.

Folkestone Education Trust (FET) (no moat) reported a strong FY18 financial result, broadly in line with our expectations. Our earnings forecasts are largely unchanged, and we retain our fair value estimate at $3.20 per unit. FET reported a 6.3% increase in distributions per unit (DPU) to 15.1 cents per unit and expects a further 6% growth in FY19, which is in line with our forecasts. Growth was driven by an 11% increase in distributable income, offset by a reduction in the payout ratio due to the capitalisation of interest costs relating to development properties. Most of the growth came from acquisitions net of disposals, with the remainder due to organic rental increases and reflecting management's strategy to move leases away from consumer-price-index-based escalators and towards fixed 3%-plus escalators. Net tangible asset (NTA) per unit increased by 11% to $2.78, with units now trading at a slight discount NTA, which has rarely occurred in recent years. FET's key performance indicators improved across the board. Aside from the 11% improvement in distributable income, the trust also increased its weighted average lease expiry (WALE) from 9.1 to 9.9 years and its weighted average debt maturity from 3.5 to 5.0 years in FY17. We attribute these improvements in part to the management team but also to the underlying stability of the childcare sector, which is supported by growing federal government subsidies and the recently introduced Child Care Subsidy (CCS). Management continues to reposition the portfolio towards higher-quality and slightly larger metropolis-based centres. A fall in capitalisation rates from 6.7% to 6.3% resulted in a 15% increase in the value of the portfolio to $973m. Portfolio valuation growth enables increased borrowings, but although gearing only increased to slightly 29%, net debt increased 21% to a record of $296m. To reduce

Goodman Group GMG	
Fair Value ($)	10.20 ↑
Price/Fair Value	1.04
IMR	Strongly Positive

GPT Group GPT	
Fair Value ($)	5.10 ↑
Price/Fair Value	1.04
IMR	Neutral

Mirvac Group MGR	
Fair Value ($)	2.20 ↑
Price/Fair Value	1.11
IMR	Neutral

this risk of interest rates normalising, FET maintains gearing at a manageable level and hedges interest-rate exposure, with 56% hedged until FY23. IMR Neutral.

Goodman Group's (GMG) (narrow moat) FY18 operating earnings rose 8% to 46.7 cents per security (cps) marginally above guidance and our forecast. Compositionally, this was a strong result, with GMG beating our expectations for growth in assets under management (AUM) and margins on development completions. Upgrades to our forecasts for management fees, development margins and rents, results in a 6% and 12% upgrade, respectively, to our FY20 and FY21 EBIT forecasts. Our fair value estimate increases 14% to $10.20. We raise our FY19 earnings forecast by 2% to align with the guided 7% growth and raise outer year growth assumption for AUM on the surprisingly large 11.4% jump in external AUM in 2H18 to $35.1bn. Rent growth across the portfolio accelerated to 3.2% over the year, reflecting the surging demand from online retailers and GMG's strategy to focus on sites in strategically important locations. We don't see this level of rent growth being sustained for long. Our long-term annual rental growth assumption is 2.0% to 2.5% for FY23 and beyond. EPS has grown at a six-year CAGR of 7.4% and our forward forecasts imply a 10-year forward CAGR of 5.3%. The strategy to fund development activity off balance sheet has weighed on earnings in the development division. The compensation for this comes first from lower gearing, with GMG gearing now at 5%, and 16% on a look-through basis. Second, business risk has reduced materially as an increasing proportion of the development and leasing risk has been transferred to the funds. The silver lining in this strategy is funds on GMG's property management platform are acquiring assets far cheaper than previously. This provides a significant boost to fund performance (which includes revaluation gains). The $35bn of external assets generated a return for the past year of 15.0%, 14.4% in FY17 and over 20% in FY16. This outperformance has resulted in a large build-up of performance fees, which will be released over the next five-plus years. The performance fees in FY18 were approximately $100m, up over 250% on the circa $35m in FY17 and FY16. Providing there is no major event impacting asset values, management expects performance fees to track around current levels for a few years. We have assumed performance fees as a percentage of AUM gradually decline, materially in outer years, mainly due to an unwinding of the very favourably tailwind of ultra-low interest rates. But the effect of annual lower performance fees will be compensated for in outer years by a substantially large base in fee-generating assets. AUM looks set to rise by $3.5 to $5bn annually. IMR Strongly Positive.

GPT Group's (GPT) (narrow moat) 1H18 earnings on a funds from operations (FFO) basis of 16 cents per security (cps) were in line with expectations and increased 3.1% on 1H17. Guidance was reiterated for 3% growth in FFO per security and distributions of 25.3 cps and our forecasts are consistent with guidance. The big positive was the ongoing strength in the CBD office markets in Sydney and Melbourne. Vacancy rates for both are now about 4.5%. GPT estimates rents for its offices in these markets are now 8% below market rates. Provided office demand remains solid, this supports rental growth for the next two to three years. Thereafter, more office space is scheduled to come to market, weighing on future rent growth. We have raised medium-term office rents expectations, and our fair value increases from $5 to $5.10 per security. Performance across the retail portfolio continues the multi-year trend where traditional apparel and department store sales are shifting to other areas including bricks-and-mortar consumer electronics and online retail. GPT has substantially remixed its portfolio but the weighting to apparel remains high. The category represents 30% of specialty sales at June 2018, but down on the 38% three years ago. The major revision to our office forecast is stronger rental bumps on reletting over the next three years in Sydney and Melbourne. Supporting factors of demand are lower corporate taxes and high immigration. While we have raised rent growth expectations for 2019 to 2021, we've assumed market rents move sideways for five years from 2022 as new supply comes to market and there is an easing of current stimulatory monetary settings. IMR Neutral.

Mirvac Group's (MGR) (no moat) FY18 operating profit of 15.6 cents per security (cps) was up 8% on FY17 and at the top end of the guidance range of 15.3–15.6 cps. Earnings going forward will be reported on a funds from operations (FFO) basis. FY19 guidance is for FFO growth of 2% to 4%, implying FFO of 16.7 to 17.1 cps and distributions of 11.6 cps, up 5% on FY18. We forecast FFO of 16.7 cps, at the bottom of the guidance range. Following upgraded rental growth expectations for the Sydney and Melbourne office assets, our fair value estimate

Scentre Group SCG	
Fair Value ($)	3.85 →
Price/Fair Value	1.08
IMR	Neutral

Stockland Group SGP	
Fair Value ($)	4.45 →
Price/Fair Value	0.94
IMR	Negative

increases from $2.15 to $2.20. After successive years of strong growth, MGR's residential development business has nosedived, with FY18 net sales of $980m, down 32.5% on the $1.45bn in FY17. The value of residential presales going into FY19 is $2.17bn, down 21% from a year ago. We are forecasting a 20% fall in FY19 residential settlements to 2,700 lots, broadly aligning with the 21% decline in presales going into FY19. We don't foresee residential profits falling by 20% as there will be fewer impaired lots in the sales mix and vacant land-lot prices in Melbourne are broadly flat to slightly positive. Two months into FY19, MGR has secured 60% of its targeted FY19 EBIT, which is below the 78% at the same time last year, indicating the residential sales team has a lot of work ahead to hit guidance. The office and industrial portfolio was the strongest performing division. Ultralow vacancies in the Sydney and Melbourne office markets are the major drivers of the like-for-like growth in net operating income of 12.7%. The relatively high near-term rental growth in the Sydney and Melbourne markets reflect the favourable combination of solid demand growth and limited new supply additions in 2018 and 2019. Upgraded cash flow assumptions for the Sydney and Melbourne office assets is the primary reason for the upgrade to our fair value estimate. The retail portfolio continues to outperform most listed peers with specialty sales up a comparatively strong 3.7%. The above-average performance is largely due to the high concentration to Sydney where the economy is growing very strongly. IMR Neutral.

Scentre Group's (SCG) (narrow moat) 1H18 funds from operations (FFO) of 12.38 cents per security (cps), up 3% on 1H17. Distribution growth was lower at 2% to 11.08cps as SCG retains more cash to help fund developments. Our fair value estimate is unchanged at $3.85 per security. Forecast revisions are minor, including slightly raised expectations for redevelopment projects at Eastgardens in inner Sydney for $720m. Guided 2018 distribution is 22.16cps, exactly double the 1H distribution. Management reiterated 2018 guidance for growth in net rental income of 2.5%–3.0%. Moderating growth is mostly due to lower inflation, as most specialty leases contain annual escalators of CPI plus 2%. But it also reflects headwinds to tenant sales growth and short-term leasing at malls about to undergo redevelopment. The longer tenant sales trail rent growth, the more likely it is SCG will have to reduce rents when leases come up for renewal. We still forecast long-term rental growth around 2.5% across the portfolio. This is at the bottom end of SCG's current 2.5%–3% near-term rental growth guidance and may explain why our fair value estimate is 9% below the current security price. Sales performance has slightly improved over the past six months, with trailing six-month sales for all specialty (under and over 400 sqm) up 2.1% versus trailing 12-month sales growth of 1.6%. We had expected a stronger showing from the specialty retailers across SCG's portfolio, given relatively low unemployment and management's efforts to remix to more contemporary categories. Specialty sales remain sluggish, with sales for retailers under 400 square metres (sqm) up 0.9% for the year. This is in sharp contrast to the 3.6% growth reported for specialties over 400 sqm. We see the divergence being mostly due to sales cannibalisation of smaller fashion retailers by low-cost international giants like H&M, Zara, and Uniqlo. The unresolved challenge is how to level the playing field with the larger-format retailers, which can negotiate better rental deals due to their scale and ability to lure foot traffic to the mall. IMR Neutral.

Stockland Group's (SGP) (narrow moat) FY18 earnings on a funds from operations (FFO) basis, were slightly ahead of forecast mainly due to a higher-than-expected number of residential settlements of 6,438 lots. Even though the housing market has demonstrably cooled, SGP is guiding for FY19 settlements to remain above 6,000 lots. Residential margins look set to remain near peak 2018 levels of 18% for the next year and gradually taper off thereafter. Margins are likely to hold up even through house prices have softened as many large projects have built up large contingencies over the past few years and these will be gradually released as the projects wind down. We forecast FY19 earnings of 37.5 cents per security (cps) implying growth of 5.4% which is consistent with guidance for growth of 5% to 7%. Distribution guidance of 27.6cps puts the distribution payout ratio just below the bottom of the target range of 75%–85%. This seems prudent as we are forecasting a further cooling in the residential market, resulting in a fall in volumes in FY20 to under 6,000 lot settlements. Our assumption for a cooling in the Australian housing market is the primary reason for our forecast FFO declines of circa 2% in each of FY20 and FY21. The other factors weighing on medium-term FFO are earnings dilution from planned asset sales and a gradual lift in borrowing costs. Despite risks ahead for Australian housing, SGP looks well placed to adapt. The retail shopping centre portfolio is going through a challenging period as retail spending in pockets of

Vicinity Centres VCX	
Fair Value ($)	2.85 ↑
Price/Fair Value	0.94
IMR	Neutral

Ansell ANN	
Fair Value ($)	27.00 ↑
Price/Fair Value	0.92
IMR	Strongly Negative

Cochlear COH	
Fair Value ($)	173.00 ↑
Price/Fair Value	1.19
IMR	Negative

Queensland slows due to weakness in the mining and agriculture markets. The new head of the commercial property division has taken steps to address this, offloading 12 smaller malls totaling $400m. The disposal will see a gradual down-weighting to retail and a higher weighting to industrial as SGP has $100m of developments under way and a further $600m in the development pipeline. IMR Negative.

Vicinity Centres' (VCX) (narrow moat) FY18 earnings on a funds from operations (FFO) basis of 18.2 cents per security (cps) were in line with guidance. Our fair value estimate increases 5% from $2.70 to $2.85 per security as we raise long-term rental growth projects as a further $1.9bn of lower growth assets are planned to be sold over the year to June 2019. This is a very significant sales program, representing 11.5% of the portfolio by value. Gearing will fall materially from 26.4% at June 2018 to approximately 18% on a pro forma basis. Capital released will be redeployed initially to the retail development opportunities. In around three years, the first of the flagged 12 mixed-use opportunities are likely to commence, generating yields on capital deployed and raising the amenity in the underlying assets. Major forecast revisions include the divestment of $900m of properties to seed the new Vicinity Keppel Australian Retail Fund (VKF) and modest earnings upside in FY20 from funds management. Our forecasts align with FY19 guidance for FFO of 18 to 18.2cps. Most of VCX's best and biggest assets have recently undergone or are about to undergo development and are excluded from the sales metrics, making it difficult to get a clear picture as to how tenants across the portfolio are trading and hence an insight into medium-term rental growth. High rent paying specialty stores were reporting generated sales growth of just 0.9%, but this would be less than the overall portfolio due to the exclusion of the better malls from the official sales metrics. IMR Neutral.

Healthcare

Ansell (ANN) (narrow moat) delivered FY18 results in line with expectations after adjusting for the divestment of its sexual wellness business. NPAT of US$146.7m on group revenue of US$1.49bn, up around 23% and 8%, respectively from FY17 and on a continuing business basis, tracked our forecast of US$150m and US$1.48bn. A full-year dividend of US$ 45.5 cents per share was declared. We maintain our long-term forecasts and raise our fair value estimate by 4% from $26 to $27 per share after adjusting for an A$/US$ exchange rate of 0.73. Looking beyond the many moving parts and adjustments resulting from its ongoing transformational program, growth in ANN's two major global business units of healthcare and industrial was in line with forecasts, with organic growth of about 4% in constant-currency terms, in the middle of management's targeted 3%–5% range. We remain positive on ANN's strategic rationale of streamlining operations and consolidating distribution channels, rather than catering to retail end customers under its transformation program, and we see the divestment of its sexual wellness business as a move in the right direction. Still, we think the targeted savings in the key operating metric of SG&A may take longer to realise than we first assumed. We now forecast SG&A will rise to 24% of revenue in FY19, compared with previous forecasts of 22.8%, though we still expect the company to hit our projection by FY23. Management guided to FY19 EPS of US$1.00–US$1.12. Our updated forecast is at the low end of this range. We also think the mix shift towards more synthetic alternatives will benefit gross margins, with the metric averaging around 40% over the next five years. From a balance sheet perspective, ANN is in solid shape, with net cash of US$31m after the US$568m in proceeds from the divestment of the sexual wellness business. According to management, capacity remains for US$1bn–US$1.4bn in debt to fund acquisitions with a targeted range of net debt/EBITDA of 1.5–2 times. IMR Strongly Negative.

Cochlear (COH) (wide moat) delivered another sound FY18 result, meeting our expectations. Reported NPAT of $245.8m was in the middle range of guidance, and just short of our forecast of $250m. We were impressed by the improvements in cost of goods, reflecting manufacturing efficiencies, lower warranty cost, and lower repair expenses resulting from the centralisation of repairs globally in Malaysia. This culminated in gross margin expansion from 71% in FY17 to 73%. We now think these efficiencies are sustainable. As such, we increase our fair value estimate by 9% from $159 to $173 per share after increasing our medium-term gross margin assumption from 71% to 73%. We forecast this metric trending towards 73.5% over five years, given assumed additional efficiency gains. We also remain positive on the growth prospects given the adult opportunity in developed markets and paediatric market in emerging markets, and we remain comfortable with an 11% five-year CAGR for group revenue. Cochlear implant sales revenue from the Americas (U.S., Canada, and Latin

CSL Limited CSL	
Fair Value ($)	207.00 ↑
Price/Fair Value	1.02
IMR	Strongly Positive

Healthscope HSO	
Fair Value ($)	2.40 →
Price/Fair Value	0.88
IMR	Neutral

America), representing 48% of group revenue, was a highlight, increasing 11% to $648.5m. This was largely driven by 15% growth in cochlear implant units, with strong uptake among the 65-plus senior market in the US. We remain positive on this segment in developed markets, given the ageing demographics. We expect COH's installed-recipient pool to grow at an average of 11% per year over the long term, with the global cochlear implant recipient pool growing 12% per year but COH's market share to decline from around 60% currently to 56% by 2022. We also assume an average cochlear implant system price of around $25,000, together with price inflation of around 2% per year. Service divisional revenue, comprising the latest Nucleus 7 sound processor release in 2Q18, grew strongly at 15% year on year in constant-currency terms and included full-year contribution from Sycle, acquired in May 2017. We expect momentum in this division to remain buoyant and we forecast revenue five-year CAGR of around 10%, with divisional revenue representing 25% of group revenue in 2023. Sales generated by COH's acoustic business, its Baha product range, declined 1% year on year after cycling against a strong FY17. But, we see the global ramp-up of the Baha SoundArc as expanding the addressable paediatric market acting as a growth driver of the division. The financial position is strong with net debt/EBITDA of 0.23 times providing confidence in COH's ability to maintain its 70% dividend payout ratio with ample capital available to fund construction of a manufacturing plant in China, which is now under way. IMR Negative.

CSL Limited's (CSL) (narrow moat) FY18 result beat recent guidance and our expectations with NPAT of US$1.729bn buoyed by solid product performances across multiple fronts. These included: impressive growth in the flagship immunoglobulin portfolio in the U.S.; successful launch of Haegarda; ongoing adoption of KCentra in the U.S.; and achieving breakeven in the Seqirus flu vaccine business as targeted. We increase our fair value estimate by 4% from $200 to $207 per share after incorporating A$/US$ exchange rate of 0.73, guidance of 10% of revenue for R&D spend, and capital expenditures in FY19 of between US$1.2 and US$1.3bn to support ongoing expansion of plasma donor sites in the US. This compares with our previous assumption of 11% R&D spend given the commencement of CSL112's phase 3 trial. We have also incorporated FY19 NPAT guidance of US$1.88bn–US$1.95bn. As such, we forecast FY19 NPAT of US$1.94bn. Our revised fair value estimate includes increased valuation of the CSL112 opportunity given time value of money considerations and now accounts for around $57 per share. CSL's immunoglobulin portfolio, representing 40% of group revenue, performed ahead of expectations with Privigen and subcutaneous Hizentra delivering growth of 13% and 12%, respectively, year on year, in constant currency terms. This was largely driven by the expanded approval of both products in the neurological indication of chronic inflammatory demyelinating polyneuropathy (CIDP). We forecast double-digit growth over the next five years and a five-year revenue CAGR of 10% for the division. Specialty products, representing 19% of group revenue, grew an impressive 24% buoyed by the launch of Haegarda. The uplift also included a strong contribution from KCentra, which grew 32% in the US driven by increased utilisation in trauma settings for reversal of bleeding using warfarin. We expect both to support our forecast of revenue five-year CAGR of around 20% for the division. Seqirus, CSL's flu vaccine division, representing 11% of group revenue, achieved a major milestone by breaking even at the NPAT level, while generating US$52m in EBIT on revenue of US$1.1bn. Net cash flow from operations grew a robust 53% to US$1.9bn, with net debt/EBITDA a very manageable 1.33 times. As such, we remain comfortable with CSL's ability to support FY19 capital expenditure guidance of around US$1.2bn. IMR Strongly Positive.

Healthscope's (HSO) (narrow moat) FY18 results contained myriad non-recurring items, reflecting a year of restructuring and remedial action across the hospital portfolio. Despite a stronger 2H, NPAT of $151m on group revenue of roughly $2.3bn, down 10.3% and up 3.7% on FY17 respectively, trailed our forecast for $181m and $2.4bn after adjusting for the recent divestment of Asian pathology assets. The main factor was the weaker-than-expected margin performance in the hospital division, which posted an EBITDA margin of 16.4%, compared with our forecast of 17.8%, hurt by the impact of case mix variability and wage indexation. HSO announced it will establish a new unlisted property trust to hold most freehold hospital property assets on a sale and leaseback basis and will seek to sell a 49% stake to a third-party investor for around $1bn. After incorporating FY19 guidance of at least 10% growth in hospital operating EBITDA and adjusting for the sale and leaseback of property assets, our fair value estimate of $2.40 per share is unchanged. The Australian hospitals division remains the key value driver for HSO, now representing 90% of

InvoCare IVC	
Fair Value ($)	17.00 →
Price/Fair Value	0.74
IMR	Strongly Negative

Primary Health Care PRY	
Fair Value ($)	3.50 ↓
Price/Fair Value	0.81
IMR	Strongly Negative

group revenue and 86% of group EBITDA, up from 88% and 82% respectively after the divestment of Asian pathology. We also remain comfortable with our projection for revenue in the hospital division to grow at a five-year compound rate of 8%. Our outlook is supported by the Northern Beaches Hospital, representing 450 beds and 20 operating theatres, which is due to commence operations in 1H19, and its contribution of an anticipated $300m in revenue over a two-year period, as well as the ongoing brownfield expansion program. We also remain comfortable with our projection for revenue in the hospital division to grow at a five-year compound rate of 8%. Our outlook is supported by the Northern Beaches Hospital, representing 450 beds and 20 operating theatres, which is due to commence operations in 1H19, and its contribution of an anticipated $300m in revenue over a two-year period, as well as the ongoing brownfield expansion program. We assume the $1bn from the sale of 49% of the property trust, coupled with the $279m generated from the sale of the Asian pathology assets, will be used to reduce debt. While we view the transaction as roughly value-neutral, HSO's financial risk profile will improve meaningfully and forecast net debt/EBITDA declining from 6.41 times in FY18 to 1.42 times in FY19. As such, we remain comfortable with HSO's ability to fund dividends at a payout ratio of around 70%. IMR Neutral.

InvoCare's (IVC) (wide moat) 1H18 operating EBITDA was flat at $54m and is tracking marginally below our full-year expectations, mainly due to soft industry volume, and some pricing weakness. Operating EPS declined by 7% to 21.6 cents per share, reflecting higher depreciation and interest expense a consequence of the major reinvestment program. The dividend was down from 18.5 to 17.5 cents per share fully franked. FY18 performance is tracking broadly in line with guidance, which was premised on the death rate reverting to more normalised levels, which hasn't been the case. Management has flagged potential downside to this guidance if the death rate does not increase. While FY18 is shaping up to be a more challenging year than we had previously expected, we maintain our $17.00 per share fair value estimate. Most of these challenges are either temporary in nature (the store closure for refurbishment, and lower prices) or cyclical (the decline in the annual number of deaths), both of which will normalise longer-term. The Protect and Grow initiatives are showing positive signs, with completed locations under the Network & Brand Optimisation (NBO) program exceeding modelled EBITDA by 30%. The NBO rollout is on-track with 40% of the network to be complete in FY18, and 70% of completed NBO locations have met or exceeded expectations. IVC will emerge with a completely refreshed service and product offering, in a great position to resume growing market share, and better ability to justify its premium pricing. IVC has ramped up acquisition activity, securing an additional 1% market share in Australia and around 4% in New Zealand year-to-date. We project IVC's share of the Australian and New Zealand market to increase to around 40% over the next 10 years, from 33% currently, through a combination of acquisitions and greenfield expansion. IMR Strongly Negative.

Primary Health Care's (PRY) (no moat) FY18 results met our expectations following recently issued guidance. Key metrics of the FY18 result included underlying NPAT of $92.3m on group revenue of $1.74bn, which came in essentially flat and up 4.9%, respectively, year on year. However, management surprised by announcing a $250m capital raising to fund the acquisition of a day-hospital network, along with new initiatives aimed at improving operational capacity in existing medical centres and upgrading pathology infrastructure over a five-year horizon. The capital raising is an underwritten 1-for-5.21 rights issue at $2.50 per share. Our revised forecasts include the capital raising and incorporate the estimated impact to earnings of the day-hospital group, subject to the planned spend, but does not factor in potential synergies with existing medical centre services such as IVF, radiology, and pathology. As such, we lower our fair value estimate by 9% from $3.85 to $3.50. Performance in medical centres remained soft with an 89-basis-point decline in EBITDA margin to around 30%, reflecting lower operating leverage and lower full-time equivalent (FTE) general practitioner (GP) numbers of 945 compared with 959 at the end of FY17. This was below our forecast margin of 36% and highlights the vulnerability of PRY's profitability to GP numbers. Our current forecasts have FTE GP numbers reaching around 1,040 by 2023, with medical centre revenue growing at a five-year CAGR of 2.6%. However, we do see upside risk associated with funding from the capital raising, providing PRY with some leeway in contract negotiations with new GP recruits. The FY18 dividend of 10.6 cents per share, fully franked, represented a payout ratio of about 60%. We remain comfortable with PRY's ability to maintain its dividend, given the strength of free cash flow generation, which was up around 4% in FY18 to

Ramsay Health Care RHC	
Fair Value ($)	76.00 ↓
Price/Fair Value	0.72
IMR	Strongly Negative

ResMed Inc. RMD	
Fair Value ($)	13.50 ↑
Price/Fair Value	1.16
IMR	Neutral

$147m. From a balance sheet perspective, PRY is carrying a relatively high level of debt with net debt/EBITDA of around 4 times. But, including the raising we see this trending towards 1.37 times over the same period, not including revenue and cost synergies between the day hospitals and existing assets. IMR Strongly Negative (pre-announcement)

Ramsay Health Care's (RHC) (narrow moat) FY18 results were in line with recent guidance provided but outlined a softer FY19 than we forecast. NPAT of $579.3m on revenue of $9.2bn, up 6.8% and 5.4%, respectively, tracked our expectations. The final dividend of 86.5 cents took FY18 dividends to $1.44 per share, fully franked, representing an increase of 7% and equating to 51.5% payout of adjusted EPS. The key driver was the Australian division, representing 54% of group revenue, which grew at a more subdued 5.5% on FY17 compared with historical averages of around 7%–8%. In contrast, the 12.1% improvement in EBITDA to $896m led to a divisional EBITDA margin of 18%, up 106 basis points, evidence of improved operational efficiencies. Nonetheless, management's FY19 guidance of EPS growth of up to 2% disappointed, citing slower growth in Australia due to softer volumes, ongoing challenges in the United Kingdom, and a neutral outlook in France. This sharply trails our prior outlook for double-digit earnings gains, and after incorporating management's guidance, primarily in the Australian division, including revised guidance of the procurement initiative, we reduce our fair value estimate by 7% from $82 to $76 per share. We have reduced our UK growth outlook given challenges to NHS admission created through the implementation of demand management strategies and guidelines around elective-care services on the part of the government. With potential disruption of Brexit adding to the government's budgetary woes, we now expect growth to remain flat over the next five years, versus our previous five-year revenue CAGR of 1%. Operations in France, now accounting for 38% of group revenue, delivered a flat performance at revenue and EBITDAR levels, in line with expectations, given a negative tariff environment that RHC expects to continue to FY19. As such, we still forecast modest top-line growth of around 1% beyond FY19, reflecting underlying volume growth broadly in line with the general population. The balance sheet remains robust. Cash flow from operations was a solid $995m from $882 in FY17. Net debt/EBITDA edged up to 2.3 times from 2.2 but remains at healthy gearing levels. We forecast net debt/EBITDA for FY19 at 2.00 times, trending down to 1.60 by FY21, given solid cash from operations. As such, we remain comfortable with RHC's capacity to fund its development pipeline of brownfield capacity expansion projects and dividends at the current payout rate.
IMR Strongly Negative.

ResMed Inc. (RMD) (narrow moat) delivered a strong 4Q18 result with solid growth on all fronts and geographies despite falling slightly short of our expectations for the full year. Non-GAAP net income of US$508m on group revenue of US$2.3bn, was up 27% and 13% respectively, year on year, compared with our forecasts of US$551m and US$2.3bn. Nonetheless, 4Q mask sales impressed, growing at around 13%, in constant currency (CC), and above market rates for the full year in both the US and Rest of World, benefiting from the continuing strong demand of both the AirFit F20 full-face mask and AirFit N20 nasal mask. Devices also performed strongly up 8% year on year, in CC terms. We raise our fair value estimate from US$94 to US$100 per share after adjusting for guidance in research & development (R&D) costs as a percentage of group revenue, time value of money, and factoring in the expected contribution of the recent HealthcareFirst acquisition into FY19 forecasts. Specifically, we have reduced R&D costs from 6.5% to 6% of group revenue. Our revised fair value estimate equates to A$13.50 per CDI based on an A$/US$ exchange rate of 0.74, up from A$12.00 per CDI previously. Recent studies cited by management pegs the global prevalence of people with mild, moderate, or severe sleep apnoea at around 936 million. And with an estimated penetration of around 15%, coupled with a growing awareness of sleep apnoea and its associated medical conditions, we expect double-digit growth to continue and remain comfortable with our forecast for global mask sales to grow at a five-year annual CAGR of 10%. This compares with a five-year sales CAGR of 8% for devices. The balance sheet remains solid and well supported by ongoing strong cash flows from operations. Impressively, FY18 cash flow from operations grew by 22% to US$505m with reported debt/adjusted EBITDA at around 0.43 times, compared with around 2.29 times in FY16 following the sizable US$800m acquisition of Brightree. As such, we remain comfortable with management's ability to both support a dividend payout ratio of around 65% while also funding strategic acquisitions such as the cloud-enabled software provider company HealthcareFirst. IMR Neutral.

Sonic Healthcare SHL	
Fair Value ($)	$25.50 ↑
Price/Fair Value	1.00
IMR	Negative

BHP Billiton BHP	
Fair Value ($)	24.50 →
Price/Fair Value	1.27
IMR	Neutral

Sonic Healthcare (SHL) (narrow moat) reported FY18 results broadly in line with our expectations with steady growth achieved on multiple fronts. Underlying EBITDA increased by 6.4% in constant currency (CC) to $962m, compared to guidance of 6%–8% growth and our $953m forecast. NPAT of $476m on group revenue of $5.54bn, up 11% and 8%, respectively, compared with our forecasts of $470m and $5.4bn. This compares with our five-year group revenue CAGR of 6% and expectations of group operating margin expanding from 12.5% in FY18 to around 14% by FY23. We believe this is achievable, given SHL's strong record of efficiency gains and its well-established consolidation strategy executed to date. FY18 dividend was 5% higher at 81 cents per share, 30% franked on a 72% payout. Our fair value estimate increases 6% to $25.50 per share to reflect the time value of money and a 1% increase in our growth assumption for Australian pathology. FY19 EBITDA guidance of 3%–5% growth could be conservative given potential acquisitions in Germany. As such, our 8% forecast increase assumes uplift from acquisitions in the short term. International pathology revenue in aggregate grew 10% year on year and now represents about 58% of group revenue, with Germany again the standout, with good traction in both the UK and Ireland and Switzerland. Domestically, Australian pathology, although a diminishing part of the pathology mix, delivered solid organic growth of around 6%, while diagnostic imaging achieved 7% organic growth. We think SHL's growing footprint in Germany raises prospects for potential synergies for neighbouring operations in Switzerland and Belgium. Our five-year revenue CAGR forecast for Germany and Switzerland is unchanged at 7%. Germany, which accounted for 21% of FY18 group revenue, has been a focus for several years and grew by a solid 12% in CC terms. SHL now has around 15% market share, with the market still highly fragmented. Management has flagged further acquisitions with scale efficiencies expected to lift margins. Switzerland operations grew at 5% in CC terms. Australian pathology, representing 25% of group revenue, delivered better-than-expected 6% growth, buoyed by the commencement of the national bowel cancer screening contract in 2H. The contract should add around $30m to revenue per year and we raise our five-year CAGR from 5% to 6%. Sonic Imaging, representing 9% of group revenue, was another high point, delivering 7% organic growth. IMR Negative.

Materials

BHP Billiton's (BHP) (no moat) FY18 adjusted NPAT declined 37% to US$3.7bn. The unadjusted result was impacted by several one-off items totalling US$5.2bn aftertax. These included US$650m of expenses associated with rectifying the Samarco disaster, US$1.8bn of non-cash charges relating to the balance sheet impact of the change to US tax rates, and a US$2.75bn after tax impairment of the US onshore shale assets, which are to be sold later this year. Adjusted NPAT attributable to BHP, including the discontinued US shale operations, which were held for the full period, was US$8.9bn, up 30% on FY17. Shale contributed an adjusted net loss of US$0.7bn. Copper was the key driver of the improved adjusted profit. Divisional EBIT more than doubled to US$4.4bn mainly due to the copper price with the 24% rise in volumes also helping. For the whole group, price added US$4.1bn to EBITDA higher costs offsetting about half of the benefit. The result was slightly weaker than we expected, due to higher operating costs and slightly lower revenue. BHP says it will also take an additional year to achieve its planned US$2bn of cost savings, now aiming for FY20. The headwinds from lower earnings and a slower rate of cost savings are not sufficiently material to warrant a change in our fair value estimate, and it remains $24.50 per share. Capital expenditure guidance unchanged, but with the exit of shale, some incremental additional expenditure will be directed to likely higher returning projects. Improving returns at Olympic Dam, now one of the lowest returning of the group, is a key focus. Another is mining fleet productivity with automation of the fleet an enabler. BHP still expects to be able to reduce medium-term unit operating costs at both its Pilbara iron ore and Queensland coking coal assets, in line with our broad expectations. BHP is in strong financial shape with net debt declining 33% to US$10.9bn, thanks to free cash flow of US$12.5bn. Net debt is towards the bottom of BHP's preferred US$10bn–$15bn range. We think this means a greater share of future free cash flow will likely be directed towards shareholder returns. The US$ 63 cents per share fully franked dividend was a 2H record, while the FY18 dividend of US$1.18 per share was 42% higher than FY17. We expect dividends to moderate slightly in the future and forecast US$1.10 and US$1.00 per share in FY19 and FY20, respectively. A rising payout ratio, given the strong financial position, should partly offset the expected decline in earnings from lower forecast iron ore, coal, and copper prices.
IMR Neutral.

Fortescue Metals Group FMG	
Fair Value ($)	3.70 →
Price/Fair Value	0.95
IMR	Neutral

Rio Tinto RIO	
Fair Value ($)	48.00 →
Price/Fair Value	1.48
IMR	Negative

Iluka Resources ILU	
Fair Value ($)	10.50 →
Price/Fair Value	0.90
IMR	Strongly Negative

Fortescue Metals Group's (FMG) (no moat) FY18 adjusted NPAT fell 58% to US$879m from FY17. The result was weaker than we forecast, a function of lower sales revenue and higher costs, including US$289m of costs associated with the early repayment of debt. The fall almost entirely reflects the lower realised iron ore price of US$44 per tonne, down 17% on the average of US$53 per tonne in FY17. The lower realised price was due to the widening discount for lower-grade iron ore. The average price for the benchmark index 62% grade iron ore was almost flat at US$69 per tonne versus US$70 in FY17. Underlying NPAT almost halved to US$1.08bn after excluding the US$202m of aftertax expenses from early debt repayment. We reiterate our $3.70 per share fair value estimate. We agree with FMG the current elevated price discounts for lower-grade iron ore reflects high steel maker margins which are unlikely to persist. Our expectation for a narrowing price discount provides a partial offset to our forecast for a lower mid-cycle iron ore price of US$40 per tonne from 2023. By FY23, we expect FMG to realise a price of US$33 per tonne. This represents a more than halving of the discount relative to the 62% benchmark to 17% per wet metric tonne versus an estimated 40% in FY18. Our expectation for discounts to normalise means FMG is trading at a smaller premium to our fair value estimate than BHP and Rio Tinto. Management reiterated FY19 guidance, expecting production of 165 to 173 million tonnes (mt) and our forecast remains 170mt. The ultimate level of production will depend on the mix of products and this will depend on the market. FMG will introduce a higher-grade 60% product from FY19 and will balance output for its various products depending on the price differentials. Unit operating cost guidance remains US$12 to US$13 per tonne, near the US$12.36 per tonne achieved in FY18. Planned capital expenditure of US$1.2bn is about one third higher than FY18, reflecting early expenditure for development of the new Eliwana mine, which is due to start production in 2022. The company remains in sound financial shape. IMR Neutral.

Rio Tinto's (RIO) (no moat) 1H18 adjusted NPAT of US$4.4bn was 5% higher than a year ago but slightly below our expectations. Adjusted EBITDA increased 1.7% to US$9.2bn, with the contribution from copper and diamonds up 76% to US$1.4b on stronger prices and volumes. This outweighed the headwind from energy and minerals, where EBITDA fell 28% to US$1bn, mainly due to the loss of earnings from Coal and Allied, sold in 2H17, and the strike at Iron Ore Company of Canada. Pilbara iron ore EBITDA was flat at US$5.7bn, with increased volumes offsetting lower prices, while aluminium increased 10% to US$1.8bn with higher prices and volumes, partly offset by higher costs. Inflation pressure continued to build, particularly in the aluminium operations, where the price of key inputs rose materially. Higher costs offset about 70% of the benefit from higher prices in the aluminium division. Returns to shareholders were a feature of the result. RIO declared a 1H18 dividend of US$1.27 per share fully franked, up 15% from US$1.10 per share a year ago. This was in line with the 15% increase in adjusted earnings per share to US$2.52, with the payout ratio steady at 50%. RIO will buy back a further US$1bn of shares. The share repurchases are relatively expensive, being in a period of relatively high commodity prices and earnings. RIO plans to return a further US$4bn in aftertax proceeds from asset sales in the second half, but the form of returns is yet to be decided. Capital expenditure guidance for FY18 and FY19 is maintained but is modestly increased by 8% to US$6.5bn for FY20. The balance sheet remains very strong with net debt of just US$5.2bn, down about 30% in a year. We don't see any pressing need for a further strengthening, with annualised net debt/ EBITDA at just 0.3. RIO is well placed financially for any potential downturn, which we think is appropriate, given the length of the current upswing. In the absence of a meaningful acquisition, the door is left open for a greater proportion of future cash flows to be returned to shareholders. IMR Negative.

Iluka Resources' (ILU) (no moat) 1H18 NPAT of $126m was more than double the adjusted 1H17 NPAT of $53m and slightly ahead of our expectations. The uplift was entirely due to higher prices with mineral sands revenue increasing 21% to $607m despite 3% lower combined zircon, rutile and synthetic rutile sales volumes of 439,000 tonnes. Adjusted group EBITDA was up 80% to $279m, driven by the higher prices. The contribution to EBITDA from the Mining Area C iron ore royalty was basically steady at $29m. ILU's realised zircon price rose 46% to US$1,240 per tonne while rutile was up 20% to US$906 per tonne versus a year ago. Pricing momentum remains strong with the rutile price up 14% for 2H18 while zircon will rise 11% from the 4Q18. We maintain our $10.50 per share fair value estimate. The unchanged fair value estimate reflects several negative and positive factors which broadly balance out. On the negative side, ILU expects the cost to develop the Sembehun mine and expand the processing plant at Sierra

South32 Limited S32

Fair Value ($)	2.70 →
Price/Fair Value	1.35
IMR	Strongly Positive

Oil Search OSH

Fair Value ($)	6.00 →
Price/Fair Value	1.47
IMR	Neutral

Rutile to be 40% to 60% more than the prior estimate of US$300m. In addition, the company will also incur higher operating costs at Sierra Rutile following unplanned outages in 1H18. Management expects unit costs of goods sold for the group to increase from $710 to $725 per tonne. The capital cost increase is an unpleasant surprise, a result of a prior estimate from Sierra Rutile's previous management team. Offsetting those negatives are several positives. Further near-term zircon and rutile price increases are the key positive. ILU has continued to sell inventories to support customer demand and faster than we expected. Inventories are now close to normal levels. Management has increased its 2018 zircon production guidance by 10% to 330,000 tonnes to help satisfy robust customer demand. With the faster-than-expected drawdown of inventory, and robust 1H18 free cash flow of $232m, the balance sheet continues to improve. Net debt is now just $34m, down from $305m a year ago. This sees ILU well placed for the planned period of elevated capital expenditure starting from 2H18. Given the upcoming capital expenditure, ILU paid out a lower-than-expected 10 cents per share interim dividend. As a result, we reduce our FY18 dividend forecast from 40 to 30 cents per share. IMR Strongly Negative.

South32 Limited (S32) (no moat) delivered a solid FY18 result. Adjusted NPAT increased 13% to US$1.3bn compared with FY17. Adjusted earnings per share rose by over 18% to US$ 26 cents, partially due to S32 buying back 98 million shares. Higher commodity prices were the key growth driver and boosted EBIT by US$1.5bn. However, inflation, higher royalties and operating costs, and adverse foreign exchange movements trimmed EBIT by US$0.7bn. Further, weaker volumes from Illawarra coking coal operations and Cannington also detracted from EBIT to the tune of US$0.6bn. FY18 earnings were somewhat below our forecast, due to higher costs in aluminium and lower realised prices in South Africa coal. However, FY19 guidance is in line with our expectations. Cost inflation is detracting from future margins, but our higher near- and mid-cycle thermal coal forecasts mean our profit forecasts for the five years ending FY23 are little changed overall. The lower A$ is also a modest benefit to our fair value estimate, which we maintain at $2.70 per share. Management expects to increase volumes overall by about 5% in FY19, with a partial recovery in volumes at Illawarra coal and incremental expansions in aluminium and alumina the main drivers. The key medium-term growth projects—the Eagle Downs coking coal project and the Hermosa zinc deposit—stem from recent acquisition activity. The financial position is very strong, with net cash at end June of US$2bn. Payment of US$1.4bn for the Eagle Downs and Hermosa acquisitions falls due in FY19 and will draw down most of the excess cash. The company also has US$380m earmarked for further share repurchases in FY19. Despite these large outflows, in the absence of a large acquisition, the balance sheet should remain strong for the foreseeable future. We think a conservative balance sheet is appropriate, given the cyclical nature of commodity prices and the relatively high capital intensity of the business. IMR Strongly Positive.

Energy

Oil Search's (OSH) (no moat) 1H18 NPAT declined 39% to US$79m, close to expectations, featuring earnings impacts from the PNG earthquake. We make no change to our $6.00 fair value estimate. A lower than expected US$ 2 cent per share dividend was a surprise, a payout of just 38% of already quake-impacted earnings, the board presumably watching the balance sheet. Our 2018 and 2019 EPS forecasts are little changed at 31 and 47 cents, respectively. OSH guides for 24–26 mmboe of production and US$435–530m in capital and exploration expenditure in 2018. We sit at the approximate mid-point in each case. Creditably, 2H18 output is anticipated to have rapidly recovered to at/above pre-earthquake levels. We rein-in our 2018 DPS forecast to 15 cents for a modest unfranked 1.7% yield at the current share price, equating to a 47% payout, still toward the high end of the 35%–50% guidance range. 1H18 net operating cash flow, after exploration and evaluation expenditure of US$98m, halved to US$117m, close to our US$126m expectations. Management expects cash balances to begin rebuilding from 2H18, despite capital expenditures. Net debt is US$3.18bn, following the 1Q18 acquisition of Alaska Slope for US$416m, and OSH must prepare for intended expansionary expenditure at PNG LNG. 1H18 group sales volumes fell 30% to 9.8 million barrels of oil equivalent (mmboe) following the magnitude 7.5 quake. Higher realised average pricing, up 20% to US$58 per boe, was a useful partial offset. Unit costs increased 65% to US$18.70 per boe, reflecting remediation work, make-up LNG cargo purchases, and reprioritised maintenance. Our assumed mid-cycle unit cost assumption remains US$12.75 per boe in 2022 dollars at our unchanged US$60 per barrel Brent crude forecast. Existing producing PNG assets comprise $3.10 or just over half our fair value

Santos STO	
Fair Value ($)	7.00 ↑
Price/Fair Value	0.99
IMR	Strongly Positive

Woodside Petroleum WPL	
Fair Value ($)	46.50 ↑
Price/Fair Value	0.79
IMR	Neutral

estimate, after allocating the full $2.70 in group net debt. Our assumption for a third PNG LNG train contributes $1.20 or 20% of fair value. For the less risk averse, removing the 3% PNG sovereign risk premium from our cost of equity would increase fair value by 37% to $8.20, or 9% shy of the current share price. IMR Neutral.

Santos' (STO) (no moat) 1H18 underlying NPAT of US$217m was in line with our US$215m expectations, with no implication for fair value or earnings forecasts. But the overshadowing Quadrant acquisition looks a beauty, and our initial assessment of 7.5% fair value accretion to $7.00 per share has every chance of proving conservative. In 2019, the first full year of earnings contribution, we estimate Quadrant to drive 26% EBITDAX per share growth (the X for exploration), close to STO's assessment of around 30%. Quadrant increases pro forma 2017 proven and probable (2P) reserves by 26%, or 220 mmboe, to 1,068 mmboe, and production by 32% to 79 mmboe. That places STO in the realms of Woodside's 84 mmboe 2017 production. STO isn't buying anything it doesn't already know well, isn't overstretching its balance sheet, and isn't running off on a tangent. It already owns material stakes in Quadrant assets and anticipates combination synergies of US$30m–US$50m annually. We assume the low end, which would mean no increase in administrative costs despite the increase in scale. STO expects Quadrant to result in net debt/net debt plus equity of just 34% at end 2018 versus the current 25%, and for this to fall below 30% by end 2019. We estimate 26%, and the resumed dividend policy to stand. Quadrant's assets are plain-vanilla, long-life conventional Western Australian offshore hydrocarbon assets with a large inventory of molecules from which to backfill existing infrastructure and from which to increase resources and drive growth. STO expects Quadrant's high-calibre projects to reduce its free cash flow break-even from US$36 to US$32 per boe, speaking to the high quality of the acquired assets. Quadrant has high-margin, CPI-linked contracts that delivered a realised 2017 average price of US$4.90 per gigajoule, ahead of STO's US$4.57 in 2017. In addition to delivering increased asset ownership and operatorship, Quadrant strengthens STO's offshore operating capability and confers 52,000 square kilometres of Carnarvon Basin acreage, from which multiple near and medium-term development and appraisal opportunities arise. Dorado is a case in point. Infrastructure and Quadrant's offshore operating expertise will be able to be leveraged across STO's portfolio to potentially powerful effect. IMR Strongly Positive.

Woodside Petroleum (WPL) (no moat) reported a 12% increase in underlying 1H18 NPAT to US$566m, about 4% shy of our US$590m forecast. However, the small miss reflects chiefly a higher-than-anticipated effective corporate tax rate of 32%, due to timing issues. Net operating cash flow improved 22% to US$1.2bn, around 10% ahead of our expectations, facilitating faster-than-anticipated net debt reduction to just US$3bn. Our long-term operating assumptions are unchanged. We increase our fair value estimate by 3% to $46.50, simply due to continued weakening in the A$/US$ exchange rate to roughly 0.73 from 0.75 prior. Our FY18 underlying EPS forecast marginally improves from $2.15 to $2.18, with the weaker A$ more than offsetting any earnings shortfall. An improved 1H18 dividend of US$ 53 cents is in line with expectations, but the more favourable dollar translation again sees our full-year DPS increased 3.0% from $1.72 to $1.77. At the current $35.30 share price, the 2018 dividend equates to a handy fully franked 5.0% yield, and that in a company with no shortage of healthy growth prospects. WPL's 100 mmboe production target for 2020 is in line with our own, before we forecast growth to 130 mmboe from 2024, with a second Pluto LNG train contributing. WPL delivered 44.3 mmboe of production in 1H18 and increased FY18 guidance to from 85–90 mmboe to 87–91 mmboe. Our target stands at 91 mmboe, already slightly above guidance high-end. Our dividend yield forecast assumes continuation of an 80% payout ratio. WPL has minimal near-term debt maturing and annualised 1H18 net debt/EBITDA of just 0.9 has the balance sheet in excellent shape for well publicised development plans. We expect this to include a second Pluto LNG train accessing Scarborough gas, and development of the Browse gas field for the North West Shelf joint venture. Concept selects for Scarborough and Pluto T2 are targeted by end this year. The proposed Scarborough gas resource development in support of a second Pluto LNG train is being accelerated to ready for startup status by as soon as 2024 with second train capacity increased to 4.0–5.0Mtpa. We hold our forecast at 4.5Mtpa, with the second train comprising $5.00 per share or 11% of our group fair value estimate. Pluto in its current one-train-only configuration comprises 50% of our group fair value estimate. IMR Neutral.

Newcrest Mining NCM	
Fair Value ($)	23.00 →
Price/Fair Value	0.82
IMR	Neutral

Aurizon AZJ	
Fair Value ($)	3.80 ↑
Price/Fair Value	1.11
IMR	Neutral

Monadelphous MND	
Fair Value ($)	10.50 →
Price/Fair Value	1.42
IMR	Neutral

Gold

Newcrest Mining's (NCM) (no moat) FY18 result was in line with our expectations. Adjusted NPAT of US$369m (A$476m) was in line with our US$369m (A$483m) forecast and 6% below FY17. The lower adjusted NPAT versus FY17 was due to a 1.5% decline in gold output and a 6% increase in all-in sustaining costs to US$836 per ounce, with more gold coming from relatively higher-cost mines. With the result meeting our expectations, we maintain our $23 per share fair value estimate. FY19 guidance is to produce 2.35–2.6 million ounces of gold and 100,000–110,000 tonnes of copper. Unit cost guidance was also higher than we expected. As a result, we slightly lower our production forecasts and reduced our near-term earnings forecasts. However, over the long term, we think the potential to extract further cost efficiencies and incremental volume growth through expansions at Lihir and Cadia will increase future earnings. We also update our forecast to assume a 100% chance of the Wafi-Golpu project proceeding. We value NCM's interest at 85 cents per share, assuming the Papua New Guinean government exercises its right to 30% and dilutes NCM's ownership from 50% to 35%. NCM is in strong financial shape. Operating cash flow of US$1.4bn was in line with FY17, while free cash flow was US$0.6bn. Net debt fell 30% to US$1bn. Net debt/EBITDA of 0.7 and EBIT/net interest cover of 6.1 are both comfortable. Liquidity was ample with cash approaching US$1bn. NCM also has meaningful undrawn debt. IMR Neutral.

Mining Services

Aurizon (AZJ) (narrow moat) reported a good FY18 result with underlying NPAT up 10% to $542m, 3% above expectations. The result was driven by cost-out initiatives, improved volumes in the coal division, and closure of loss-making bulk operations. Earnings in the rail network division were flat. The outlook is weak, with earnings likely to fall over the next two years on headwinds across the business. We increase our fair value 3% to $3.80 after rolling our financial model. FY19 guidance is for above-rail underlying EBIT of $390m to $430m, down from $479m in FY18 due to cessation of iron ore haulage contracts and higher costs as AZJ prepares for new coal haulage contracts. Above-rail earnings should improve in FY20 as costs reduce and new contract revenue ramps up. Network EBIT will depend on when the new, lower regulatory tariffs apply. If AZJ remains on transitional tariffs for the entire FY19, EBIT should be $470m to $490m. But if tariffs from the tough UT5 regulatory decision were implemented for the full year, EBIT would be $340m to $360m. Our forecasts, which are largely unchanged, assume UT5 starts in FY20. Dividends comfortably beat expectations, but that's not a good thing. We recently downgraded our forecasts to factor in the need to retain earnings to cope with rising gearing and major earnings headwinds. Instead, the board declared FY18 dividends of 37.1 cents per share, up 20% on FY17 and representing a payout ratio of 100% of underlying earnings—and comes on top of a $300m share buyback earlier in the year. Meanwhile, group gearing—net debt/net debt plus equity—rose 270 basis points to 42.3%, and network division gearing—net debt/regulated asset base—rose 830 basis points to 62.4%. Coal division EBIT rose 2% to $429m, though the result was a little better than it appears as some added costs were to support volume growth. This lays a platform for stronger earnings. The coal industry remains buoyed by strong coal prices, with both coking and thermal coal prices double the levels of the FY16 nadir. Network EBIT was flat at $481m, and we expect something similar in FY19. But once UT5 tariffs start, assuming AZJ is mostly unsuccessful in its appeal, EBIT should fall nearly 30% to about $350m a year. Regulatory risk is a key threat and we believe things will only get worse in the next coal industry downturn. IMR Neutral.

Monadelphous (MND) (no moat) reported FY18 NPAT of $71.5m, only marginally below our $72.7m expectations and our $10.50 per share fair value stands. Our long-term assumptions remain substantially unchanged. A surprising element of the result was the 41% increase in revenue to $1.78bn. But this was negated by a commensurate increase in operating costs with EBITDA margin falling 120 basis points to 6.6%, and 60 basis points below our 7.2% forecast. We don't see long-term consequence and our mid-cycle EBITDA margin assumption remains 7.6%. Management says there is strong demand for services in resources and energy and there is a surge in oil and gas construction revenue. This is at odds with published data showing total Australian energy capital expenditure changed little in FY18 at approximately $26bn, before an expected precipitous fall in FY19. And after more than five years' construction, the Ichthys LNG project—a revenue insulating core for MND—began production in July. MND expects lower construction revenue in FY19 due to project timing and Ichthys run off. We are less bearish, anticipating similar levels to FY18, with higher operating and sustaining capital expenditure levels to add support. Offshore Ichthys maintenance services will be added to MND's maintenance

CIMIC Group CIM	
Fair Value ($)	29.00 →
Price/Fair Value	1.74
IMR	Neutral

Downer EDI DOW	
Fair Value ($)	5.40 →
Price/Fair Value	1.47
IMR	Neutral

contracts for Chevron at Barrow Island, for Shell at Prelude FLNG, and for Woodside at Karratha. Annual maintenance revenue can be small compared with the substantial upfront construction revenue, but overall, we project group FY19 group revenue to increase by 3.5% to $1.85bn. A strong balance sheet has MND well positioned to participate in new projects as and when they arise. FY18 net operating cash flow halved to $51.6m, missing our $63m target. But the balance sheet regardless remains in a healthy and appropriate net cash position of approximately $200m or $2.15 per share. Priorities are to continue to grow water and irrigation in Australia and New Zealand, deliver renewable energy projects through Zenviron, and progress options to enter other Australian infrastructure markets. We agree with the diversification. Despite MND predicting major resources construction opportunities in FY20 and beyond, Morningstar's outlook for resources is more tempered. IMR Neutral.

Engineering & Construction

CIMIC Group (CIM) (no moat) reported a 12.4% increase in 1H18 NPAT to $363m, modestly below our $380m expectation. Management guidance for FY18 NPAT of $720–$780m is unchanged but our forecast softens slightly from $768m to $759m. CIM will pay a 1H18 fully franked dividend of 70 cents per share and our full-year expectation is for $1.43 per share. The quality of 1H18 earnings improvement was high, as EBITDA margin held ground at 11.3% with no significant one-off items. 1H18 EBITDA margin particularly impressed, given revenue growth from the services segment, a lower 7.5% margin business. Construction EBITDA margin improved from 9.5% in 1H17 to 10.1% and mining margin held at 21%. From this context, CIM's lack of work-in-hand (WIH) growth might be viewed as evidence of creditable discipline in bidding for new contracts. We continue to think the market remains over-enthused by the implication of high-profile public infrastructure spending. The important metric from our perspective remains CIM's work-in-hand (WIH). At 30 June, WIH was $34.8bn, down marginally from December's $36.0bn print, and equivalent to 2.5 years' current revenue. While a notoriously lumpy metric, the fact that like-for-like WIH has not materially changed in dollar terms in more than two years, and in fact has fallen in revenue terms, from 3.0 years' worth in 1H16, should concern. Our $29 fair value anticipates five-year EBITDA CAGR of just 1.5%, to $1.6bn by FY22. 1H18 net operating cash flow increased 20% to $636m, slightly ahead of our expectations. Free cash flow also impressed, up 70% to $384m and well ahead, with lower-than-anticipated capital expenditure of just $253m. This allowed the net cash position to improve by 43% versus December to $1.3bn, a commendable position for a business in a highly cyclical industry. We project net operating cash flow to remain above $1.2bn per year and growing, and for CIM to remain in growing net cash including maintenance of a 60% payout ratio. IMR Neutral.

Downer EDI's (DOW) (no moat) Underlying FY18 NPAT of $250m came in 9% below our $274m forecast, but without implication for long-term assumptions. Net operating cash flow increased by 32% to $583m, boosted by the Spotless Group acquisition. But this too was also below our $655m expectations. The FY18 dividend of 27 cents missed our 31 cents target, a 61% payout, but was calculated over the lower-than-anticipated earnings. We make no change to our $5.40 fair value estimate. DOW provided FY19 guidance for a 16% improvement in NPAT to $291m, including $44m in goodwill amortisation. We sharply lower our FY19 NPAT forecast to $294m, now just marginally above guidance. We achieve this by slowing the rate of anticipated margin improvement from FY18's low mark to mid-cycle levels. The FY19 guidance anticipates increased road construction and surfacing from state government investment, growth in renewable energy projects, strong growth in minerals processing, and growth in oil and gas maintenance. We expect similar from a revenue perspective, and our slightly more bullish profit outlook rests on considerable margin improvement. We forecast group FY19 EBITDA margins to increase by 130 basis points to 7.8%. Much will rest on eking further margin gains from transport, utilities and EC&M. Work-in-hand (WIH) increased by 7.5% to $42bn in FY18, the gains substantially in mining and in transport services. But DOW is burning through over $1bn per month in revenue that must be replaced just to stand still. We have previously expressed concern work levels weren't supporting the high market expectations. While we recognise there will be volatility in work levels over short time frames and more large contracts will come through, particularly in the public infrastructure arena, these are necessary to replace income in addition to growing it. Current WIH per share levels of $70 are considerably higher than circa $50 FY10 peaks, but $12bn FY18 revenue was more than double $5.8bn in FY10. And many of the newer rail and maintenance contracts are considerably longer-dated than mining and EC&M contracts traditionally

Lendlease LLC	
Fair Value ($)	18.50 ↑
Price/Fair Value	1.05
IMR	Neutral

Fairfax Media FXJ	
Fair Value ($)	0.75 ↑
Price/Fair Value	1.11
IMR	Neutral

News Corporation NWS	
Fair Value ($)	20.50 ↓
Price/Fair Value	0.90
IMR	Strongly Negative

dominating; less revenue per year but accruing over a longer period. IMR Neutral.

Lendlease (LLC) (no moat) reported FY18 earnings of $792m or 137 cents per security (cps) up 1.3% and marginally above our forecast of 135cps. The result was messy, with construction EBITDA falling $260m due to engineering related impairments, but largely offset by significant uplift in non-cash revaluations of investments by $228m to $305m. We forecast FY19 earnings grow 2% to 140cps, with a strong recovery in construction earnings, but a higher tax rate of 27% and lower revaluation gains. Our fair value estimate increases 6% from $17.50 to $18.50 per security on a more upbeat outlook for assets under management (AUM) growth and higher recurring fee income. Historically build-to-sell apartments made up a large proportion of completions, generating high margins due to strong price growth in residential. Going forward, this will decline, shifting towards build-to-rent apartments, telecom towers, retirement living villages, and office towers. Margins on these will be lower, but most of the completed product will be lapped up by associated entities on LLC's investment management platform. We raise growth expectations for AUM, and associated fee income. This is a positive in two ways: first, it enables LLC to grow earnings with less of its own capital; and second, earnings volatility and business risk reduce as income from fund management activities is more annuity-style. Growth in AUM was the key positive from the result, up by 15% or $3.8bn over the year to $29.6bn. The recent troubles in the Australian engineering business look largely over, but there will be little contribution from yet-to-be completed projects. LLC continues to target a 5% margin for its Australian construction business. However, we don't see the Australian engineering and construction margins anywhere near 5% over the longer term. Our view is premised on the highly competitive nature of the industries. IMR Neutral.

Traditional Media (Print & Television)

Fairfax Media's (FXJ) (no moat) FY18 normalised NPAT fell 12% to $125m, albeit in line with forecast. Final DPS was down 10% to 1.8 cents, fully franked, bringing the FY18 dividend to 2.9 cents, 69% franked. At the operating level, EBITDA (including associates) fell 6% to $217m and 2% shy of our estimate. The slight miss was mainly driven by disappointing results in regional newspapers and New Zealand operations, with cost rationalisation not quick enough to respond to deteriorating revenue declines and not helped by the drought in Australia. We raise our fair value estimate by 7% to 75 cents per share, predominantly driven by upgrades in two areas. First, it reflects cost-driven lifts to our metropolitan publishing forecasts, where we see the FY18 improvement continuing at a greater pace than previously anticipated, aided by cost-savings from the recently-struck print-sharing agreement with News Corporation. Second, we have cut our corporate overhead cost estimates by $8m a year on average over the forecast horizon, to around $20m per year. This is in recognition of the impressive halving of these expenses in FY18 to $23m versus our $32m forecast, with management confidently projecting sub-$20m level on a rate-run basis in FY19. The metropolitan media division saw revenue decline 6% year on year, in line with our expectations. However, aggressive cost cuts led to a 7% rise in core EBIT to $47m. High-single-digit growth in digital subscriptions was encouraging. Drought-impacted regional media revenue fell 7% year on year. Continued cost-saving initiatives were not enough to meet our expectations, and the division's EBIT margin slipped from 15.4% to 12.7%. Despite the drought, revenue continues to fall at a slower pace each year and we expect revenue to bottom out in FY22, from which point, we forecast sustainable EBIT margin to be around 11%. Domain's result was broadly in line with our forecasts. The balance sheet remains in good health, with net debt of $136m equating to a healthy 0.5 times net debt/EBITDA ratio. The interest coverage ratio, EBITDA/interest expense, increased to 40 times indicating FXJ is in a strong financial position. IMR Neutral.

News Corporation's (NWS) (no moat) 4Q18 result disappointed. We cut our fair value estimate by 4% to US$15.30 (or A$20.50) per share. While the Foxtel-boosted 49% lift in 4Q18 normalised EBITDA to US$327m met our expectations, it masked some compositional weaknesses. The halving of Foxtel's EBITDA to US$76m, versus our forecast of US$104m is disappointing, given NWS has just upped its interest from 50% to 65% with the pay TV operator's result now consolidated in NWS accounts. Pressure on Foxtel is likely to continue, as revenue impact of diversifying into lower-priced streaming products will be compounded by the cost impact of investment into content (cricket, a step-up in National Rugby League rights cost), as well as the burden of introducing more genre-specific subscription video on demand offers. Management looks to have bitten the strategic bullet at Foxtel, gearing to push more aggressively into digital streaming which we see as a better option than

Nine Entertainment NEC	
Fair Value ($)	1.70 ↑
Price/Fair Value	1.33
IMR	Neutral

Seven West Media SWM	
Fair Value ($)	0.70 ↑
Price/Fair Value	1.43
IMR	Neutral

losing subscribers to third parties such as Netflix and other sports-specific streaming apps. A 35% jump in "Other" losses to US$46m was also discouraging. We recognise the need to carry a certain amount of firepower to incubate some loss-making ventures or to find the next growth units such as REA Group or Move. However, we view US$173m of such annual costs as too high. While the 82%, or US$32m, jump in Book EBITDA to US$71m was impressive, we treat the growth as mostly a one-off event. An estimated US$21m of the increase reflects the windfall from sub-licensing the "Lord of the Rings" trilogy titles to Amazon in 4Q18—something we are not extrapolating in our forecasts. The combined effect of these dynamics has led to an average 5% fall in our EBITDA forecasts for the next three years. This drove the 4% cut in our fair value estimate. A US$ 10 cents dividend took the FY18 dividend to US$ 20 cents per share unfranked, equating to a 45% payout ratio of normalised full-year EPS of US$ 44 cents. Balance sheet remains solid, with net cash of US$82m. IMR Strongly Negative.

Nine Entertainment (NEC) (no moat) produced a stellar 25% jump in FY18 underlying EBITDA to $257m and while it was in line with our expectations, we were impressed with the quality of the result. The 2% beat relative to our forecast on TV EBITDA, up 27% to $238m was particularly notable, leading to TV EBITDA margin of 20.7%, from 17.4% a year ago. The performance highlights the sheer operating leverage, one that can magnify when revenue tailwinds from a recovering TV advertising market, combines with strong ratings growth on a largely fixed-cost base. Strength of the operating momentum is such management has guided to FY19 EBITDA of $280m to $300m, necessitating a circa 20% upgrade to our near-term earnings estimates. In fact, our FY19 $309m EBITDA projection is higher than guidance, as we believe NEC's forecast 1% growth for the TV advertising market is conservative, we forecast 2%, especially with likely flow of political advertising amid current turmoil in Canberra. We lift our fair value estimate by more modest 13% to $1.70 per share as our view remains anchored on a long-term, mid-cycle TV revenue market share and EBITDA margin of 37.5% and 16.5%, respectively. This compares with NEC's eight-year historical average of 37.0% for revenue share and 19.3% for EBITDA margin, with our conservatism predicated on continuing structural threats from digital media giants on TV consumption. We commend NEC for taking advantage of the stock price to acquire Fairfax—a combination that will ensure audience and advertiser relevance, at least longer than if these two entities stayed independent. IMR Neutral.

Seven West Media's (SWM) (no moat) FY18 normalised NPAT fell 15% to $143m. Including one-offs, reported NPAT was $135m. Dividends remain suspended, as restoring balance sheet health continues to take priority. Debt fell $76m in 2H18 to $635m and net debt/EBITDA was down to 2.3 times, from 2.4 times a year ago. We see management's FY19 target below 2.0 times as achievable, with our forecast at 1.9 times. We lift our fair value estimate by 6% to 70 cents per share. This is the first upgrade in recent memory, reflecting not only the 3% beat on FY18 EBIT of $236m, but also the strong earnings guidance. Indeed, management's projected FY19 EBIT growth of 5% to 10% has led to an average 10% increase to our medium-term operating earnings forecasts, providing the foundation for our intrinsic assessment uplift. The expected return to profit growth in FY19, after six straight years of decline, is underpinned by a confluence of factors. The recovery in the TV advertising market (up 2.5% in FY18, 3.8% in 2H18) is likely to continue in FY19, by 2.0% on our forecast. This will coincide with Seven's resurgent TV ratings which achieved a record 41.6% commercial share in 2H18, driving our forecast 39.3% share of the TV advertising market for Seven in FY19, up from 38.1% in FY18. All this will be augmented by continuing benefits of the current cost-out program, one resulting in a $21m saving in FY18 and is projected for a further $10m to $20m in FY19. We project SMW's mid-cycle metropolitan TV advertising revenue share at 37.5% longer term, with sustainable margin pegged at 16.0%. This is below the 22.7% average EBIT margin achieved over the past eight years, reflecting the continuing impact of structural pressures on the industry from digital and mobile insurgents, as well as the likely re-emergence of cost pressures to slow audience losses to these disruptors. Divisionally, TV EBIT fell 14% to $216m, slightly below our estimate. This was driven by the well-documented ratings struggles which led to a fall in TV market revenue share from 40.2% to 38.1%. However, a strong 2H18 recovery saw ratings share at an all-time industry record of 41.6%. Newspaper EBIT fell 19% to $21m, driven mostly by better-than-expected cost reduction. Magazine EBIT jumped from $4m to $10m. This was the first increase in recent memory, mainly aided by significant cost savings from recent restructuring. IMR Neutral.

Carsales.com CAR	
Fair Value ($)	14.50 ↑
Price/Fair Value	1.06
IMR	Strongly Positive

Domain Group DHG	
Fair Value ($)	3.10 →
Price/Fair Value	1.12
IMR	Positive

REA Group REA	
Fair Value ($)	59.00 ↑
Price/Fair Value	1.46
IMR	Positive

New Media

Carsales.com's (CAR) (narrow moat) reported a good FY18 result, which was broadly in line with our expectations. Although the 19% increase in revenue was higher than our 17% forecast, EBITDA growth of 16% was lower than the 20% we expected. The result was also distorted somewhat by the change in accounting policy for SK Encar following the increase in CAR's ownership from 49% to 100% in January 2018. We increase our fair value by 4% to $14.50 which largely reflects the time value of money. The result was a confidence booster as CAR continues to generate strong growth from its dominant domestic business, which comprises around 75% of group EBITDA and which increased revenue by 10% and EBITDA by 9%. Like the other main online classified advertising platforms, revenue growth is being driven by price rather than volume and we expect CAR to continue to leverage its network effect based economic moat and associated pricing power for the foreseeable future. CAR is also successfully diversifying into adjacencies to its core business with its data, research, and services division, which comprises around 10% of group EBITDA, continuing to grow nicely, with revenue up 7% and EBITDA margins of 59%. We expect this business to continue to grow at similar rates for the foreseeable future, with growth supported by expansion into the international businesses where data can be leveraged easily due to the internationally homogenous nature of cars. International expansion plans are progressing well with good growth in South America, in contrast to Seek's challenges in the region. Although the South American businesses are relatively small, the company has leading positions in several countries and the addressable markets and growth potential are meaningful. Key performance indicators are improving, and we forecast a revenue CAGR of 26% for the division over the next decade. We also expect the South Korean business, which comprises 14% of group EBITDA, and is now fully owned, to continue to grow and we forecast an EBITDA CAGR of 9% over the next decade. The capital-light business generates good cash flows enabling relatively low financial leverage and sustainable dividends. Cash conversion was impacted by the consolidation of SK Encar. However, we expect cash flow to recover in FY19. Debt metrics remained comfortable at 30 June, with net debt/EBITDA of 1.9 and the EBIT/interest cover of 18, and we expect these metrics to steadily improve over the coming years.
IMR Strongly Positive.

Domain Group's (DHG) (narrow moat) FY18 result was broadly in line with our forecasts, and we have maintained our fair value estimate at $3.10 per share. As with REA, DHG hasn't yet been significantly affected by the recent downturn in the Australian real estate market. We forecast EPS to grow by 15% in FY19 and at a CAGR of 13% over the next decade, driven by a combination of revenue growth and margin expansion. The 17% increase in group revenue to $357m was expected and similar to the 16% revenue growth generated by REA's Australian businesses. The 12% increase in group EBITDA to $116m, was also in line with our forecast. In comparison, REA generates four times the EBITDA generated by DHG from its Australian listings business with a margin of 64%, versus 46% for DHG's comparable business. Over the next decade, we expect DHG to reduce this margin gap but not to match REA's margins. This is partly because we expect REA to spend more on marketing for the foreseeable future. In FY18 DHG spent $41m on marketing versus REA's $74m. We also expect DHG's group EBITDA margin to experience a drag from its relatively low-margin print business, which we expect to experience margin compression as its revenue falls. From a balance sheet perspective, DHG remains in good shape. Like REA, the company operates a capital-light business model, which we expect to enable sustainable franked dividends and relatively low financial leverage for the foreseeable future. DHG had just $126m in net debt at 30 June, which implies a comfortable net debt/EBITDA ratio of 1.1 and EBIT/interest coverage ratio of 12. We expect these metrics to steadily improve over the coming years, assuming no material acquisitions or share buybacks are undertaken. IMR Positive.

REA Group's (REA) (narrow moat) FY18 result was broadly in line with our expectations, with the 20% increase in revenue to $808m matching our forecast and the 23% increase in underlying EBITDA to $471m, 2% ahead of our forecast. We were slightly surprised by the strength of the Australian real estate business, which increased revenue by 14% and generated an EBITDA margin of 64.4%, up from 63.8% in FY17, despite property market weakness. We increase our revenue growth forecasts for the Australian real estate division, which has increased our fair value estimate by 5% to $59.00 per share. Management did not provide FY19 earnings guidance but expects margin expansion, which is consistent with our forecasts. Nevertheless, earnings growth is slowing. Our model assumes an EPS CAGR of 11% over the next decade versus a

SEEK SEK	
Fair Value ($)	18.00 →
Price/Fair Value	1.18
IMR	Strongly Negative

JB Hi-Fi JBH	
Fair Value ($)	24.50 ↑
Price/Fair Value	1.01
IMR	Neutral

21% CAGR over the past five years. Revenue growth is still effectively being driven by price increases rather than higher volumes, which is enabled by REA's leading market position, its narrow economic moat, and the relatively small cost of advertising on its platform relative to the value of the asset being sold. The company is attempting to diversify into new businesses such as financial services and agent marketing, but we expect the group's relatively high margins to attract increased competition, particularly from key competitor Domain Group, which generates a relatively low group EBITDA margin of around 32%. However, REA remains in great shape, and the company's challenges will increasingly be in deploying the cash it generates, which raises the threat of value-destructive acquisitions. Net debt increased to $317m largely due to $313m in acquisitions. We expect REA to generate $483m in operating cash flow in FY19 with net debt eliminated by FY20. Longer term we expect a higher payout ratio. IMR Positive

SEEK (SEK) (narrow moat) preannounced the key components of its FY18 financial result, meaning the official result came as little surprise. On an underlying basis, NPAT fell 1% despite a 24% increase in revenue and 16% increase in EBITDA, with higher reinvestment, depreciation and amortisation, net interest expense, and share based payments, the main factors. Despite the short-term lack of profit and EPS growth, SEK continues to deliver strong revenue growth, which seems to be the "new black" in investment markets these days. Management expects revenue growth of 15% to 20% in FY19, although reinvestment will trim EBITDA growth to 5% to 8%. This guidance is broadly in line with our forecasts which includes FY19 revenue growth of 22% for the Chinese business Zhaopin, which now comprises around 37% of group revenue. We expect Zhaopin to be a key revenue driver for the group over the next decade but fierce competition in the Chinese market is necessitating high levels of investment in the short term. From a balance sheet perspective, SEK remains in good shape despite a tripling in net debt to $573m in FY18 which was impacted by the privatisation of Zhaopin during the year. We remain comfortable with credit metrics, including the net debt/EBITDA ratio of 1.3 and EBITDA/net interest expense of 17 and expect all metrics to gradually improve over the next five years. The lengthy result presentation was peppered with justifications of the strategy but there's no avoiding the fact the market is likely to remain cautious on the strategy until profit growth and cash flows starts to accelerate. Management is not concerned about profit margins in percentage terms as much as revenue growth and profits in dollar terms, which is evident in the steady decline in the EBITDA margin from 47% in FY09 to 33% in FY18 and we forecast further weakness to 30% in FY19. However, we also expect margins to recover longer term and we forecast an average EBITDA margin of 35% over the next decade. IMR Strongly Negative (pre-announcement)

Retailers

JB Hi-Fi's (JBH) (no moat) FY18 group sales of $6.85bn were in line with guidance and our estimate, with NPAT of $233m slightly ahead of our $230m forecast, but in line with guidance. Final dividend was steady at 46 cents per share fully franked, with FY18 dividend up from $1.18 to $1.32 per share. We increase our fair value estimate by 7% to $24.50 per share, mainly due to the time value of money. We expect JBH to continue consolidating the fragmented Australian consumer electronics market, taking share from smaller bricks-and-mortar retailers, and our revenue and EBIT margin estimates are largely unchanged over our 10-year forecast period. In Australia, FY18 group sales grew by 6.8%, well ahead of the Australian consumer electronics and home appliances market at 2.6%. The Good Guys business, acquired in 2016, and the software category within JB Hi-Fi Australia were a drag on group sales. On a comparable 12-month basis, total sales at The Good Guys were up by 1.5% with like-for-like sales growth of only 0.9%. We expect a stronger FY19 for The Good Guys, with much of the disruption associated with the new ownership behind it, and the introduction of a new incentive scheme for its sales staff to accelerate sales growth. The Australian segment increased total sales by 9.4% and like-for-like sales by 6.2%. Excluding the struggling software category and weak DVD sales, the segment increased total sales by a meaningful 11.9% and like-for-like of 8.6%. The New Zealand operations posted another disappointing result, but its contribution to the group is immaterial. Online sales are rapidly growing and outperforming in-store sales growth across all three segments, increasing by 32% at JB Hi-Fi Australia, by a relatively muted 7% at The Good Guys, and almost doubling in New Zealand. We estimate e-commerce drove about 20% of like-for-like sales growth in Australia, with in-store like-for-like sales growth in the physical store network growing by just under 5%. Australian online penetration increased to 5.1% of total sales, up from 4.5% in FY17. FY19 sales guidance of

Harvey Norman HVN	
Fair Value ($)	3.40 →
Price/Fair Value	1.02 ●
IMR	Negative ⊖

Wesfarmers WES	
Fair Value ($)	39.00 →
Price/Fair Value	1.32 ●
IMR	Positive ⊕

$7.1bn, equates to growth of 3.6%. We are more optimistic and forecast group sales to increase by 5.8% to $7.25bn. Over the next decade, we expect average group sales growth of 4% and EBIT margins to hover around current levels of 5% as competition keeps a lid on gross margins. IMR Neutral.

Harvey Norman Holdings' (HVN) (no moat) FY18 underlying NPAT of $377m was virtually flat on FY17. Adjusted earnings were 5% short of our estimate, mainly on lower-than-expected operating profits in both the Australian and international businesses. The FY18 dividend was 30 cents per share fully franked at a payout ratio of 89% of underlying EPS, higher than our 25 cents estimate. We lift our dividend payout expectations from 70% to 80% over our forecast period. There was little to excite in the results and the core Australian franchisees segment saw sales momentum deteriorate further in the first two months of FY19. Management announced a renounceable entitlement offer to raise $164m to keep gearing in check. The $2.50 per share offer price is well below our fair value estimate. The positive impact of the time value of money on our fair value estimate is offset by the weaker-than-expected result, the more cautious earnings outlook, and the dilutionary effect of the equity raising. We maintain our fair value estimate of $3.40 per share. In Australia, intense competition in the consumer electronics and home appliances categories weighed on prices as franchisees protected market share. Franchisee sales slowed markedly in 2H18. Headline franchisee sales of $5.8bn were up only 2.6% year on year, falling 1.5% short of our sales estimate and our sales growth forecast of 4.1%. Franchisees had a bleak start to FY19, with total sales and comparable sales both going backwards, down 2.0% and 1.1%, respectively. This compares with JB Hi-Fi's slow but positive like-for-like sales growth in July, at 0.3% for JB Hi-Fi Australia and 1.4% for The Good Guys. Price-cutting and investments in customer service and online delivery options crimped franchisees' operating margins and hence franchising fees to HVN. Franchising operating margins were down 52 basis points to 4.9%, more severe than our expectation of a 15-basis-point decline. We expect competition to remain intense, but HVN to be a formidable contender and its Australian operating margin to average 4.8% in the long term. The international company-operated stores account for about 20% of group profits. Total sales were up by 9.3% versus our estimate of 5.8% sales growth. We expect strong sales growth, especially in Malaysia, to result in total international retail sales growing at an average rate of 10% over the next two years, before moderating to around 3% in the longer term. However, operating margins in the retail segment increased by 30 basis points to 5.4%, short of our 5.9% estimate. The property segment was a partial offset, with underlying operating profits, excluding property revaluations, of $137m above our estimate of $128m, owing to slightly higher revenue and slightly lower costs. IMR Negative.

Wesfarmers (WES) (narrow moat) posted FY18 underlying NPAT in line with our estimates. The results of its two key businesses, Bunnings and Coles—together accounting for two thirds of group operating profits—were broadly in line with our expectations. However, the department store segment, comprising only 15% of group EBIT, surprised with solid results well above expectations. We interpret the segments' results—EBIT margins are no longer reported separately—as Kmart sustaining its strong EBIT margins generated last year, and the weaker Target chain turning the corner in terms of its earnings earlier than we had expected, despite fierce competition. We raise our fair value estimate by 4% to $39, due to increased earnings forecasts, slightly lower capital expenditures, and the time value of money. On average, we lifted EPS by 2% annually, mainly reflecting slightly higher EBIT margins in the department store and home improvement segments. In FY18, group revenue increased by 2.1%, while underlying NPAT declined by 3.5%. Dividend was steady at $2.23 per share. Bunnings Australia and New Zealand contributed $1.5bn to group EBIT, as expected. Like-for-like food sales at Coles continued to improve in 4Q18 and momentum has continued into 1Q19. Still, EBIT margins at Coles, including liquor and convenience, declined more than we had expected, by 30 basis points to 3.8%. Department store EBIT of $660m was 15% ahead of our estimate. Price-cutting drove double-digit growth in transactions at Kmart, and we estimate operating leverage more than offset lower prices. Total sales at Target sales declined by 4.7%, but we estimate EBIT margins were some 100 basis points higher than our 1% forecast. Target's gross margins were boosted by operational improvements in sourcing of merchandise, markdowns, sales mix, shrinkage, and store productivity. The conglomerate looks to have its ducks in line. The recent flurry of corporate transactions leaves WES post-Coles-demerger with a stable dominated by three retail businesses we expect to grow strongly, take market share, and sustain relatively high EBIT margins—namely Bunnings, Kmart, and Officeworks. These

Woolworths WOW	
Fair Value ($)	24.50 →
Price/Fair Value	1.16
IMR	Neutral

Breville Group BRG	
Fair Value ($)	10.00 ↑
Price/Fair Value	1.34
IMR	Strongly Positive

core businesses are a great platform to build on, either organically or through acquisitions, and the already robust balance sheet is set to become even stronger. IMR Positive.

Woolworths (WOW) (narrow moat) FY18 results broadly in line with our estimates. FY18 NPAT of $1.724bn and operating profit from ongoing operations of $2.684bn, excluding central overheads compared with our estimates of $1.751bn and $2.648bn, respectively. Australian supermarket sales growth came roaring back in FY17 after significant price cuts and since then comparable sales growth outpaced arch rival Coles throughout FY18. Unfortunately, the competition rarely sleeps for too long. The strong supermarket sales growth over the past two years underpinned gradual food EBIT margin expansion, but we expect this trend to reverse in FY19. We expect the ongoing competition to remain intense and keep EBIT margins in check. The entry of hypermarket chain Kaufland, if successful, as well as the possibility of Amazon rolling out its Fresh offering, present threats to our base-case scenario of stabilising market shares across the industry and EBIT margins for WOW at around 4% in the longer term. The Australian supermarket segment represent two thirds of WOW EBIT from continuing operations. The Australian supermarkets segment increased sales by 4.3%, with comparable sales slowing to an Easter-adjusted 3.1% in 4Q18. Comparable sales decelerated to 1.3% in the first seven weeks of FY19. We expect sales to rebound slightly from current levels, and forecast total sales growth of 4.4% for the segment, including an additional trading week. Food EBIT margins of 4.7% were ahead of our 4.5% estimate and food EBIT was 3% higher than our forecast. We expect EBIT margins to decline by 20 basis points in FY19, driven by slower sales growth, higher wage costs, and ongoing investments in digital and service. Endeavour Drinks generated EBIT of $516m accounting for 19% of the group operating profit from ongoing operations. This was 2% lower than our estimate and struck on a lower-than-expected EBIT margin of 6.2%. Total sales grew by 4.5%, or 3.6% on a comparable basis, in line with forecast. New Zealand total and comparable supermarket sales grew by 3.4% in local-currency terms as expected, but by just 0.9% in A$. EBIT fell 10% to A$262m as the cost of doing business increased and accounted for 10% of group EBIT. Management will update on the future of the petrol business year end—IPO or trade sale. A divestment could crystallise value and open the door to further capital management. Following the recent Caltex transaction, which sees a $50m payment to WOW, and strong cash conversion a special dividend of 10 cents per share was declared along with a 93 cents ordinary dividend, both fully franked. We forecast a payout ratio of 75%, up from 70% previously, and an ordinary dividend of $1.07 in FY19. IMR Neutral.

Small Retailers

Breville Group (BRG) (narrow moat) delivered a strong FY18 result with underlying NPAT up 9% to $59m, broadly in line with our expectations. Performance varied between segments, as the core global product segment (85% of group earnings) increased EBIT by just 1%, whereas the distribution segment, which distributes third-party designed products, increased EBIT by over 100%, albeit off a relatively small base. The final dividend of 16.5 cents per share, took FY18 dividend to 33 cents per share (partially franked), an 8% increase on FY17. We lift our fair value estimate from $9 to $10 per share to reflect the time value of money, stronger sales growth in North America and the rest of world region (ROW) and a sustained margin recovery in the distribution segment. Revenue growth in the core global product segment was 13% in constant currency, but the profit contribution was slightly disappointing with the EBIT margin contracting from 15.4% to 13.9%. However, this is no cause for alarm, as this reflected increased marketing and R&D expenditure, along with the European expansion, which is still in its infancy. Management is increasing marketing/R&D investment to 12% of sales, compared with 10.5% in FY18. Within the global product segment, North America and ROW did most of the heavy lifting, growing by 16% and 11%, respectively. Whilst we had expected the continued strong performance in North America, the ROW performance was stronger than expected. While the company doesn't separate out the regions within ROW, we believe Europe was the main driver, and management indicated it delivered around $62m in revenue, equivalent to around two thirds of the ROW revenue. We project global product revenue growth of around 10% per year over the next five years, which captures the additional return on the increased investment into marketing and R&D. Our estimates incorporate: (1) moderate mid-single-digit growth in Australia and New Zealand, given the maturity and competitive nature of this market; (2) around 10% annual growth in North America, underpinned by new product launches and expansion into new categories; and (3) a continuation of the current low-to mid-teens growth in ROW, which assumes a

Domino's Pizza Enterprises DMP	
Fair Value ($)	53.00 →
Price/Fair Value	0.99
IMR	Neutral

Greencross GXL	
Fair Value ($)	6.00 →
Price/Fair Value	0.61
IMR	Neutral

Super Retail Group SUL	
Fair Value ($)	7.50 ↑
Price/Fair Value	1.18
IMR	Strongly Positive

successful launch of the Sage brand in Europe. IMR Strongly Positive.

Domino's Pizza Enterprises (DMP) (no moat) FY18 underwhelmed with same-store sales growth and underlying NPAT below guidance, but broadly in line with our more cautious estimates. However, with the growth trajectory still intact, we maintain our fair value estimate of $53 per share, underpinned by the solid runway of new organic stores and continuing, albeit moderating, same-store sales growth for the group on a par with the global Domino's business. Management reiterated its store count goal for FY25, and we expect further guidance on store growth beyond 2025 in the coming months. Underlying NPAT of $133m was slightly ahead of our $131m estimate, but below the guided $142m. Sales growth in both Europe and Australia missed guidance and came in slightly below our estimates, but Japan surprised on the upside. Management upgraded same-store sales growth guidance for Europe by 100 basis points (bp) in November 2017, only to miss the lower end by 30bp. European EBITDA margins in Europe were steady, but we expect these to gradually widen in the medium term, as synergy benefits following the German Hallo Pizza acquisition are realised, the new French leadership team establishes itself, and the business scales up significantly. We forecast European like-for-like sales growth of 4% for FY19, in line with guidance of 3%–6% growth, and total sales further boosted by the opening of 140 new stores. In Australia and New Zealand, same-store sales growth of 4.5% was below the guidance range of 6%–8%. EBITDA margins increased nevertheless, owing to the scale benefits, as well as the derecognition of options costs. As the global business continues to grow, we expect the group's overhead costs allocated to the Australian business to be further fractionalised, increasing EBITDA margins by another 400 bp over the next decade. Australian franchisee profitability, a prerequisite for DMP to increase its domestic footprint, was steady and for FY19 to date. This was despite an increase in wages. Japanese same-store sales rebounded from a weak 1H18, eking out 0.9% growth, and beating our estimate of flat comparable sales. or the group, we forecast FY19 like-for-like sales growth of 3% and 220 net new store openings, compared with guidance of 3%–6% and 225–250 stores, respectively. DMP's medium-term comparable sales growth outlook is in line with the expectations of its master franchisor, Domino's Pizza Inc, of international same-store sales growth in the range of 3%–6%. IMR Strongly Negative.

Greencross' (GXL) (no moat) underlying FY18 EBITDA fell by 6% to $98m, albeit in line with our expectations, and the recent guidance. The main cause was weakness in the Australian stand-alone veterinary and emergency clinics, although the performance stabilised in 4Q18 and now showing signs of improvement. Underlying NPAT declined by 14% to $37m, slightly behind our estimates reflecting higher than expected depreciation charges. The 5.5 cents final dividend took FY18 dividend to 15.5 cents per share fully franked, down almost 20% on FY17, with the payout maintained around 50%. We trim our near-term EBITDA estimates by around 5%, and project 7% annual growth on average over the next three years, reflecting a slower retail store rollout, softer vet sales, and the margin-dilutive impact of the new in-store clinics. However, our thesis and $6.00 per share fair value estimate remain intact. We have long been advocates of the integrated model, the benefits of which are taking longer than expected to materialise. We do, however, expect margins to improve in the long run as the integrated stores mature, driving a re-rating. Early success of this strategy is highlighted by the 8.5% like-for-like (LFL) sales growth generated by the integrated sites during FY18, double the pace of stand-alone clinics. The core Australian retail business continues to deliver amid the challenging competitive landscape. The 5% increase in LFL sales is encouraging and reflects around 3% price growth and a modest growth in basket size. We expect similar levels of growth going forward, underpinned by accelerating online sales, and continued investment into the loyalty programs, and increased foot traffic on the back of the integrated services. While FY18 was a challenging year for the veterinary business, the performance stabilised in 4Q and improved in early FY19 trading. We forecast sales to continue growing at a mid-to high-single-digit pace for the foreseeable future, which incorporates around 4% LFL sales per year and ongoing rollout of vets within the retail stores. EBITDA margins took a hit to just over 10%, but we expect a recovery to around 12% long term. We expect net debt to return towards 2 times EBITDA in the next two to three years as the focus shifts from expansion of the physical network. IMR Neutral.

Super Retail Group's (SUL) (no moat) FY18 underlying NPAT of $145m beat our estimate by 6%, largely driven by a stronger outdoor segment. The EBIT contribution from the newly acquired Macpac business even surpassed management's expectations. The results of the two key segments

Ainsworth Game Tech AGI	
Fair Value ($)	1.70 →
Price/Fair Value	0.66
IMR	Strongly Positive

Crown Resorts CWN	
Fair Value ($)	15.00 ↑
Price/Fair Value	0.90
IMR	Strongly Positive

accounting for almost 90% of group EBIT, auto and sports, were broadly in line with our expectations. Our long-term sales growth and EBIT margin forecasts for the individual segments are substantially unchanged. However, we lift our fair value estimate by 4% to $7.50 per share, reflecting the time value of money. Auto sales increased 5.3% to $1bn, 1% lower than our estimate. EBIT margins of 11.6% were in line with our forecast. We forecast margins to increase to 12% in the near term and remain at those levels. The auto segment further extended its market leadership, increasing its market share by one percentage point to 29%. Comparable auto sales increased by 5% in the first six weeks of FY19, slightly ahead of our unchanged full-year estimate of 4.2% and headline sales growth of 6.2%. In the longer term, we expect sales growth to moderate to around 4% with the total store count to reach 333, slightly below management's 345. Sporting goods performance was affected by the transitioning of Amart stores to the Rebel format, with comparable sales growing at 2.0%. Headline sales increased by 3.2% to $979m as expected with market share maintained. EBIT margins were affected by the transition, down 30 basis points to 9.3% and lower than our forecast of 9.6%. We estimate sales growth at 2.5% in FY19 and EBIT margins to decline by a further 30 basis points. In the long term, we expect total sales growth to average 2% and EBIT margins to stabilise at around 8%, owing to increasing competition from Amazon, JD Sports and Decathlon. Outdoor sales and margins were boosted by the Macpac acquisition. Total sales grew by 4.8% to $580m with EBIT of $30m, both ahead of our estimates. The strength of the Macpac business masks the weak results from the larger BCF business. We expect the outdoor segments' EBIT margin to increase to 6.7% by FY20 through contributions from the higher-margin Macpac business and the realisation of synergy benefits. IMR Strongly Positive.

Gaming & Leisure

Ainsworth Game Technology's (AGI) (narrow moat) FY18 underlying NPAT declined by 32% to $39m, although this weakness had been previously flagged, and the result was broadly in line with our expectations and our $1.70 per share fair value estimate is unchanged. AGI experienced continued market share losses in the domestic market and rest of the world, along with lower margins in North America. On a more positive note, the final dividend of 2.5 cents per share exceeded our expectations, taking FY18 dividends to four cents per share fully franked equivalent to a 46% payout ratio. At the group level, we project mid-single-digit revenue growth on average over the next five years, which assumes stabilisation of Australian market share, a resumption of growth in North American outright sales, albeit at a very modest pace, and increasing penetration of the Latin American participation market. We forecast EBIT to grow faster, at around 10% on average, given the high degree of operating leverage within the business, and a faster-than-expected revenue improvement could deliver substantial margin upside from our current estimates. We continue to believe AGI is undervalued. While the negatives overshadowed in FY18, several positives worth highlighting were: (1) early signs of ship-share improvement in the domestic market, following new game title releases; (2) a strong 10% increase in group participation machines (double over the last five years) particularly in Latin America, which should increase earnings stability; (3) R&D expenditure increased by 1% to 13% of revenue. While management expects to maintain R&D at around 13% of sales going forward, it is expected to be higher in absolute dollar terms which implies stronger revenue in FY19. This level of R&D is higher than the 11% long-term average, which is pleasing as future sales are highly dependent on innovation and game development, both areas in which we believe the company has dropped the ball in recent years; and (4) the balance sheet is also in healthy shape, with net debt steady at around 0.5 times EBITDA, providing the company a buffer to weather the cyclical down periods. IMR Strongly Positive (pre-announcement).

Crown Resorts' (CWN) (narrow moat) FY18 normalised NPAT increased by 13% to $387m, in line with our $383m forecast. As expected, the recovery in VIP gaming at the Melbourne facility was the main growth driver, offsetting soft revenue from Perth and Aspinalls. We lift our fair value estimate by 7% to $15 per share, reflecting an increase in our earnings forecasts. We raise our EBIT estimates by around 4% on average over the next two years to reflect continued growth in VIP and improving outlook for main-floor gaming, which should offset lost earnings from recently-divested CrownBet. At the current price, the stock offers modest upside with a healthy dividend yield of around 4.5%, partially franked. Further, we see potential for additional share buybacks or special dividends in future, as we believe CWN will be significantly underleveraged upon completion of the Sydney casino project. Crown Melbourne's VIP turnover rebounded at a faster pace than we

The Star Ent Group SGR	
Fair Value ($)	4.80 ↑
Price/Fair Value	1.08
IMR	Strongly Positive

Tabcorp TAH	
Fair Value ($)	4.50 →
Price/Fair Value	1.09
IMR	Strongly Positive

previously expected, increasing by over 70% to almost $44bn. We have adjusted our near-term forecasts, and now expect turnover to reach the previous $52bn high by the end of FY19. Despite growing rapidly over the past decade, Australia's share of the global VIP market is negligible, and CWN should be able to continue growing its VIP business at a high-single-digit pace, on average, for at least the next five years. Some weakness in the WA economy is likely to continue weighing on Perth's main floor gaming in the near term. FY18's soft performance was no surprise, and Perth's revenue declined by 3%, with main-floor tables and VIP hit the hardest. Perth's EBITDA margins should remain at 30% on average, in line with current levels, with revenue growth constrained in the low- to mid-single-digit range. The Sydney project is progressing well, and on track for completion in 2021. Management reiterated total project cost of $2.2bn ($1.4bn net of apartment sales). We assume the new casino comes on line by the start of FY22 and takes approximately two to three years to ramp up, at which time we expect it to earn returns on capital north of 10%, comfortably exceeding the 8.5% cost of capital. Based on our estimates, by FY24 Sydney will generate around 20% of group EBITDA, roughly on par with Perth.
IMR Strongly Positive.

The Star Entertainment Group's (SGR) (no moat) impressive FY18 result was driven by record VIP turnover. Normalised NPAT increased 20% to $258m consistent with our forecasts. A final dividend of 13 cents took FY18 dividends to 20.5 cents per share fully franked, a 28% increase on FY17. This translates to 67% of underlying EPS, slightly ahead of our expectations. We lift our fair value estimate by 9% to $4.80 per share to reflect: (1) a stronger VIP outlook; (2) improving main-floor gaming in Sydney; and (3) revenue uplift at the Gold Coast as it reaps the benefits of recent expansion and refurbishment projects, each of which contribute to an average 5% increase in our earnings projections over the next five years. Management also indicated capital expenditure peaked in FY18. The recovery in VIP was the main driver of earnings growth, with Sydney turnover up over 55% on FY17 to $52bn, and now ahead of rival Crown. Whilst we had predicted a gradual recovery in turnover, the timing beat our expectations, and for the first time in SGR's history breached $50bn. The rebound did come a slightly higher cost, with taxes, levies, rebates, and commissions up 21% on FY17. We expect as turnover stabilises, these additional costs will moderate in the coming years. Notwithstanding, group EBITDA margin held steady at around 22%, and should improve by a modest 100 basis points in the coming years on the back of ongoing cost-cutting and operating leverage. We expect the strong momentum in domestic gaming revenue to continue, growing at a mid-single-digit pace in the near term. This will be driven by continued market share gains in slot machines and mean reversion of hold rates, which at 18% are below long-term averages. Premium mass is also likely to perform better than previously expected, despite the ongoing refurbishment of the Sovereign room and temporary relocation of these facilities. We still expect SGR's premium business to suffer upon Crown Sydney's opening, which we expect will make a 20% dent in domestic table revenue by the time the rival facility ramps up in FY22. The balance sheet improved evidenced by net debt declining from 1.8 to 1.2 times EBITDA. This was a function of exceptional 105% cash conversion as well as the $490m equity placement in 2H18, partially offset by peak capital expenditure. SGR should have no issues sustaining a 70% dividend payout ratio for the foreseeable future. IMR Strongly Positive.

Tabcorp's (TAH) (narrow moat) FY18 underlying NPAT rose by almost 40% to $246m, although the bulk of the growth was due to the half-year earnings contribution from the recently acquired Tatts. This fell short of our expectations, however, reflecting timing of the merger synergies. We have not changed our $4.50 per share fair value estimate, as our long-term outlook remains broadly unchanged. We maintain our narrow moat rating, and despite the shares trading marginally above our fair value estimate, they still offer an attractive 5% fully franked dividend yield. A final dividend of 10 cents per share, took FY18 dividend to 21 cents per share, fully franked. Management is aiming to pay out 100% of FY19 underlying earnings, equivalent to 22 cents per share. The primary focus remains the integration of the recently acquired businesses. EBITDA synergies of $8m were delivered in FY18 (mainly on the cost side) and management expects synergies to increase to $50m in FY19, reaching the unchanged target of $130m annually by FY21. Around two thirds of the target benefits are on the cost side, the remaining third through revenue improvement, particularly in the wagering segment driven by improved digital capability. We trim our near-term earnings projections to reflect the updated synergy timeline, although our estimates from FY21 onwards are unchanged. Group revenue should grow by around 5% on average to FY21. We forecast group EBITDA margins expanding by

Village Roadshow VRL	
Fair Value ($)	2.50 →
Price/Fair Value	0.90
IMR	Neutral

APA Group APA	
Fair Value ($)	9.65 ↑
Price/Fair Value	1.19
IMR	Neutral

approximately 250 basis points to 24% by FY21, from our FY19 forecast, mostly driven by cost synergies. Performance in the wagering division, which accounts for approximately one third of FY18 pro forma EBITDA presynergies, was mixed. On a pro forma basis, combined wagering revenue increased by 2%, although it was the TAB brand which did most of the heavy lifting, offsetting Ubet's 1% decline. The TAB brand continues to deliver strong digital turnover and fixed odds revenue growth, both in the mid-teen percentage range, offsetting a deteriorating retail business. We expect the highly resilient lotteries business, which generates around one third of group earnings pre-synergies, to continue delivering mid-single-digit earnings growth for the foreseeable future. The recent launch of the new Powerball game will increase the number of large jackpots in line with consumer preference, which gives us confidence in our revenue growth expectations.
IMR Strongly Positive.

Village Roadshow's (VRL) (no moat) FY18 result contained no surprises. The 33% slump in EBITDA to $91m and the $7m normalised net loss were both in line with our expectations. Fair value is unchanged at $2.50 per share. This is just as well, given it was only six weeks ago management provided earnings guidance as part of disclosure to raise $50m from shareholders. This new equity has provided much-needed relief to the balance sheet, which ended FY18 with an alarming net debt/EBITDA of 3.7 times. We project this leverage metric to fall to 2.5 times by the end of FY19, driven not only by the equity raising in July but also a material reduction in forecast capital expenditure to $51m, from $85m in FY18. Furthermore, there is no change to our substantial 26% forecast lift in FY19 EBITDA to $114m, a level still substantially below the historical five-year average of $147m. We see operating performances in FY19 to date as supportive of our recovery assumptions. First, yield on theme park ticket sales is up 35% in July from a year ago, accelerating from the 16% growth in 2H18. This is an encouraging sign of a more rational pricing environment on the Gold Coast, with aggressive discounting finally dissipating. Second, the new TopGolf venue is on track to contribute $5m in EBITDA in FY19. Third, three recently-opened cinemas will boost earnings, further aided by a better film slate. Finally, we see collateral damage from the Dreamworld tragedy receding, albeit gradually, with our FY19 theme parks EBIT forecast of $15m still materially below the normalised five-year average of $50m. IMR Neutral.

Utilities & Infrastructure

APA Group's (APA) (narrow moat) FY18 EBITDA increased 3% to $1.52bn, slightly above expectations and guidance. NPAT came in at $265m. Operating cash flow rose 4% to 90.7 cents per security (cps) comfortably covering distributions of 45cps. FY19 guidance is for EBITDA of $1.5bn to $1.575bn, 3% growth at the mid-point. This modest growth comes despite ongoing substantial investment in new projects, highlighting headwinds in existing assets, including lower demand on some pipelines and lower returns for regulated assets. We expect earnings headwinds to continue as gas market rule changes designed to reduce gas transportation costs ramp up. Nonetheless, APA remains one of Australia's better-quality infrastructure companies, warranting a narrow economic moat rating. We marginally upgrade near-term earnings forecasts toward guidance and lift our underlying DCF-based valuation 4% to $8.30. Our fair value estimate increases 2% to $9.65, being the mid-point of our underlying valuation and the takeover offer price of $11, reflecting our estimated 50% chance of success. Distribution guidance, if the takeover doesn't succeed, is 46.5cps. The core business—Energy Infrastructure—reported a 3% increase in EBITDA to $1.5bn, mainly on 4% growth in Queensland, which is APA's largest market by a wide margin. Queensland benefited from the start of a new pipeline for an LNG export customer, as well as favourable US currency and CPI movements, which impact earnings for the large Wallumbilla Gladstone Pipeline. Other key states were mixed, with Victoria and Western Australia up 1.5% and 1.2%, respectively, while New South Wales fell 1.6%. We expect modest earnings growth to continue for the medium term, as completion of new gas pipelines and renewable energy developments offset headwinds in existing assets. The smaller businesses of Asset Management and Energy Investments were also mixed, with EBITDA increasing 13% to $66m and falling 5% to $23m, respectively. The balance sheet is sound. The large equity raising earlier in the year helped gearing fall 200 basis points to 65.4%, where it sits at the bottom of management's 65%–68% target range. Net debt/EBITDA was 6.3 times, which is close to the upper limit of what we consider reasonable for highly defensive infrastructure companies. However, we expect credit metrics to improve in coming years as retained cash flows should be adequate to fund expansion projects. Guidance is for growth capital expenditure of $425m in FY19, and $300m to $400m in the next few years, on top of about $100m of maintenance capital expenditure each year. IMR Neutral.

Auckland Int'l Airport AIA	
Fair Value ($)	6.70 ↓
Price/Fair Value	0.94
IMR	Neutral

Sydney Airport SYD	
Fair Value ($)	7.30 ↑
Price/Fair Value	1.00
IMR	Positive

Transurban TCL	
Fair Value ($)	11.50 →
Price/Fair Value	0.98
IMR	Neutral

Auckland International Airport's (AIA) (wide moat) FY18 results highlighted the positive impact of ongoing investments. While total passenger growth slowed, and lower passenger fees crimped aeronautical revenue growth retail revenue jumped an impressive 17%, as the airport began to open new commercial space in the international terminal. This timing was slightly earlier than we had expected, and underlying NPAT of NZ$263m outperformed management guidance for NZ$250m–NZ$257m, and our NZ$256m forecast. The FY19 guidance for NPAT of NZ$265m–NZ$275m matches our NZ$275m forecast. We increase our fair value estimate from NZ$7.20 to NZ$7.40 due to the time value of money, although our Australian valuation falls to A$6.70 on the back of a weaker NZ$. We expect AIA to enjoy continued high-single-digit revenue growth over the medium term, stemming from low-single-digit passenger traffic gains, positive mix shift toward international traffic, which carry higher landing fees, and continued strong gains in non-aeronautical revenue such as retail and property income. AIA met these expectations in FY18, growing consolidated revenue nearly 9% on the back of roughly 6% passenger growth. Beyond the solid retail revenue gains, AIA enjoyed 8% growth in car park revenue and 15% gains in property rental income. We expect 6% and 19% respective top line gains for these segments in FY19. We remain comfortable with our forecast for EBITDA margins to rise to about 77% by FY23, as fixed costs are spread over a larger revenue base. AIA continues to embark upon a sizable capital investment program, supporting future passenger growth through expansion of facility capacity, transportation upgrades, and security, as well as new retail and commercial space. The balance sheet remains supportive of these investments. Following the sale of North Queensland Airports in FY18, net debt/adjusted EBITDA fell to about 3.9 times from 4.3 times in FY17. We anticipate this metric climbing back to north of 4 times as the capital spending program continues, considering AIA pays out 100% of its underlying net earnings, but believe risk is low given EBITDA/interest cover of nearly 7 times. These metrics compare favourably to Sydney Airport, which is more heavily geared at 6.7 times net debt/EBITDA and about 3.0 EBITDA/ interest cover. IMR Neutral.

Sydney Airport's (SYD) (narrow moat) 1H18 results reflect continued solid international passenger growth, retail sales gains, and slight operating leverage, largely in line with our expectations. While we expect passenger growth to slow as the year progresses, we remain confident the airport will continue to enjoy gains well above population growth, alongside further retail spending benefits and expanding EBITDA margins over the long run. To this end, we lift our near-term profit outlook to account for slightly higher retail spending gains and a lower tax impact, incorporating management's reiterated outlook for full-year distributions of 37.5 cents per security, slightly ahead of our prior 36.5 cent forecast. But we maintain our long-term assumptions, and our fair value estimate increases slightly to $7.30 per security. 1H18 passenger traffic tracked our expectations. Year-to-date, domestic movements increased 2.1% versus 1H17 tracking our full-year forecast, while international traffic rose 5.2%, ahead of our 4% projection. EBITDA margins of 80.9% trailed our full-year forecast of 81.1%, as higher employee and utilities expenses offset lower maintenance costs. In sum, the airport's expenses increased 7.4%, but management noted costs rose a more modest 2.5% after normalising for non-controllable security costs and investments for new hotel property. As such, we remain confident EBITDA margins will expand to nearly 83% over the next five years with higher aeronautical prices, a positive mix shift toward international passengers, and continued operating leverage of the group's fixed costs. The announced plan to source up to 75% of electricity needs from third-party renewable sources also supports our view. Capital spending is elevated to expand automated check-in, refurbish runways, and modernise facilities. Management reiterated its planned $1.3bn–$1.5bn spend over the next four years, in line with our forecast. We are encouraged net debt/adjusted EBITDA ticked down to 6.7 times, in line with 31 December 2017, and the next major unfunded maturity is not until 2020. But because SYD opts to pay out 100% of its net operating receipts (net income plus depreciation and amortisation, and other non-cash items), taking on debt to support both its payout and capital spending programs, it will likely remain at the mercy of debt market conditions. IMR Positive.

Transurban (TCL) (wide moat) posted a solid FY18 result, with underlying proportional EBITDA rising 10% to $1.8bn as higher tolls, particularly for trucks, offset soft traffic volume growth. The result was marginally below our expectations. Traffic volumes were hurt by roadworks on and around some toll roads. Solid earnings growth should continue as traffic growth rebounds, though toll increases will be more modest going forward. FY18 distributions totalled 56 cents per security (cps), 9% franked. FY19 guidance is for 59 cps, which is slightly below

AGL Energy AGL	
Fair Value ($)	20.00 ↓
Price/Fair Value	0.98
IMR	Negative

Origin Energy ORG	
Fair Value ($)	8.00 →
Price/Fair Value	1.04
IMR	Strongly Negative

our prior expectations. Our earnings forecasts reduce slightly, but we remain comfortable with our $11.50 fair value estimate. Free cash flow was flat at $1.2bn but fell 5% on a per security basis due to dilution from the recent equity raise. Operating costs increased 4.5% to $600m, partly driven by a 26% increase in head office costs to "support business growth." The sharp focus on keeping costs flat has been jettisoned in favour of expansion. By itself cost growth isn't a major issue, but we are somewhat concerned aggressive expansion late in the cycle may come back to bite securityholders. The balance sheet remains sound, though an equity raise will be needed if the bid for WestConnex is successful. Underlying proportional net debt/EBITDA was 7.7 times, which is high but manageable given the highly defensive earnings, solid growth and low maintenance requirements. Minimal debt matures in FY19, though maturities increase substantially from 2020. We expect maturing debt to be refinanced cheaper in the near term, though factor in rising interest rates over the medium term. IMR Neutral.

AGL Energy's (AGL) (narrow moat) FY18 underlying NPAT increased 28% to $1.023bn, slightly ahead of expectations and mainly driven by a big increase in generation earnings, while headwinds in retail markets and cost inflation were a drag. FY18 dividend increased 28% from 91 cents to $1.17 per share. Guidance is for relatively flat NPAT in FY19, in the range $970m–$1.07bn. We downgrade our forecast by 8% to $1.03bn on a lower wholesale electricity price and slimmer retail margins. With weak electricity futures prices for the next couple of years and intense retail competition likely to continue, we also downgrade medium-term earnings forecasts. We now forecast earnings remain relatively flat for the medium term before growth picks up again over the longer term as we doubt wholesale electricity prices will remain depressed indefinitely. Our fair value estimate falls 5% to $20 per share. The balance sheet is strong, putting AGL in a good position to cope with earnings headwinds and fund the large development pipeline. Net debt/EBITDA fell from 1.7 times in FY17 to 1.1 times in FY18. With such a strong balance sheet, we think AGL is highly likely to refinance its $650m hybrid with cheaper senior debt, likely saving over $10m per year. The hybrids have a call date in mid-2019. Strong cash flows allowed $504m in debt to be repaid despite generous dividends and elevated capital expenditure of $778m. Capital expenditure will increase to $1bn in FY19, roughly half spent on maintenance and half on new power stations and other projects. Growth capital expenditure is likely to remain high for several years as AGL builds new generation supply to offset the closure of Liddell in 2022. However, if the government succeeds in driving down wholesale electricity prices, we would expect AGL to reduce generation investment and divert surplus cash flows to share buybacks instead. Utility bill shock and intense competition drove retail customer churn higher, with AGL forced to increase efforts to maintain customer numbers. This was a major driver behind a 15% increase in operating costs to $1.57bn. Guidance is for operating costs to fall 5% in FY19 as lower marketing spend and cost out initiatives offset CPI, debt forgiveness for struggling customers and better deals for loyal customers. Management expects further cost-out initiatives to reduce costs to $1.36bn by FY21. IMR Negative.

Origin Energy's (ORG) (no moat) FY18 underlying EBITDA increased 36% to $2.95bn, driving a 110% increase in FY18 underlying NPAT to $838m. The result was good, but below expectations due to higher corporate costs and a slightly weaker-than-expected result from the integrated gas divisions. The utility business was in line with expectations and guidance. Forward guidance disappointed, with EBITDA in the utility business to fall around 6% in FY19, mainly due to competitive pressure. Considering medium-term headwinds from government policy to improve utility bill affordability, it is hard to see where earnings growth will come from in this division. The other negative surprise was an outlook for higher maintenance capital expenditure at ORG's LNG export business than we previously assumed. We downgrade our near-term earnings forecasts in line with guidance but remain comfortable with our $8 fair value estimate. Energy markets—the utility business—underlying EBITDA increased 21% to $1.81bn, in the middle of the guidance range and in line with expectations. Growth was driven by stronger wholesale electricity and gas prices, as well as stronger gas sales volumes as major peers faced gas supply constraints. Electricity sales volumes fell 5% on customer losses, milder weather and ongoing improvements in energy efficiency. Underlying FY19 EBITDA guidance disappointed, coming in at just $1.5bn to $1.6bn, 14% lower than FY18, due to a combination of tough retail competition and a change in the treatment of electricity hedge premiums. The latter suggests this division was overstating earnings in prior years, a corporate governance concern and highlighting the

Spark Infrastructure SKI	
Fair Value ($)	2.40 →
Price/Fair Value	0.96
IMR	Neutral

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

risk of relying on unaudited management adjusted earnings numbers, particularly when companies are facing financial difficulties. Integrated Gas, which primarily comprises the 37.5% stake in the APLNG LNG export business, reported underlying EBITDA of $1.25bn on stronger prices for LNG and domestic gas and ramp up of LNG production. LNG prices are based on oil prices, which have more than doubled since early 2016. The balance sheet continues to improve. Gearing reduced from 42% to 35% from 42%, and debt/EBITDA fell below 3.5 times from close to 5 times in FY17. While ORG remains much higher leveraged than peers, gearing is getting close to management's target and dividends are likely to be reinstated in FY19.
IMR Strongly Negative.

Spark Infrastructure (SKI) (no moat) reported a good 1H18 result and is tracking a little better than we were expecting. Proportional EBITDA increased nearly 8% to $420m on stronger earnings at Victoria Power Networks and TransGrid, while earnings at SA Power Networks fell marginally. Proportional operating cash flow increased 7% to $135m or 8 cents per security, which was in line with distributions. We increase our FY18 forecasts slightly but remain comfortable with our $2.40 fair value estimate. Victoria Power Networks (VPN) was a surprise positive performer. Revenue rose 7% and operating costs fell 18%, driving EBITDA 15% higher to $428m. Some of the improvement appears to be one-off, so we expect growth to moderate for the full year. 1H revenue benefited from regulated tariff increases of a little over CPI and large increases in semi- and unregulated revenue. Customer numbers rose 1.3%, though electricity demand was flat. The medium-term earnings outlook is relatively good, with regulated tariffs set to increase around 4% on 1 January 2019 and closer to 5% on 1 January 2020. SA Power Networks' (SAPN), EBITDA fell 3% to $335m, though would have been broadly flat if release of unneeded storm provisions were backed out. Customer numbers increased 0.6% and electricity demand fell 1%. Regulated revenue rose 3% on regulated tariff increases and an increased bonus for good network reliability. RAB increased 1.7% to $4.2bn. Regulated tariffs increased 2.7% on 1 July 2018 laying a solid platform for earnings growth in 2H18. Good momentum should continue FY19, with the regulator allowing a 3.4% tariff increase in July 2019. TransGrid EBITDA increased 8% to $328m on stronger unregulated revenue and good cost control. Unregulated revenue benefited from growth in contracted assets, mainly connections to new wind farms, and line relocation work. Regulated revenue fell 1% but should increase in 2H following recent tariff increases. RAB increased just 0.5% to $6.4bn. Strategy is to organically expand its network of transmission lines while improving efficiency at this formerly government owned business. SKI's financial position is sound. IMR Neutral.

Telecommunications

Telstra's (TLS) (narrow moat) FY18 earnings release was uneventful, with the 5% decline in EBITDA to $10.1bn in line with our expectations and FY19 guidance reiterated at an EBITDA range of $8.8 to $9.5bn. FY18 NPAT fell 8% to $3.6bn, with EPS coming in at 30 cents from 33 cents in FY17. The final DPS of 11 cents and FY18 22 cents were in line with our expectations and fully franked. While still early days, there are some encouraging signs of TLS' fightback plans bearing fruit. The 174,000 post-paid mobile subscriber addition in 2H18 was solid. The 135,000 increase in fixed-line retail-bundle broadband customers in 2H18 was also notable. While these increases are coming at a cost (mobile EBITDA margin down 290 basis points to 39.9%, fixed data margins almost halving to 16.0%), it is critical TLS shores up its customer base and positions itself to monetise them in the upcoming 5G era. The cost-out story is also taking shape, with $480m in core fixed expenses cut in FY18, or $700m cumulative over the past two years. The importance of continuing progress on this front, towards the $2.5bn cost-reduction target by FY22 cannot be underestimated, not only to offset competitive pressures and NBN's margin-crunching impact but for the sake of management credibility. Indeed, this 'self-help' measure is a key plank behind our unchanged fair value estimate of $4.40 per share, while the solid balance sheet arms TLS with the necessary financial resources to see through the 'fightback' and transformation journey. Divisionally, Mobile EBITDA fell 6% to $4bn, with increasing competitive intensity reflected in the 3% to 4% decline in average revenue per user and the abovementioned fall in margin. Fixed (voice and data) EBITDA declined 42% to $1.3bn, driven by the loss of 470,000 fixed voice customers. This loss saw fixed voice revenue decline 15% to $2.6bn and the EBITDA margin fall from 48% to 35%. Revenue declined 0.2% to $2.5bn. Network Applications and Services has begun to deliver on the promise of strong growth. Revenue increased 8.6% to $3.6bn, driven by a 14.4% increase in cloud services revenue to $428m, along with 11% growth in Industry Solutions, which includes NBN commercial works, to $1.4bn. EBITDA margin increased from 9%

Vocus Group VOC	
Fair Value ($)	2.90 →
Price/Fair Value	1.03 ●
IMR	Strongly Positive ⊕

Amcor AMC	
Fair Value ($)	14.60 ↓
Price/Fair Value	0.96 ●
IMR	Negative ⊖

ARB Corporation ARB	
Fair Value ($)	15.00 ↑
Price/Fair Value	1.31 ●
IMR	Neutral ○

to 10% leading to EBITDA of $362m. Free cashflow increased from $4bn to $4.9bn, owing to lower working capital for NBN activities as well as lower spending on spectrum. IMR Strongly Positive.

Vocus Group (VOC) (narrow moat) ended FY18 with flat adjusted EBITDA of $366m, while suffering a 17% fall in normalised NPAT to $127m. These were largely in line with our expectations, albeit at the lower end of management projections back in February. Critically, the result was not generated under the watch of the recently-appointed CEO Kevin Russell who has promptly reset the FY19 EBITDA base at $350m to $370m. While this dreaded "year of reinvestment" initiative has led to an average 5% cut to our medium-term earnings estimates, our outer forecasts are largely unchanged. As such, our $2.90 per share fair value estimate is intact. The new CEO's view that VOC's single-digit market shares in various telecom market segments are low is hardly a revelation, especially relative to its enviable infrastructure footprint. The issue to-date has been execution, something Kevin Russell is fully cognisant of. We are encouraged by his plans to aggressively chase revenue opportunities, and maintain our 6% five-year earnings CAGR forecast, with EBITDA approaching the $500m mark in five years' time. We are equally encouraged by the improving cash flow performance (88% EBITDA/cash conversion in FY18, up from 52%), providing breathing space to its leverage covenant limit of 3.75 times versus the 2.73 times at end-FY18. Optimism regarding the new CEO's turnaround plans may have partly driven stock price rally. However, sentiment may have also been aided by potential consolidation activities in the telecom space, with merger talks between TPG Telecom and Vodafone Hutchison fuelling speculation VOC may also become involved. IMR Strongly Positive.

Industrials

Amcor's (AMC) (narrow moat) FY18 result was softer-than-expected with operating income of about US$1bn 11% below our expectations, owing largely to the North American beverage business unit, which was hurt by soft demand due to a wet start to the North American summer. Beverage volumes were accordingly 5% lower than FY17. While we expect volume growth to recover in FY19, we reduce our fair value estimate by 6% to $14.60. Rigid segment sales fell 3.1% to US$2.8bn, primarily due to lower North America beverage volumes. EBIT fell 9% to US$312m. Volumes compared unfavourably with our expectations for modest volume growth of 1.6%. Unfavourable mix shift accompanied the falling volumes, with higher-margin Hot-Fill PET volumes falling 9% year-on-year and outpacing the total decline in segment volumes. We do not expect a repeat in FY19. We expect segment volume growth to revert to 1.6%, with segment sales growing 5.7%, largely reflecting the passing on of raw material cost inflation. Flexibles segment sales climbed 4.9% to US$6.5bn, in line with our expectations. Currency translation delivered all the benefit, however, with sales falling 0.1% on a constant-currency basis. As such, our expectations for volume growth of 2.7% in FY18 did not come to fruition. Segment EBIT margins were 12.8%, down slightly on FY17 but still ahead of our expectations for 12.5%. In FY19 we expect a resumption of flexibles volume growth to 2.6%. Together with resin price inflation of 4.1%, which we expect to be fully passed on, we anticipate sales growth of 6.2%. The relatively stable operating margins of 12.8% in the flexibles segment, just 10 basis points lower than FY17, were largely the result of swings and roundabouts. Resin price volatility resulted in US$43m in raw material cost inflation that wasn't effectively passed on, largely the consequence of surging and volatile oil prices. While this should have crimped margins, incremental benefits from the segment restructuring program of US$36m provided an offset. The balance sheet strengthened slightly, with net debt/EBITDA falling from 3.0 to 2.8 times but remains stretched relative to its through-the-cycle target of 2.25 to 2.75 times. The Bemis transaction, should it receive shareholder approval and proceed, will not result in a marked increase in leverage, with net debt/EBITDA expected to increase to circa 2.9 times upon completion. IMR Negative.

ARB Corporation (ARB) (narrow moat) reported a solid 10% increase in FY18 underlying NPAT of $54m. While this was in line with our expectations, we have increased our fair value estimate from $14.50 to $15 per share to reflect slightly stronger offshore growth. Despite raising our fair value estimate, the stock is expensive at the current price. We project 10% annual EPS growth on average over the next five years, compared with 3% generated on average over the past three years. A fully franked final dividend of 19.5 cents per share took FY18 dividends to 37 cents per share, fully franked, equivalent to around 55% of underlying earnings. Revenue increased 12% to $426m, with solid performance in each region. The main driver was the core Australian market, which distributes to

Brambles BXB	
Fair Value ($)	11.20 →
Price/Fair Value	1.01
IMR	Strongly Positive

Qantas Airways QAN	
Fair Value ($)	5.00 ↑
Price/Fair Value	1.25
IMR	Negative

ARB stores, auto dealers, and fleet operators. Locally, sales grew 11% and exceeded our expectations, underpinned by new store openings, new product releases, and market share gains. The Australian aftermarket accounts for around two thirds of group sales, marginally higher than in 1H17. This level of growth is unsustainable in the mature local market, especially given our weakening outlook for the mining sector and Western Australia economy. We estimate the market growth at around 3%–4% per year, reflecting annual growth in in four-wheel drive sales, and we expect ARB can increase local revenue around 6% on average in the near term, with continued new product releases and further share gains. We expect domestic EBIT margins to remain flat at around 20%. Over the past decade, domestic revenue and EBIT have grown at the same pace. We attribute this to relatively low operating leverage and large exposure to inputs costs including steel, which are generally passed through to customers. Exports are likely to be the main growth driver for the foreseeable, and we expect offshore earnings to double over the next decade, reaching 20% of group earnings. In FY18, exports grew by 15% and now represent approximately 28% of group sales. Despite net cash declining from $28m to $5m, the balance sheet remains in pristine condition. IMR Neutral.

Brambles (BXB) (wide moat) FY18 underlying NPAT of US$656m tracked our forecast for US$636m, up 7% on FY17, trailing revenue growth. But we remain positive on the long-term opportunity. We are encouraged BXB saw continued volume gains, improved new-business wins, and pricing actions helping to partially offset transport and lumber cost inflation, and expect further profitability improvement long term as contract renewals and pricing mechanisms flow through with a lag. Management flagged plans to divest the IFCO reusable plastic crate (RPC) business, although this has no impact on our valuation, given the independence of the segment, the uncertainty around the potential form of the transaction, and the lengthy associated timing in FY20. We retain our $11.20 fair value estimate. CHEP Americas increased revenue by 6%, outpacing our 4% forecast. Offsetting this, rising costs and a time lag between price increases led to expenses growing more quickly than anticipated, with underlying operating margins of 16% slightly lower than the 16.5% we projected. Underlying profit of US$351m slightly trailed our US$356m forecast. Management expects cost pressures to continue, offset by operational efficiencies and lagged pricing surcharges. Plant automation remains a focus with plans to spend US$150m–US$160m in the three years starting FY19 to lift levels of automation in the US business to 85% from around 20% currently, which we expect to spur 300 basis points of EBIT margin improvement by FY22. The European business is already 80% automated. CHEP EMEA growth was strong, climbing 16%, substantially outpacing our 5% forecast, with margins of 24.9% similarly higher than our 24.5% assumption. Amid flat pricing in pallets, growth was principally driven by increased volume and foreign currency movements, along with strong performance in the RPCs and containers businesses. We still forecast mid-single-digit revenue growth from the segment over the next several years, but steady margins, given the already high level of automation and solid profitability in the segment. CHEP Asia-Pacific was a bit weaker, with sales falling 2% against our forecast for a 1% decline, as Australian RPC and automotive contract losses from 2016 continue to roll through the top line. We expect this business to return to growth in FY19, however, and are encouraged outside of the contract losses, sales grew 3%. Moreover, the segment's 23.5% operating margins are in line with our long-term forecast. IFCO's revenue grew a solid 13%, ahead of our 11% forecast, with positive pricing leading to 12.4% margins, above our 12% expectation. Although we're impressed by the division's continued solid volume growth and operating leverage, management has outlined a plan to divest the IFCO RPC business by December 2019. A trade sale or IPO is envisaged. IMR Strongly Positive.

Qantas Airways (QAN) (no moat) FY18 was another stellar result with underlying profit before tax (PBT) up 15% to $1.6bn, despite a 25% jump in the jet fuel price. The key earnings drivers were strong ticket revenue across Qantas Domestic, Qantas International, and Jetstar, which each increased revenue by 5%–8%. EBIT margins were also solid, expanding by 60 basis points at the group level to 10.5%. While this performance was consistent with our expectations, we are becoming increasingly confident in the company's ability to extract cost efficiencies and increase prices, offsetting operating cost inflation and the growing fuel bill, ultimately helping to sustain margins. A final dividend of 10 cents fully franked, taking FY18 dividends to 17 cents, 59% franked. As QAN has exhausted its accumulated tax losses, we expect future dividends to be fully franked. A $332m on-market share buyback was also announced. QAN has returned

Qube Holdings QUB	
Fair Value ($)	2.55 ↑
Price/Fair Value	1.07
IMR	Strongly Positive

Blackmores Limited BKL	
Fair Value ($)	135.00 ↑
Price/Fair Value	1.06
IMR	Strongly Positive

$3.1bn to shareholders since October 2015. We increase our fair value by 20% to $5.00 per share. This follows a revision of our cost base assumptions, including oil, which we expect to peak in FY19 and commence falling thereafter, along with transformation benefits, which we expect will meet the company's $400m FY19 target. We also anticipate stronger yields, particularly in the domestic market, which increased by approximately 8% in FY18, where the company should be able to pass most of the cost pressure onto consumers. Despite some near-term fuel pressure, we lift our average EBIT margin forecast to 10% on average over the next five years, from 9%. Our revenue assumptions are broadly unchanged, forecasting growth at a low- to mid-single-digit pace on average. We expect the operating margin to fall by around 1% to 9.7% in FY19, mainly reflecting the higher fuel costs, although EPS should grow at a modest single-digit pace. Management indicated the fuel bill is likely to jump by over 20% to almost $4bn, despite hedging and improving fuel economy. We forecast oil prices to taper off from FY20 onwards driven by additional shale production coming on line, stabilising at our mid-cycle forecast of US$60 per barrel. For FY19 management guided to flat group domestic capacity and a modest 1% increase in international capacity, and we expect this pace to be maintained. This conservative approach to capacity management should support improving utilisation, which in turn should help offset some of the higher fuel price. IMR Negative.

Qube Holdings (QUB) (narrow moat) reported a solid FY18 result, with underlying NPAT increasing 4% to $107m, in line with our expectations. More importantly, management pointed to solid growth in FY19. The outlook is improving in a couple of areas, mainly at the Patrick stevedoring business and the ports and bulk business. We make minor upgrades to our medium-term earnings forecasts and increase our fair value estimate 6% to $2.55. We continue to like the long-term growth strategy of building a vertically integrated logistics company, which should afford QUB cost advantages over competitors. But much of this positive outlook is already factored in. Additionally, we see risks around exposure to the volatile resources sector, the potential for a slow ramp up at Moorebank, and the expiry of Patrick's Fremantle lease in 2019. Logistics division EBITDA fell 5% to $63m, mainly due to temporary negatives—the drought and loss on the empty container park. A new park has been purchased nearby. The drought will continue to impact earnings in FY19 but won't last forever. The outlook is fairly stable, with solid growth in containerised freight volumes likely to be partly offset by intense competition causing downward pressure on prices. Ports and bulk performed well, with EBITDA increasing 19% to $88m, benefiting from the recovering resources industry and strong imports of cars and consumer goods. It enters FY19 with good momentum, aided by new customer contracts and investment in new assets. Though we expect consumer spending to soften as house prices retreat, and China's fixed asset investment is likely to cool over the longer term. Infrastructure and property division EBITDA increased 118% to $33m on the full year contribution of AAT. Leasing up of the Minto site following its recent redevelopment also helped, though most earnings upside will come in FY19. QUB's share of Patrick's underlying earnings increased 28% to $35m, on 8% growth in volumes and cost synergies. The outlook is good, with two recent contract wins likely to aid stronger volumes in FY19. Productivity improvements are tracking well, and planning for rail automation at Port Botany is progressing. The main risk is the Fremantle lease expires in June 2019 and the port authority is seeking public expressions of interest. Fremantle is significant to Patrick, representing 17% of its container volumes. Management flagged some delays at Moorebank in gaining regulatory and environmental approvals, with completion of the rail terminal pushed back by up to six months. Delays shouldn't materially impact the long-term returns from this project. Minimum capital expenditure in the first five years has increased from $400m to $642m on the warehouses for Target and Qube and the decision to automate the rail terminal. Positively, management flagged strong tenant interest. We continue to believe this will be a long-term success, driving substantial cost efficiencies for tenants importing large volumes of containers through Port Botany.
IMR Strongly Positive.

Consumer Staples

Blackmores Limited (BKL) (narrow moat) exceeded our expectations with FY18 NPAT of $69.2m on group sales of $747m, up 19.3% and 7.8% year on year, respectively, compared with our forecasts of $65.9m and $742m. Growth continues to be driven by China and the broader Asian region, as well as its premium Bioceutical product range in the domestic market. EBITDA margin of 14.8%, representing an expansion of around 115 basis points, was a highlight, reflecting improved cost of goods and implementation of a global pricing strategy. We increase our fair value estimate by 9%

Coca-Cola Amatil CCL	
Fair Value ($)	9.40 →
Price/Fair Value	1.01 ●
IMR	Positive ⊕

Treasury Wine Estates TWE	
Fair Value ($)	11.70 ↑
Price/Fair Value	1.55 ●
IMR	Positive ⊕

from $124 to $135 per share, given time value of money considerations and a revised cost of revenue margin outlook, which we now see as trending to 48.6% by 2022 from 50% previously. We remain positive on the Asian opportunity and expect the domestic sales mix to continue moving offshore over the next five years. As a result, we see Australia's contribution trending towards 53% of group revenue by 2023 from 65% currently. Sales growth of 22% and 20% in China and the other Asia segment, respectively, exceeded our expectations, with operating margins for both regions expanding incrementally, reflecting strength of brand in these markets, the key source of our narrow moat rating. China sales were driven by BKL's direct export to the Chinese business, combined with growth of in-China sales and buoyed by online promotional events. Our China sales forecast outlook is unchanged at 18% per year over the next five years. Similarly, we think solid growth in developed markets such as Singapore and Korea, in addition to joint-venture partnering in emerging markets such as Indonesia, albeit off a small base, bodes well for sustained momentum. We remain comfortable with a five-year revenue CAGR of 10% in Other Asia. Australia and New Zealand, representing 65% of group revenue, declined by 2% from FY17. This was in line with our expectations and reflects the waning impact of the daigou shopper phenomenon. We estimate daigou sales accounted for around 16% of total domestic sales of BKL-branded products and forecast these to continue to decline. In the medium term, we forecast a five-year CAGR of around 2%, but longer term, we see growth normalising around 3%. The Catalent manufacturing capability should be positive and support EBIT margins of around 23% achieved in FY18, with efficiencies gained in transitioning to the new distribution centre at Bungarribee in Western Sydney. The Bioceuticals division, representing 16% of group revenue, was the highlight domestically, growing 13% year on year. We remain positive on the prospects, given the degree of product differentiation and breadth of the product range. Further, we see growing engagement through educational forums as building loyalty among naturopaths and allied healthcare professionals and increasing brand value and pricing power. We have a five-year CAGR forecast of 10%.
IMR Strongly Positive.

Coca-Cola Amatil (CCL) (narrow moat) reported a 5.9% decline in underlying NPAT of $178.8m from 1H17, putting it behind our full-year $386m forecast. But, there was a lot to like in the result with volume declines in its core Australian beverages business were less than expected, continued solid gains in alcohol and coffee, and strong results in New Zealand and Fiji. However, Indonesian challenges continued, and despite solid segment profitability, we are less confident the business can quickly rebound to growth. We reduce our earnings forecasts over the next five years by about 4%, which offsets the time value of money since our last update. We maintain our $9.40 fair value estimate. CCL finally seems to be seeing the fruits of its labour its Australia. Volumes declined 0.3% versus 1H17, which was the best performance in three years, and tracks our forecast for a 0.2% fall for the full year. Average revenue per case ticked up 1.1%, trailing our full-year 3.5% expectation, as the company cut prices and saw negative mix shift toward water and grocery sales, but this should improve given further container deposit pass-throughs and continued success in product innovation. Brand Coca-Cola is now seeing year-over-year growth as of July, driven by Coke No Sugar and new flavour launches, alongside gains in water and sports drinks. We think the company's ability to leverage its relationships with both the Coca-Cola Company and local retailers to drive available shelf space supports our narrow-moat rating. Encouragingly Australian EBIT margins are tracking ahead of our full-year forecast, at 14.4% versus our 13.7% projection. CCL continued to enjoy solid performance in New Zealand and Fiji, with volumes and revenue up more than 7% and EBIT margins expanding 30 basis points to 17.8%—on track to hit our full-year forecast for margins to widen 50 basis points to 19.4%. Similarly, the alcohol and coffee segment saw revenue increase 9%, outpacing our forecast for 7% gains, albeit on a slightly lower margin of 8.3% versus our 9.5% projection. We expect further solid gains in these businesses, owing to continued new product launches, strong execution, and further investment. Indonesia was soft, with the combined Indonesia and PNG segment seeing volumes and revenue fall about 3%. This result sharply trails our prior expectation for 5% revenue growth in 2018, as continued challenging economic conditions have led to declining end market performance.
IMR Positive.

Treasury Wine Estates' (TWE) (no moat) FY18 results were in line with our forecasts, with Australian earnings a positive surprise. Group operating margins were slightly better than we expected, at 21.8% versus 20%, but this was largely due to continued deliberate efforts to shed sales of

Adelaide Brighton ABC	
Fair Value ($)	5.50 →
Price/Fair Value	1.13
IMR	Strongly Negative

Boral BLD	
Fair Value ($)	5.70 ↑
Price/Fair Value	1.22
IMR	Strongly Positive

low-margin commercial wine. As such, revenue growth of 1.1% for the full year trailed our forecast for 2.4% gains, leading to full-year operating income of $530m, only slightly ahead of our $520m forecast. We expect revenue growth to bounce back in FY19, owing to continued strong Asian end-market performance, share gains given new product launches, and higher-priced luxury and mid-range (masstige) wine flowing from the balance sheet to the income statement as the ageing process completes. The business remains a solid long-term growth engine, and we expect the business to enjoy further structural growth in China, market share gains from new product launches, and improving profitability from positive mix shift. But FY18 results show the road could be bumpy along the way. But we caution income growth will likely slow at some point from the torrid 25% annual pace seen over the past several years. We still think shares are priced for perfection in execution, end-market development, and consumer preferences, without a margin of safety to account for risks. One of the key challenges facing TWE, or any luxury wine maker, is cash flow management given a typically large amount of wine ageing on the balance sheet. FY18's performance was muted, with free cash flow falling from $300m in FY16, nearly $200m in FY17 to $101m in FY18. Similarly, cash conversion similarly was pressured but we expect it to improve given there were one-time and timing-related issues in FY18. Another risk remains execution of a major structural change in the Americas division, where the company will self-distribute 25% of its business across two U.S. states—California and Washington—and will move 15% of its business to new distribution partners elsewhere. We anticipate this will lead to improved market share, profitability, and revenue growth and the segment is on-track to meet our long-term expectations. We expect the Americas and Asia to make up the lion's share of future earnings, at 79% combined in FY23, up from 68% in FY18. IMR Positive.

Building & Construction Materials

Adelaide Brighton's (ABC) (narrow moat) 1H18 top line remained strong, energy prices and unfavourable mix shift constrained margins. Revenue increased 12% to $807m and came in 4% ahead of our expectations. Organic volume growth in cement and concrete of 7% outstripped our expectations for 3% growth and led to the top-line beat. However, operating income underwhelmed at $123.5m, and while EBIT margins of 15.3% were a mild improvement from a year earlier, they remained short of our forecast of 18.8%. While we reduce FY18 earnings accordingly, our fair value estimate is intact at $5.50 per share. Construction activity in Australia remains buoyant, driving strong year-to-date cement and concrete volume growth of 7%, ahead of our prior expectations for 3%. With cement and concrete representing circa 80% of total business volumes, we upgrade our full-year forecast to reflect 5.0% growth in cement and concrete volumes in FY18, consisting of flat residential volumes and infrastructure and industrial/commercial volume growth of 10% and 6%, respectively. Concrete and cement pricing strengthened, with average selling price growth ahead of CPI. While pricing for aggregates is also increasing in most of ABC's regional markets, sales mix shift toward lower-value and lower-margin "fill" sales reduced average selling prices and dragged on quarry margins. However, we expect the impact on margins to reverse out in FY19, as projects progress and require higher-value aggregates during later development stages. As such, we reduce our FY18 EBIT forecast by 16% to $267m, with corresponding operating margins of 15.4%. We expect margins to then improve to 19.1% in FY19 as mix and energy headwinds abate. Balance sheet flexibility remains, with net debt/EBITDA continuing in line with end-FY17 at 1.25. Net debt remains well within the board's range of 25%–45% of equity book value, ending 1H18 at 33%. Thus, ABC proceeded to return excess capital to shareholders, declaring a special dividend of four cents per share. With management conceding no major acquisitions are likely in 2H18, we expect further return of capital via special dividends, and forecast a further four cents per share special dividend in 2H18. IMR Strongly Negative.

Boral's (BLD) (no moat) solid FY18 result was driven by strong demand from Australian infrastructure and non-residential construction. Revenue rose 39% to $5.73bn, while underlying EBIT rose 50% to $688m, largely attributable to a full year contribution from Headwaters in the US. These results were largely in line with our expectations for $5.55bn in revenue and EBIT of $658m. A slight upgrade to our near-term forecasts, along with an upgraded synergy target from the Headwaters acquisition, lifts our fair value estimate by 10% to $5.70. While demand from Australian residential construction was largely flat in FY18, robust infrastructure and non-residential construction drove a 24% increase in Australian segment EBIT to $433.4m, 12% ahead of our forecasts. The infrastructure construction market, BLD's largest Australian exposure, climbed 15%, while growth in

non-residential construction also surprised to the upside at 13%. We expect this dynamic to continue in FY19 offsetting a 5% fall in total residential dwelling completions. Management anticipates EBIT will remain roughly flat, including falling contributions from the property division, and our $436m forecast matches this outlook. Longer-term we remain optimistic about Australian home completions. EBIT will be buoyed near-term by robust infrastructure demand, and we expect a five-year EBIT CAGR of 1.3% through to FY23. With the residential market headwind abating in FY23, segment EBIT growth reaccelerates to a five-year CAGR of 2.3% over FY24–FY28. North America revenue was largely in line with our expectations, but EBIT disappointed at $208m versus our $226m forecast. Lower construction materials volumes, adverse weather, and operational issues had a combined US$33m adverse impact on segment EBIT. But, synergy benefits from the Headwaters acquisition of US$39m to date came in ahead of BLD's US$32.5m target. Total expected yearly synergy benefits were also upgraded by 15% to US$115m. We expect FY19 margins to lift from 9.7% to 11.4%, driving segment EBIT of $254m. The USG Boral joint venture in Asia-Pacific markets delivered EBIT of $63m, down 9.2% year on year and below our expectations of $78m. Growth was stronger in China and South Korea, but softer demand in Southeast Asia affected the result. Nonetheless, we expect the joint venture to return to growth in FY19, with EBIT of $88m. The balance sheet remained healthy, with net debt of $2.45bn representing a multiple of 2.5 times EBITDA. This equates to a 30% gearing ratio, defined as net debt/net debt plus equity, well below BLD's debt covenant of 60%. IMR Strongly Positive.

James Hardie JHX	
Fair Value ($)	21.20
Price/Fair Value	1.00
IMR	Strongly Negative

James Hardie's (JHX) (narrow moat) 1Q19 result disappointed the market. Market share gains were muted but were in line with our expectations. Investors had expected gains in share to drive a better showing than the 5% increase in North American sales volumes. Shares sold off as the market rethinks the trajectory for future share gains. We still think increased market share will be harder to come by, with engineered wood siding alternative LP Smartside getting traction in the US market. Thus, we still expect no increase in JHX's market share in FY19, followed by a gain of 8% of share over the coming decade. While considerable, our forecast for share gains still trails management's long-term aspirations for 31.5% terminal market share. We maintain our fair value estimate of $21.20 per share. While smaller in size, the Asia-Pacific fibre cement segment delivered 7% year-on-year EBIT growth, which is roughly in line with our FY19 expectations for 6.6% EBIT growth. Meanwhile, Europe performed well, with the Fermacell acquisition having been completed early in the quarter. While it is early days, first signs are encouraging, with net sales in Europe of US$95.4m reflecting strong sales growth of 8% on a pro forma basis, excluding the tailwind from foreign exchange translation. North American input costs were higher as expected, including pulp and freight, which climbed 20% and 29%, respectively. But repricing was a greater offset, with gross margins expanding 3.7%. We still expect raw material cost inflation of 5.4% in FY19. Should commodity pricing remain elevated, or even increase, we see profitability and thus valuation remaining intact. JHX's brand equity, the source of its narrow moat, provides the necessary pricing power for the business to pass these costs on. IMR Strongly Negative.