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Australian Equity Research

April 2020

Top Stock Picks – Large Caps

Market commentary: Australian stocks are down over 20% this year, an event-driven sell off owing to the impact of the COVID-19 pandemic. Given the uncertainty, many leading companies have withdrawn their earnings guidance for the year. This uncertainty has created opportunities, with Australian companies being sold at discounted levels. Below we provide a list of companies which we designate as those "built to last". We believe these companies occupy leading positions within their respective markets, generate strong returns on capital, maintain strong financial positions and have the capacity to survive through most economic outcomes.

Banks and Financials: Our key stocks within the Financials sector are Commonwealth Bank and Macquarie Group. CBA has the strongest tier 1 capital ratio on a pro-forma basis, while it traditionally trades at a premium to the other major banks, it is at a discount to its own NTA – which is rare. For MQG, its strength in terms of earnings diversity has become its weakness as COVID-19 has emerged. Looking ahead, we expect MQG to rebound strongly which could be augmented by heightened capital markets activity.

Materials and Energy: Until we gain an understanding of the impact on global manufacturing and demand for raw materials and there is some resolution of the petroleum supply war between Russia and OPEC+ there will be volatility in share prices. However, this uncertainty is providing an opportunity to acquire quality companies when share prices are significantly below their long-term value. BHP, Rio Tinto and Woodside are well placed to deliver strong shareholder returns for investors with a two-year plus time horizon, rather than a six-month trading view.

Industrials: Within the consumer staples sector, Coles and Woolworths enjoy strong industry positions, resilient business models and are currently benefiting from the unprecedented demand for product. Amcor is similarly a beneficiary of this demand trend given it is a global leader in packaging for food, beverage, pharmaceutical, medical, home and personal-care products. Wesfarmers is similarly well positioned, with all three of its businesses – Bunnings, Kmart and Officeworks – benefiting from a surge demand. Meanwhile, Telstra is currently experiencing unprecedented demand as companies seek to enable remote working for employees.

Fig.1: Key picks

Company	Code	Price	FY21 PE (x)	FY21 Yield (%)	Franking
Amcor	AMC	13.04	11.4	6.3	0
BHP Group	BHP	28.98	10.8	4.4	100
Commonwealth Bank	CBA	61.82	13.9	6.3	100
Coles Group	COL	15.16	20.9	4.1	100
Macquarie Group	MQG	85.75	12.8	5.5	50
Rio Tinto	RIO	84.57	9.7	5.2	100
Telstra Corporation	TLS	3.07	15.7	5.2	100
Wesfarmers	WES	34.27	19.8	4.6	100
Woolworths	WOW	35.10	24.2	3.0	100
Woodside Petroleum	WPL	18.21	18.9	4.3	100

Source: EL&C Baillieu

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Amcor PLC AMC

Recommendations

Rating	BUY
Price Target	**$16.25**
Share Price	$13.04

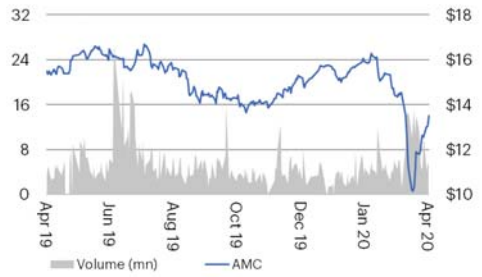
Snapshot

Monthly Turnover	$2,287.3mn
Market Cap	$13,674mn
Shares Issued	1,012.2mn
52-Week High	$16.74
52-Week Low	$9.86
Sector	Materials

Business description

Amcor plc is a global leader in packaging for food, beverage, pharmaceutical, medical, home and personal-care, and other products. The company is focused on making a range of flexible and rigid packaging, specialty cartons and closures in its two segments: Flexibles and Rigid Packaging.

12-month price & volume



Company Report

2H20 likely to benefit from spike in demand

Solid 1H20 result: Amcor delivered a solid 1H20 result, reporting a 4% increase in constant currency EBIT to US$699m. Its Flexibles business EBIT increased by 8% (on a constant currency basis) benefiting from tight cost control and synergy benefits, despite volume headwinds from its Latin America operations. Rigids EBIT declined 12% to US$130mn, with the business cycling a period of unusually strong volumes and margins in the pcp. Following the result, Amcor raised the lower end of its FY20 EPS guidance range and now expects EPS growth of 7-10%, up from 5-10% growth previously. The increase in guidance reflected lower than expected interest charges and faster than expected synergy realisation. The company expects synergies of US$80m in FY20, up from US$65m previously. Amcor maintains its target of US$180m in synergy benefits by FY22. In terms of its current US$500m buy-back, the company retains $280m to utilise toward completing its buy-back in 2H20.

Financial position: Amcor management maintain their balance sheet is strong, which is a result of consistently strong cashflow achieved in recent years. As at 31 December 2019, Amcor had a leverage ratio (net debt to EBITDA) of 2.9x. Its leverage ratio is typically lower by financial year end as cashflow is weighted to the second half. The company points out its leverage is low in a sector where 4x leverage is not uncommon. The company does not have any material refinancing or significant debt maturities over the next 12 months. The company currently has significant liquidity available also.

Outlook: In terms of current trading conditions in 2H20, Amcor is a clear beneficiary of the changing operating environment, with significantly higher spend occurring in its key consumer end markets globally. Food, beverage, medical, healthcare, and personal care categories are all in high demand around the world. Almost all of Amcor's packaging products are for 'at home' consumption through retail channels. Amcor will benefit from the significant increase in retail sales within FMCG and healthcare products. While part of the high consumer demand may be somewhat short-lived, other consumer shifts, such as the increase in demand for healthcare products, are likely to last longer.

Investment Summary

Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$USmn	9,417	9,645	12,857	12,788	12,988
EBITDA	$USmn	1,370.9	1,375.9	1,895.3	2,001.2	2,109.2
EBIT	$USmn	1,018.1	1,026.2	1,252.8	1,378.2	1,500.0
Reported Profit	$USmn	575.2	430.2	710.3	887.8	982.8
Adjusted Profit	$USmn	697.3	729.5	1,011.6	1,082.8	1,157.8
EPS (Reported)	US¢	49.4	36.3	44.2	57.2	64.4
EPS (Adjusted)	US¢	59.9	61.6	63.0	69.8	75.9
EPS Growth	%	N/A	2.9	2.2	10.8	8.7
PER (Reported)	x	16.1	21.8	17.9	13.9	12.3
PER (Adjusted)	x	13.2	12.9	12.6	11.4	10.5
Dividend	¢	60.8	64.7	73.2	81.5	88.3
Yield	%	4.7	5.0	5.6	6.3	6.8
Franking	%	0	0	0	0	0
ROE	%	97.8	23.4	18.9	22.1	24.2
NetDebt	$mn	4,227.5	5,501.6	5,472.8	5,649.9	5,331.5

Share price and valuation

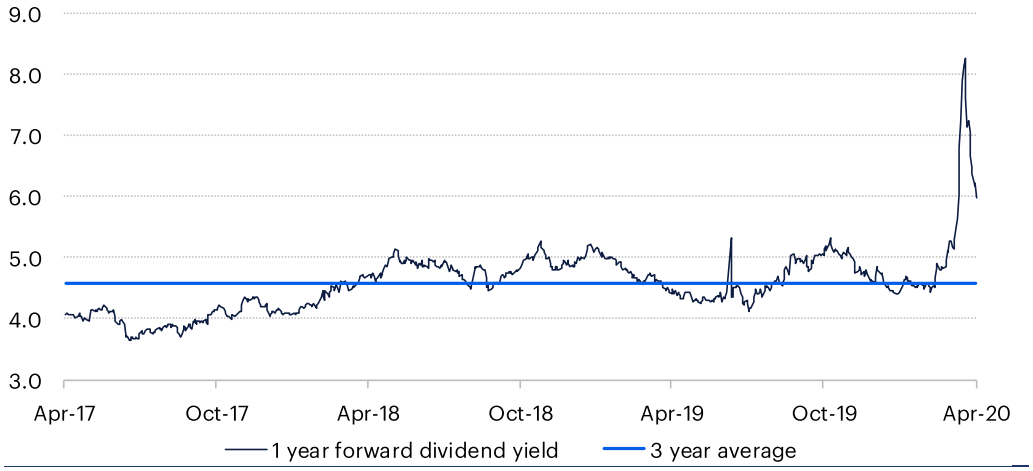
Fig.2: AMC – share price (A$)

Source: Bloomberg

Fig.3: AMC – one-year forward price to earnings ratio (consensus estimates)

Source: Bloomberg

Fig.4: AMC – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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BHP Group BHP

Recommendations

Rating	BUY
Price Target	$41.00
Share Price	$28.98

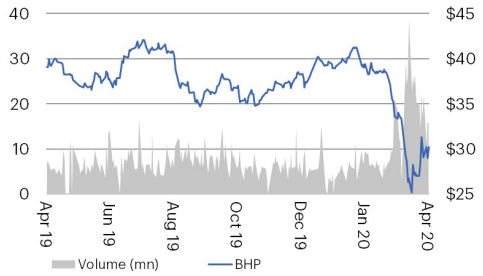
Snapshot

Monthly Turnover	$12,555.9mn
Market Cap	$89,053mn
Shares Issued	2,945.9mn
52-Week High	$42.33
52-Week Low	$24.05
Sector	Materials

Business description

BHP Group Limited is a diversified natural resources company. It operates nine units: petroleum, aluminium, base metals (including uranium), diamonds and specialty products, stainless steel materials, iron ore, manganese, metallurgical, and energy coal.

12-month price & volume



Company Report

Diversity delivers resilience

Focus on the negatives is providing opportunities: We recently downgraded our earnings for BHP on the back of the fall in the oil price. Downgrading Brent CY20 forecasts by $21/bbl to $42/bbl and CY21 by $20/bbl to $45/bbl, we reduced our earnings by 2% and 7% in FY20 and FY21. While we might still be too optimistic on the oil price, the diversity of BHP's portfolio reduces the overall impact on group earnings. It is worth noting that our estimates do not take into account the benefit the company will receive from lower prices for diesel fuel in moving the millions of tonnes of ore and waste across the world.

Iron ore now; petroleum and copper later: BHP's iron ore shipments have remained robust and even if we see some weakness in pricing during the June quarter, we expect EBIT to increase 33% YoY to US$12.5bn in FY20. This would result in Iron Ore's contribution to Group EBIT being 68%. Copper, on the other hand, is expected to generate US$3.0bn in EBIT and Petroleum just under US$1.1bn. We believe a significant portion of the de-rating in BHP's share price has come from factoring in lower copper and oil prices. We see some issues in the short term, with the virus affecting South American copper production, but believe that eventually the global cost base will support the price and demand recovery. This will see prices move higher, and BHP is well-positioned to capture the improvement following recent expenditure. In the case of oil, this appears to be overdone and is not uncommon – BHP suffers as oil prices fall and doesn't benefit as oil rallies. Having sold the US shale assets and refocused on Gulf of Mexico and Trinidad & Tobago, BHP Petroleum is back on an even keel with a number of growth projects and operating costs targeted at less than US$13/boe. This is internationally competitive and means BHP is well placed to capture some of the upside as the oil price returns to sustainable levels.

Value: BHP is trading at a P/NPV of 0.7x, and we admit it could go to the lows of 0.5x reached during the GFC if the iron price collapses. We note BHP's share price during the GFC was impacted by the takeover offer for RIO and concerns about the level of debt it would be acquiring. However, we are comforted by the 20yr+ average P/NPV of 1.0x and the potential for it to trade at 2.0x NPV should a recovery cycle exert itself post the COVID-19 crisis. Upgrade to BUY.

Investment Summary

Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$USmn	46,237	44,750	44,562	40,218	38,256
EBITDA	$USmn	24,111.0	23,158.0	24,191.7	20,805.1	18,202.6
EBIT	$USmn	16,169.0	17,065.0	18,191.3	14,659.4	11,685.0
Reported Profit	$USmn	3,705.0	8,648.0	10,178.4	8,282.7	6,530.4
Adjusted Profit	$USmn	8,933.0	9,466.0	10,496.4	8,282.7	6,530.4
EPS (Reported)	US¢	69.4	166.5	199.8	162.6	128.2
EPS (Adjusted)	US¢	167.4	182.3	206.0	162.6	128.2
EPS Growth	%	N/A	8.9	13.0	-21.1	-21.2
PER (Reported)	x	25.4	10.6	8.8	10.8	13.8
PER (Adjusted)	x	10.5	9.7	8.6	10.8	13.8
Dividend	¢	159.4	153.6	180.7	126.4	99.9
Yield	%	5.5	5.3	6.3	4.4	3.5
Franking	%	100	100	100	100	100
ROE	%	15.8	18.4	21.6	16.0	11.9
ND/ND+Eq	%	15.310,934.0	20.1	20.2	16.2	13.4

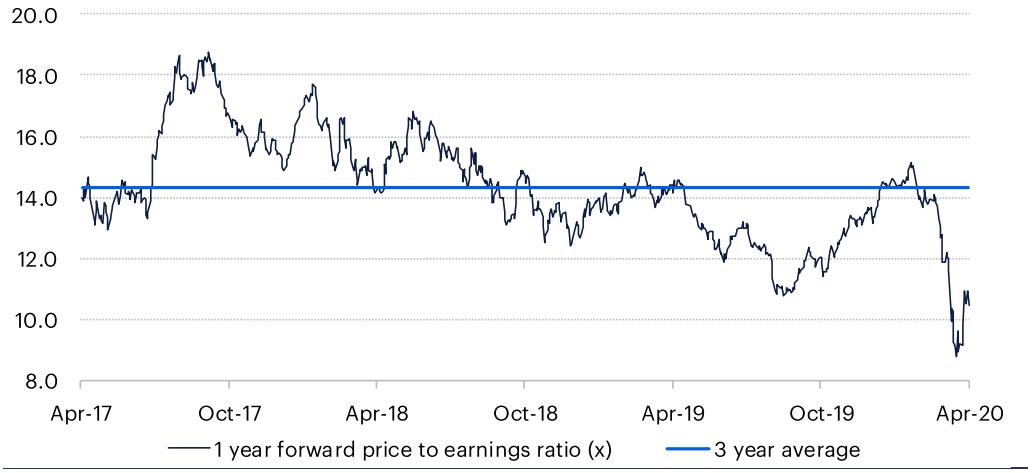
Disclosure
The author of this report owns shares in BHP.

Share price and valuation

Fig.5: BHP – share price (A$)

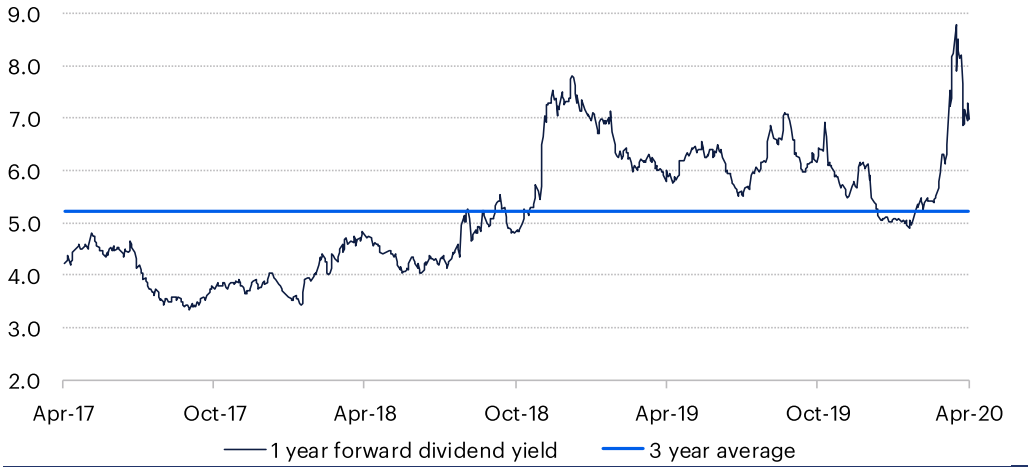
Source: Bloomberg

Fig.6: BHP – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.7: BHP – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Commonwealth Bank CBA

Recommendations

Rating	BUY
Price Target	**$65.00**
Share Price	$61.82

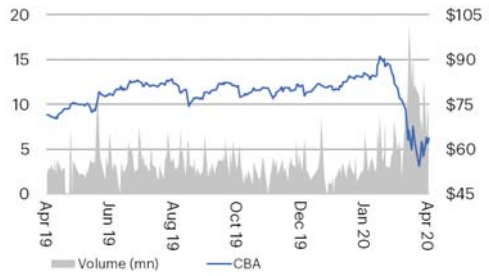
Snapshot

Monthly Turnover	$13,582.2mn
Market Cap	$112,711mn
Shares Issued	1,770.2mn
52-Week High	$91.05
52-Week Low	$53.44
Sector	Financials

Business description

The Commonwealth Bank is Australia's leading provider of integrated financial services including retail banking, premium banking, business banking, institutional banking, funds management, superannuation, insurance, investment and sharebroking products.

12-month price & volume



Company Report

Still the one

Synopsis: At a time when domestic major banks continue to converge in terms of business profile, CBA continues to stand out as the premium franchise in Australia. As a result of the recent market correction, it is currently trading at a discount to its last published net tangible asset backing of A$65 – this is a rarity.

1H20 result recap: Cash NPAT was $4.5bn (-4.3% pcp). Operating income, consisting of net interest income and non-interest income, was largely flat at $12.4bn. Interest income grew 1.7% to $9.3bn, driven by volume growth and relatively stable net interest margins. Non-interest income was down 4.6% to $3.1bn, impacted by bushfire-related insurance claims of $83m and the removal and repricing of wealth management fees. Operating expenses increased 2.6% due to wage inflation, IT, risk and compliance costs. A dividend of $2.00 was declared for the half, in line with the pcp.

Guidance/outlook: No specific outlook provided at its 1H20 result, but CBA stated its 'surplus capital position provides opportunity to consider capital management initiatives'. Any future initiatives would be in relation to lowering share count (i.e. buybacks) as it targets a gradual return to a 70-80% payout target range.

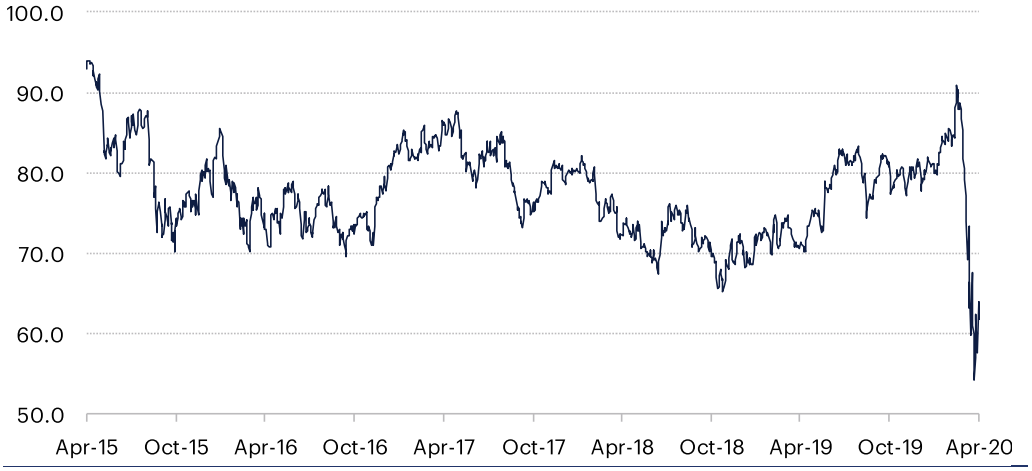
Seeing it through: We continue to see CBA retaining its premium sector status through the COVID-19 led disruption. At a macro-level, we see a range of initiatives undertaken by government and regulators to protect banks through the current crisis, including: 1) introduction of the Term Funding Facility, which will provide banks with funding up to 3% of assets for new loans to the SME sector at 0.25% per annum; and 2) the regulatory decision to not count mortgage repayment holidays as impaired assets for capital purposes. At a stock-specific level, we like: 1) stable management that has executed well since the royal commission, as evidenced by gaining mortgage market share through CY19; 2) it is essentially a mortgage bank, with 69% of its loan book secured by mortgages and 72% of its funding from deposits at 1H20; 3) it has the strongest tier 1 (CET-1) capital ratio of the majors at 12.2%; and 4) loan provisioning is the second best in class, despite being largely a mortgage bank.

Investment Summary

Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn	25,130	24,411	24,443	24,364	24,411
EBITDA	$ mn	13,861.0	12,902.3	13,403.0	13,806.2	14,244.8
EBIT	$ mn	13,056.0	11,941.3	11,358.0	11,875.5	12,333.6
Reported Profit	$ mn	9,537.0	8,571.3	9,719.4	8,418.8	8,567.5
Adjusted Profit	$ mn	9,620.0	8,706.3	8,036.2	8,384.6	8,562.4
EPS (Reported)	¢	519.8	451.8	514.6	445.6	458.5
EPS (Adjusted)	¢	524.3	459.0	425.5	443.8	458.2
EPS Growth	%	N/A	-12.5	-7.3	4.3	3.2
PER (Reported)	x	11.9	13.7	12.0	13.9	13.5
PER (Adjusted)	x	11.8	13.5	14.5	13.9	13.5
Dividend	¢	431.0	431.0	407.9	387.9	387.9
Yield	%	7.0	7.0	6.6	6.3	6.3
Franking	%	100	100	100	100	100
ROE	%	14.7	12.8	11.4	11.7	12.0
NetDebt	$mn	-36,417.0	-29,387.0	-38,005.6	-39,767.7	-41,665.7

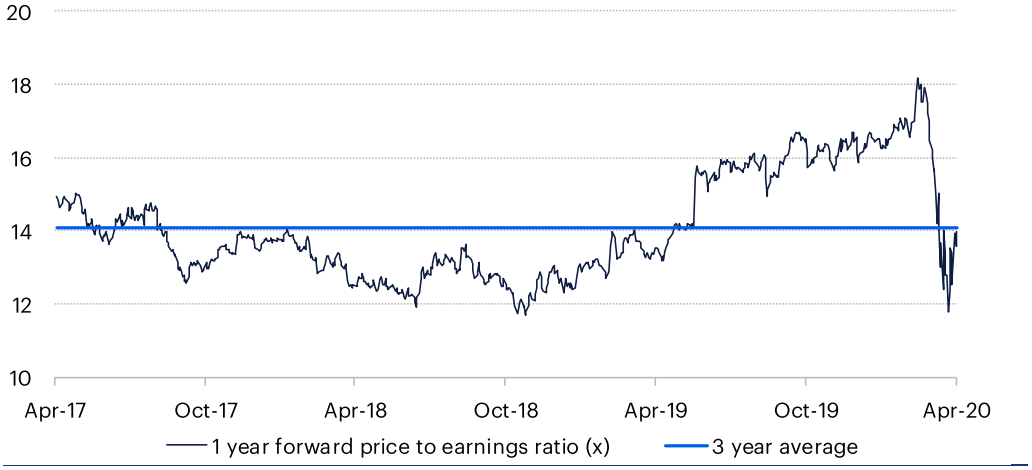
Share price and valuation

Fig.8: CBA – share price (A$)



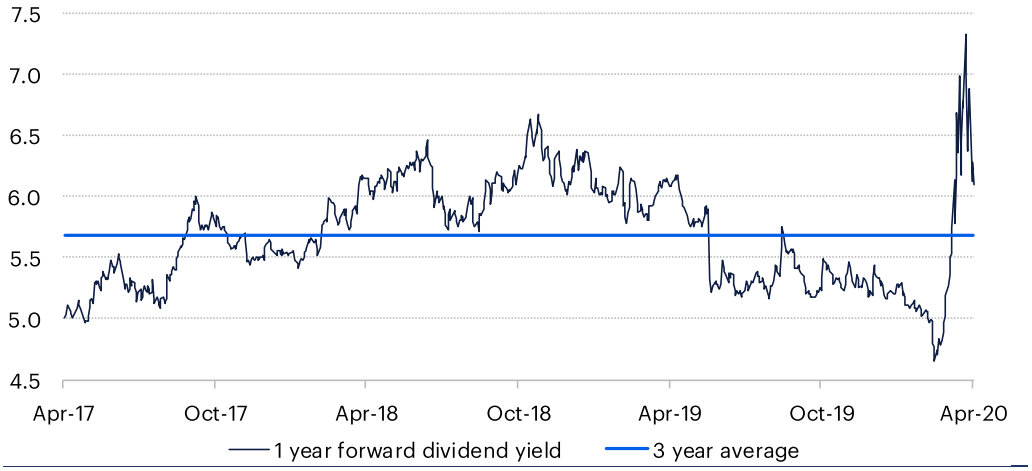
Source: Bloomberg

Fig.9: CBA – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.10: CBA – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Coles Group COL

Recommendations

Rating	BUY
Price Target	**$17.80**
Share Price	$15.16

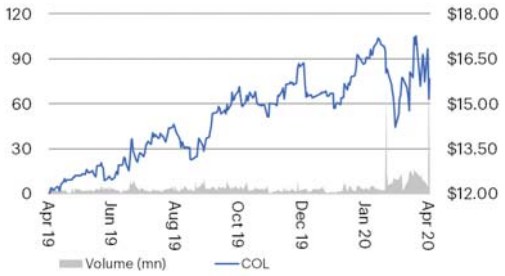
Snapshot

Monthly Turnover	$5,130.5mn
Market Cap	$21,116mn
Shares Issued	1,333.9mn
52-Week High	$18.09
52-Week Low	$11.86
Sector	Consumer Staples

Business description

Coles operates supermarkets, convenience stores and liquor stores in Australia.

12-month price & volume



Company Report

Re-focused

Solid 1H20 result: Coles increased sales revenue by 3.3% in 1H20, with sales growth achieved in all three business segments: Food, Liquor and Convenience. It was the 49th consecutive quarter of Supermarkets comparable sales growth, which increased to 3.6% in 2Q20. Supermarkets was the key driver of earnings for the period, with EBIT up 6%.

Refocused operation: Following the demerger from Wesfarmers in November 2019, Coles is a more focused operation on Food and Liquor operations. This provides an environment for a more focused management team with appropriate incentives in place.

Coles Supermarkets seeing improved sales momentum: Coles underperformed Woolworths in terms of sales growth for much of the past three years. The group achieved a 0.1% increase in like-for-like sales growth in 1Q20, which improved to 3.6% in 2Q20. This improved sales momentum continued into 3Q20, even before the current period of elevated demand currently driving sales growth.

Cost savings of $1bn identified: The new Coles management team has identified $1bn in cost savings to be achieved by FY23. Coles indicated it had achieved $95m in cost savings in 1H20, which boosted earnings during the period. Future cost savings provide scope for further margin upside going forward.

Investment view: Following the demerger from Wesfarmers, Coles has become a more focused operation, operating three business within the Food and Liquor industry. The company has seen strong sales momentum within its core Supermarket operations of late, which should boost operating margins and earnings. The company is also seeing signs of a turnaround in its troubled Convenience store operations. Finally, if the company is able to keep even a part of its targeted $1bn in cost savings, it should be positive for shareholders.

Investment Summary

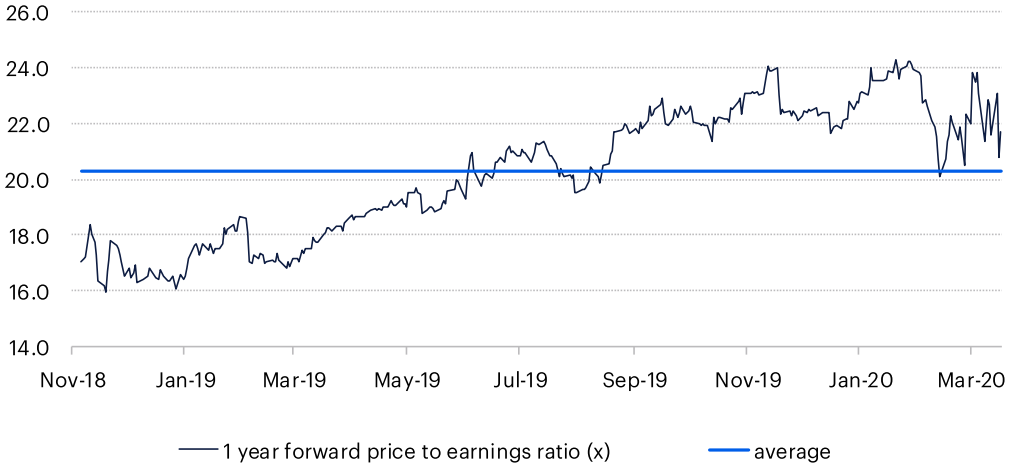
Year End:		2018 ( )	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn		38,464	36,386	37,663	39,072
EBITDA	$ mn		1,982.1	3,223.0	3,387.8	3,570.2
EBIT	$ mn		1,342.5	1,720.4	1,831.3	1,960.2
Reported Profit	$ mn		1,434.7	904.2	968.2	1,047.1
Adjusted Profit	$ mn		991.0	904.2	968.2	1,047.1
EPS (Reported)	¢		107.6	67.8	72.6	78.5
EPS (Adjusted)	¢		74.3	67.8	72.6	78.5
EPS Growth	%	N/A		-8.7	7.1	8.2
PER (Reported)	x		14.1	22.4	20.9	19.3
PER (Adjusted)	x		20.4	22.4	20.9	19.3
Dividend	¢		24.0	56.5	61.7	66.7
Yield	%		1.6	3.7	4.1	4.4
Franking	%	0	100	100	100	100
ROE	%		29.5	30.7	36.8	37.2
NetDebt	$mn		519.6	9,168.7	9,378.4	9,825.6

Share price and valuation

Fig.11: COL – share price (A$)

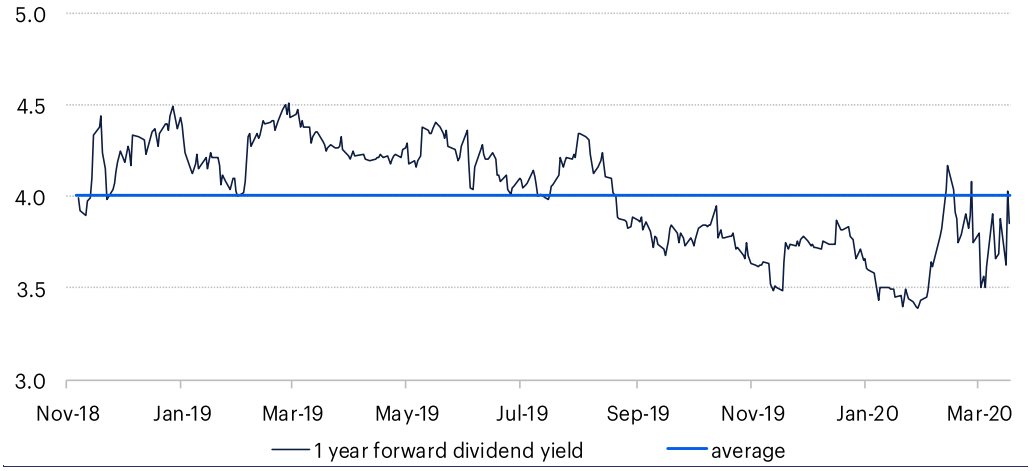
Source: Bloomberg

Fig.12: COL – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.13: COL – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Macquarie Group MQG

Recommendations

Rating	BUY
Price Target	**$110.00**
Share Price	$85.75

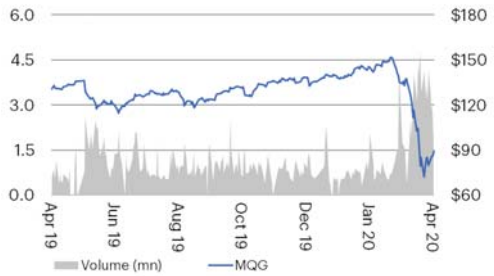
Snapshot

Monthly Turnover	$6,296.3mn
Market Cap	$31,660mn
Shares Issued	354.4mn
52-Week High	$152.35
52-Week Low	$70.45
Sector	Financials

Business description

Macquarie Group Limited (MGL) acts as a non-operating holding company. Through its subsidiaries, it provides banking, financial, advisory, investment and funds management services.

12-month price & volume



Company Report

What was good will be good again

Synopsis: The strength of MQG over the last decade has been the diversity of the group in terms of earnings streams – acted as a balancing mechanism and delivered progressive profit growth since the GFC. The impact of COVID-19 has seen markets activity significantly impacted in the second half of MQG's all-important 4Q20 (March-end) with the clear prospect of further impacts in FY21.

Business profile: MQG's business is split into two broad categories, annuity-style – Macquarie Asset Management (MAM), Banking & Financial Services (BFS) – and market-facing – Commodities & Global Markets (CGM) and Macquarie Capital (MacCap). These have a 60% and 40% contribution to Group net profit respectively. The majority of MQG's revenue comes from fee and commission income, predominantly from MAM and their funds management activities (base and performance fees) and trading income from CGM (e.g. risk management products, inventory management, FX, interest rates and equities).

Earnings risks: Interestingly, MQG has retained its guidance for "FY20 being slightly below FY19", despite the market and economic deterioration since that time. We see further risk to FY21 given annuity businesses are likely to start from a lower base and performance fees are likely to fall due to asset price deflation. This environment is likely to see increased impairments. In recognition of these risks, we recently decreased our FY20 forecasts by 12%, to sit 10% below FY19. We have also decreased FY21 forecasts by 20%, to be 7% below FY20.

Earnings upside: Whilst we have cited clear short-term earnings risks, there are also opportunities in CGM (volatility in commodity prices), MacCap (potential corporate recapitalisation) and BFS (balance sheet growth as households and businesses draw down undrawn lines of credit).

Investment view: In response to the recent share price weakness, we recently upgraded our call to BUY with a price target of A$110 (prev. A$135). While there is near term earnings risk, we consider MQG to be a quality business; one which will likely rebound quickly. A review of MQG's share price chart shows the period immediately following the GFC was a once in a decade opportunity to buy the stock.

Investment Summary

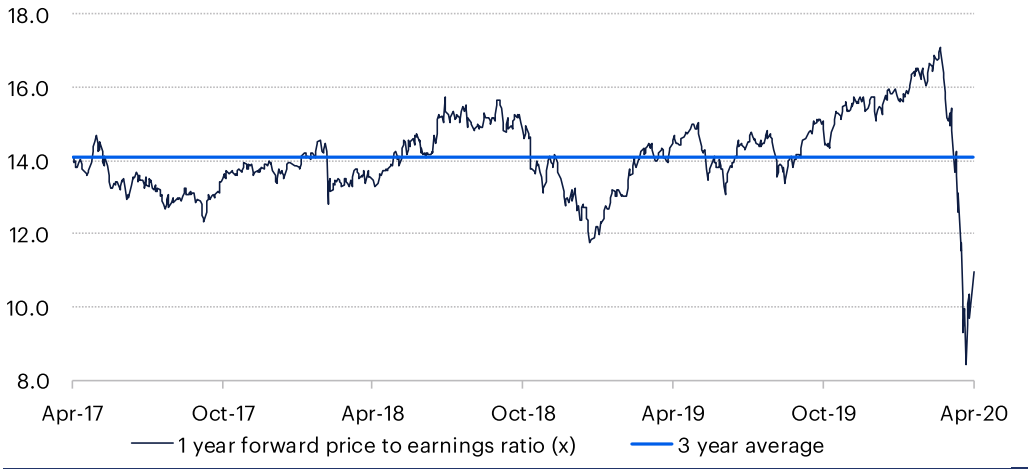
Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn	10,419	13,306	12,715	12,378	13,241
EBITDA	$ mn	3,362.3	4,184.9	3,785.7	3,619.9	3,974.8
EBIT	$ mn	2,537.0	3,867.0	3,461.3	3,290.6	3,631.3
Reported Profit	$ mn	1,630.0	2,982.0	2,692.6	2,508.0	2,769.1
Adjusted Profit	$ mn	1,630.0	2,982.0	2,692.6	2,508.0	2,769.1
EPS (Reported)	¢	489.8	849.7	754.2	668.1	725.2
EPS (Adjusted)	¢	489.8	849.7	754.2	668.1	725.2
EPS Growth	%	N/A	73.5	-11.2	-11.4	8.5
PER (Reported)	x	17.5	10.1	11.4	12.8	11.8
PER (Adjusted)	x	17.5	10.1	11.4	12.8	11.8
Dividend	¢	525.0	575.0	610.0	473.8	518.3
Yield	%	6.1	6.7	7.1	5.5	6.0
Franking	%	45	45	45	50	50
ROE	%	10.4	17.7	14.0	12.7	13.5
NetDebt	$mn	0.0	0.0	0.0	0.0	0.0

Share price and valuation

Fig.14: MQG – share price (A$)

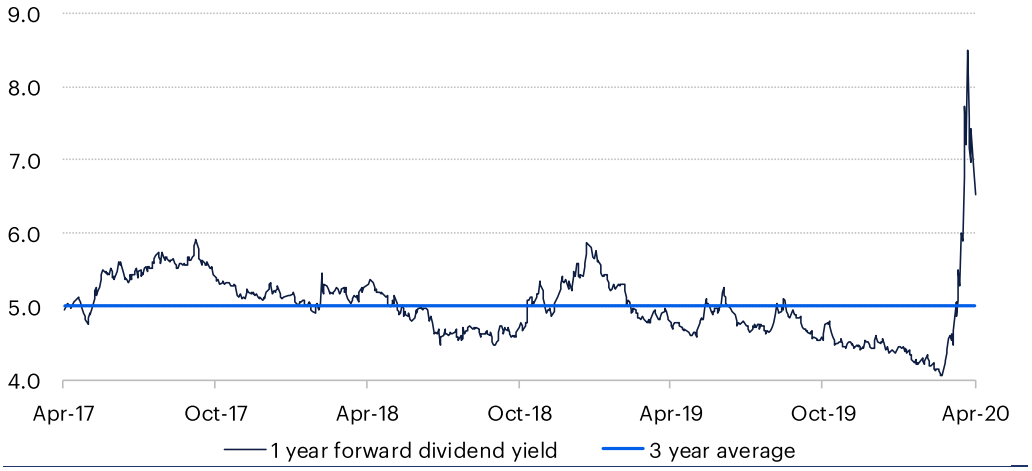
Source: Bloomberg

Fig.15: MQG – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.16: MQG – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Rio Tinto RIO

Recommendations

Rating	BUY
Price Target	**$94.00**
Share Price	$84.57

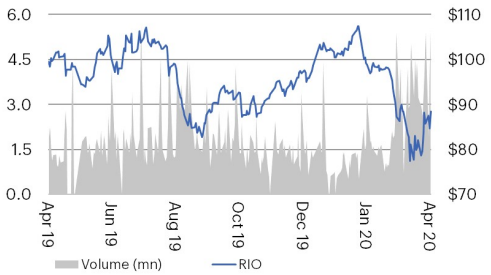
Snapshot

Monthly Turnover	$6,537.1mn
Market Cap	$32,816mn
Shares Issued	371.2mn
52-Week High	$107.99
52-Week Low	$72.77
Sector	Materials

Business description

Rio Tinto Limited is engaged in minerals exploration, development, production and processing. The Company's product groups include aluminum, copper, diamonds and minerals, energy, and iron ore.

12-month price & volume



Company Report

Steady as she goes

Not really a growth stock: RIO's business is dominated by iron ore and based on our current forecasts, it will contribute 84% of group EBIT in 2020, leaving copper and aluminium contributing 7% and 2% respectively. If production, costs and revenues continue as expected, RIO's gearing could be 5% by the end of 2020 and it could be net cash in 2021. Provided iron ore demand does not disappear, RIO can weather a lower price (we are factoring in a decline to US$80/t in Dec-20 and US$70/t in Dec-21) and if there is a potential demand shock in aluminium and copper in a COVID-19 world, we forecast downside in EBITDA of 5-7% on weaker metal prices.

Copper growth reliant on Oyu Tolgoi and exploration: Copper production growth will not come from Bingham Canyon or Escondida. Group mined copper output is expected to be flat or down in 2020 (530-570kt). Growth is to come from the development of the Oyu Tolgoi underground and could add another 170ktpa to RIO's copper output. The current hiatus and increase in time to study the options for mine development and capex may work in RIO's favour, as rushing a large cave design could lead to long-term problems. Ongoing studies and exploration at Winu may lead to RIO looking at small-scale low capex options for growth in the intervening period.

Aluminium-related assets no longer a drain: The assets have been rationalised. The Pacific Aluminium assets are the next to be sold or shut (may occur as a result of COVID-19.) The rest of the business is in reasonable shape – the bauxite operations have a place in the export market, alumina is suffering the same pressures as all alumina refineries, and the Canadian smelting operations are technological leaders and utilise abundant hydropower, offering a greener alternative to coal. The rationale for acquiring the hydro-powered smelters looked as though it was going to pay off last year when the world was focusing on green alternatives, and it may come to fruition in the coming years.

Investment view: Cash is king, and RIO's balance sheet should be moving to net cash in 2021. We do expect some volatility in RIO's share price; however, its exposure to iron provides a strong base, while copper and aluminium should deliver leverage to a post-COVID-19 recovery. Upgrade to BUY.

Investment Summary

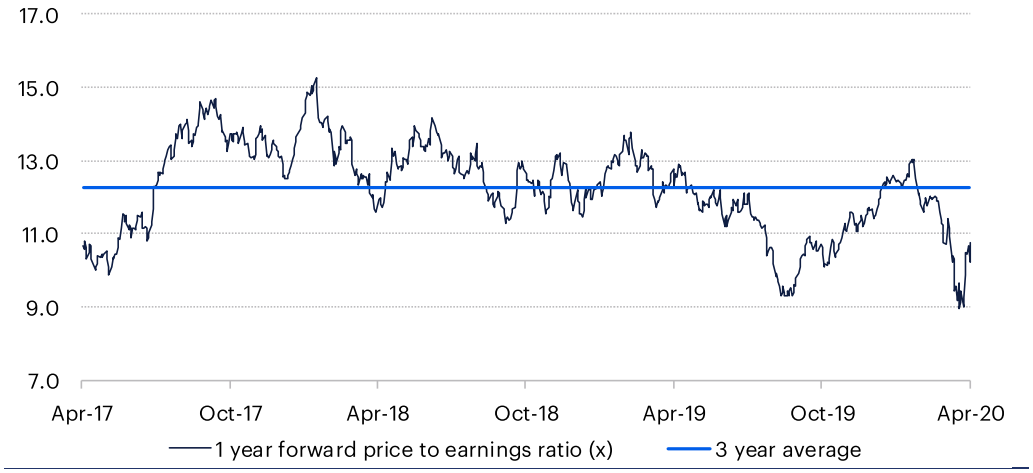
Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$USmn	40,651	43,294	43,309	41,442	38,535
EBITDA	$USmn	18,136.0	21,197.0	19,300.6	17,971.8	14,330.4
EBIT	$USmn	14,227.0	16,925.0	13,857.6	12,229.2	8,423.1
Reported Profit	$USmn	13,638.0	8,010.0	9,730.8	8,615.8	5,868.3
Adjusted Profit	$USmn	8,808.0	10,373.0	9,730.8	8,615.8	5,868.3
EPS (Reported)	US¢	787.6	487.8	596.5	528.7	360.1
EPS (Adjusted)	US¢	508.6	631.7	596.5	528.7	360.1
EPS Growth	%	N/A	24.2	-5.6	-11.4	-31.9
PER (Reported)	x	6.5	10.5	8.6	9.7	14.3
PER (Adjusted)	x	10.1	8.1	8.6	9.7	14.3
Dividend	¢	735.5	637.2	507.3	435.3	283.9
Yield	%	8.7	7.6	6.0	5.2	3.4
Franking	%	100	100	100	100	100
ROE	%	19.9	24.6	23.3	19.3	12.4
ND/ND+Eq	%	1.3	7.5	4.8	net cash	net cash

Share price and valuation

Fig.17: RIO – share price (A$)

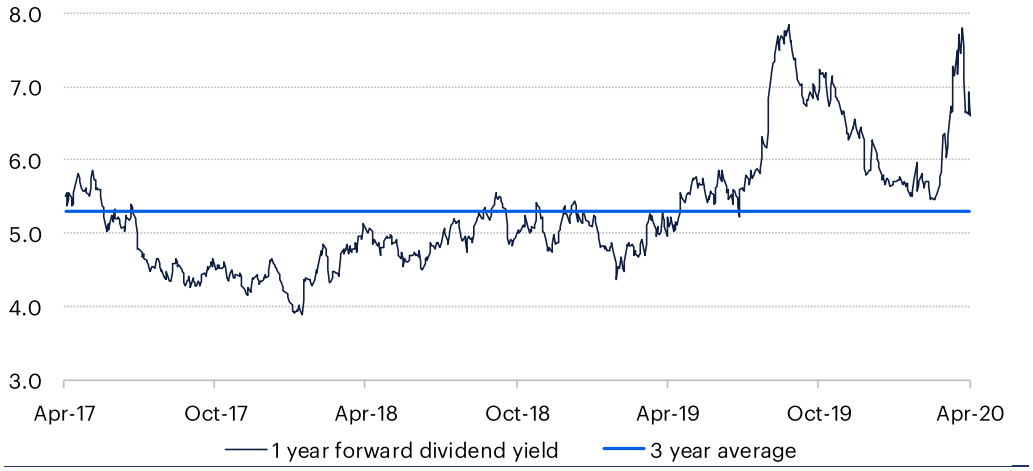
Source: Bloomberg

Fig.18: RIO – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.19: RIO – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Telstra Corporation TLS

Recommendations

Rating	BUY
Price Target	**$4.20**
Share Price	$3.07

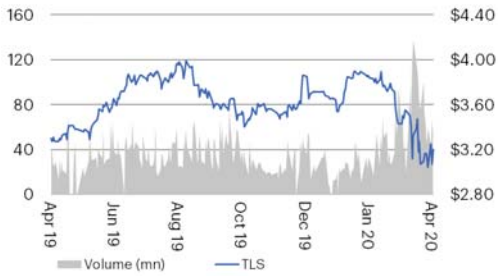
Snapshot

Monthly Turnover	$5,340.2mn
Market Cap	$38,059mn
Shares Issued	11,893.3mn
52-Week High	$4.01
52-Week Low	$2.87
Sector	Telecommunication Services

Business description

Telstra (TLS) is a provider of telecommunications services through its Australian and offshore operations. TLS has a range of businesses namely fixed broadband, mobile, data and IP, network application & services (NAS), digital media and international.

12-month price & volume



Company Report

Ringing up resilience

Background: TLS provides a range of data and voice services, including fixed and mobile telecommunications and broadband to individuals, small businesses and enterprise customers, both domestically and internationally. Demand for these services has increased significantly due to increased levels of remote working brought about by COVID-19 restrictions.

Earnings resilience high: TLS recently updated its FY20 guidance, showing some negative impact from COVID-19 but remaining within its existing guidance range. The company is now expecting EBITDA to be at the bottom end of the previously-given $7.4-7.9bn range. This was highly noteworthy as many companies have been forced to withdraw guidance altogether, such is the uncertainty of impact on some industries.

Impact of COVID-19: There will be some impact from social distancing and other restrictions, including (1) lower international roaming revenues (due to global travel restrictions); (2) temporary suspension of late payment fees and disconnections, for consumer and small business customers; and (3) the impact on NAS revenues as enterprises pull back on IT/communications spend.

Singtel bounce back post-SARS: We have looked to Singapore Telecom (Singtel) as an example of what occurred to roaming fees during and after the SARS epidemic. The impact was significant but short-term in nature and importantly, rebounded strongly after the end of the outbreak.

Strong financial position: In terms of debt levels and balance sheet strength, TLS remains in a favourable position, with its debt servicing ratio under 2x. The telco giant also has about $2.5bn in undrawn debt facilities to cover upcoming debt maturities, which total $2.0bn over the next six months.

Investment view: We have a BUY rating on TLS with a target price of $4.20. While TLS will not be immune to volatility in markets, its underlying businesses will be relatively unaffected by COVID-19. It has a strong balance sheet and is currently yielding c.5% (fully franked). When markets settle down, the hunt for yield in a low interest rate environment is likely to continue and TLS is a defensive blue chip stock with a good yield.

Investment Summary

Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn	28,841	27,807	26,441	26,077	24,936
EBITDA	$ mn	10,219.0	7,972.0	9,092.5	9,257.3	7,609.2
EBIT	$ mn	5,749.0	3,690.0	3,647.0	4,106.7	3,358.5
Reported Profit	$ mn	3,591.0	2,154.0	2,043.0	2,330.9	1,864.3
Adjusted Profit	$ mn	3,591.0	2,154.0	2,043.0	2,330.9	1,864.3
EPS (Reported)	¢	30.2	18.1	17.2	19.6	15.7
EPS (Adjusted)	¢	30.2	18.1	17.2	19.6	15.7
EPS Growth	%	N/A	-40.1	-5.1	14.1	-20.1
PER (Reported)	x	10.2	17.0	17.9	15.7	19.6
PER (Adjusted)	x	10.2	17.0	17.9	15.7	19.6
Dividend	¢	22.0	16.0	16.0	16.0	16.0
Yield	%	7.2	5.2	5.2	5.2	5.2
Franking	%	100	100	100	100	100
ROE	%	24.7	14.8	14.0	15.6	12.4
NetDebt	$mn	16,776.0	16,717.0	20,127.6	18,456.6	17,595.8

Share price and valuation

Fig.20: TLS – share price (A$)

Source: Bloomberg

Fig.21: TLS – one-year forward price to earnings ratio (consensus estimates)

Source: Bloomberg

Fig.22: TLS – one-year forward dividend yield (consensus estimates)

Source: Bloomberg

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Wesfarmers WES

Recommendations

Rating	HOLD
Price Target	**$30.07**
Share Price	$34.27

Snapshot

Monthly Turnover	$4,400.6mn
Market Cap	$40,455mn
Shares Issued	1,133.8mn
52-Week High	$47.42
52-Week Low	$29.75
Sector	Consumer Discretionary

Business description

Wesfarmers Limited is an Australia-based company. The company's principal activities are retailing operations; insurance; industrial and safety product distribution; chemicals and fertilizers manufacture, and investments.

12-month price & volume

Company Report

Momentum continues in Aust., but NZ faces disruption

1H20 result: Wesfarmers reported a 5.7% increase in underlying NPAT in FY20 to $1,142m. The result was underpinned by the strong performance of its retail operations, Bunnings, Kmart, and Officeworks. WES' retail businesses also delivered further improvements in their respective e-commerce capabilities with strong growth in online sales of 35% for the half. In contrast to the rest of the Group, Target and the Industrial and Safety division reported results which were below expectations. During the half, the company completed the acquisition of Kidman Resources Ltd and Catch Group. While relatively modest investments, both provide new growth platforms that will benefit from WES' existing capabilities.

Financial position: Reflecting the strong cash flow performance and disciplined capital investment in 1H20, Wesfarmers remains in a strong financial position net financial debt of $2,317m at the end of the period. Following the result, Wesfarmers sold a 4.9% stake in Coles Group (COL) for total pre-tax proceeds of $1,050m, further reducing its net debt. Following the sale, Wesfarmers retain a 10.1% interest in Coles.

Trading update: Wesfarmers recently provided an update on the impact of the COVID-19 virus on its businesses. Overall, momentum in the Group's retail businesses has continued in line with the first half. Strong sales growth has continued in Bunnings, Kmart and Officeworks, supported by strong growth in online sales. Bunnings and Officeworks have experienced strong demand from retail and commercial customers. The Industrial and Safety businesses are also experiencing strong demand for critical products including essential protective clothing, cleaning and hygiene products and medical gases. Despite this there has been continued weakness in the sale of discretionary products, such as apparel, which will adversely impact the improvement of Target.

New Zealand operations: In NZ, the government announced restrictions of 'non-essential' services from 25 March, for a period of four weeks. Bunnings' 53 locations in NZ remain open to trade customers, however, Kmart's 25 NZ stores will be closed.

Investment Summary

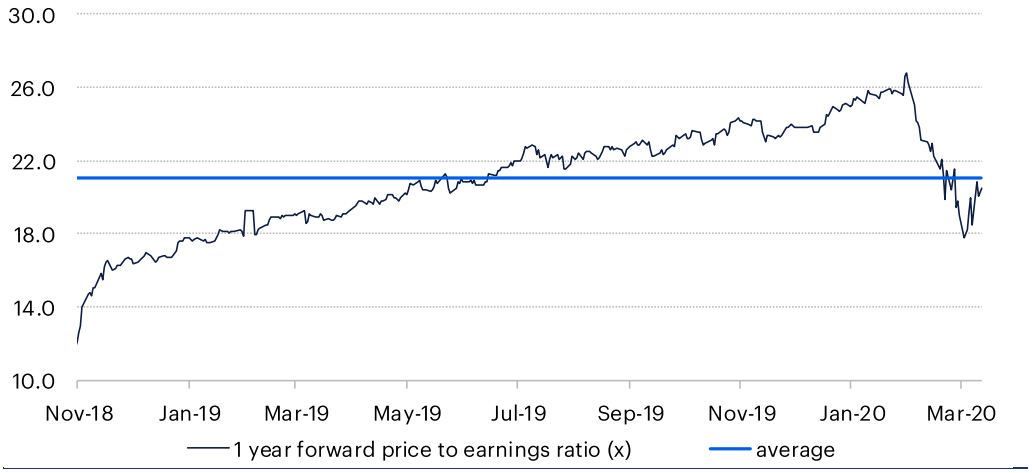
Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn	66,869	27,894	29,198	30,409	31,636
EBITDA	$ mn	5,497.0	3,269.0	4,247.1	4,444.2	4,661.8
EBIT	$ mn	4,299.0	2,732.0	2,763.6	2,905.9	3,070.8
Reported Profit	$ mn	1,197.0	5,510.0	2,088.2	1,964.9	2,078.1
Adjusted Profit	$ mn	2,904.0	1,940.0	1,893.2	1,964.9	2,078.1
EPS (Reported)	¢	105.7	486.8	184.2	173.1	183.1
EPS (Adjusted)	¢	256.3	171.4	167.0	173.1	183.1
EPS Growth	%	N/A	-33.1	-2.5	3.7	5.8
PER (Reported)	x	32.4	7.0	18.6	19.8	18.7
PER (Adjusted)	x	13.4	20.0	20.5	19.8	18.7
Dividend	¢	223.0	178.0	135.8	156.0	165.0
Yield	%	6.5	5.2	4.0	4.6	4.8
Franking	%	100	100	100	100	100
ROE	%	12.4	11.8	19.0	19.7	20.4
NetDebt	$mn	3,441.0	2,234.0	9,748.8	10,209.2	10,624.8

Share price and valuation

Fig.23: WES – share price (A$)

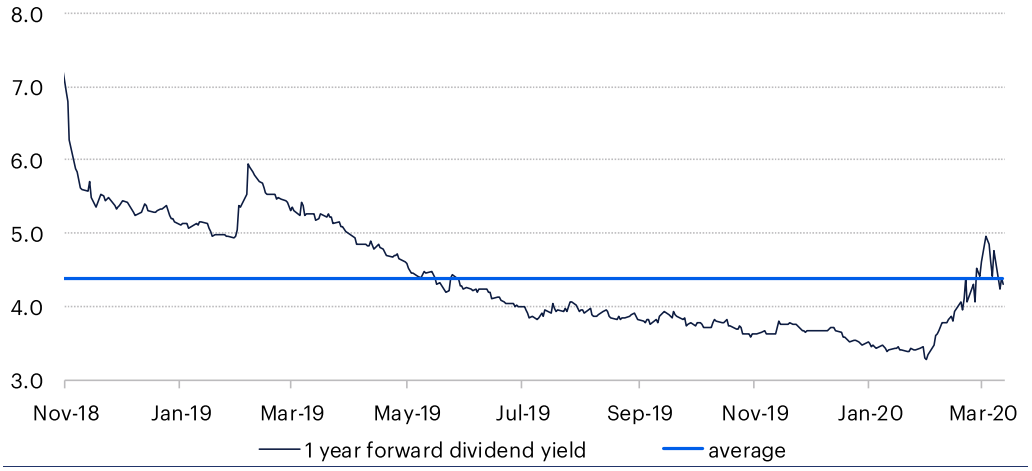
Source: Bloomberg

Fig.24: WES – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.25: WES – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Woolworths Group WOW

Recommendations

Rating	HOLD
Price Target	**$39.70**
Share Price	$35.10

Snapshot

Monthly Turnover	$6,078.2mn
Market Cap	$45,417mn
Shares Issued	1,261.2mn
52-Week High	$43.96
52-Week Low	$30.09
Sector	Consumer Staples

Business description

Woolworths Limited is an Australia-based company. The company has five segments: Australian Food and Liquor; New Zealand Supermarkets; Petrol; BIG W; Hotels.

12-month price & volume

Company Report

Still going strong

Strong 1H20 result: Woolworths 1H20 underlying NPAT increased 15.7% to $979m. The result was driven by an 8.1% increase in its Australian Food business, the core of its operations. Supermarket margins increased 12bps to 4.80% during the period (pre-AASB 16), with lower stock loss boosting gross profit margins. Big W returned to profit for the first time since 2016. Big W's EBIT of $21m was driven by improved sales growth (+3.2% comp store growth) and lower cost of doing business (CODB). Unfortunately, the under-payment to salaried team members continues to disappoint investors.

Deceleration in comparable-store sales growth temporary: One area of slight disappointment in 1H20 was the slowdown in comparable-store sales growth from 6.6% in 1Q20 to 3.6% in 2Q20. The rate of growth slipped to c.2.0% in the 3Q20 trading update. Management attributed the slowdown in sales to regional/bushfire impacted stores as well as high Asian Index stores which had underperformed. However, this has now largely abated, given the current rate of sales growth within its Supermarket operations due to the spike in demand as a result of the COVID-19 virus.

Portfolio changes potentially create additional value: The creation of Endeavour Drinks was completed in February, which combined the operations of WOW's Liquor and ALH Hotels businesses. The planned separation of Endeavour Group, through either a demerger or other value accretive alternative, was planned for later this calendar year. However, given the recent closure of the Hotels business, the process will be delayed into 2021. We believe it may leave Woolworths undergeared and may give rise to potential capital management opportunities.

Overall: WOW's 1H20 result was robust, with strong earnings growth from its core Supermarket operations in Australia and New Zealand and a return to profitability of the Big W business. Despite the delay, the ultimate separation of the Endeavour Drinks Group offers further upside to existing investors.

Investment Summary

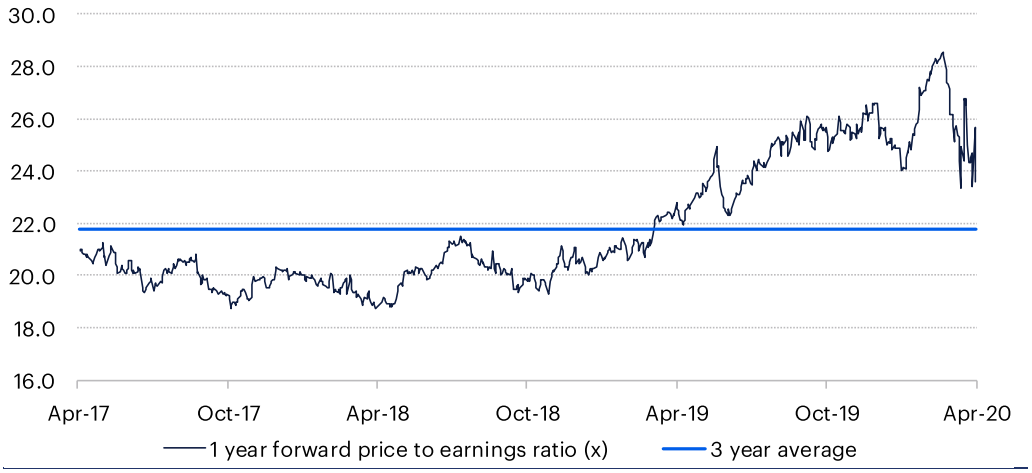
Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$ mn	57,204	60,560	62,204	64,426	66,575
EBITDA	$ mn	3,651.0	3,946.0	5,846.9	6,114.6	6,372.3
EBIT	$ mn	2,548.0	2,724.0	3,401.0	3,596.2	3,780.8
Reported Profit	$ mn	1,724.0	2,693.0	1,624.9	1,832.1	1,930.4
Adjusted Profit	$ mn	1,605.0	1,752.0	1,716.9	1,832.1	1,930.4
EPS (Reported)	¢	132.2	205.0	129.1	145.3	153.1
EPS (Adjusted)	¢	123.1	133.4	136.4	145.3	153.1
EPS Growth	%	N/A	8.3	2.3	6.5	5.4
PER (Reported)	x	26.5	17.1	27.2	24.2	22.9
PER (Adjusted)	x	28.5	26.3	25.7	24.2	22.9
Dividend	¢	103.0	102.0	98.7	106.2	111.9
Yield	%	2.9	2.9	2.8	3.0	3.2
Franking	%	0	100	100	100	100
ROE	%	16.0	16.9	17.6	19.3	19.2
NetDebt	$mn	1,530.0	2,063.0	17,141.7	17,794.3	18,270.6

Share price and valuation

Fig.26: WOW – share price (A$)

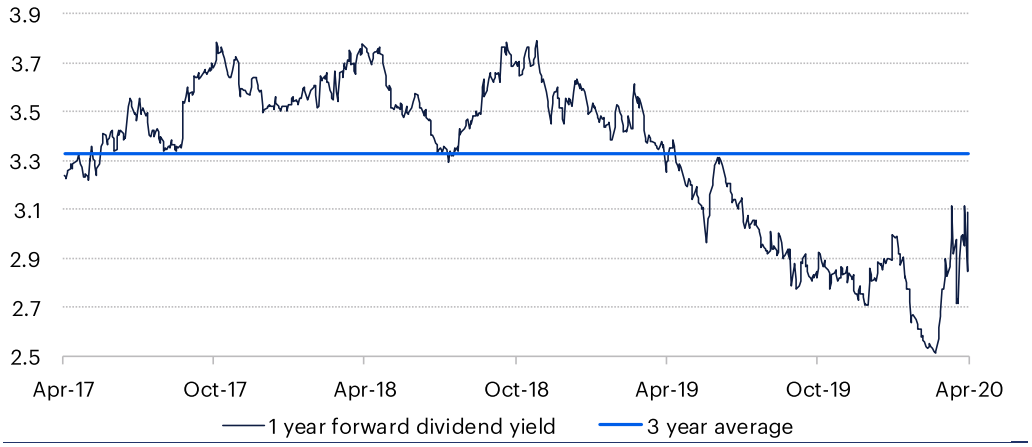
Source: Bloomberg

Fig.27: WOW – one-year forward price to earnings ratio (consensus estimates)



Source: Bloomberg

Fig.28: WOW – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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Woodside Petroleum WPL

Recommendations

Rating	BUY
Price Target	**$28.89**
Share Price	$18.21

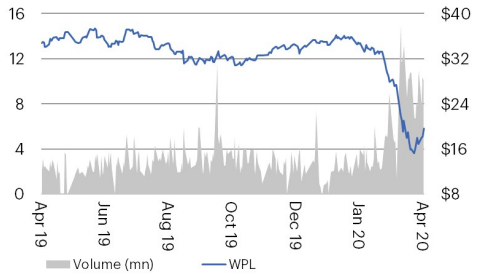
Snapshot

Monthly Turnover	$3,815.0mn
Market Cap	$18,744mn
Shares Issued	954.4mn
52-Week High	$37.55
52-Week Low	$14.93
Sector	Energy

Business description

Woodside explores for, develops and produces oil and gas from operating assets located in Australia and Internationally. Its key assets include interests in and/or operatorship of the North West Shelf LNG project, Pluto LNG and Wheatstone.

12-month price & volume



Company Report

Resilient enough to weather the storm

Resilience: In our view, WPL's balance sheet and cost base are the best of the major Australian E&P companies. Since 2017, WPL has reduced its breakeven cash flow cost of production from US$34/boe to US$22/boe in 2019. In 2020, this should fall to ~$20/boe and could be below US$10/boe if further discretionary capex is cut.

Market capex concerns now largely removed: The WPL board has prudently taken steps to manage WPL's financial position relative to the oil and LNG price environment. WPL announced it would cut 50% of the expenditure in the 2020 work plan (a reduction of US$2.4bn), which includes 60% of the investment expenditure following a review of all non-committed activities and the deferral of final investment decisions for Scarborough, Pluto Train 2 and Browse. Sangomar development is slated to continue, albeit at a slower pace due to disruption in equipment manufacture and delivery as well as the interruption to contract work from COVID-19.

Deferring major capex puts WPL in a strong position: As at the end of February, WPL had cash on hand of US$4.9bn, total liquidity of US$7.9bn and gearing of only 13.8%. After including the investment changes and the guidance on hedging as well spot LNG prices, we have operating cash flow after capex of US$698m in 2020, rising to $1,809m in 2022. This leaves gearing at 8.7% in 2020, well below the loan covenant gearing limit of 70%, and a net cash position in 2022. The CEO notes that WPL has now "cleared the decks", leaving management to reset the organic and inorganic growth opportunities which can be followed.

The world does not end at US$30/bbl: We estimate that even with oil at US$30/bbl, WPL would generate a profit of US$129m in 2020 with an EBITDA of US$2.3bn. In 2021, without any further business changes, WPL would post a loss of US$178m on a healthy EBITDA of US$1.8bn.

Investment view: We see WPL as the most resilient to oil price weakness vs peers, with far less bank covenant risk, and optionality to defer growth until market conditions improve. It is well positioned to capture opportunities presented by a distressed sector.

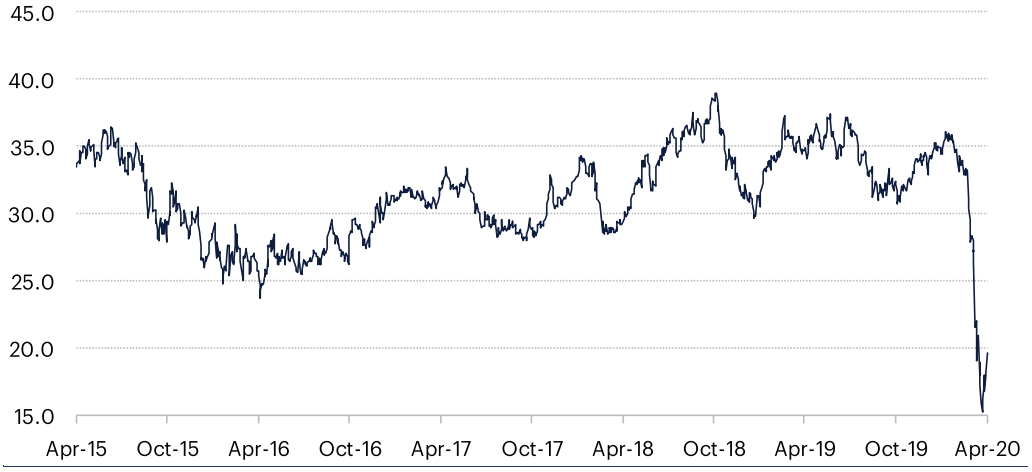
Investment Summary

Year End:		2018 (A)	2019 (A)	2020 (E)	2021 (E)	2022 (E)
Revenue	$USmn	5,240	4,873	3,710	3,786	4,596
EBITDA	$USmn	3,814.0	3,531.0	2,660.8	2,817.0	3,379.8
EBIT	$USmn	2,278.0	1,811.0	885.4	1,120.2	1,679.9
Reported Profit	$USmn	1,364.0	343.0	339.7	547.8	953.3
Adjusted Profit	$USmn	1,416.0	1,063.0	339.7	547.8	953.3
EPS (Reported)	US¢	148.1	36.6	36.3	58.5	101.8
EPS (Adjusted)	US¢	153.7	113.6	36.3	58.5	101.8
EPS Growth	%	N/A	-26.1	-68.0	61.3	74.0
PER (Reported)	x	7.5	30.2	30.5	18.9	10.9
PER (Adjusted)	x	7.2	9.8	30.5	18.9	10.9
Dividend	¢	204.3	129.3	48.0	77.6	135.5
Yield	%	11.3	7.1	2.6	4.3	7.5
Franking	%	100	100	100	100	100
ROE	%	8.7	6.2	2.1	3.3	5.7
ND/ND+Eq	%	11.6	8.5	8.7	4.1	net cash

Disclosure
The author of this report owns shares in WPL.

Share price and valuation

Fig.29: WPL – share price (A$)

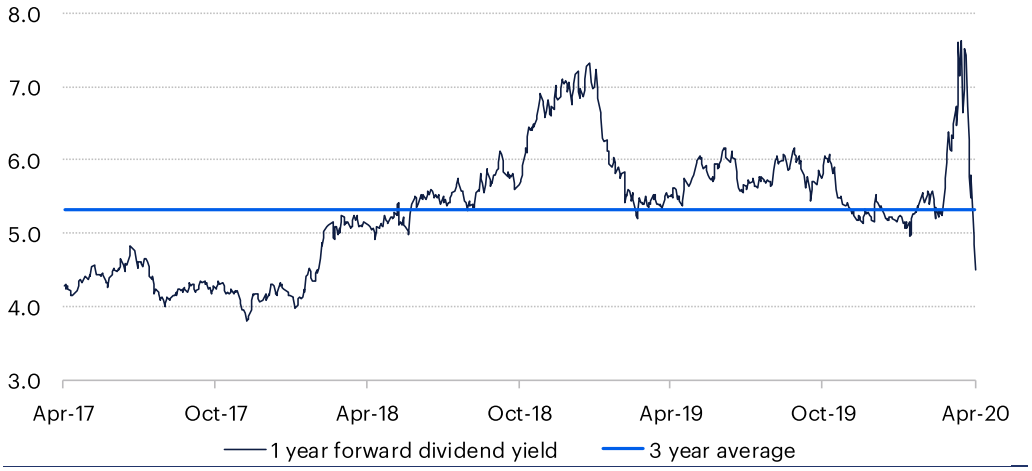


Source: Bloomberg

Fig.30: WPL – one-year forward price to earnings ratio (consensus estimates)

Source: Bloomberg

Fig.31: WPL – one-year forward dividend yield (consensus estimates)



Source: Bloomberg

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