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Yovich & Co WEALTH MANAGEMENT

Yovich & Co. Market Update

30 September 2023

	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Month	11554.48	7517.78	3119.88	7439.13	34721.91	14034.97	0.9202	0.5967	5.50%
Month Close	11296.43	7249.67	3110.48	7608.08	33507.50	13219.32	0.9322	0.5995	5.50%
Change	-2.23%	-3.57%	-0.30%	2.27%	-3.50%	-5.81%	1.31%	0.47%	0.00%

History has once again proven to be correct, with September not favouring investors. All major indices we monitor, except for the FTSE, experienced a decline for the month. The NZ dollar depreciated against the AUD and USD throughout the month, but managed to regain ground and ended the month positively. At the time of writing, we are only 12 days away from the government voting. Over the past three decades, we have observed that the market tends to rise by an average of 2.7% in the three months following an election. Furthermore, when National has emerged as the victor, the average gain has been even higher.

The revised GDP reading of 0.0% for the March quarter indicated that NZ did not slip into a technical recession. The GDP reading for the June quarter showed growth of 0.9%, resulting in an annual growth rate of 3.2%. An interesting comment by Doug Steel, an economist at BNZ, provides some context: "Technical recession or not, there is absolutely no doubt that economic conditions are tough for many". A significant portion of the economic growth has been driven by an increase in the population. GDP per capita increased by just 0.2% during June and fell by 1.6% between October 2022 and March 2023. This helps explain why it feels like a recession for individuals in the real economy, even though the overall figures are growing. The main contributors to the increase in GDP were expenditure on GDP (1.3%), service industries (1%), and goods producing (0.7%). On the other hand, primary industries were detractors (-1.9%), and retail trade, accommodation, and restaurants were down (-1.0%), primarily driven by furniture, electrical, and hardware retailing.

The biggest movers of the month ending 30 September 2023				
Up			Down	
Serko (SKO.nz)	11.40%		Sky City (SKY.nz)	14.60%
Skellerup (SKL.nz)	9.67%		NZX Limited (NZX.nz)	11.67%
Synlait (SML.nz)	4.38%		A2Milk (ATM.nz)	10.94%
KMD Brands (KMD.nz)	3.57%		Vista Group (VGL.nz)	9.43%
Summerset (SUM.nz)	3.03%		EBOS (EBO.nz)	8.75%

In August 2023, New Zealand's business confidence showed a notable improvement, rising by 9 points to reach -4, the highest since mid-2021. Expected own activity also surged by 10 points, reaching +11. Various activity indicators experienced an uplift. Despite these positive trends, inflation indicators continued to ease, suggesting a favourable balance between economic growth and inflation.

On 4 October, the Monetary Policy Committee (MPC) will review the Monetary Policy Statement and OCR setting. It is expected for the Reserve Bank of NZ to maintain the OCR at the current rate of 5.50%, mirroring the announcement made by Jerome Powell on 20 September 2023. During that meeting, the Federal Reserve in the United States chose to keep its key interest rate stable for the second time in three recent meetings, signalling a moderation in their fight against inflation due to easing price pressures. However, Fed officials indicated an expectation to implement another rate hike in one of the next two remaining meetings this year. As in the previous meetings, these decisions remain data-dependent. Consumer inflation has reduced from a peak of 9.1% in June 2022 to 3.7%, although it remains above the Fed's 2% target. Policymakers emphasised that they are not close to declaring victory over persistent inflation, a significant concern over the past 40 years. The Fed anticipates keeping rates high into 2024, with another hike expected by the year's end. They estimate only two interest rate cuts for the next year, contrasting with the four cuts predicted earlier. These comments slightly spooked the financial markets, with growth and current defensive assets amplifying the month's downward trend, due to the expected downward pressure on demanded goods, company margins, and the perception that inflation may not yet be under control. A follow-on effect has also been seen in the Volatility Index (VIX.ID), which increased by 34.85% since 22 September. The VIX is a contrarian indicator, with the theory of buying when the VIX is high and selling shares when the VIX is low.

The NZ interest and US rate swaps we monitor (2, 5, and 10-year) steadily increased in September, with New Zealand rates finishing the month at 5.72%, 5.48%, and 5.18% respectively. But what does this mean?
Changes in the two-year mortgage rate depend on how much it costs a bank to borrow money for that period, known as the two-year wholesale borrowing cost, reflected in the two-year swap rate. The swap rate is influenced not only by the current official cash rate but also by expectations of the average cash rate over the next two years. When people anticipate higher inflation and expect tighter monetary policies, they seek more compensation for locking their money in for two years instead of opting for flexible, short-term deposit rates. Short-term deposit rates (like those for 90 days or less) are heavily influenced by the current official cash rate. In anticipation of monetary tightening, swap rates increase before the actual policy change. For example, in 2021, between January and early October, when the cash rate was 0.25%, the one-year fixed mortgage rate rose from 2.29% to 3.19%, and the two-year rate rose from 2.49% to 3.59%. These increases occurred before the cash rate changed. Moreover, increasing interest rates have an inverse effect on bond prices. Therefore, bond investors will witness the dollar value of their current bonds decreasing, especially as new bonds with higher coupon rates come to the market.

Investment News

Sheffield Resources (SFX.asx)

Provided an update on the progress of the Thunderbird Mineral Sands Project in Western Australia. The commissioning of the processing plant is in full swing, aligning with the initial budget of $484 million. Key developments include the mobilisation of the Dry Mining Unit (DMU), commissioning of LNG storage tanks and power stations, and are on-track for ore production by Q4 2023. The first mineral sands product delivery to customers remains set for Q1 2024, showcasing the project's successful advancement. Bruce Griffin, Executive Chair, expressed optimism for achieving production milestones in the coming months. The Due Diligence and Valuation Report by Arrowhead Business and Investments Decisions, an independent research company based in New York, provides great detail and is worth a look.
Current Share Price: AU$0.46.

The Warehouse (WHS.nz)

Net Profit after tax (NAPT) for FY23 was down 66.6% to $29.8m compared to $89.3m for FY22. Group sales (The Warehouse, Warehouse Stationery, Noel Leeming, Torpedo 7, and The Market.com) increased 3.2% to $3.4b, with The Warehouse being the main contributor, up 9.6% at $1.9b. Groceries make up 18.7% of the total sales, reflecting how consumers' choices are being directed to essential goods, reducing their spending towards discretionary goods (Noel Leeming and Torpedo 7) as this high interest rate environment affects retail spending. Higher interest rates are also impacting the company, with gross margins reducing to 33.4% from 35.3%. Net debt has reduced from $83.4m (half year) to FY end of $48.1m, with available liquidity of $421.9m. The Warehouse Group has announced a gross final dividend of 11.11 cents, payable on 1 December 2023.
Current Share Price: $1.78, **Consensus Target Price**: $1.91, **Consensus Forecast Dividend Yield**: 10.10%.

Marlin Global (MLN.nz)

Advises that the final exercise date for the Marlin Global Limited warrants (“MLNWF”) is Friday, 10 November 2023. Any MLNWF warrants not exercised by that date will lapse and all rights in regard to them will expire. The final day of trading MLNWF will be Wednesday, 8 November 2023. The final exercise price of the Marlin Warrants is $0.92.

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Company Spotlight – Fisher & Paykel (FPH.nz)

Fisher & Paykel Healthcare is a global leader in medical devices and systems used in respiratory care, acute care, and the treatment of obstructive sleep apnea. The company follows a consistent growth strategy, continually expanding its range of innovative medical devices to enhance care and outcomes for patients across a growing range of applications. Their products are sold to hospitals and healthcare facilities worldwide through direct sales offices and a network of distributors that cater to hospitals, homecare providers, and other medical device manufacturers.

Fisher & Paykel has two primary revenue streams: Hospital and Homecare. The Hospital revenue comprises 27% hardware and 73% consumables, while Homecare follows a similar composition of 16% hardware and 84% consumables.

During the COVID-19 pandemic, Fisher & Paykel experienced a surge in demand for its products, resulting in record-high revenues and a share price of $37.89 in August 2020. At that time, the company's management adopted a strategy of "supply at all costs." Two years later, as demand for hospital goods decreased, management shifted their focus towards operational efficiency. This change underpins the management's confidence in gross margin improvement, targeting an increase of approximately 200 basis points. In the full year, Hospital product group revenue was $1.02 billion, marking a 15% decrease compared to the previous year and an 18% decrease in constant currency. Hospital hardware sales were down 53% in constant currency compared to the 2022 financial year, which was significantly impacted by global COVID-19 surges. During the 2023 financial year, hardware sales in countries or regions that did not experience COVID-19 surges were tracking somewhat close to pre-pandemic patterns.

As part of global integration, Fisher & Paykel's manufacturing is split between 61% in New Zealand and 39% in Tijuana, Mexico. Additionally, a new manufacturing facility in China is currently being commissioned. This split offers benefits such as time zone overlaps, medical device manufacturing expertise, diversified product supply, proximity to major markets, and relatively stable manufacturing labour costs.

Fisher & Paykel Healthcare Metrics							
	2023A	2024 Forecast	%Change	2025 Forecast	%Change	2026 Forecast	%Change
EPS Normalised	0.43	0.43	-0.24%	0.5605	30.36%	0.6941	23.83%
Cash EPS	0.6006	0.6136	2.17%	0.7437	21.20%	0.8714	17.16%
Cash Flow / Share	0.4095	0.6502	58.78%	0.7527	15.76%	0.87	15.59%
Dividend Per Share (DPS)	0.405	0.3861	-4.66%	0.3968	2.76%	0.453	14.17%
Price per Earnings (PE) Ratio	50.186	50.1872	0.00%	38.4993	-23.29%	31.0893	-19.25%
Net Asset Value / Share	2.8794	2.98	3.49%	3.14	5.37%	3.33	6.05%
Book Value / Share	3.0272	3.0812	1.79%	3.2633	5.9086	3.5496	8.77%
Gross Dividend yield (%)	2.60	2.50	-3.85%	2.6	4.00%	3.0	15.38%
Revenue	$ 1,581,100,000	$ 1,706,686,180	7.94%	$ 1,908,792,680	11.84%	$ 2,116,004,980	10.86%
EBIT	$ 332,200,000	$ 348,933,130	5.04%	$ 450,447,390	29.09%	$ 549,812,930	22.06%
Net Income (normalized)	$ 250,300,000	$ 252,231,310	0.77%	$ 324,174,240	28.52%	$ 397,068,140	22.49%
Net (Debt), Cash	-$ 37,700,000	$ 232,374,210	-716.38%	$ 331,377,050	42.60%	$ 275,644,970	-16.82%
Return on Equity (%)	19.1	14.1246	-26.05%	17.4041	23.22%	19.81	13.82%
Return on Assets (%)	15.2	-10.558	-30.54%	12.4755	18.16%	14.3552	15.07%

Source: IRESS

The forecasted consensus data above forecasts Fisher & Paykel to have increasing revenues, EPS, and dividend yield increasing from FY25 onwards. Fisher & Paykel has a market capitalisation of $9.7 billion, making it the second-largest listed company in New Zealand. With over 50 years of experience as a medical device manufacturer, it operates in a market characterised by high barriers to entry and is estimated to be worth NZ$25 billion and still growing. The company has a consistent track record of doubling revenue (in constant currency terms) every 5 to 6 years and a strong history of increasing dividend payments. Yovich & Co. view this stock as a core investment for a portfolios.

Current Share Price: $21.38, **Consensus Target Price**: $22.41, **Consensus Forecast Dividend Yield**: 2.6%.