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Yovich & Co. Market Update

30th April 2023

As at 28th April	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11927.50	7522.98	3301.26	7914.13	33808.96	12072.46	0.9173	0.6136	5.25%
Week Close	12019.84	7500.95	3323.27	7870.57	34098.16	12226.58	0.9344	0.6171	5.25%
Change	0.77%	-0.29%	0.67%	-0.55%	0.86%	1.28%	1.86%	0.58%	0.00%

The NZ market had a positive result last week, up 0.77%, however it was a mixed bag globally. The US market saw gains, with the S&P500 Index up 0.87%, however the Australian and UK markets both lost ground, down 0.29% and 0.55% respectively. The tech sector led the rise for the US market, with strong earnings being reported in that sector so far in the current reporting season. Fears about the banking sector also seemed to decline. The major indices finished in positive territory for April, with the NZ market up 1.14%, and the US market up 1.46%. The Australian and UK markets were up 1.83% and 3.83% respectively.

Inflation measures coming from the US and Australia during the week signalled slowing inflation. The US personal consumption expenditures increased 0.1% for the month, taking the annual change down from 5.0% to 4.2%. In Australia, the quarterly CPI report was stronger than expected, but the rise of 1.4% for the quarter brings the annual inflation rate down from 7.8% to 7.0%. The market has lowered expectations now of a further rise in the cash rate from the Reserve Bank of Australia.

Both the RBA and the Federal Reserve in the US are due to make their next interest rate decisions this week. While the market in Australia expects no movement, interest rates in the US suggest a rise in the Fed Funds rate of 0.25%. While market interest rates below 2 years increased during the week, rates over 2 years declined, with the 2-year Treasury rate down 11bps to 4.02%, and the 10-year Treasury rate down 7bps to 3.46%. In NZ, the 2-year swap rate increased by 3bps to 5.05%, while the 5-year swap rate was down 2bps to 4.30%.

The NZD appreciated against both the USD and the AUD over the week, up 1.86% against the AUD to 0.9344, and up 0.58% against the USD to 0.6171. The Dow Jones Commodity Index was down by 1.49%, and the price of Brent Crude oil was down a further 2.8% to below US$80 per barrel.

The RBNZ is proposing to ease mortgage LVR restrictions from 1st June, as banks are telling the Reserve Bank that they expect mortgage borrowing to remain subdued over the next six months. There are signs that house prices may be close to bottoming, according to ANZ economists. ANZ has revised its peak-to-trough forecast to 18% from 22%, with current levels down around 16%.

The biggest movers of the week ending 28th April 2023				
Up			**Down**	
Kiwi Property Group	4.55%		Synlait Milk	-24.77%
Meridian Energy	3.41%		The a2 Milk Company	-6.05%
Contact Energy	3.30%		Vista Group International	-5.38%
Vital Healthcare Property Trust	2.64%		Pacific Edge	-4.12%
Serko	2.44%		Scales Corporation	-3.37%

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Market Highlight – Synlait Milk Profit Downgrades

Synlait Milk has provided two consecutive profit downgrades, starting in March, with the most recent announcement on 26th April. The share price of the company has plummeted from $3.50 at the end of January, to $1.61 at the end of last week.

What Do Synlait Milk Do?

Synlait Milk is a Canterbury-based dairy company that produces a range of dairy products, including infant formula, milk powders, and ingredients that are used in the production of infant formula. The a2 Milk Company is a key customer of Synlait, which buys A2 infant formula and other products from Synlait to distribute. The supply arrangement with a2 Milk makes up a significant proportion of Synlait's revenue and gross profit. The a2 Milk Company specialises in dairy products that contain only the A2 protein, with its major products being A2 milk, and infant formula, and these products are sold globally, with a significant market being China.

Other major customers of Synlait are Bright Dairy and New Hope Nutritionals, both Chinese dairy companies. Bright Dairy own roughly 40% of Synlait Milk, and a2 Milk also has a shareholding.

Profit Downgrades

Looking back to FY21, Synlait made its largest financial loss, largely due to a general decrease in demand of dairy products during the Covid-19 lockdown period, especially in China. This flowed through to Synlait as a drop in demand from the a2 Milk Company for infant formula, which came as an unexpected shock to the company. As a result, Synlait made a 2-year plan that included lowering inventory levels to improve working capital and generate positive cash flows. This would enable the company to complete its capital expenditure programme and reduce debt to comfortable levels over a two-year timeframe. The goal was by the end of FY23, to return to similar levels of profitability, operating cash flows, and debt ratios as achieved prior to FY21.

In December 2022, Synlait provided guidance that its half-year profit would be lower than FY22, due to delayed shipments and sales phasing, and increased costs due to supply chain challenges and inflation. However, it maintained its guidance that it will have completed its two-year recovery plan by the end of FY23, albeit citing several risks that could materially impact the guidance.

In March this year, Synlait released its profit guidance early, rather than waiting until its half-year result, because the expected profit was lower than what the market was expecting. The announcement noted that the two-year recovery plan will now take three years. The FY23 NPAT guidance was $15m-$25m. The key drivers of the downgrade were reduced demand for its Advanced Nutrition products, increased costs, supply shortages, and challenges in implementing the new SAP software system.

The latest announcement came on 26th April, with the profit guidance for FY23 being reduced further to ($5m)-$5m. The major reason for the downgrade was further demand reductions in Advanced Nutrition, mostly from one customer (likely a2 Milk), impacting infant formula volumes and base powder production.

Focus for the Company

The share price has tanked this year based on the above announcements, falling 36% during March, and a hefty fall of 27% on 26th April following the latest announcement. The share price has now fallen 54% this year.
Synlait is focussed on diversifying its customers, and reducing its cost base and inventory to strengthen its balance sheet. The Board notes that demand from a new multinational customer will assist in delivering strong growth in Advanced

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Nutrition sales volumes in FY24. The company has been able to have their banking covenants amended for the remainder of FY23, including less onerous interest cover ratios and leverage ratios.

For investors thinking about whether to invest, this should be viewed as a higher risk investment given the uncertainties relating to diversifying its customer base, and reducing costs at a time of high inflation. However, given the fall of the share price, there may be reward in the way of strong capital gains if Synlait can bring their recovery to fruition.

Investment News

Argosy Property (ARG.NZ) – Portfolio Revaluation

Argosy Property has recorded a full-year portfolio revaluation loss of $146.4m, being a 6.4% decrease on book value. Overall capitalisation rates softened by 68bps to an average of 5.84%. The impact of softer cap rates was partially offset by increases in market rents, with the market showing a clear premium attached to green buildings. The CEO said that Argosy's focus on green property assets is showing benefits in tenant demand, and now in relative value. Argosy's portfolio is 10.8% under-rented.
Current Share Price: $1.12, **Consensus Target Price**: $1.22

Fisher & Paykel Healthcare (FPH.NZ) Receives OIO Approval to Acquire Karaka Site

Fisher & Paykel Healthcare has received approval from the Overseas Investment Office (OIO) to proceed with its acquisition of a 105ha site in Karaka, Auckland. The company plans to construct a second NZ campus to complement its existing location at the Highbrook development in East Tamaki. Development of the new campus will occur over 30 to 40 years, with the initial focus being a private plan change to re-zone the land, and commencing earthworks over the next five years.
Current Share Price: $27.68, **Consensus Target Price**: $24.13

Air New Zealand (AIR.NZ) Updates Earnings Guidance for FY23

Air NZ upgraded its earnings guidance for FY23, due to continued strong levels of demand on both the domestic and international networks. Jet fuel prices have also declined below those assumed in the earlier guidance provided in February. Based on the increased demand, and assuming an average jet fuel price of US$95 per barrel, Air NZ now expects earnings before taxation for FY23 to be in the range of $510m-$560m, being an increase from $450m-$530m in February.
Current Share Price: $0.76, **Consensus Target Price**: $0.85