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Yovich & Co. Market Update

12th June 2022

As at 10th June	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11417.34	7472.44	3195.46	7532.95	32899.70	12012.73	0.9028	0.6486	2.00%
Week Close	11136.28	7145.16	3284.83	7317.52	31392.79	11340.02	0.9006	0.6379	2.00%
Change	-2.46%	-4.38%	2.80%	-2.86%	-4.58%	-5.60%	-0.24%	-1.64%	0.00%

It was a tough week for sharemarkets globally, with the NZ market down 2.46% over the week. The US S&P 500 index fell 5.05%, while the Australian market also fell by 4.38%.

Causing the sell-off was a higher than expected inflation report in the US, which moved bond yields higher, and caused a sell-off in the sharemarket. Where the market had forecast annual inflation to May of 8.3%, the result was 8.6%, the highest level since December 1981. The US 10-year Treasury yield increased by 11bps to 3.02%. NZ rates moved higher also, with the 5-year swap rate up 16bps to 4.10%.

The Reserve Bank of Australia has increased its cash rate by 50bps to 0.85%, and maintained that they are willing to do "what is necessary" to tame inflation with "further steps" in the "months ahead”.

The USD DXY (US dollar index) was stronger again, resulting in the NZD/USD moving downwards by 1.64% to 0.6379. Oil continued to climb higher, with the price increasing by 0.39% over the week to US$122 per barrel.

The biggest movers of the week ending 10th June 2022				
Up			Down	
SkyCity	4.74%		Sky TV	-12.50%
Serko	4.72%		Westpac	-11.52%
Fonterra Shareholders’ Fund	3.63%		Pacific Edge	-8.86%

Investment Topic – The P/E Ratio

The P/E ratio stands for the Price-to-Earnings ratio, which is a simple way of valuing a company using its current share price compared to its earnings per share. The ratio tells you what price you are paying for the earnings produced, and is used to compare the share price of one company versus another company in the same industry, or to compare a company against its own historical record.

Earnings Per Share

The ‘E’ part of the ratio is the earnings produced by the company. To be consistent, the price per share needs to be compared with the earnings per share. This is calculated as a company’s net profit divided by the outstanding shares of its common stock.

Adjustments to EPS

The above calculation provides the basic EPS, using the company’s net profit for the given financial year. However, there are some adjustments that companies make in order to provide a fairer representation of earnings.

- Diluted EPS: Companies might have stock options and other convertible securities, which if exercised would increase the number of shares outstanding. Diluted EPS calculates the EPS using the potential increased number of shares outstanding, and therefore provides a lower or equal EPS.
- Normalised EPS: Normalised earnings are profits that have been adjusted to exclude irregular non-recurring expenses or gains, for example an extraordinary gain or loss on a fixed asset being sold, such as a building.

Diluted normalised EPS provides a truer picture of a company's underlying profitability.

Forward P/E Ratio
The above P/E ratio, using previous earnings, is sometimes referred to as the trailing P/E ratio. The alternative is to use the forward P/E ratio, which uses the future estimated earnings of the company. As an example, Ryman Healthcare's trailing P/E ratio is 17.5, with normalised EPS of $0.51, and a current share price of $8.94. The forward P/E ratio however is 16.1, using estimated consensus earnings for FY2023 of $0.555.

Growth versus Income Stocks
Growth companies are characterised by higher than average growth in earnings, with most of the earnings being reinvested in the company to grow, as opposed to being paid out as dividends. Given the higher expected earnings in the future, growth stocks typically have higher P/E ratios, as investors are willing to pay a higher amount for current earnings, with the expectation of growth. This growth in earnings will translate in the future to both growth in dividends, and growth in the share price (if the P/E ratio remains static). Examples in NZ are Ryman Healthcare, which has a target of 15% growth year on year, and Fisher & Paykel Healthcare, whose growth in earnings was covered in last week's market update. Tech companies are usually growth-oriented, with some paying no dividend at all, instead reinvesting profits back into the company for future growth. Tech companies typically have high P/E ratios, as investors have long-term investment horizons for these stocks.

Income stocks on the other hand are characterised by lower than average growth, with the majority of earnings being paid out as dividends, for example utility companies such as the power generators. These companies typically have lower P/E ratios, as investors do not expect aggressive growth in earnings, and are usually investing for the high dividend rate.

Impact of Interest Rates on P/E Ratios
Higher interest rates, as we are currently experiencing, have the impact of making shares less attractive on a relative basis, as share returns are balanced against the cost of money (interest rates) over the medium to long term. Over recent history, as interest have tended downwards, we have seen shares become more attractive, and as a result we have seen P/E ratios across the board increase, called 'P/E expansion'. Now that we have started to see interest rates go back up, we are seeing the reverse, being 'P/E contraction'. This translates to a decrease in share prices across the market.

The overall P/E ratio for the NZ market has decreased from 28 in December to 24 now, however this is still higher than the long-term average of 17.

Investment News

Fonterra (FSF.NZ) Announces Share Buy-back Programme

The co-op has announced it will undertake a buy-back of up to $50m of shares in the Fonterra Shareholders' Market (FSM), commencing 30th June. The co-op considers the prevailing price has undervalued Fonterra shares, which is a key reason for announcing the buy-back. They have also considered the merits of the buy-back against other investment

opportunities in the pipeline. Once purchased, the shares will be cancelled, meaning future earnings are distributed to a lower number of shares.
Current Share Price: $3.14, **Consensus Target Price**: $3.61

Air New Zealand (AIR.NZ) Updates Forecast – Lower Loss

Air NZ has updated their forecast for the current financial year. The previous guidance was for a loss of less than $800m; they now expect the loss to be less than $750m. While the macroeconomic environment continues to be uncertain, travel has recovered, with domestic business travel demand at 90% of pre-Covid level, and strong passenger booking on short haul and international routes.
Current Share Price: $0.595, **Consensus Target Price**: $0.73

Property For Industry (PFI.NZ) Sells 39 Edmundson Street, Napier

PFI has sold their 39 Edmundson Street property in Napier, unconditionally, for a gross sales price of $5.25m, representing a yield of 4.7%. The property was last valued in December 2021 at $4.64m.
Current Share Price: $2.435, **Consensus Target Price**: $2.49