Australia Equity Market Outlook: Q4 2023

Plenty of opportunities in undervalued market despite economic headwinds.

Morningstar Equity Research

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Market Outlook

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Uncertainty and Higher Bond Yields Likely to Shackle Market

Our expected subdued performance for the September quarter 2023 played out, with the S&P/ASX 200 benchmark slipping slightly, with an intraday low point of 6,958 on Sept. 22 (a 3.4% decline from June 30) and the total return S&P/ASX 200 Accumulation Index easing marginally.

The 2023 reporting season came and went, with most meaningful share price movements determined by guidance commentary rather than results. Significant, but not unexpected falls in reported profits of mining companies, particularly the heavyweight iron ore trio BHP, Rio Tinto, and Fortescue Metals, affected the overall level of corporate earnings. A feature of this reporting season was very high impairments and restructuring costs of over AUD 20 billion, led by consumer discretionary and utilities.

The forward guidance was mixed but with a cautious and subdued bias overall. Further updates on earnings can be expected at annual general meetings through late October and November.

Three major banks, ANZ Group, National Australia Bank, and Westpac will report results for the year ended Sept. 30 and will also determine the near-term direction of the financial services sector, which represents almost 26% of the S&P/ASX 200 index. The spotlight will be on expense growth with wage inflation key. Bank impairment charges should remain benign, and provisions are adequate.

Ultralow Bond Yields were Abnormal and are Unlikely to Return

Australian Government 10-year bond yields.

Source: Reserve Bank of Australia. Data as of Sept. 25, 2023.

Uncertainty and Higher Bond Yields Likely to Shackle Market

Basic materials, which represent 24% of the S&P/ASX 200 index, will be influenced by the iron ore price, exclusively reliant on Chinese demand and the ongoing stimulus programs to support its ailing real estate sector and to reignite household spending.

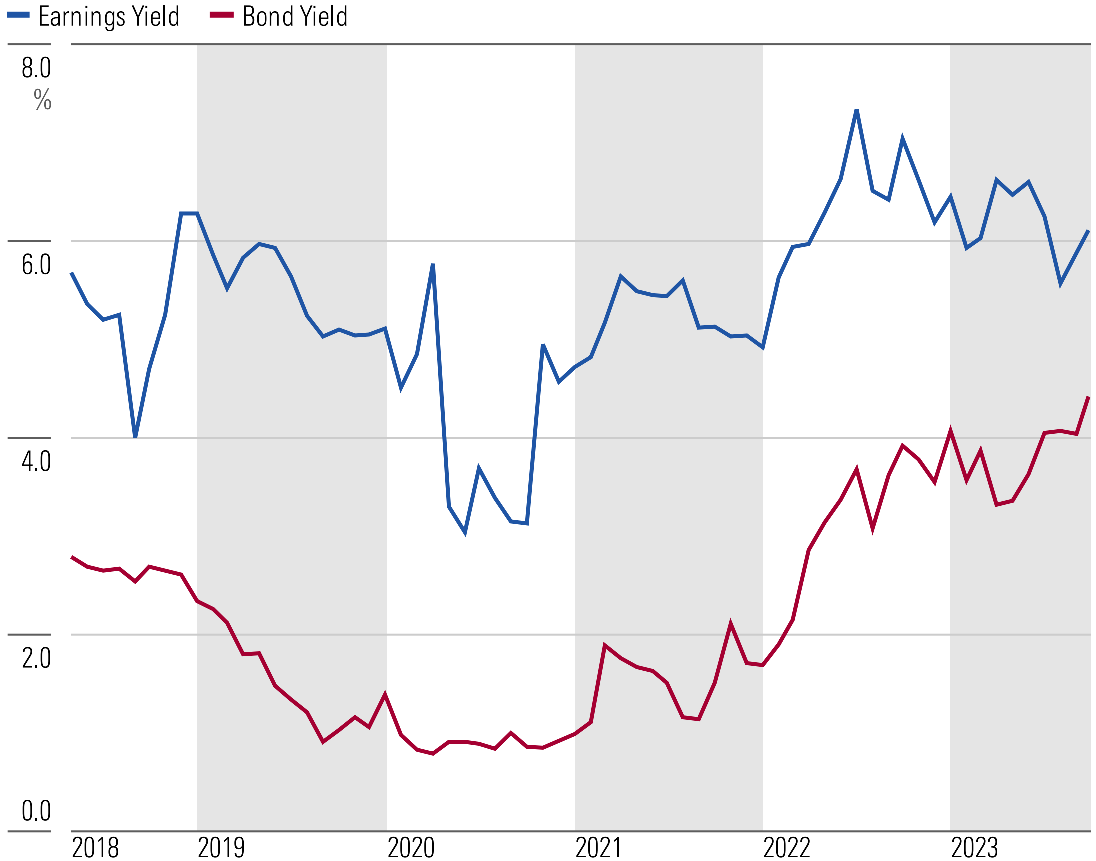
The outlook for fiscal 2024 is for moderating growth in corporate profitability with higher interest rates and operating costs putting pressure on margins. Those exposed to discretionary spending will continue to see a deterioration in revenue while consumer staples should generally ride out the storm, though margins will likely contract with sales volumes easing and competitive forces increasing.

Key economic data including inflation, labor force, and retail sales will influence bond yields. Higher yields will put pressure on equity valuations that are yet to fully adjust to a return to a more normal yield environment. The timing of cuts to the official cash rate are generally seen as a second-half 2024 event. Banks are cutting fixed loan rates but that will not influence the Reserve Bank of Australia.

We expect the market to remain under pressure and trade in a relatively narrow band between 6,800 and 7,200 through the December quarter. Any weakness in offshore mega tech stocks is unlikely to have a meaningful impact, while the progress of further stimulus by Chinese authorities will be of far greater importance. A turning point is likely if bad economic news forces the central bank to start cutting rates.

Rising Bond Yields a Headwind for Stock Prices Given an Already Slim Yield Spread

Forecast earnings yield for ANZ stocks Morningstar covers, Aust Govt 10-yr bond yield.



Source: Reserve Bank of Australia, Morningstar. Data as of Sept. 25, 2023.

Economic Outlook

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More Unsettled Weather Ahead

Australia's ebbing economic tide will continue through the December quarter, easing in intensity during the March quarter. It may not turn up before the June quarter of 2024.

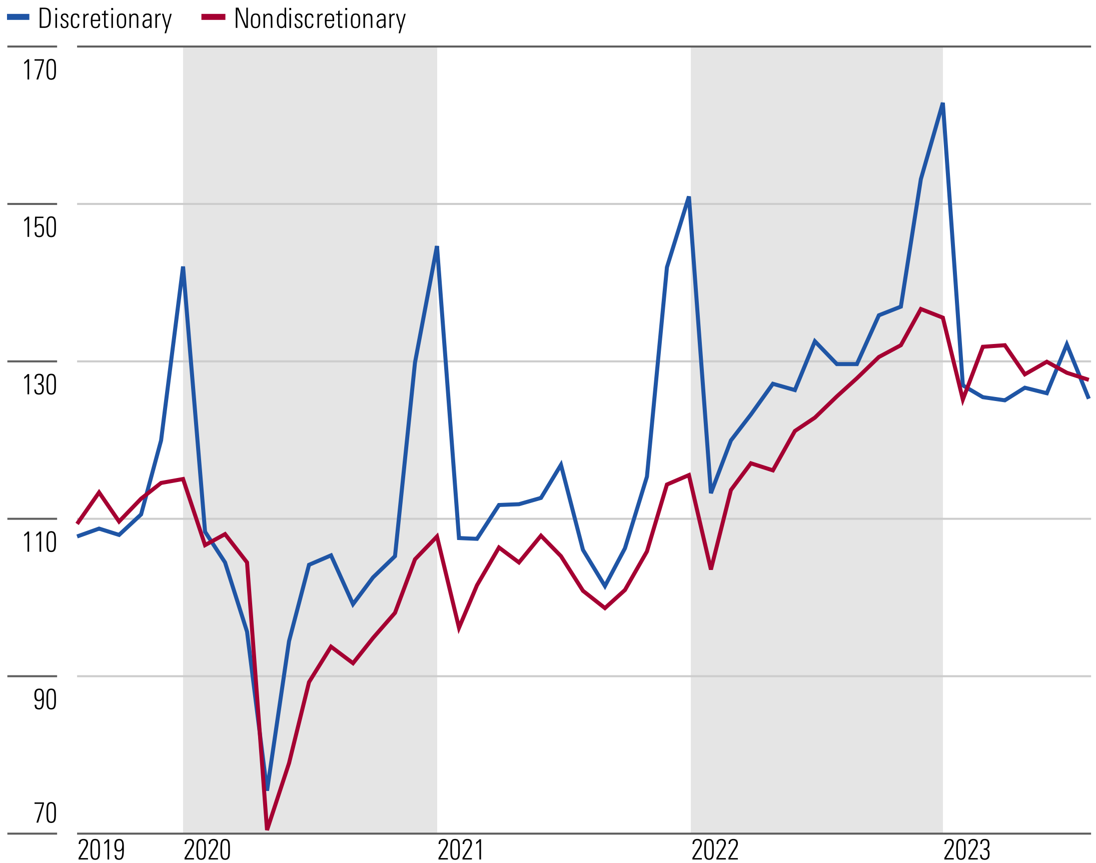
Annual gross domestic product growth eased to 2.10% in the June quarter, but as economic activity slows further in the second half, GDP growth for full-year 2023 is likely to be closer to 1.00%. Per-capita GDP has already chalked up consecutive quarters of contraction in both the March and June quarters. The RBA's current forecasts for GDP growth are 1.00% in 2023 and 1.75% in 2024. This compares with long-term annual GDP growth of 3.37% between 1960 and 2023.

Household consumption, the main driver of economic growth, is being affected by an unpleasant mix of high mortgage rates, elevated cost-of-living expenses, and sticky core inflation, which are collectively driving a contraction in real disposable income. These pressures will continue into the December quarter and beyond, stunting economic growth probably through the June quarter of 2024. Growth in household consumption is expected to remain weak through March as discretionary spending continues to fall.

While inflation has eased since peaking in December 2022, services inflation remains sticky and accelerated in the June quarter to an annual rate of 6.3%, the highest since the introduction of the GST in 2001. The September quarter results, to be released on Oct. 25, will be critical to the RBA's decision at the Nov. 7 meeting. A further rate increase is more likely than not.

Household Consumption Has Stalled

Household spending indexes, current price.



Source: Australian Bureau of Statistics, Monthly Household Spending Indicator. Data as of July 31, 2023.

More Unsettled Weather Ahead

The headline Consumer Price Index inflation rate will be driven by the 25% plus surge in global oil prices since June 30, driving automotive fuel prices to record levels. The pervasive nature of rising fuel prices throughout the economy cannot be underestimated and while stripped from core and trimmed mean calculations, they increase the call on household disposable income, a particular concern for the heavily indebted.

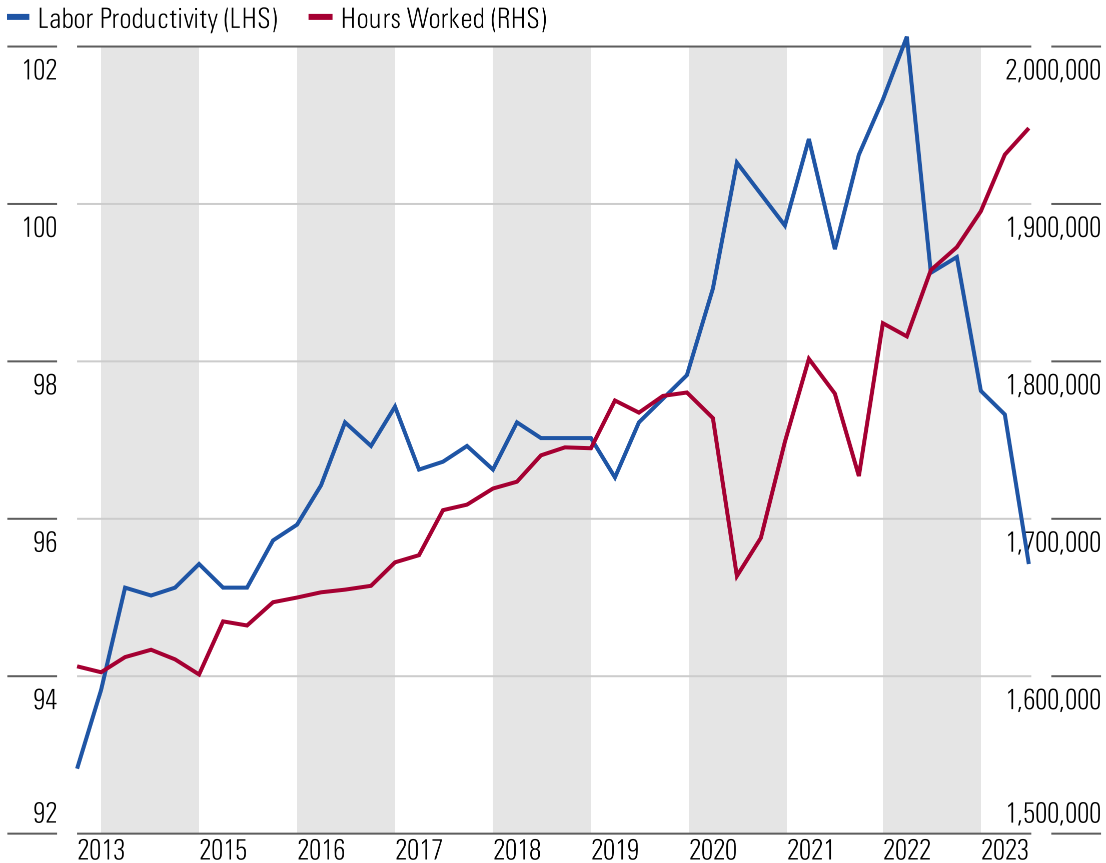
The timing of rate cuts has been pushed out as the higher-for-longer scenario gathers momentum, mostly from offshore. The RBA needs to have more certainty around inflation and is unlikely to change direction unless the economic picture deteriorates meaningfully.

The Wage Price Index rose 0.8% in the June quarter taking the annual rate to 3.6% (private sector 3.7% and public sector 3.1%). Increases in wage awards by the Fair Work Commission, which kicked in on July 1, are currently working their way through the economy adding to corporate operating costs. With labor productivity continuing to decline, there is additional upward pressure on real wages, underpinning cost-push inflationary pressures. This remains at the forefront of RBA thinking when considering all the implications for monetary policy.

The labor market conditions are also expected to soften with the unemployment rate moving closer to 4% by year-end. Private sector investment is also expected to weaken.

Declining Labor Productivity Underpins Inflationary Pressures

Nonfarm labor productivity per hour index and hours worked per month.



Source: Reserve Bank of Australia. Data as of June 30, 2023.

Valuation Overview and Top Picks

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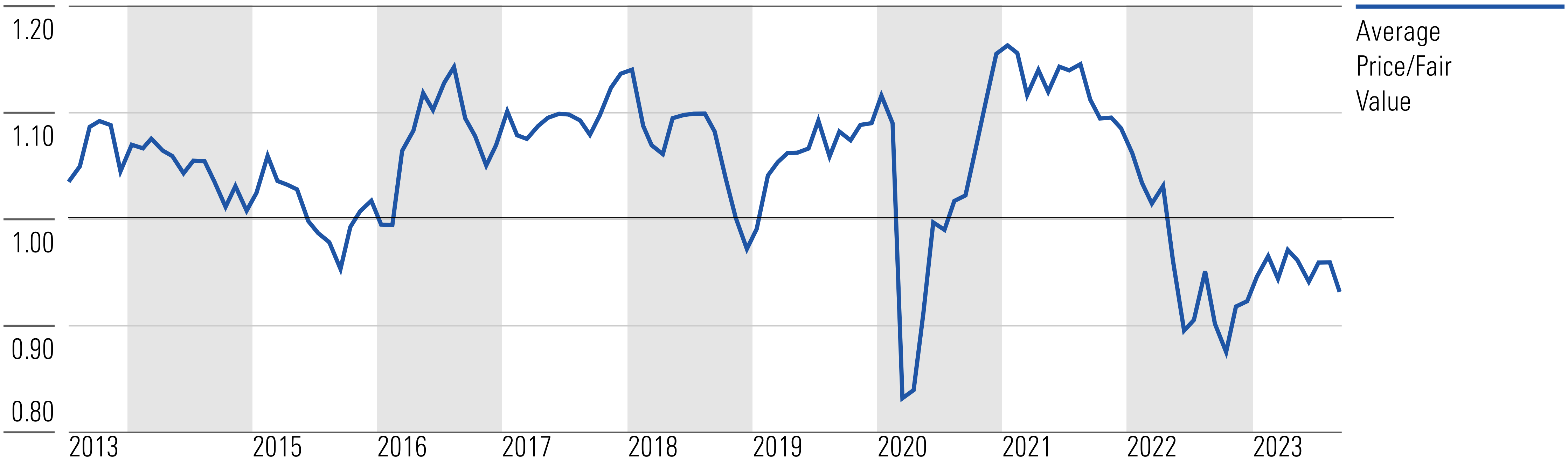
VALUATION OVERVIEW

Market Trades at a Discount

Stock markets trended lower through the September quarter. As of Sept. 22, 2023, our Australia and New Zealand coverage trades at a 9% discount to fair value on average, compared with a 15% discount at the September 2020 low and an average 5% premium over the past 10 years.

Stocks Undervalued on Average

Morningstar Australia and New Zealand coverage: monthly average price/fair value estimate.



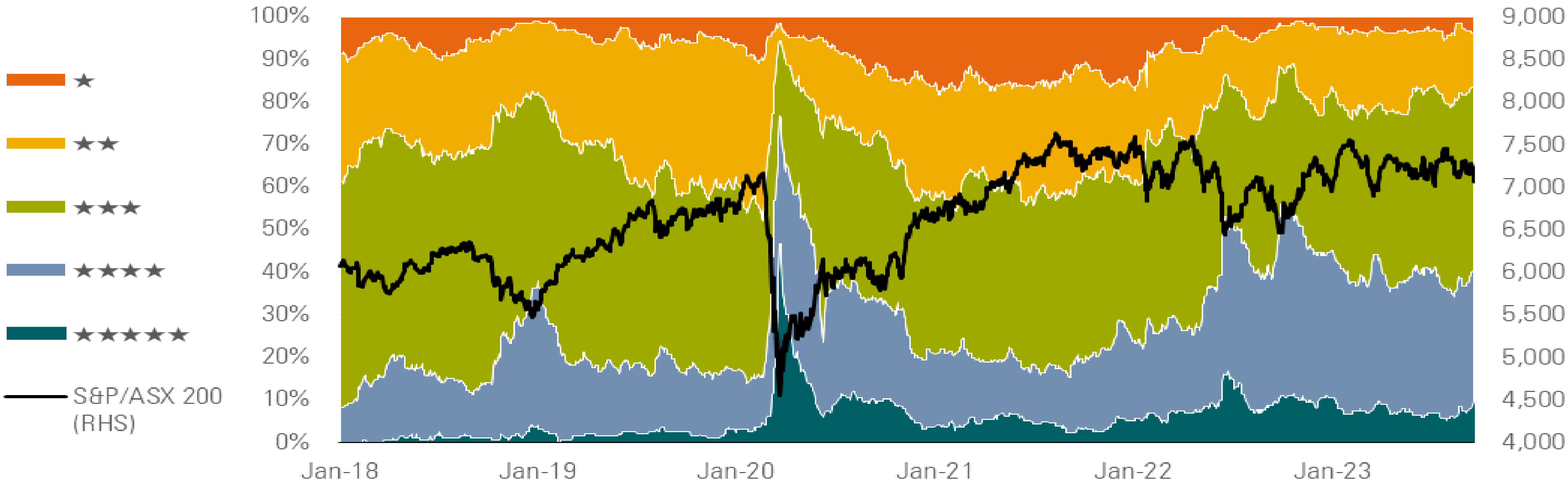
Source: Morningstar. Data as of Sept. 22, 2023.

4- and 5-Star Ratings Abound

Forty-three percent of Australian and New Zealand stocks under coverage are either 4- or 5-star-rated, comparing favorably with the trailing 10-year average of 22%. High-quality stocks are in strong demand, but we still see plenty of opportunities. A third of moat stocks and close to half of no-moat stocks are 4- or 5-star-rated.

Market Uncertainty Caused a Significant Increase in the Number of Undervalued Companies Since 2021

Star rating distribution over time (Australian-listed firms only).



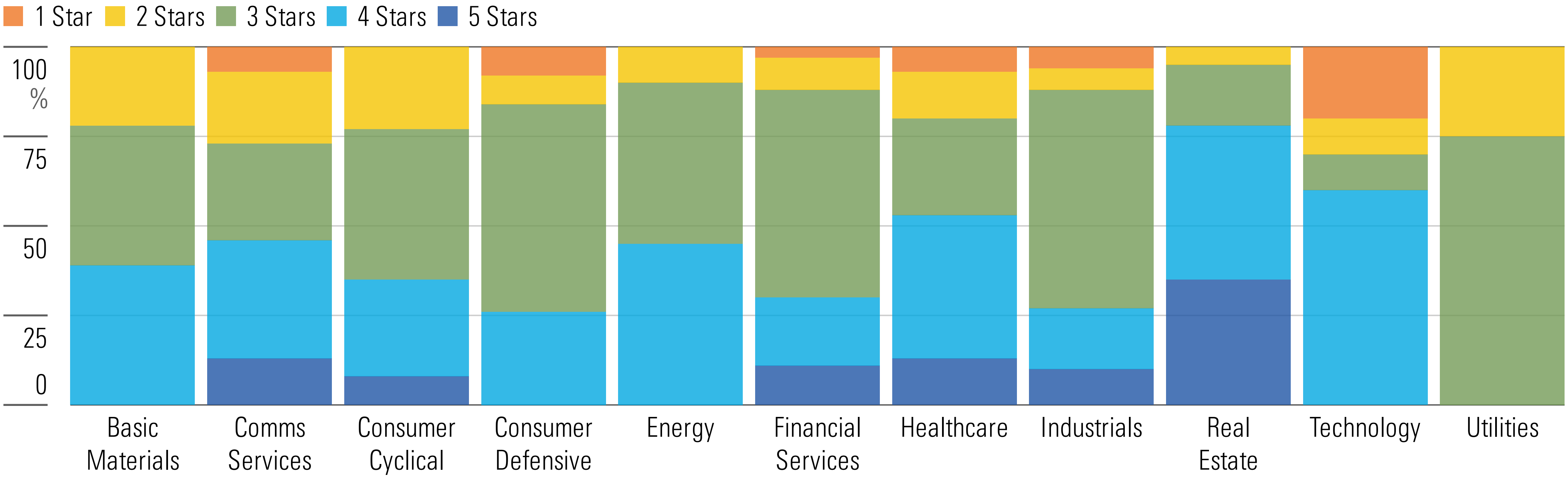
Source: Morningstar. Data as of Sept. 22, 2023.

Positive Ratings in Many Sectors

The real estate sector is significantly undervalued after a selloff in September triggered by fears of higher bond yields depressing distribution potential and hurting credit metrics. Further downside is possible, particularly for highly geared REITs, but we see plenty of opportunities for investment in high-quality names with more favorable outlooks. We also see opportunities across technology, healthcare, energy, and communications.

Plenty of Positive Ratings in Most Sectors

Star rating distribution by sector.



Source: Morningstar. Data as of Sept. 22, 2023.

Top Picks in Each Sector

Company and Sector	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)
Basic Materials							
Newcrest Mining (NCM)	★★★★	AUD 33.00	AUD 26.83	Medium	None	0.81	AUD 23.5
South32 (S32)	★★★★	AUD 4.10	AUD 3.35	High	None	0.82	AUD 15.4
Nufarm (NUF)	★★★★	AUD 7.70	AUD 4.75	High	None	0.60	AUD 1.8
Communication Services							
TPG Telecom (TPG)	★★★★	AUD 7.40	AUD 5.51	Medium	Narrow	0.74	AUD 10.4
Nine Entertainment Company (NEC)	★★★★	AUD 2.80	AUD 2.05	High	None	0.73	AUD 3.3
Southern Cross Media Group (SXL)	★★★★★	AUD 1.70	AUD 0.73	High	None	0.44	AUD 0.2
Consumer Cyclical							
Kogan.com (KGN)	★★★★	AUD 10.70	AUD 5.08	Very High	None	0.48	AUD 0.5
SKYCITY Entertainment Group (SKC)	★★★★★	AUD 3.20	AUD 1.78	High	Narrow	0.54	AUD 1.4
Domino's Pizza Enterprises (DMP)	★★★★	AUD 68.00	AUD 53.28	High	Narrow	0.78	AUD 4.7
Consumer Defensive							
Bega Cheese (BGA)	★★★★	AUD 4.00	AUD 2.71	Medium	None	0.68	AUD 0.9
Endeavour Group (EDV)	★★★★	AUD 6.10	AUD 5.26	Low	Wide	0.85	AUD 9.7
The a2 Milk Company (A2M)	★★★★	AUD 7.20	AUD 4.31	High	Narrow	0.59	AUD 3.2

Source: Morningstar. Data as of Sept. 22, 2023.

Top Picks in Each Sector

Company and Sector	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)
Energy							
Beach Energy (BPT)	★★★★	AUD 2.50	AUD 1.63	High	None	0.65	AUD 3.8
Santos (STO)	★★★★	AUD 12.30	AUD 7.64	High	None	0.62	AUD 25.3
Whitehaven Coal (WHC)	★★★★	AUD 9.80	AUD 6.75	Very High	None	0.67	AUD 5.5
Financials							
ANZ Group Holdings (ANZ)	★★★★	AUD 31.00	AUD 25.03	Medium	Wide	0.81	AUD 77.2
Perpetual (PPT)	★★★★★	AUD 30.50	AUD 21.02	Medium	Narrow	0.68	AUD 2.4
Westpac Banking (WBC)	★★★★	AUD 28.00	AUD 21.14	Medium	Wide	0.75	AUD 76.4
Healthcare							
Ansell (ANN)	★★★★	AUD 30.00	AUD 22.49	Medium	Narrow	0.75	AUD 2.9
ResMed (RMD)	★★★★★	AUD 39.00	AUD 21.60	Medium	Narrow	0.56	AUD 33.3
Ramsay Health Care (RHC)	★★★★	AUD 68.00	AUD 52.33	Medium	Narrow	0.76	AUD 11.8
Industrials							
Ventia (Australia) (VNT)	★★★★★	AUD 4.00	AUD 2.77	Medium	None	0.68	AUD 2.3
Aurizon Holdings (AZJ)	★★★★	AUD 4.70	AUD 3.54	High	Narrow	0.76	AUD 6.7
Amcor (AMC)	★★★★	AUD 17.50	AUD 14.25	Low	Narrow	0.82	AUD 21.1

Source: Morningstar. Data as of Sept. 22, 2023.

Top Picks in Each Sector

Company and Sector	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)
Real Estate							
Lendlease (LLC)	★★★★★	AUD 14.45	AUD 7.13	High	None	0.50	AUD 5.1
Dexus (DXS)	★★★★★	AUD 10.80	AUD 7.16	Medium	Narrow	0.66	AUD 8.0
Charter Hall Group (CHC)	★★★★★	AUD 15.90	AUD 9.67	Medium	Narrow	0.61	AUD 4.8
Technology							
WiseTech Global (WTC)	★★★★	AUD 95.00	AUD 66.85	High	Narrow	0.71	AUD 22.5
FINEOS Corporation (FCL)	★★★★	AUD 3.30	AUD 2.11	Very High	Wide	0.62	AUD 0.7
Megaport (MP1)	★★★★	AUD 17.00	AUD 10.96	Very High	None	0.65	AUD 1.8
Utilities							
Manawa Energy (MNW-NZ)	★★★★	NZD 6.30	NZD 4.65	Medium	Narrow	0.74	NZD 1.5
AGL Energy (AGL)	★★★	AUD 12.80	AUD 10.71	High	Narrow	0.84	AUD 7.4
APA Group (APA)	★★★	AUD 9.50	AUD 8.42	Medium	Narrow	0.89	AUD 10.8

Source: Morningstar. Data as of Sept. 22, 2023.

Basic Materials

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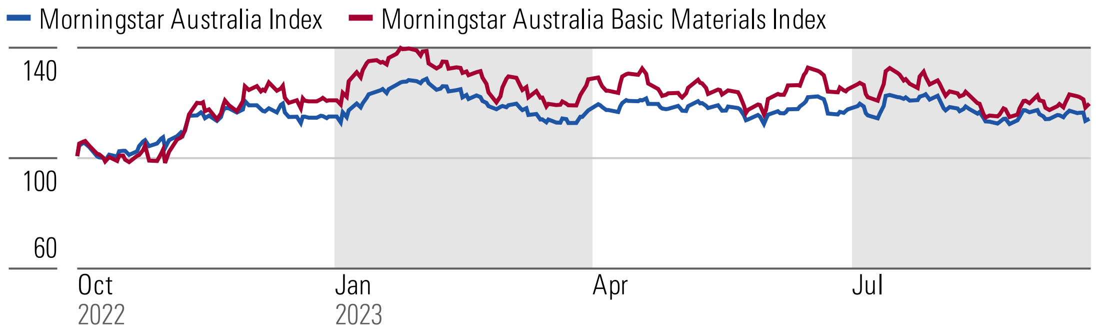
Subdued China Reopening and Miners Modestly Undervalued

Commodity prices and miners' share prices have generally stabilized after falling on concerns about China's subdued reopening and a possible Western recession. Miners' earnings are under pressure from increasing labor, fuel, logistics, and other expenses, though cost inflation looks to be moderating. Longer-term, we think demand from China is likely to soften as consumption takes over as the key driver of economic growth rather than investment, allowing iron ore and copper prices to fall closer to the cost of production.

Our basic materials coverage is now modestly undervalued on average. In our mining coverage, gold miners including Newcrest Mining remain the standout. Higher real interest rates and a rising U.S. dollar have pushed U.S. dollar gold prices down from recent near-record highs. However, the weaker AUD/USD exchange rate has partly supported AUD gold prices. Iron ore miners' share prices were broadly unchanged over the quarter. Despite an apparently weak property market in China, the iron ore price remains elevated and so too the shares.

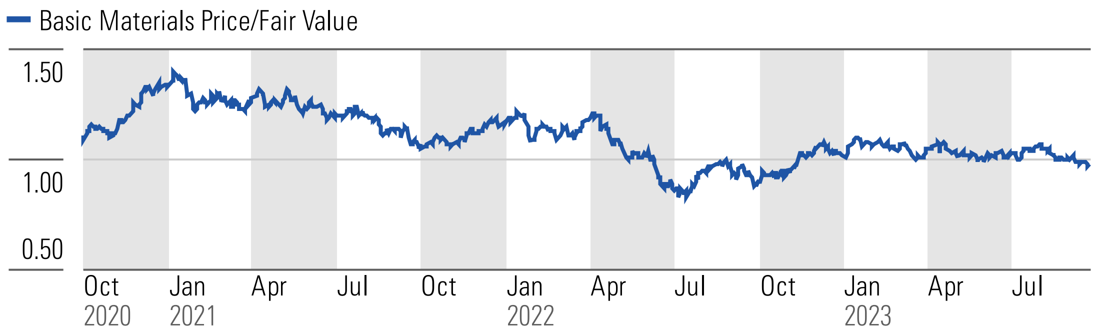
Explosives company Incitec Pivot is considerably cheaper than peer Orica given market misgivings around a demerger/sale of Incitec's fertilizer segment and Jeanne Johns stepping down as CEO. We think this represents opportunity. We see explosives re-contracting into a tighter market and easing labor and supply chain tightness as core drivers of earnings growth. Crop protection specialist Nufarm enjoys attractive fundamentals including a growing population and rising disposable income, also supported by arable land constraints.

Miners Holding Up Despite China Weakness and Recession Risk



Source: Morningstar. Data as of Sept. 22, 2023.

Basic Materials Coverage Is Fairly Valued on Average



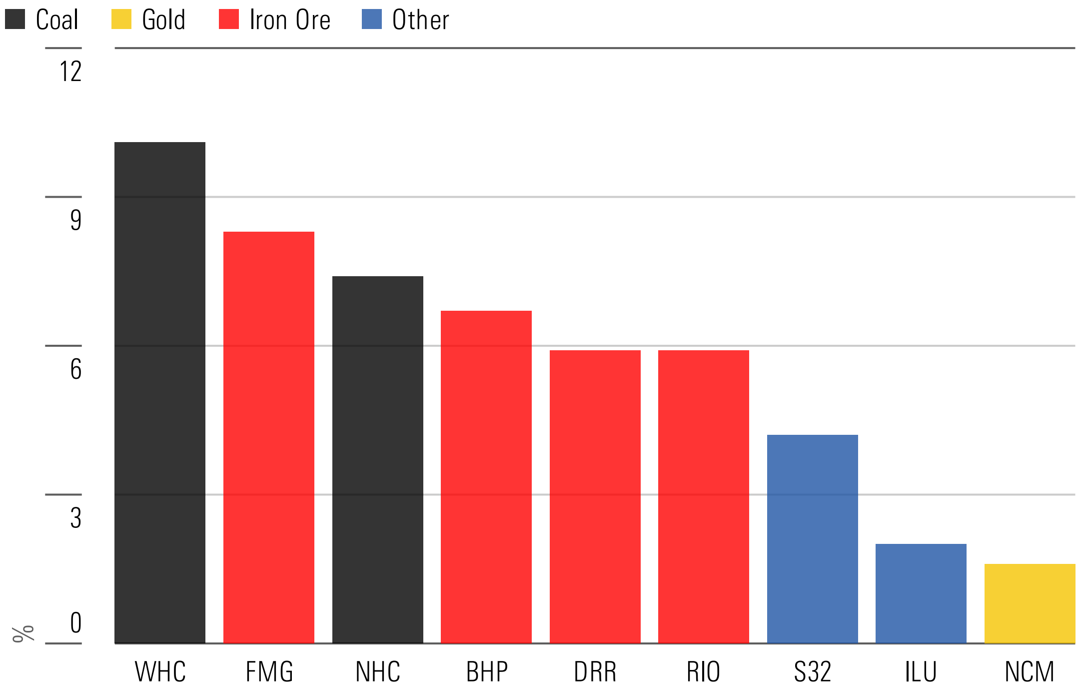
Source: Morningstar. Data as of Sept. 22, 2023.

Subdued China Reopening and Miners Modestly Undervalued

Balance sheets are strong, and dividends and buybacks are a priority. However, high prices incentivize miners to tilt to growth, including merger and acquisition, greenfield exploration, and extensions or expansions of existing mines. As a result, both capital and exploration expenditure are increasing, and we expect dividends to fall.

Forecast Yields Are Still Attractive for Thermal Coal and Iron Ore Miners

Forward dividend yields.

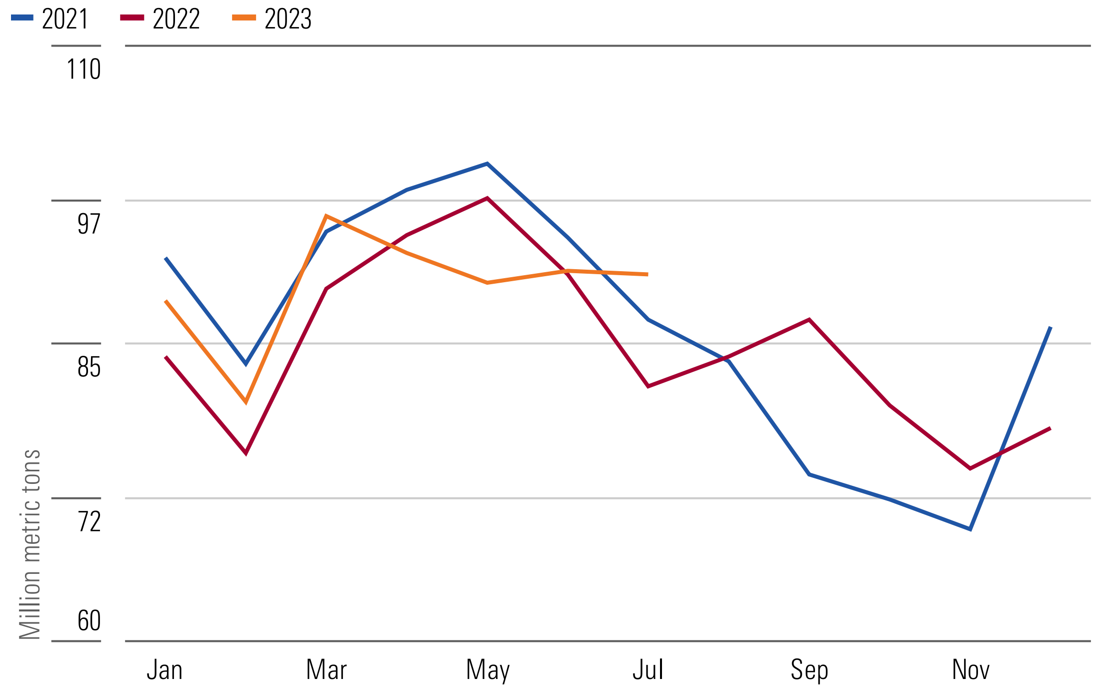


Source: Morningstar. Data as of Sept. 22, 2023. Excludes franking credits.

China steel production is high, supporting iron ore demand and prices. But steelmakers are losing money, symptomatic of weak end-user demand. A government-enforced steel production cap is possible and would be negative for iron ore miners. Underlying steel demand from property and infrastructure development in China is key for iron ore.

China's Steel Production Growing in 2023 Despite Headwinds

Monthly China steel production (million metric tons).



Source: World Steel Association. Data as of July 31, 2023.

Basic Materials

Name/ Ticker Newcrest Mining (NCM)		**Rating** ★★★★	Newcrest rejected Newmont's two earlier nonbinding indicative offers, but the latter firm's higher offer is reasonable and likely enough to seal a deal, subject to approvals. The combined entity will be the world's largest gold miner with pro forma 2023 production of roughly 8 million ounces of gold from its mines in the Americas, Australia, Papua New Guinea, and Ghana, around double that of Barrick Gold, the world's second-largest gold miner by production. It will also produce roughly 190,000 metric tons of copper and have numerous development projects that we think are valuable and perhaps overlooked. With Newcrest shareholders set to inherit shares in the combined group and Newmont's shares having sold off with lower gold prices, we think there is still value in Newcrest. Newmont's sales were weak in the first half of 2023, but we think they will recover over the remainder of the year, helping lower unit cash costs and improve margins.
Price AUD 26.83	**Fair Value** AUD 33.00	**Uncertainty** Medium	
Market Cap (bil) AUD 24.0	**Economic Moat** None	**Capital Allocation** Exemplary	
Name/ Ticker Nufarm (NUF)		**Rating** ★★★★	Australian agricultural innovator Nufarm maintains fiscal 2023 guidance for modest underlying earnings growth assuming normal seasonal conditions. Nufarm's earnings are sharply seasonally skewed to the fiscal first half, though cash flows don't normally present until the second half. Nufarm's modest dividend doesn't particularly appeal, but it is a growth story. We project a five-year EPS CAGR of just over 16% for an attractive prospective P/E of less than 10 by fiscal 2027 based on the current share price. Nufarm's top 22 pipeline crop protection projects have all passed proof of concept and target an addressable market of around USD 6.6 billion. As for seed technologies, Omega-3 canola revenue is growing fast and bioenergy carinata offtake is agreed with BP.
Price AUD 4.75	**Fair Value** AUD 7.70	**Uncertainty** High	
Market Cap (bil) AUD 1.8	**Economic Moat** None	**Capital Allocation** Standard	
Name/ Ticker South32 (S32)		**Rating** ★★★★	No-moat-rated South32's undemanding valuation metrics, diversified portfolio of future-facing commodities and strong balance sheet are attractive. Its strategy is to transition its portfolio to metals such as aluminum, alumina, copper, and zinc that are more likely to benefit from decarbonization and electrification. As such, while elevated metallurgical coal prices saw the division comprise around one-third of fiscal 2023 EBITDA, we forecast metallurgical coal to be less than 10% of EBITDA at the end of our forecast period in fiscal 2028. A 2023 result that was weaker than expectations and concerns over lower near-term commodity prices drive its 18% discount to fair value in our view.
Price AUD 3.35	**Fair Value** AUD 4.10	**Uncertainty** High	
Market Cap (bil) AUD 15.2	**Economic Moat** None	**Capital Allocation** Standard	

Source: Morningstar. Data as of Sept. 22, 2023.

Communication Services

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Defensive Telcos Contrast With Choppy Media Sector

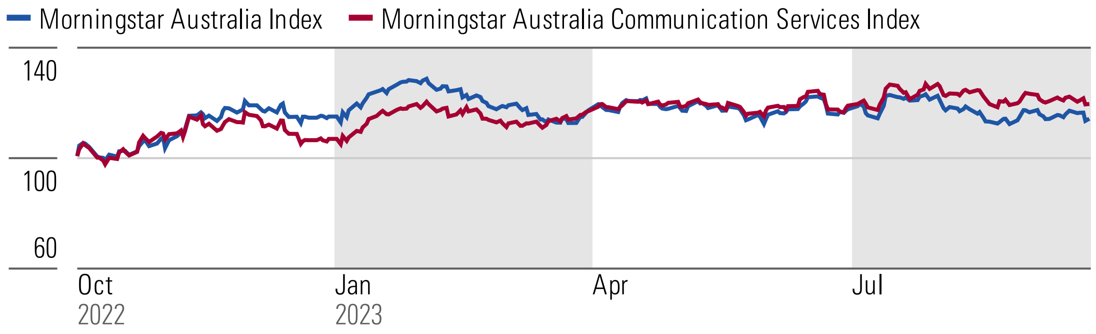
In telecom, earnings dependability is to the fore given an uncertain economic backdrop. Mobile momentum is building as the industry's focus on rational pricing and return on capital continues amid a positive transition to 5G. The drag from the National Broadband Network and legacy/fixed-line businesses is easing. Critically, despite inflationary pressures, costs are under control, driven by digitization and simplification, as legacy operations fade.

These trends underpin the resilient cash flow and dividend outlook for telecom companies, so much so that mutterings of growth aspirations are emerging. Telstra is assessing acquisitions in IT services; Spark is diving into the Kiwi data center space; and Chorus is reorganizing to pursue new opportunities. Corporate interest persists with a private equity tilt at TPG Telecom's enterprise and government fiber assets the latest.

In media, advertising, and entertainment, expenditures are in a cyclical funk. Companies are responding by being more cost-conscious and judicious about the value they place on content. They are insisting on digital/streaming rights when negotiating for programming and assessing talent and staff costs more stringently.

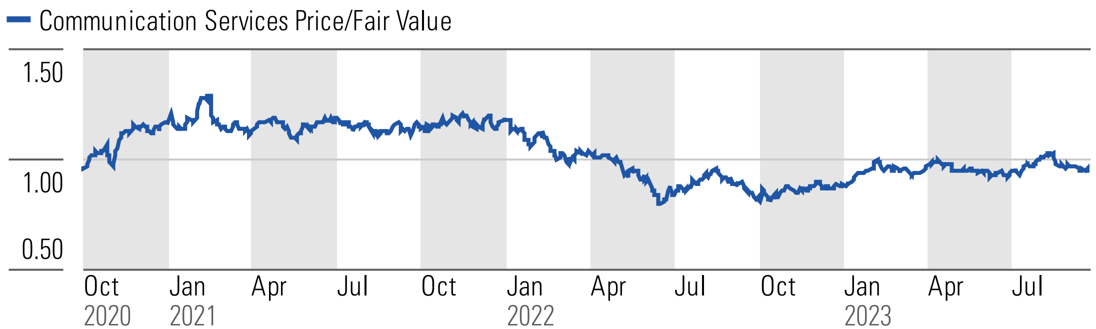
If depressed sentiment and valuation multiples continue, M&A activity could rise in the sector. Balance sheets are solid and there are strategic benefits to consolidation, as media companies seek to leverage content across multiple channels.

Communication Sector Outperformance Reflects Defensive Telecom



Source: Morningstar. Data as of Sept. 22, 2023.

Sector Discount Due to Depressed Media Stocks



Source: Morningstar. Data as of Sept. 22, 2023.

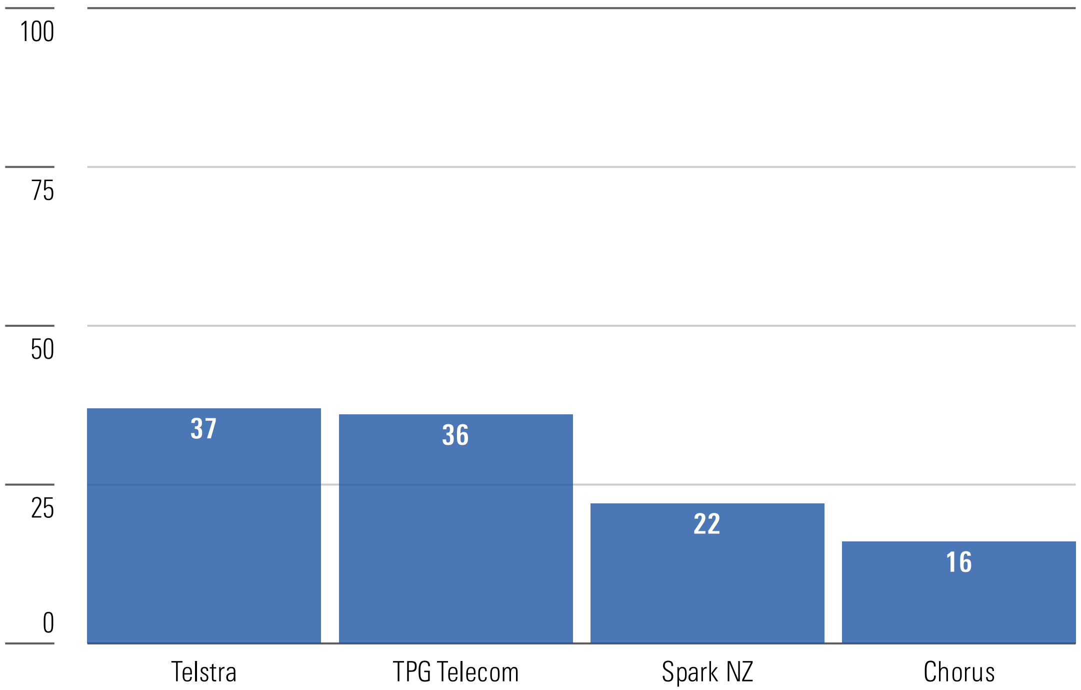
Defensive Telcos Contrast With Choppy Media Sector

Telecom companies are benefiting from the decline of legacy high-maintenance voice and copper-related operations, and low-margin consumer broadband, beholden to uneconomic regulations. The decline helps to reduce costs and improve margins.

Unlike the last downturn in 2020, media company balance sheets are strongly positioned to weather the malaise in advertising and consumer entertainment spending. Cash flows are positive across the board and every group under our coverage is either buying back shares or recently finished doing so.

Legacy Revenue Reducing in Importance for Telecom Companies*

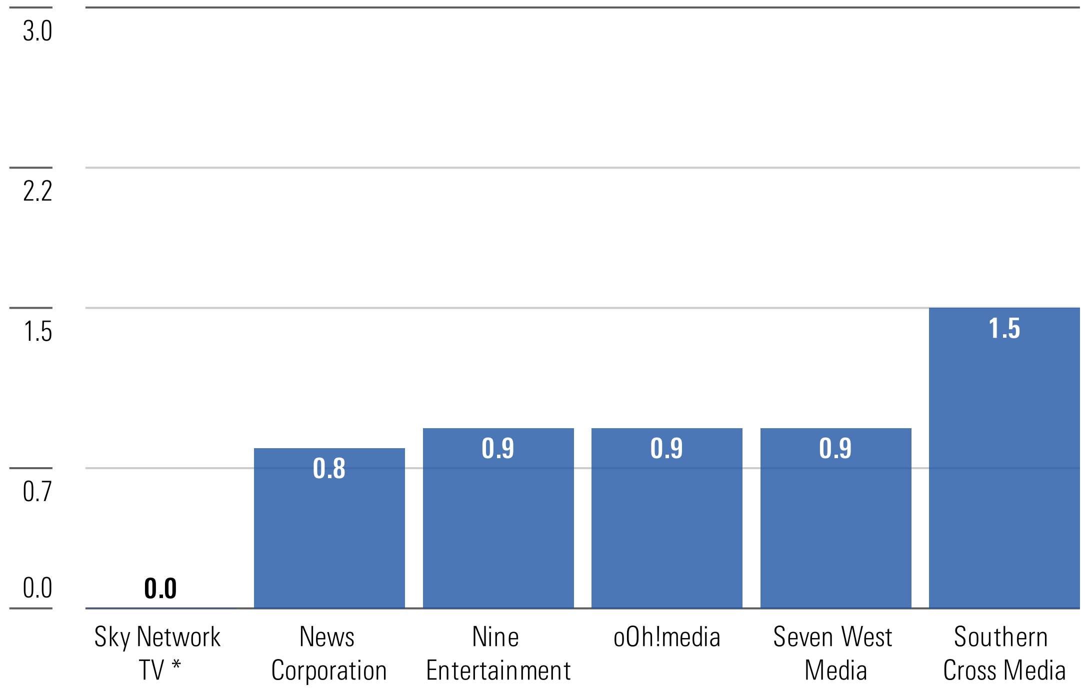
Legacy Revenue as a % of Group Revenue



* Legacy revenue defined as from copper/voice-related operations and consumer fixed-line broadband.
Source: Company reports and Morningstar estimates.

Media Sector Well Positioned for Cyclical Weakness

Net debt/EBITDA



* Net cash position.
Source: Company reports and Morningstar estimates.

Communication Services

Name/ Ticker		Rating	
TPG Telecom (TPG)		★★★★	Shares in narrow-moat TPG Telecom screen as the most attractive under our Australian telecom coverage. We see clear catalysts for earnings recovery on several fronts and forecast an adjusted EBITDA CAGR of 8% over the next three years. Recovery from COVID-19 effects, benefits from a more rational mobile market, and synergies from the Vodafone merger are the key drivers, augmented by growth from fixed wireless and the corporate division. Market concerns linger over execution of the current simplification and cost-cutting program, regulator resistance to its regional strategy via infrastructure-sharing, and the overhang of major shareholders whose holdings are now out of escrow after the Vodafone merger. However, we believe these concerns are more than reflected in the share price, especially given the longer-term tailwinds for the telecom industry as it transitions to 5G.
Price	**Fair Value**	**Uncertainty**	
AUD 5.51	AUD 7.40	Medium	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 10.2	Narrow	Standard	
Name/ Ticker		**Rating**	
Nine Entertainment Company (NEC)		★★★★	No-moat Nine Entertainment spans Australia's advertising and entertainment space. Exposure to the structurally challenged free-to-air television advertising market is complemented by a broadcast streaming offering, a subscription video-on-demand service, and 60% ownership of digital real estate business Domain. The publishing unit has transformed to become a digital-first news provider, decreasing exposure to traditional print media. Business diversification and a solid balance sheet position Nine to weather the current downturn in advertising markets. The ability to flex costs and utilize efficiencies is not at the expense of the competitive position, with Nine's audience, revenue share, and subscriptions growing across all businesses.
Price	**Fair Value**	**Uncertainty**	
AUD 2.05	AUD 2.80	High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 3.3	None	Standard	
Name/ Ticker		**Rating**	
Southern Cross Media Group (SXL)		★★★★★	No-moat-rated Southern Cross Media's near-term earnings trajectory is pedestrian, hampered by the weak advertising market and digital radio investments. However, as the Australian radio market leader, the earnings outlook from fiscal 2024 is positive, as radio advertising normalizes and digital radio losses reduce. Radio accounts for close to 80% of group earnings. Importantly, fundamentals remain solid, with radio's advertising share increasing slightly in metropolitan markets to 27.2% in fiscal 2023 and regional share likely steady. The balance sheet is solid, the company is free cash-generative, trading multiples are depressed, and the yield is attractive.
Price	**Fair Value**	**Uncertainty**	
AUD 0.73	AUD 1.70	High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 0.2	None	Standard	

Source: Morningstar Equity Research. Data as of Sept. 22, 2023.

Consumer Cyclical

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Consumers Are Prioritizing Food and Drink Over Wants

The RBA may be done with rate rises for now, but monetary settings are tighter.

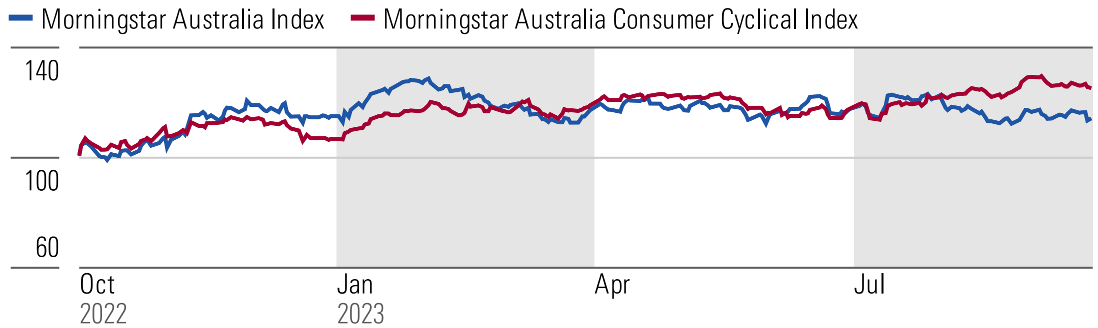
While interest rates stay high and household incomes struggle to keep up with inflation, we expect nonessential goods demand to be soft. With demand soft, discretionary retailers are competing with discounts and promotions. And with wages rising as well, earnings are under pressure.

But for some, cost pressures are easing. Steep declines in international food prices bode well for fast-food restaurants. Quick service restaurant operator Collins Foods and master franchisee Domino's Pizza screen as undervalued.

Within gaming, the recovery from pandemic lows contrasts with elevated regulatory scrutiny. While profitability has recovered strongly at venue-exposed businesses like casinos and Tabcorp, operating restrictions, increased levies, and advertising limitations are set to weigh on earnings in the near term.

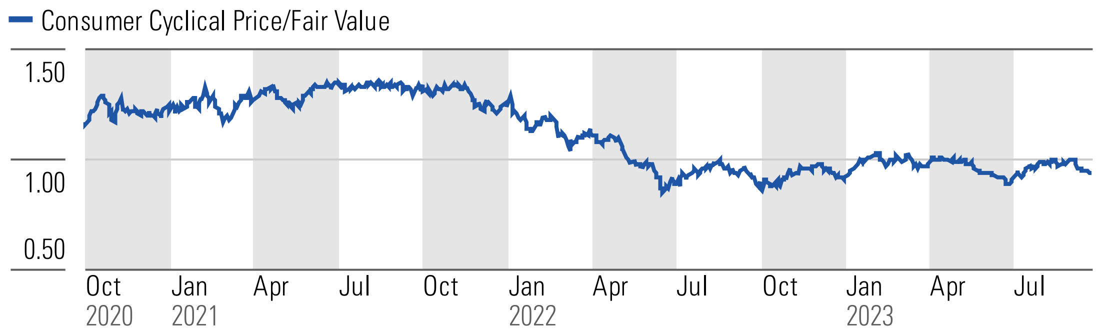
We think Lottery Corp is better placed in this environment, as lottery products are mostly removed from problem gambling and money laundering concerns. Alternatively, casinos like Star and SkyCity are most at risk with operating restrictions, fines, and increased levies weighing. But we think pessimism is overblown, and casino shares trade at substantial discounts to our fair value estimates.

Despite Headwinds, Cyclicals Have Outperformed



Source: Morningstar. Data as of Sept. 22, 2023.

Sector Value Beginning to Emerge on Average



Source: Morningstar. Data as of Sept. 22, 2023.

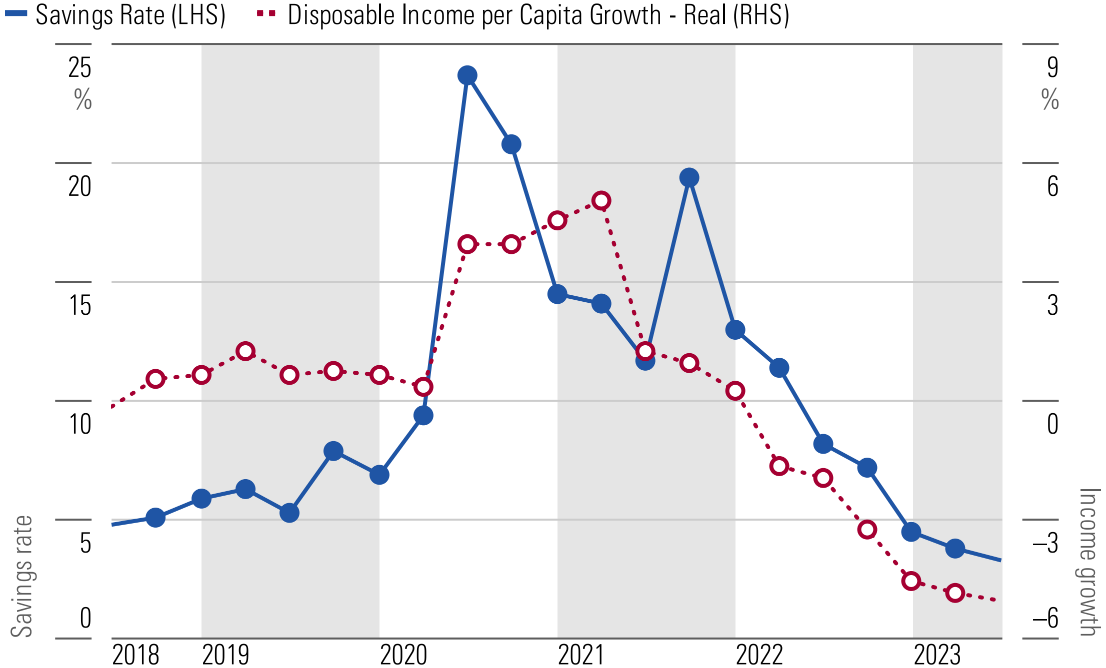
Consumers Are Prioritizing Food and Drink Over Wants

In aggregate, households are saving less. We suspect consumers are spending more of their income, dampening the savings rate, given the excess savings built during the pandemic and from the period of relatively low unemployment.

Younger shoppers are spending less. While important for retailers with significant exposure to the youth shopper, like JB Hi-Fi and Lovisa, consumers aged under 25 years only account for 3% of Australian retail sales.

Real Household Incomes Declining and Savings Rates Low

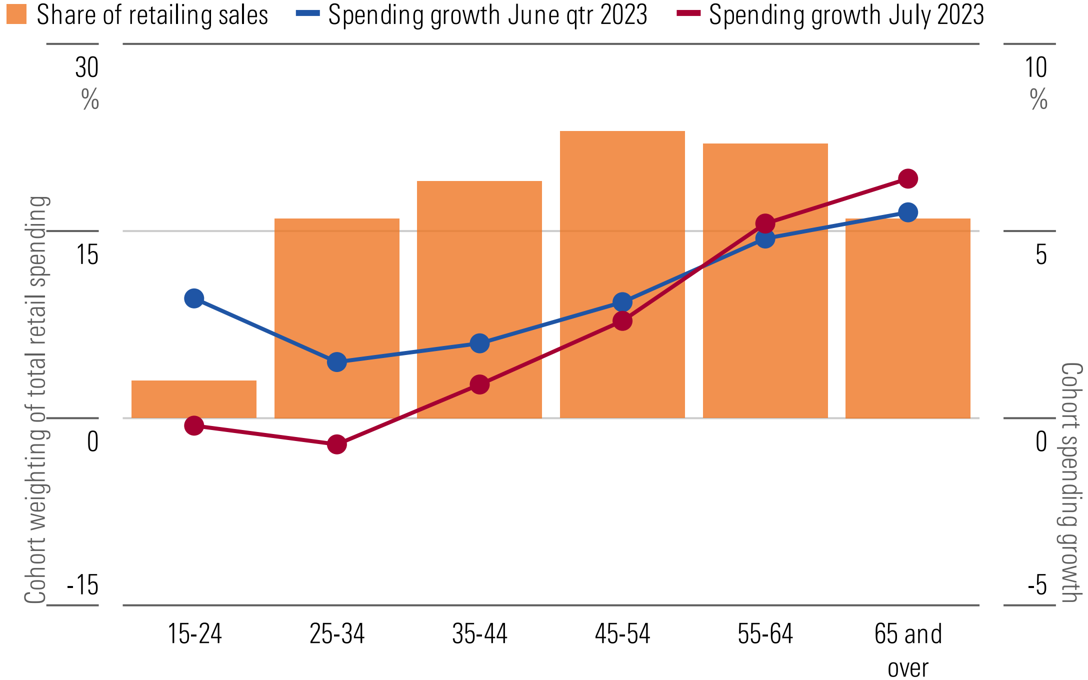
Quarterly savings rate and rolling 12-month disposable income per capita versus PCP.



Source: Australian Bureau of Statistics, Morningstar estimates. Data as of June 30, 2023.

Younger Cohorts Becoming Frugal but Older Shoppers Underpin Retail Sales

Split of total retailing spending by age cohort. Spending on debit/credit cards vs PCP.



Source: Commonwealth Bank of Australia, Australian Bureau of Statistics, Morningstar estimates.

Consumer Cyclical

Name/ Ticker		Rating	
Kogan.com (KGN)		★★★★	We ascribe share price weakness to a material decline in sales and earnings from boom-time levels. The market appears more cautious than us on Kogan's ability to expand margins, or its long-term growth, which we expect to be underpinned by a structural shift to e-commerce. We expect revenue growth to reignite as consumer spending growth moves to online and for margins to expand, as operating expenses normalize. Despite a challenging macroeconomic environment, recent trading is encouraging. For the month of July 2023, adjusted EBITDA increased over 130% on the same month last year. We expect further cost efficiencies to drive margin expansion, with revenue supported by growing Kogan First subscriptions.
Price	**Fair Value**	**Uncertainty**	
AUD 5.08	AUD 10.70	Very High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 0.5	None	Exemplary	

Name/ Ticker		Rating	
SKYCITY Entertainment Group (SKC)		★★★★★	Regulatory headwinds weigh on SkyCity shares. A short-term suspension of the New Zealand casino license is likely, the Adelaide casino license is under review, and there is significant uncertainty around the Austrac civil penalty against SkyCity Adelaide—we expect about NZD 50 million. Regulatory and compliance costs are up sharply, much of which we expect to be permanent with a step-up in headcount. But we think pessimism is overblown. SkyCity's properties are enjoying significant revenue and earnings growth with pandemic restrictions over, capital spending is set to ease as NZD 1 billion in major projects across Auckland and Adelaide complete, and the long-dated and exclusive license in Auckland means it should benefit from the continued recovery in New Zealand tourism.
Price	**Fair Value**	**Uncertainty**	
AUD 1.78	AUD 3.20	High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 1.4	Narrow	Standard	

Name/ Ticker		Rating	
Domino's Pizza Enterprises (DMP)		★★★★	We view Domino's as a high-quality company with a long growth runway. We forecast a 24% earnings CAGR for the next five years, underpinned by its global store rollout. Domino's sales growth has been volatile, and the share price tends to reflect near-term trading conditions rather than longer-term potential. The near-term outlook is uncertain and hinges on a moderation in elevated inflation. However, we believe the market is overly discounting Domino's intact and significant long-term growth potential. We forecast the network to grow to 6,200 stores by fiscal 2033, from some 3,800 as of June 2023, below management's long-term target of 7,100. Hitting management's target would lift our valuation by 11%.
Price	**Fair Value**	**Uncertainty**	
AUD 53.28	AUD 68.00	High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 4.8	Narrow	Exemplary	

Source: Morningstar. Data as of Sept. 22, 2023.

Consumer Defensive

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Supermarket Profits Overshadowed by Rising Wages and Competition

We expect mid-single-digit food sales revenue growth in fiscal 2024 given industry tailwinds, including above-average population growth and a shift to more at-home meal preparation from eating out—a reversal of recent trends. However, the tailwind of grocery price inflation is easing, while wages and other costs for supermarkets are pushing higher—on balance meaning likely slightly lower operating margins.

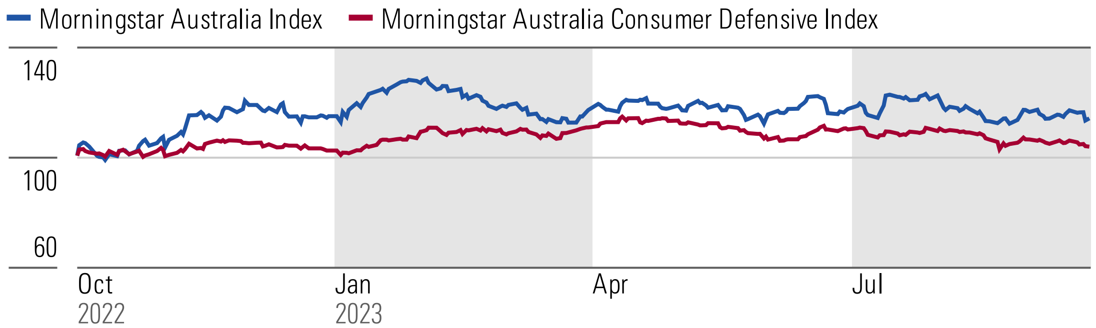
Competition among Australian grocers is likely to intensify. Faced with tighter budgets and rising prices, grocery shoppers have adjusted by switching to private label products at Woolworths and Coles, or by frequenting discounter Aldi. Hard times are also mean more shoplifting—a global, industrywide phenomenon.

We estimate Metcash's IGA network is losing market share to the majors and Aldi. While spending on essentials is defensive, we think Metcash's business model, which prioritizes convenience over value, is exposed to consumers trading down to lower-price competitors.

Rising input costs have weighed on supplier margins. Commensurate price increases prove slow to respond as the balance of power lies with the supermarket giants—the most important customers for Bega, Costa, and Inghams. While labor costs remain elevated at the suppliers, there is some relief ahead in inputs like feed.

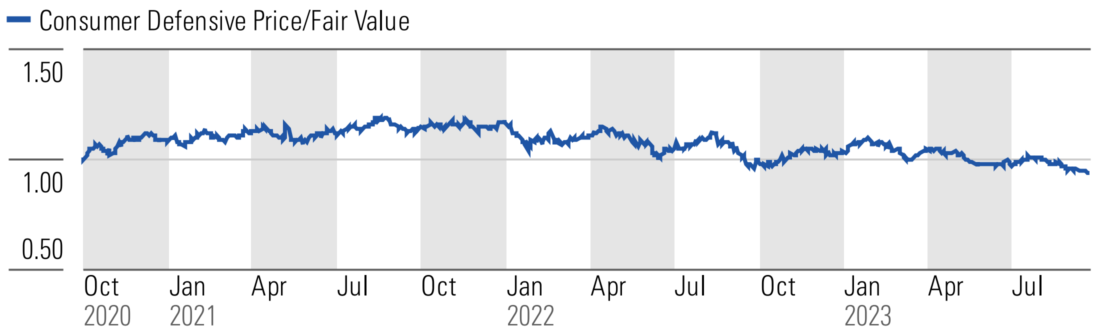
We think a derating of defensive yield stocks is a key near-term risk, given higher interest rates, but Australia's largest liquor retailer Endeavour screens as undervalued.

Defensives Have Underperformed Despite Economic Headwinds



Source: Morningstar. Data as of Sept. 22, 2023.

Defensives Close to Fairly Valued on Average but There Are Some Opportunities



Source: Morningstar. Data as of Sept. 22, 2023.

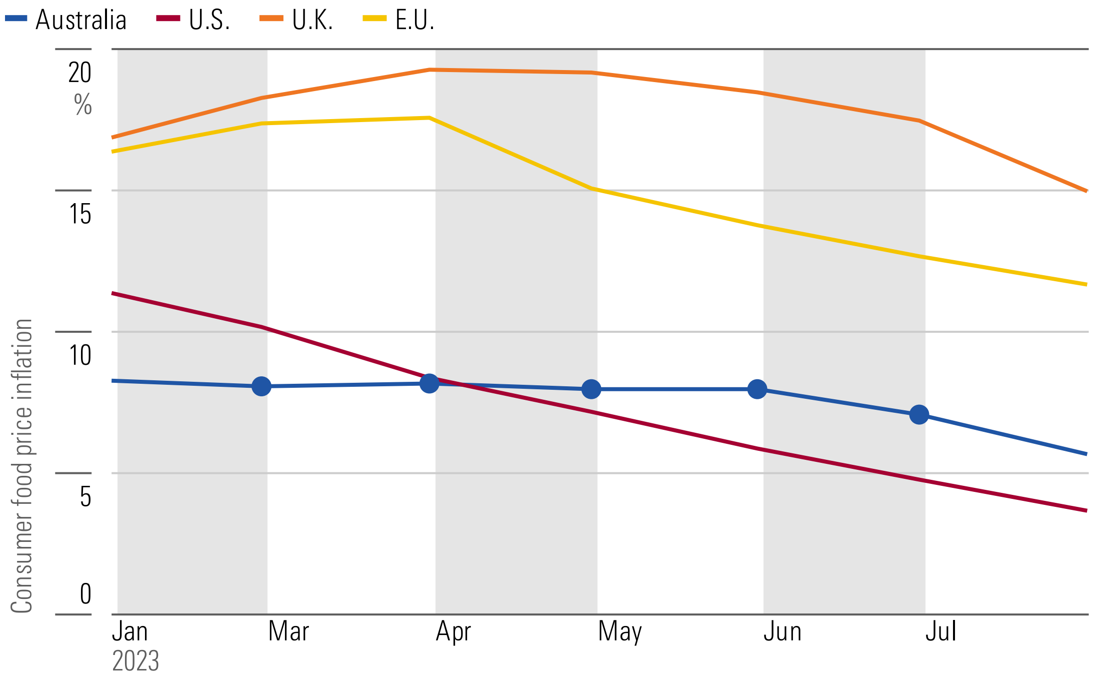
Supermarket Profits Overshadowed by Rising Wages and Competition

Consumers are buckling under cost-of-living-pressures. Nevertheless, Australian food price inflation is moderate compared with some other, less concentrated grocery markets, like the United Kingdom and the EU.

A significant drop in global food commodity prices—such as feed and milk—points to lower input costs for supermarket suppliers and easing supermarket shelf price inflation.

High Food Price Inflation Is a Global Phenomenon

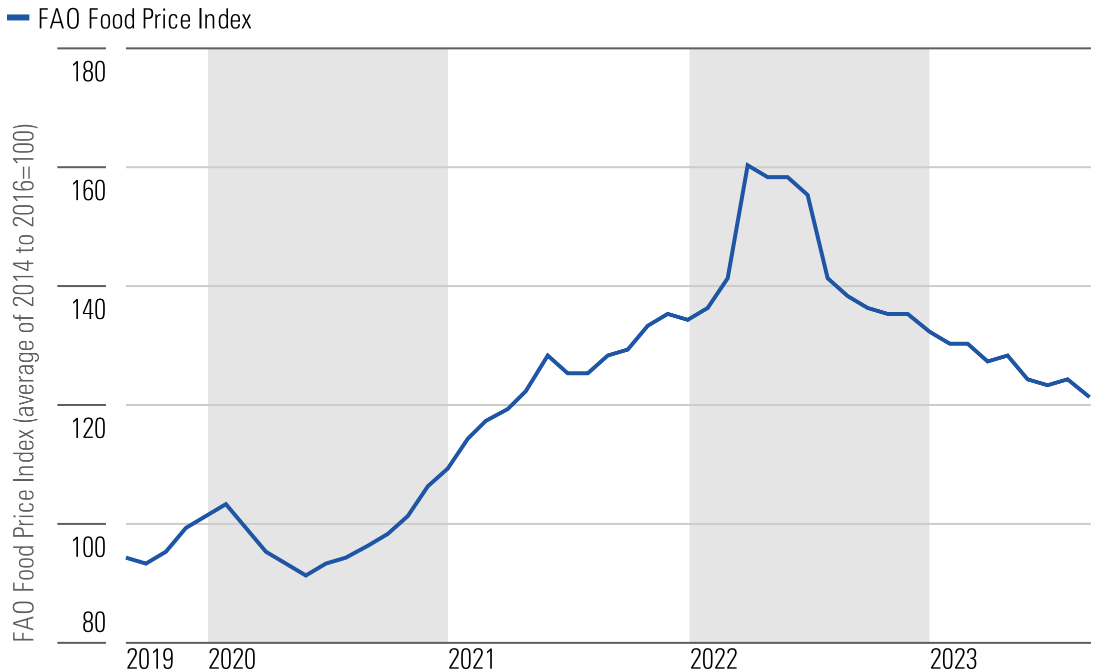
Monthly food and nonalcoholic beverages' CPI versus the PCP.



Source: Australian Bureau of Statistics, U.S. Bureau of Labor Statistics, U.K. Office for National Statistics, European Central Bank. Data as of July 31, 2023.

Falling Food Commodities Imply Moderating Shelf Price Inflation

Index of international food commodity prices.



Source: Food and Agriculture Organization of the United Nations. Data as of July 31, 2023.

Consumer Defensive

Name/ Ticker		Rating
Bega Cheese (BGA)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 2.71	AUD 4.00	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 0.8	None	Standard

Despite a collapse of profitability in Bega's bulk segment, we estimate the branded segment alone can justify Bega's stock price. Bega's consumer brands are proving more resilient than others. Even with cost-of-living pressures and consumers trading down, Bega's brands managed double-digit price increases and grew volumes 5% in fiscal 2023. Bega is increasingly focusing on its branded portfolio, and we expect the bulk business to shrink materially. With an oversupply of milk processing capacity, competition is high for raw milk in Australia, despite falling global prices. The disconnect between the global milk price and Australian farmgate prices has decimated Bega's bulk business margins. But there is upside should the business turn around faster than we expect—either through capacity rationalization, from Bega or competitors, or from an increase in local milk supply or global commodity pricing.

Name/ Ticker		Rating
Endeavour Group (EDV)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 5.26	AUD 6.10	Low
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 9.4	Wide	Exemplary

We think the market’s concerns regarding regulatory risk are overdone. Liquor demand is defensive and likely underpinned by inflation and population growth. The premiumization trend also likely counterbalances the structural decline in per-capita liquor consumption. We forecast gaming restrictions proposed by the Victorian government to weigh on Endeavour’s earnings, and we expect New South Wales to follow suit. But we estimate the combined impact to be moderate with EPS declining by 1% in fiscal 2025. From fiscal 2026, we expect group profit to grow at an average rate of 6% to fiscal 2033.

Name/ Ticker		Rating
The a2 Milk Company (A2M)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 4.31	AUD 7.20	High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 3.1	Narrow	Standard

There is much to like about a2 Milk, notably in China, the key battleground. A2's share of Chinese-language-labeled infant formula continues to grow, supported by a2 Platinum's solid brand health underpinning its narrow moat. Granted, there are hurdles. Births in China are declining and the tailwind of consumers preferring foreign brands no longer blows. Offsetting the falling number of births in China, we anticipate premiumization to continue and a2 Milk to capture market share. We forecast 9% annual revenue gains to fiscal 2028 as channel inventory levels normalize and market share increases; alongside improved sales of higher-margin English-label product and operating leverage from higher revenue.

Source: Morningstar. Data as of Sept. 22, 2023.

Energy

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Energy Commodity Markets Tighten but Opportunities Remain

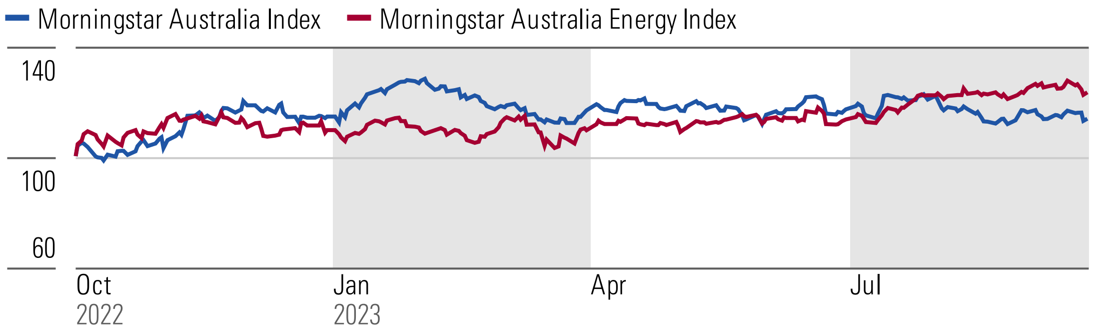
We expected OPEC production cuts to tighten oil markets, driving supply deficits and higher prices in the second half of 2023. And things are tracking to script with Brent crude up more than 20% since June 2023 to just shy of USD 95 per barrel. This is nearly 60% ahead of our midcycle estimate, which kicks in from 2025. It is a very healthy price for Australian exploration and production companies, including for gas producers via Brent-referenced LNG contracts.

LNG prices are high. The implied contract LNG price, which is based on oil prices with a roughly three month-lag, is currently USD 13 per mmBtu, a 55% premium to our midcycle estimate. Asian spot prices are even better at about USD 16 per mmBtu, important for Woodside and Santos which sell up to a third of LNG into spot markets.

Longer-term, we still see secular oil demand falling, but not before the early 2030s in our base case and we expect the rate of decline to be modest given growing jet fuel and petrochemicals demand. We are particularly bullish on natural gas demand to balance renewable energy generation and for peaking power. We think the Australian E&Ps should enjoy a multidecade runway to maintain and grow operations, and to generate robust free cash flows. Much of this is likely to go to shareholders via buybacks and dividends.

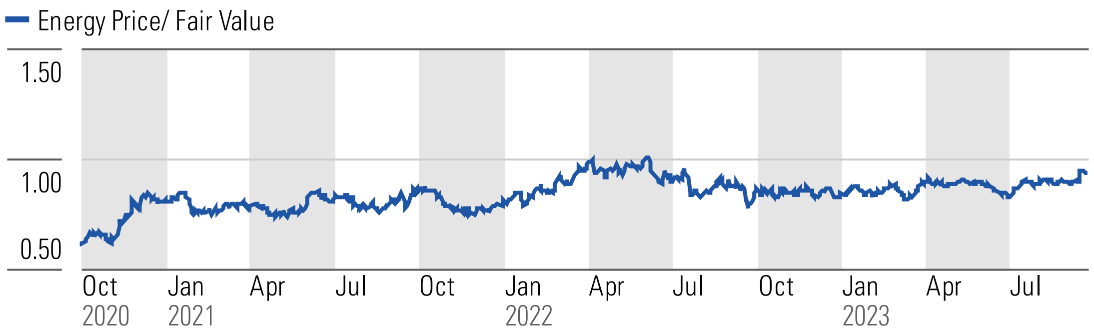
Near-term energy prices are well supported, with Russian and Saudi Arabian production cuts and rising demand from China. Also, Aramco is considering selling a further USD 50 billion in shares to the public, which should galvanize Saudi supplyside discipline in support of pricing.

Opportunities in Energy Despite Recent Outperformance



Source: Morningstar. Data as of Sept. 22, 2023.

Oil and Gas Producers Undervalued



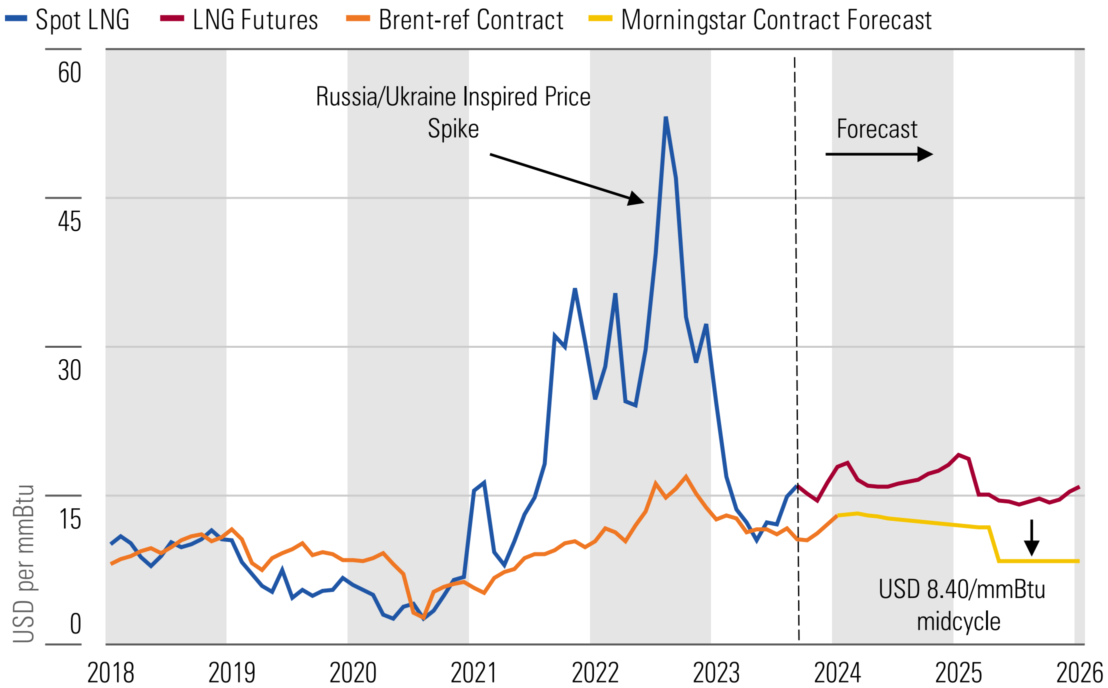
Source: Morningstar. Data as of Sept. 22, 2023.

Energy Commodity Markets Tighten but Opportunities Remain

Spot prices have risen above our midcycle levels of USD 60 per barrel for Brent crude and USD 8.40 per million Btu for Asia liquefied natural gas, with spot LNG futures more bullish than for Brent crude. However, prices remain well below the exceptional 2022 peak.

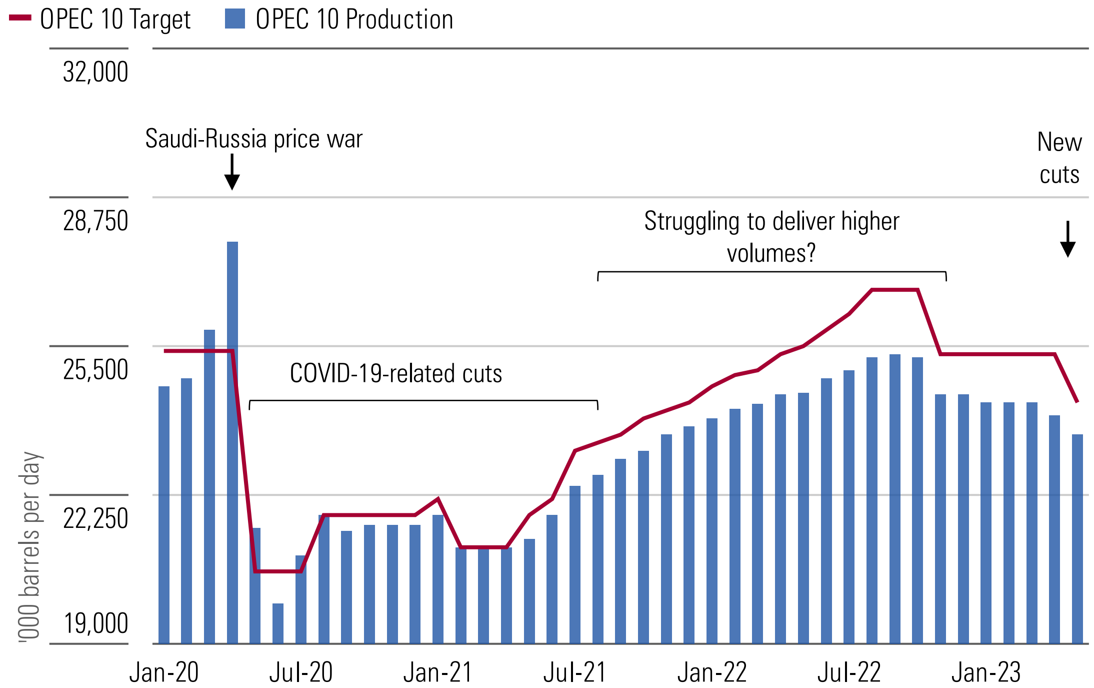
OPEC plans substantial production cuts for 2023 and 2024. Official quotas reduced by 1.4 million barrels per day in June 2023 with Saudi Arabia cutting production by 1.0 million barrels per day from July. Supply surpluses are expected to give way to deficits in the second half of 2023 and early 2024.

Spot LNG Price Above Brent-Referenced Contract Levels and Futures Are Bullish



Source: Meti/investing.com/CME as of Sept. 8, 2023, Morningstar.

OPEC Cuts Suggest the Cartel Wants High Oil Prices



Source: OPEC. Data as of June 13, 2023..

Energy

Name/ Ticker		Rating
Beach Energy (BPT)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 1.63	AUD 2.50	High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 3.7	None	Standard

We forecast strong earnings growth for Beach, but the market may be penalizing shorter field life and cost blow-outs at its Waitsia gas project in the Perth Basin. While some discount is warranted, we think it's too harsh. Beach recently removed targeted cost and schedule estimates for Waitsia after new contractor, Webuild, took over from Clough, now in administration. First gas from Waitsia was previously expected at end 2023. While disappointing, we still expect Waitsia to be a value-accretive cornerstone asset for Beach. We forecast a healthy EBITDA CAGR of 8.7% to USD 1.0 billion in fiscal 2028 versus fiscal 2023.

Name/ Ticker		Rating
Santos (STO)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 7.64	AUD 12.30	High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 24.8	None	Standard

We don't think Santos is being sufficiently credited for new oil and gas developments underway. A solid balance sheet and low costs, including a freight advantage to Asia, mean the company is well placed to weather any cyclically low prices. But crude and LNG prices are strong now, and gas has a growing role to fuel the world, including to complement increasing renewable energy production. We forecast group hydrocarbon growth of 70% by 2027 from 2023, chiefly from the Pikka oilfield development in Alaska and reinvigoration of Darwin LNG's output with the Barossa gas field development. We forecast strong four-year EBITDA CAGR of 7.5% to USD 5.6 billion by 2027 versus 2023.

Name/ Ticker		Rating
Whitehaven Coal (WHC)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 6.75	AUD 9.80	Very High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 5.7	None	Standard

Whitehaven benefits from above-average thermal coal prices. The Russian invasion of Ukraine, and subsequent sanctions on Russia, supports energy prices and reinforce the importance of energy security. Cash flow is strong, and the company had pro forma net cash of AUD 1.4 billion as at end June 2023. Excess cash is likely to be returned to shareholders via dividends and share repurchases, though the company is considering growth options. We think demand for Whitehaven's high-quality thermal coal will remain strong for at least the next decade, especially from Asian countries such as Japan, South Korea, and Taiwan. High-quality thermal coal meets the energy needs of these countries while also reducing emissions as obligated under various international agreements. Opposition from regulators to bringing on new supply could also support prices longer-term.

Source: Morningstar. Data as of Sept. 22, 2023.

Financial Services

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Shaun Ler | shaun.ler@morningstar.com

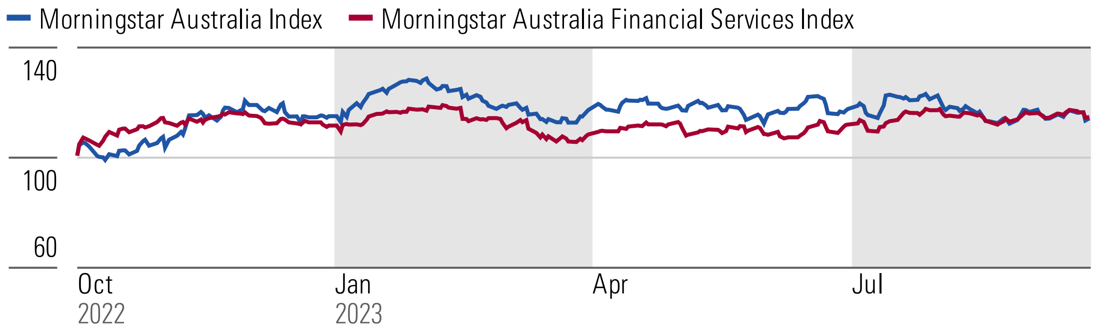
Fallout From Interest Rate Tightening Manageable

We see value in Australian banks, with most trading at material discounts to our fair value estimates. The earnings trajectory is negative as more expensive customer deposits and aggressive mortgage discounting hurts margins despite the tailwind of higher cash rates. We expect margins to stabilize in 2024 and improve in 2025. There are tentative signs of more rational pricing. With higher funding costs and fewer scale benefits, smaller banks and nonbank lenders are struggling to make adequate returns. We expect they will follow the majors' lead on pricing. The number of borrowers in arrears is low but rising as households cut discretionary spending. The major banks hold surplus capital, which provides comfort dividends can be maintained as earnings soften.

The earnings outlook for general insurers, IAG Group and Suncorp, is positive. Higher claims and reinsurance costs are being matched with higher premium rates. Additionally, much higher cash rates are driving a material increase in investment income on policyholder and shareholder funds. We prefer the insurance brokers Steadfast, AUB Group, and PSC Insurance Group who ride these tailwinds without the underwriting risk.

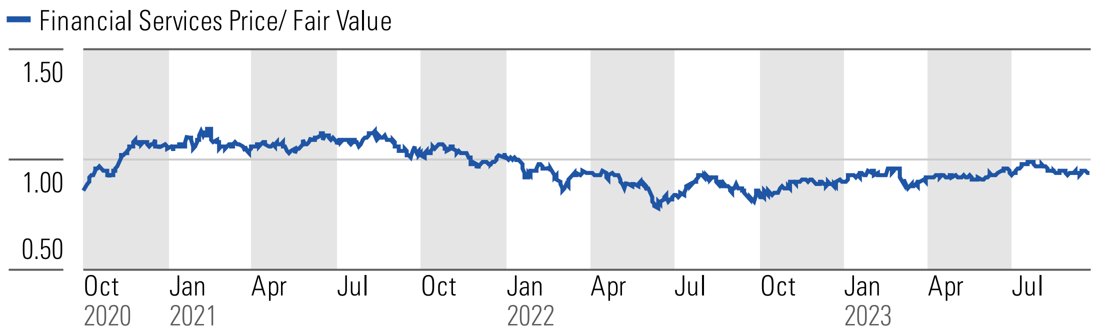
Most asset and wealth managers we cover are likely to see earnings recover in fiscal 2024 from cyclically challenged lows in fiscal 2023. Industrywide fund flows are slowly recovering as interest rates stabilize—a trend we foresee continuing throughout fiscal 2024. The resurgence in flows should steady and potentially improve funds under management and fee revenue, especially for better-performing, diversified businesses.

Banks and Asset Managers Unloved in Tightening Monetary Policy Cycle



Source: Morningstar. Data as of Sept. 22, 2023.

We Prefer Wide- and Narrow-Moat Names Among Cheap Financials



Source: Morningstar. Data as of Sept. 22, 2023.

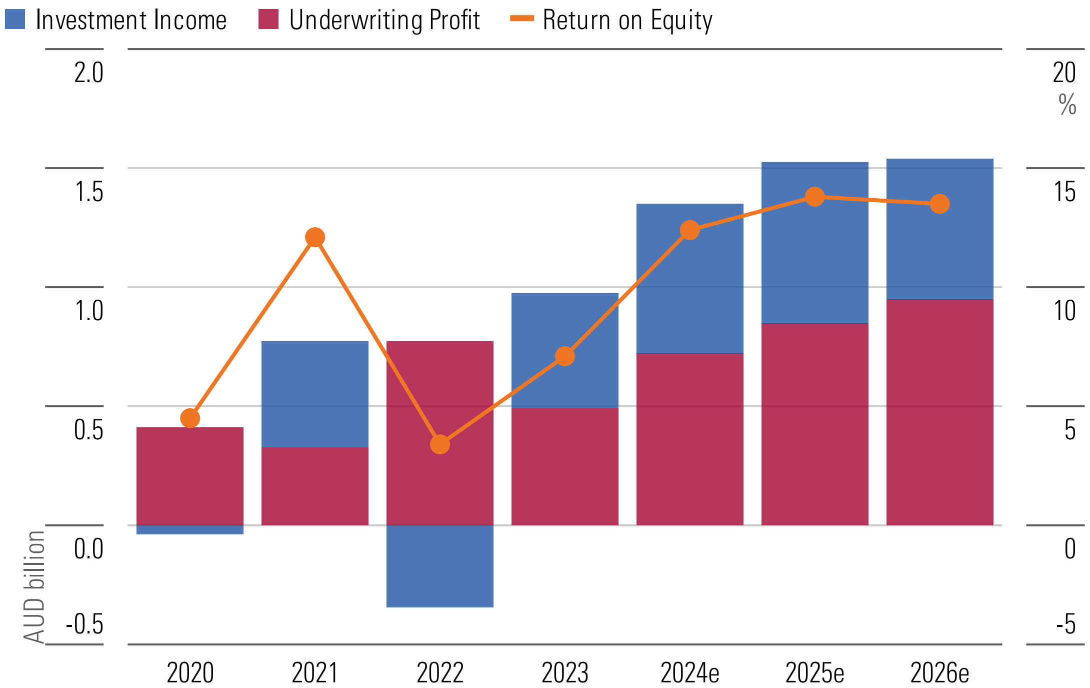
Fallout From Interest Rate Tightening Manageable

Despite higher earnings from investment income, general insurers Suncorp and Insurance Australia Group continue to lift premium rates. Premium rate increases are necessary for insurers to achieve returns above our 11% cost of equity estimate.

As stock markets stabilize, investors are slowly reallocating their funds into riskier asset classes like equities. This shift should stabilize funds under management, and hence revenue, of many wealth managers that were adversely affected by prior redemptions.

Tailwind of Higher Investment Income Already in the Share Price

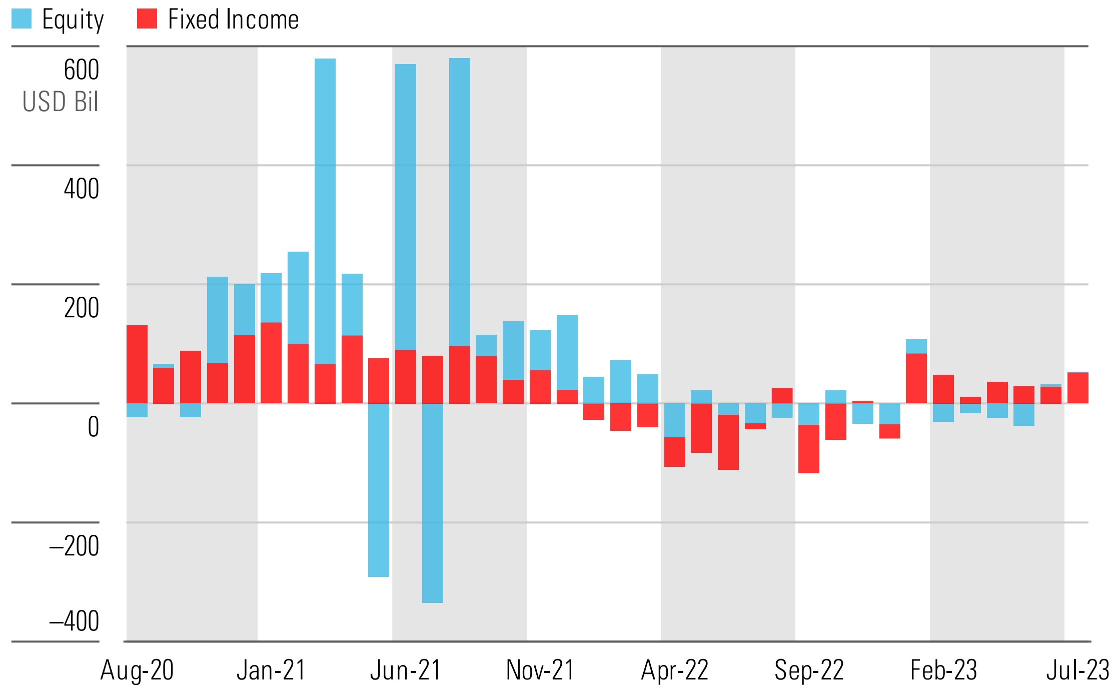
Insurance Australia Group forecasts.



Source: Company reports, Morningstar. Data as of Sept. 15, 2023.

Early Signs Risk Appetites Are Returning Among Global Investors

Estimated net flows into asset classes, global markets.



Source: Morningstar Direct. Data as of July 31, 2023.

Financial Services

Name/ Ticker		Rating
ANZ Group Holdings (ANZ)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 25.03	AUD 31.00	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 75.1	Wide	Standard

ANZ Group has lost material home loan market share, and having less funding sourced from low-cost household customer deposits hurts margins. We suspect the shares do not fully factor in the margin benefit of rising cash rates and process investments which should improve the competitiveness of this wide-moat bank. In recent months, ANZ Group has grown home loans ahead of market, and with no worse margin pressure than peers. Exposure to corporate lending, which has seen less price competition than mortgages, helps. While improving the loan approval process and customer offering comes with added expenses, they should drive earnings growth and returns on equity. Suncorp Bank should improve bank efficiency if the deal is approved, but integration costs make it unlikely to be materially value-accretive.

Name/ Ticker		Rating
Perpetual (PPT)		★★★★★
Price	**Fair Value**	**Uncertainty**
AUD 21.02	AUD 30.50	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 2.4	Narrow	Standard

We believe the market is overlooking narrow-moat Perpetual's likely earnings growth from better flows and cost reductions. While Perpetual's investments business is in net outflow, we believe the division's gradually improving investment performance supports new mandate wins and aids lower redemptions. We also expect staff retention and product distribution efforts to manage outflow risk. Additionally, we anticipate improved flows for both wealth management and corporate trust from an eventual stabilization in interest rates and macroeconomic conditions, relative to present levels. Both businesses face less competitive intensity relative to the investments business. Elsewhere, there is room for cost reduction from centralizing operations and removing duplicate functions following the acquisition of Pendal, while Perpetual itself is cycling off a period of elevated investment.

Name/ Ticker		Rating
Westpac Banking (WBC)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 21.14	AUD 28.00	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 74.1	Wide	Standard

Wide-moat Westpac has lost market share in home loans and pulled its cost-saving targets, but we think it will improve on both fronts. Despite intense competition, we expect margins to benefit from a large customer deposit funding base. Westpac is Australia's second-largest lender, number two in mortgages and number three in business loans. Funding cost advantages should allow the bank to reprice loans to generate better margins as smaller banks struggle to make a decent return on equity given higher wholesale funding costs. Bank cost inflation is meaningfully tied to customer remediation and improving risk management, and much of this should dwindle. Market share has stabilized in recent months, supporting our confidence there are no serious loan approval issues. Westpac has surplus capital, is well provisioned, and pays generous fully franked dividends.

Source: Morningstar. Data as of Sept. 22, 2023.

See Important Disclosures at the end of this report.

Healthcare

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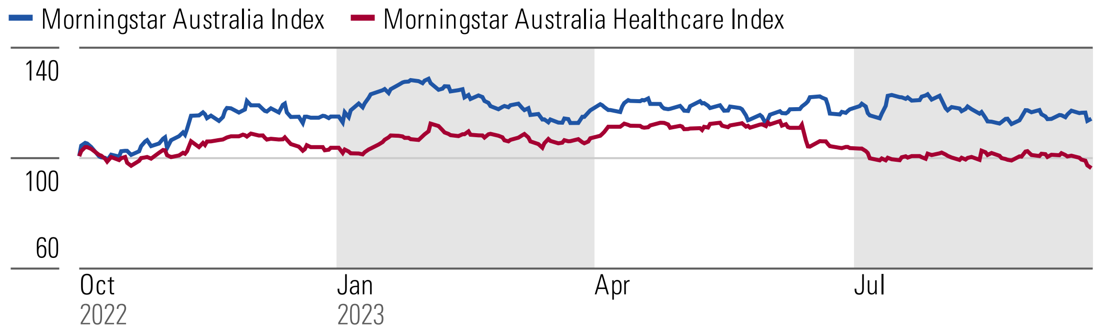
Buying Opportunities for High-Quality Healthcare Names

The healthcare sector underperformed the Morningstar Australia Index in the September quarter of 2023 due to sector heavyweights not satisfying market expectations. We view the sector as fairly valued on average but see buying opportunities with roughly half of our coverage trading in 4- or 5-star territory. The most attractive names are ResMed, where we expect continued strong revenue growth, and Ramsay and Ansell where we see margins expanding. Meanwhile, Pro Medicus, Cochlear, and Ebos are our most overvalued stocks.

We maintained our fair value estimates for most of our healthcare coverage over the August 2023 reporting season. We revised just four fair value estimates with an average increase of 4%. We increased our fair value estimate for CSL by 5%, partly due to the stronger U.S. dollar. We still expect CSL Behring's gross margin to recover to its prepandemic level by fiscal 2027, consistent with management's timeframe of three to five years. As plasma supply improves, we expect blood donor fees to fall and margins to expand as labor and overhead costs scale and as manufacturing yields improve.

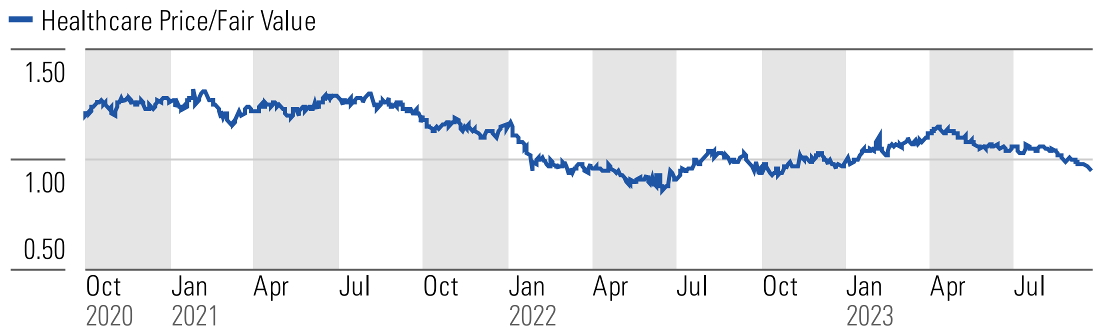
While costs slightly increased for ResMed in the September quarter 2023, we remain positive on its long-term trajectory. We think the global sleep apnea market is underpenetrated and large enough for CPAP machines to remain a key treatment despite concerns weight loss drugs will cause major disruptions. We're also positive on margins as we expect the sales mix to shift back to higher-margin masks and as cost inefficiencies of manufacturing both the AirSense 10 and AirSense 11 cease.

Healthcare Has Underperformed the Broader Market



Source: Morningstar. Data as of Sept. 22, 2023.

Several Names Attract in Fairly Valued Sector

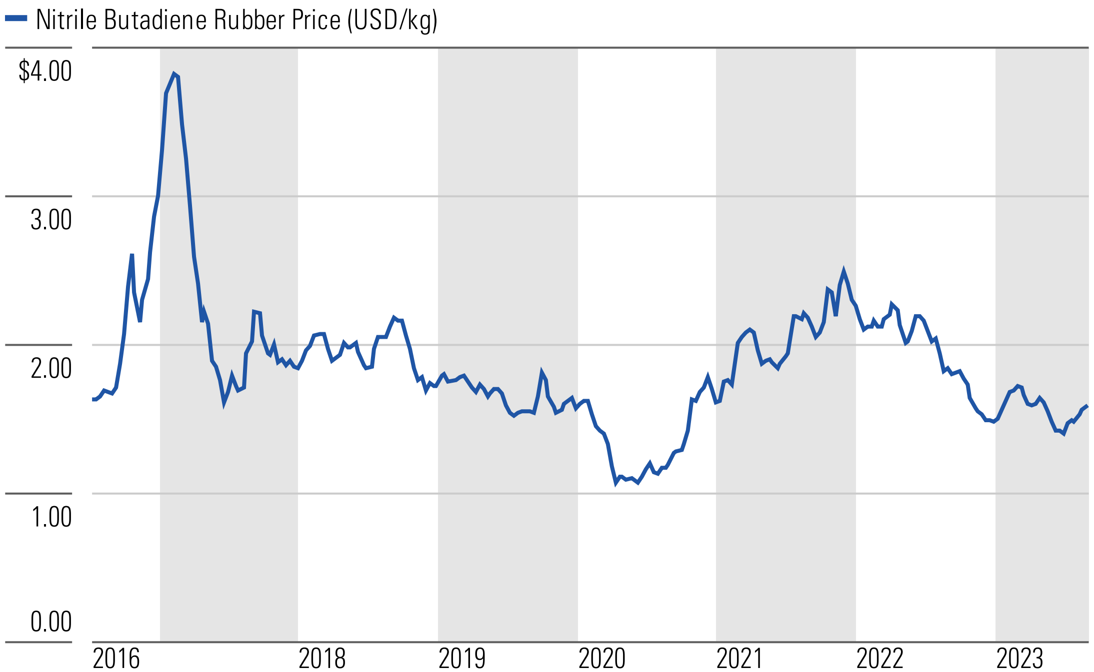


Source: Morningstar. Data as of Sept. 22, 2023.

Buying Opportunities for High-Quality Healthcare Names

We expect Ansell to benefit from easing input costs. The cost of nitrile butadiene rubber, which is a byproduct of petroleum used to make synthetic latex, is almost 40% below the December 2021 peak. NBR is about 15% of Ansell's total operating costs.

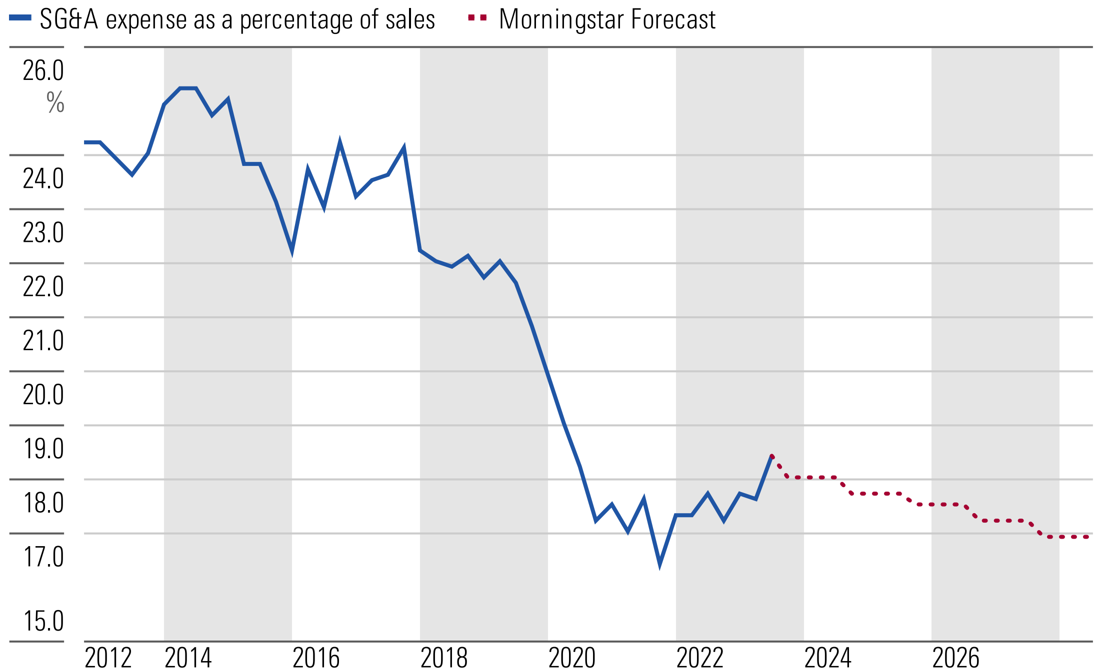
Synthetic Rubber Costs Trending Lower From 2021 Peak



Source: China National Bureau of Statistics, Haver Analytics. Data as of Aug. 30, 2023.

ResMed's selling, general, and administrative expenses have ticked up recently as a proportion of sales, but we expect those costs to stabilize lower due to operating leverage. We think the historical downward trend partly reflects increasing mainstream understanding of sleep apnea and its treatment, which means selling is more efficient.

Operating Leverage to Support ResMed's Margins



Source: Morningstar estimates, Company filings.

Healthcare

Name/ Ticker		Rating	
Ansell (ANN)		★★★★	We expect Ansell's margin pressures to abate. Pricing for undifferentiated single-use exam gloves has stabilized and a productivity program is set to deliver over USD 45 million of cost savings by fiscal 2026, a fifth of current group EBIT. Employee expenses are falling through automation and reducing duplication of leadership responsibilities. Despite current customer destocking, we see limited competitive pressure and reiterate Ansell's narrow moat based on intangible assets. We forecast gross margin expansion as Ansell insources more manufacturing, better utilizes its facilities, and improves the sales mix. See our special report "Undervalued Ansell Provides Investors Adequate Margin of Safety" published on Nov. 10, 2022, for more details.
Price	**Fair Value**	**Uncertainty**	
AUD 22.49	AUD 30.00	Medium	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 2.9	Narrow	Exemplary	
Name/ Ticker		**Rating**	
Ramsay Health Care (RHC)		★★★★	Narrow-moat Ramsay's June quarter 2023 showed solid margin improvement but profitability was constrained by inflationary pressures and accelerated investment in digital and cyber security. However, we are optimistic for margin expansion. Importantly, labor shortages are easing with immigration recovering, and Ramsay continues to invest in recruiting and training programs. We expect margins to expand as Ramsay uses less agency staff, as case mix and volumes normalize for nonsurgical services, as capacity utilization improves, and as digital investment efficiencies are realized. The firm is also well placed longer-term as it adds development capacity.
Price	**Fair Value**	**Uncertainty**	
AUD 52.33	AUD 68.00	Medium	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 12.0	Narrow	Exemplary	
Name/ Ticker		**Rating**	
ResMed (RMD)		★★★★★	ResMed's device sales are strong with Philips hampered by remediation work, sleep apnea diagnosis rates recovering, and component supply constraints easing. Recent share price weakness reflects concerns weight loss drugs will disrupt the sleep apnea industry. However, we think widespread adoption of these drugs will take time given the high cost, limited supply, and side effects. Obesity is also just one risk factor for sleep apnea, and many sleep apnea patients who experience weight loss are still obese. In most cases, they will likely still benefit from a CPAP device. See our special report "The Start of Unconstrained Sales for ResMed" published on July 25, 2023, for more details.
Price	**Fair Value**	**Uncertainty**	
AUD 21.60	AUD 39.00	Medium	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 31.4	Narrow	Exemplary	

Source: Morningstar. Data as of Sept. 22, 2023.

Industrials

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Industrials Opportunities Despite Economic Headwinds

The industrials sector has kept up with the broader market despite fears of an economic slowdown. The sector appears fairly valued on average and we see select buying opportunities. Our top picks are Ventia, Aurizon, and Amcor.

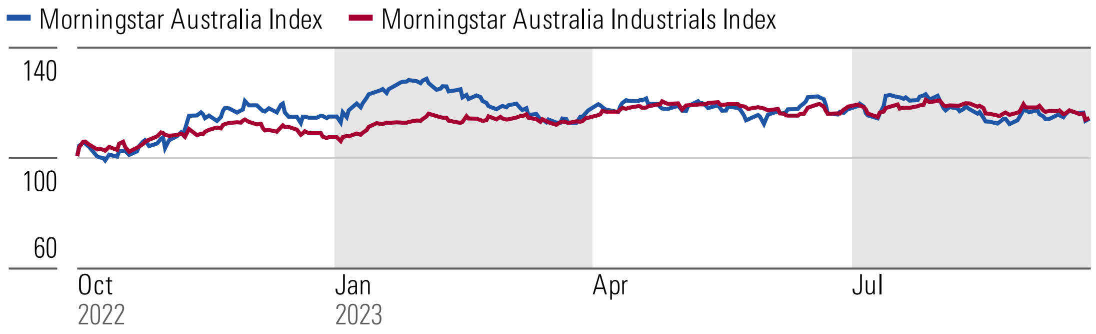
Urban services businesses Downer EDI and Ventia Services Group trade at material discounts to their fair value despite strong revenue trajectories supported by a positive outlook for government demand. Both are multidisciplinary defense services providers, and the federal government plans transformative expenditure across all areas of defense estate management and advisory. They also specialize in renewable energy solutions and should benefit from significant investment toward Australia's Net Zero target.

Airline profitability has turned around dramatically from pandemic losses to record, or near-record, profitability. Air travel demand has returned strongly, but capacity is still constrained by the availability of aircraft, labor, and parts.

Container imports recovered strongly in mid-2023, but we expect more headwinds for logistics company Qube as rate hikes flow through the economy. Coal export volumes are recovering as La Nina fades, a positive for Aurizon, which also benefits from CPI-linked tariffs and higher regulated returns.

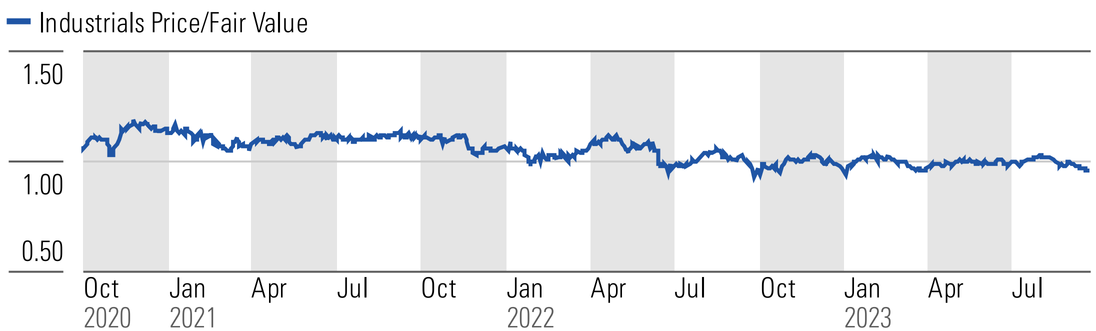
Share prices for toll road owners Transurban and Atlas Arteria have fallen but are still not cheap. Toll roads are benefiting from fixed cost leverage as traffic volumes recover and CPI-linked tolls boost cash flows. Rising interest rates and credit spreads are a headwind, but interest rate hedging softens the short-term blow.

Industrials Keep Pace With the Broader Market



Source: Morningstar. Data as Sept. 22, 2023.

Industrials Screen as Fairly Valued on Average



Source: Morningstar. Data as of Sept. 22, 2023.

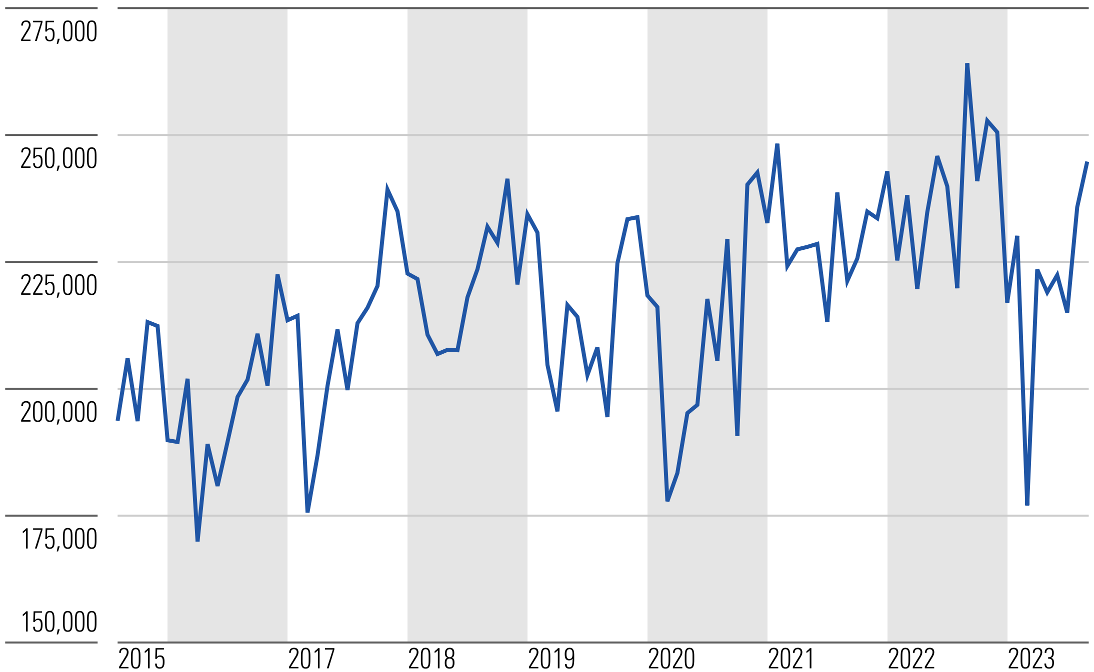
Opportunities in Industrials Despite Economic Headwinds

Higher interest rates and inflation didn't dent consumer spending for long, and container imports have bounced back sharply in recent months. This is good for Qube, but more rate hikes can't be ruled out as the new RBA governor tries to tame sticky inflation.

Air travel demand continues to recover despite capacity constraints, leading to full planes, expensive tickets, and tremendous profitability. But we expect pricing competition to return as capacity bottlenecks ease for Qantas and its competitors.

Container Volumes Bounce Back Sharply

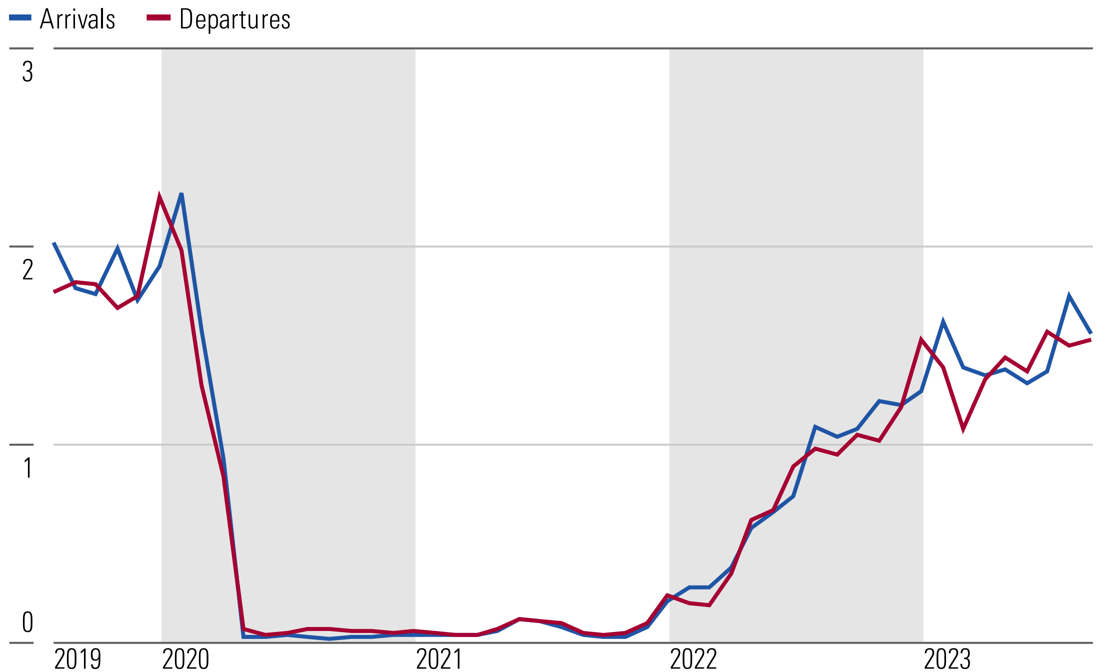
Port Botany monthly container volumes (twenty-foot equivalent units).



Source: NSW Ports. Data as of Aug. 31, 2023.

International Air Travel Activity Continues to Recover

Monthly overseas arrivals in and departures from Australia (million passengers).



Source: Australian Bureau of Statistics. Data as of Aug. 31, 2023

Industrials

Name/ Ticker		Rating
Ventia (Australia) (VNT)		★★★★★
Price	**Fair Value**	**Uncertainty**
AUD 2.77	AUD 4.00	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 2.4	None	Standard

The market is seemingly unimpressed by Ventia, perhaps reflecting a large but declining vendor shareholdings overhanging since the IPO. However, we project EPS growing at a near-6.5% CAGR to 2027 and a fully franked yield nearing 8% also by 2027. We like the relatively defensive revenue streams with maintenance cash flows comparatively resilient to external shocks. Business capital requirements are low, expected at less than 1% of revenue. Over the next four years, macro tailwinds including population growth, outsourcing volume rates, and environmental regulations underpin Ventia's expectation for the market to grow at robust 6.6% CAGR for Australia and New Zealand.

Name/ Ticker		Rating
Aurizon Holdings (AZJ)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 3.54	AUD 4.70	High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 6.5	Narrow	Standard

Shares of narrow-moat Aurizon offer an attractive yield, underpinned by high-quality rail infrastructure and haulage operations. Considerable downside is priced into the shares and our analysis suggests risks for investors are skewed to the upside. Haulage volumes were weak in fiscal 2023 given wet weather, but the outlook is for volumes to recover, haulage tariffs to rise with the CPI, and as the regulator allows the rail track to earn higher returns. We think environmental concerns are overblown, providing an opportunity for investors to buy a better-than-average-quality company at a discount. Aurizon largely hauls coking coal from globally competitive mines. A commercially viable alternative to coking coal to make new steel is a long way off.

Name/ Ticker		Rating
Amcor (AMC)		★★★★
Price	**Fair Value**	**Uncertainty**
AUD 14.25	AUD 17.50	Low
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 20.5	Narrow	Standard

While recent volume trends are weak, we are more constructive over Amcor's medium- and long-term volumes, given exposure to the defensive areas of consumer stables, personal care, and healthcare. We forecast improvement once customer destocking and consumer trading down completes. Longer-term, we expect incremental improvement in returns on invested capital. This reflects forecast strong single-digit organic sales growth through the reinvestment of free cash flows into emerging markets and higher-margin differentiated products.

Source: Morningstar. Data as of Sept. 22, 2023.

See Important Disclosures at the end of this report.

Real Estate

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Tough Conditions Now but Long-Term to Improve

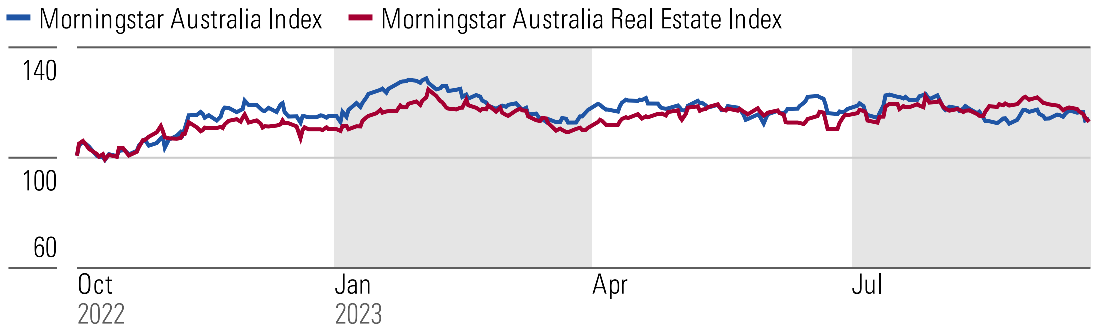
Recent transactions suggest the market is too bearish on major office REITs Dexus, GPT Group, and Mirvac. In August 2023, Dexus sold One Margaret St Sydney at a 16% discount to the December 2022 book value, which isn't bad considering risk from the building's short tenant leases. Yet Dexus' depressed security price implies an enterprise value 25% below book value for the rest of the portfolio—too bearish in our view. We think office rents have bottomed. CBDs are set to get busier in 2024 and beyond as employers formalize hybrid work, and as public transport projects complete in Brisbane, Melbourne, and Sydney.

Mirvac's office portfolio should benefit from improving conditions, and we see value in its funds management and residential development businesses, neither of which are captured in net tangible assets. Australia faces an acute dwelling shortage, yet weaker developers have exited. Mirvac's solid balance sheet and its development pipeline means it can launch six apartment projects in fiscal 2024, against a backdrop of depressed dwelling approvals suggesting limited competing supply.

Retail REITs face recession risk but two years of strong retailing has helped landlords to sign good tenants on long leases. Consequently, major retail REITs such as Charter Hall Retail, Region Group, Scentre Group, and Vicinity Centres screen as undervalued.

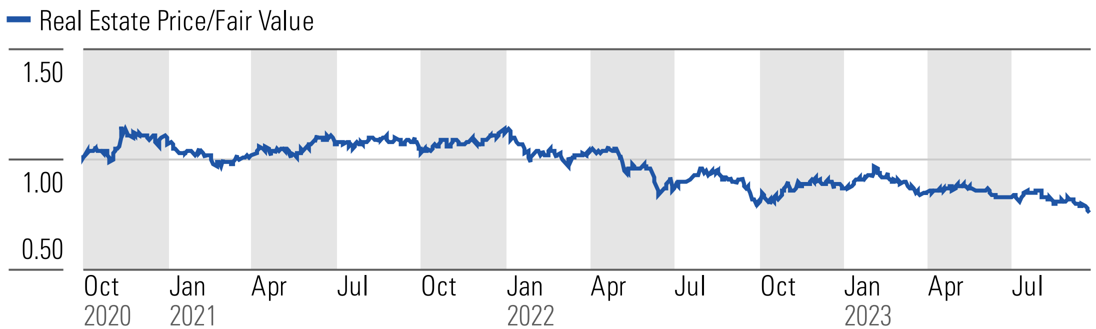
The heat came out of storage REITs, arguably as storage conditions in the United States finally moderated, prompting a local takeover premium to evaporate. National Storage REIT looks fairly valued but not cheap, with downside risks including the lack of leases in storage, and rents softening as consumer spending weakens.

Real Estate Likely Weak Until Interest Rates Peak



Source: Morningstar. Data as of Sept. 22, 2023.

Property Was Expensive but Now Looks Cheap



Source: Morningstar. Data as of Sept. 22, 2023.

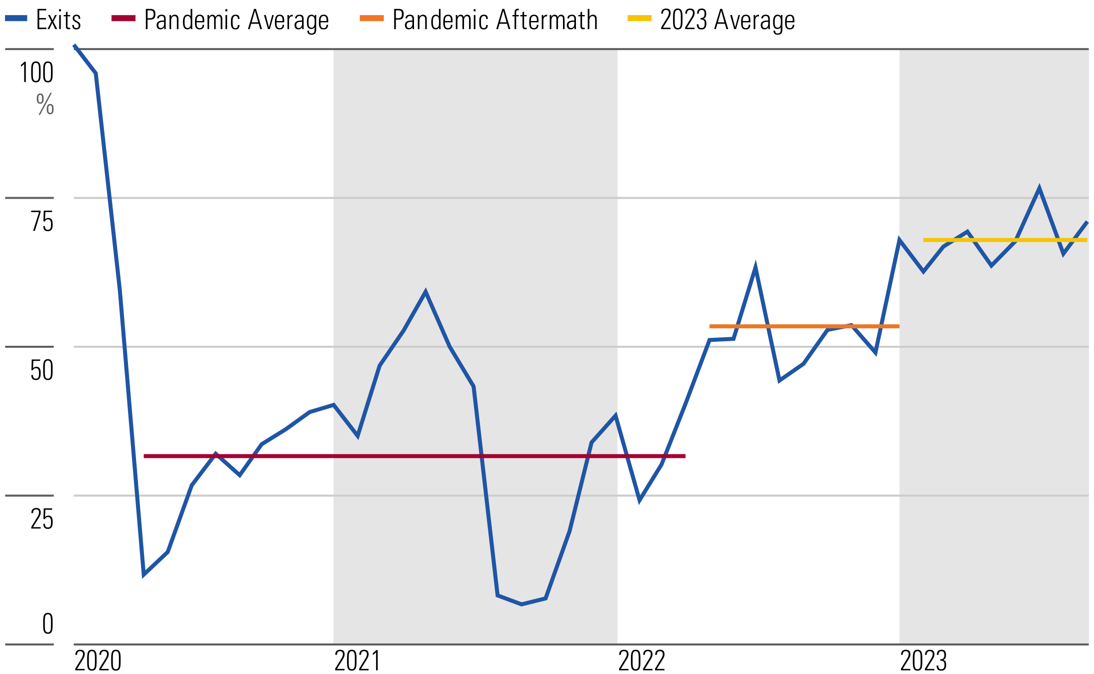
Tough Conditions Now, but Long-Term to Improve

Train passenger data shows CBDs are still getting busier, positive for office rents. Sydney Metro says its CBD opening in 2024 will allow up to 200 city trains per hour, up from 120. Substantial rail upgrades are also set for Melbourne and Brisbane.

Commercial property prices and NTAs are down and have further to fall in our view. However, we think listed REIT prices factor in too much downside. REITs with substantial intangible businesses not captured in the NTA look particularly cheap including Dexus, GPT, Mirvac, and Scentre Group.

Train Passengers Increasing and Likely Busier Again in 2024

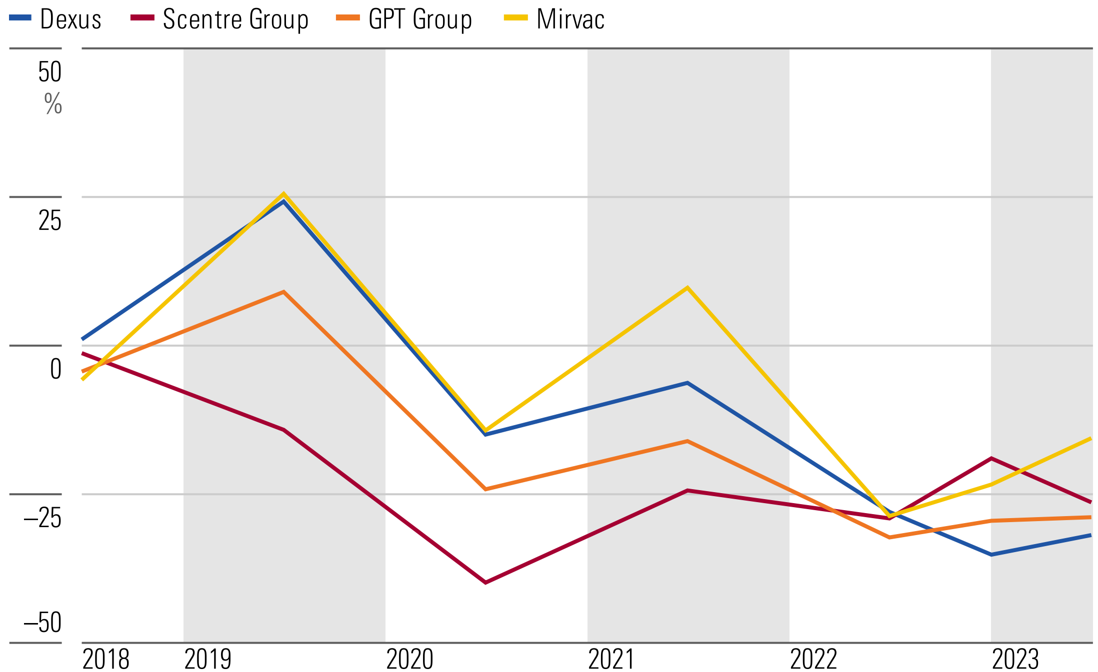
Sydney CBD monthly train passenger exits as % of 2019.



Source: TransportForNSW; Circular Quay, Martin Place, Wynyard. Morningstar. Data as of Aug. 31, 2023.

REIT Security Prices Already Factor in Substantial Falls in Property Values

Premium (discount) to NTA



Source: Company filings, Morningstar. Data as of Sept. 19, 2023.

Real Estate

Name/ Ticker		Rating
Lendlease (LLC)		★★★★★
Price	**Fair Value**	**Uncertainty**
AUD 7.13	AUD 14.45	High
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 4.9	None	Standard

Lendlease securities trade near NTA. This is overly pessimistic, given much of the group's EBITDA comes from intangible sources of income in its development, construction, and investments businesses that are excluded from NTA. Despite headwinds, core operating profits rebounded in fiscal 2023. We expect further substantial uplift in development earnings in 2024, and management earnings longer-term. Management reaffirmed at its annual results in August 2023 that it's on track for more than AUD 8 billion of development completions in fiscal 2024. The target looks reasonable given development work in progress increased to AUD 23 billion (up from AUD 18 billion at December 2022). Downside risks look more than priced in, and we see substantial upside if Lendlease reaches its targets in 2024 or 2025.

Name/ Ticker		Rating
Dexus (DXS)		★★★★★
Price	**Fair Value**	**Uncertainty**
AUD 7.16	AUD 10.80	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 7.7	Narrow	Standard

Dexus trades at a material discount to NTA, which doesn't include the intangible value of the group's funds management business. Funds management contributed roughly 15% of funds from operations in fiscal 2023, up from 10% in fiscal 2022. Dexus missed out on acquiring some AMP mandates, but we see this as a short-term setback and expect funds management contributions to grow. Meanwhile Dexus' office portfolio looks to be stabilizing with lockdowns past, and tighter financial conditions likely to curtail future office supply. We expect higher interest rates to weigh on office valuations, but not as much as implied by Dexus' security price. The group's industrial properties, about 25% of its portfolio, are performing well.

Name/ Ticker		Rating
Charter Hall Group (CHC)		★★★★★
Price	**Fair Value**	**Uncertainty**
AUD 9.67	AUD 15.90	Medium
Market Cap (bil)	**Economic Moat**	**Capital Allocation**
AUD 4.6	Narrow	Exemplary

We think Charter Hall securities overly discount weaker operating conditions, and its development pipeline is likely to continue to add to funds under management. Higher interest rates hurt performance and transaction fees, which more than halved in fiscal 2023. But relatively repeatable base management revenue grew 20% and is about two thirds of Charter Hall's funds management revenue. We believe there is a long-term trend toward institutions investing in property via specialized property fund managers, instead of directly. We expect Charter Hall to reap inflows in the long run, due to its strong track record, rising tax and management complexity, and as international investors seek local expertise. Charter Hall has minimal debt. Look-though gearing—net debt/assets including debt in its funds—is higher at 34%. But Charter Hall can call on committed equity lines from fund investors, and the more indebted vehicles typically have very strong tenant covenants and a high proportion of fixed rate debt. We think Charter Hall is well-prepared for tougher conditions.

Source: Morningstar. Data as of Sept. 22, 2023.

Technology

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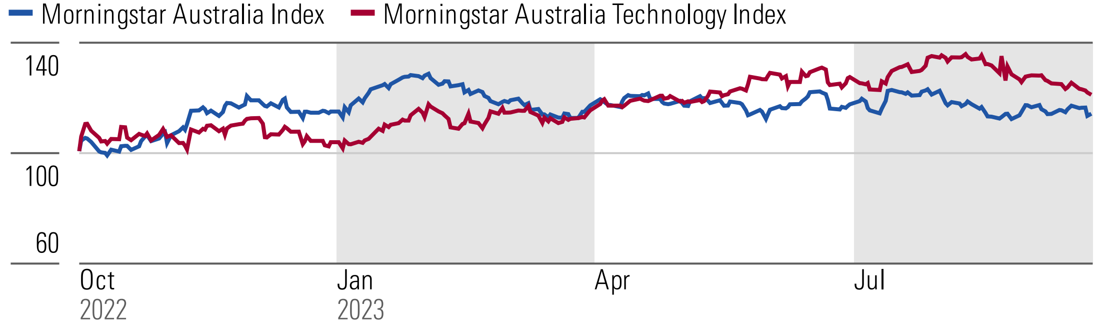
The Technology Sector Is Continuing a Shake-out and Consolidation Around Moatier Companies

As the tide of free money has been going out, investors are starting to see which technology companies have been swimming naked. For most of the past decade, a tide of cheap money flowed into the sector. As a result, it became increasingly difficult to see which companies had strong value propositions, unit economics, products, cultures, and competitive advantages. As money became more expensive in 2022 with rising interest rates, a countdown started for weaker companies that could no longer juice revenue growth with more profitless spending and deeply negative cash flows.

The logistics technology sector provides clear examples of this. Freightos, an aspiring disruptor to WiseTech's industry, was forced into listing via a special purpose acquisition company in 2023 after its cash reserves dwindled. Its share price has since fallen 80%. This quarter it laid off 13% of its employees given weaker revenue growth. Similarly, Project 44, a heavily financed aspiring visibility competitor to WiseTech, laid off about 10% of its staff. WiseTech meanwhile, maintained impressive growth and accelerated its hiring, growing product development headcount by 80% through fiscal 2023.

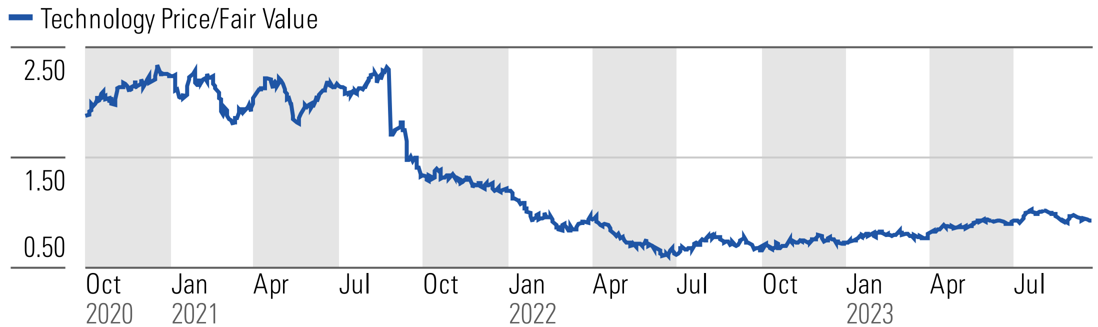
Businesses with stronger customer propositions, such as Tyro and Fineos, continue to attract new clients and/or are improving margins. Conversely, commoditized, capital-intensive players like Zip are ceding share to larger competitors like Afterpay and Klarna given reduced access to growth capital. Such companies are often forced to resort to fee increases to support profitability. However, this approach is likely to accelerate their loss of market share.

Morningstar Australia Technology Index Outperforming



Source: Morningstar. Data as of Sept. 22, 2023.

Technology Sector Screens as Fairly Valued



Source: Morningstar. Data as of Sept. 22, 2023.

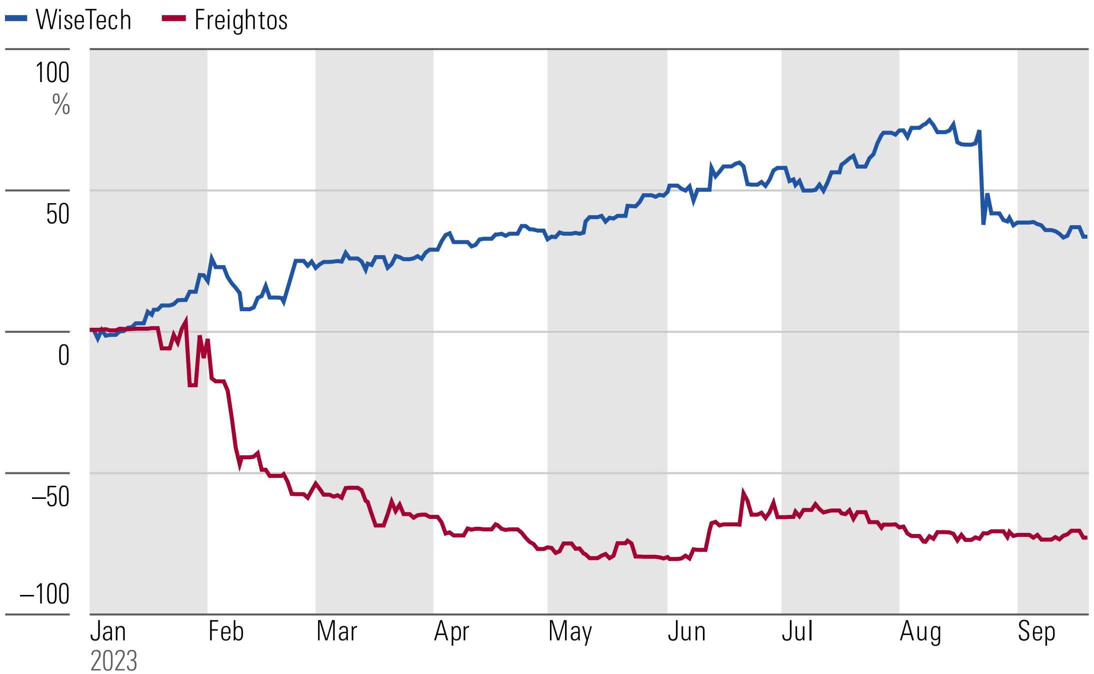
The Technology Sector Is Continuing a Shake-out and Consolidation Around Moatier Companies

WiseTech's productivity tools are helping its blue-chip customer-base outperform their competitors, making these tools especially important in a weaker logistics market. Freightos' business meanwhile is almost a mirror image, due to weaker fundamentals, and has seen its business and valuation shrink without cheap money fuelling growth.

Tyro Payments' value proposition of addressing merchant friction points, rather than being a generic merchant acquirer, is likely to assist with continuous market share and earnings growth even in tougher economic conditions. This contrasts with consumer financing firms Zip and Humm where the offerings are more commoditized.

Freightos' Valuation Deflated as Interest Rates Rose

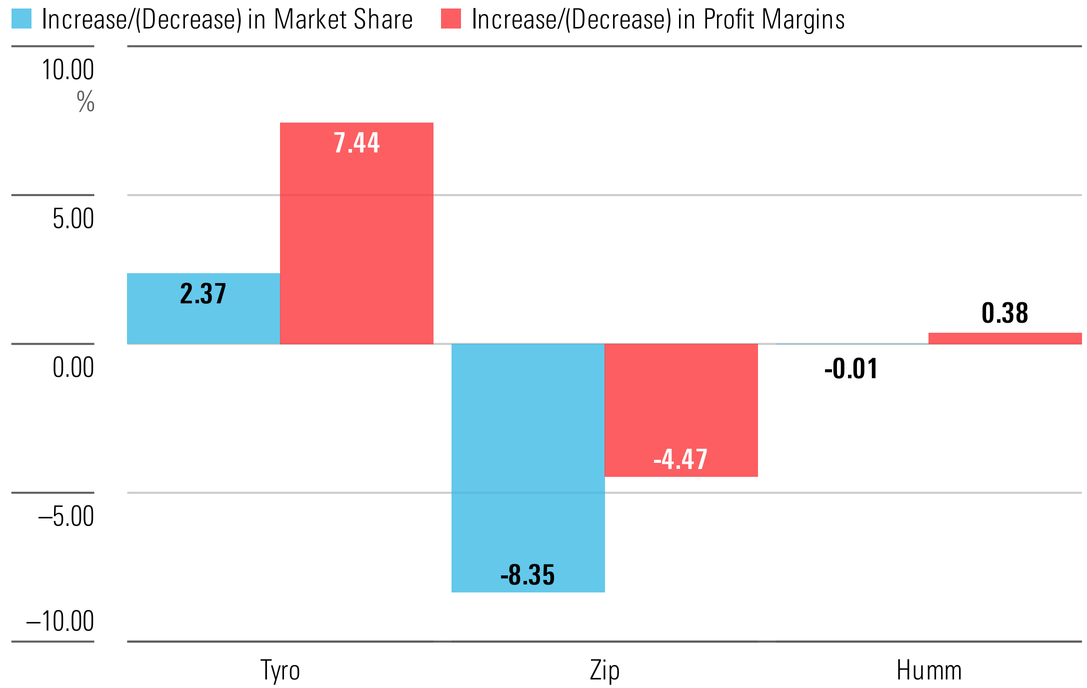
Year-to-date share price performance for WiseTech and Freightos (Index = Jan. 1, 2023)



Source: Pitchbook. Data as of Sep. 19, 2023.

Challenging Times Reveal Enduring Fintech Business Models

Market share and profit margin changes in fiscal 2023



Source: Morningstar, Company Filings, FIS. Data as of Sep. 19, 2023.

Technology

Name/ Ticker		Rating	
WiseTech Global (WTC)		★★★★	We view narrow-moat WiseTech as a well-managed, high-quality company with a large and highly winnable market opportunity. We see WiseTech as providing technology to help logistics companies outperform their competition through increased productivity. The market for logistics services naturally selects for the lowest-cost providers and coupled with the cost advantages WiseTech provides, we think the large market opportunity is highly winnable. WiseTech's business quality is supported by a blue-chip client base, a highly recurring revenue model, and industry-leading annual customer retention rates.
Price	**Fair Value**	**Uncertainty**	
AUD 66.85	AUD 95.00	High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 22.3	Narrow	Exemplary	

Name/ Ticker		Rating	
FINEOS Corporation (FCL)		★★★★	We believe wide-moat Fineos has investment merits not generally found within the broad band of profitless technology companies. We think the market underestimates revenue upside from the adoption of cloud software by insurers and the increasing stickiness of Fineos' insurer customers. Fineos is well placed to win new business supported by long-standing customer relationships and their referrals. Fineos is not yet profitable but reinvests to solidify switching costs with its sticky customer base, win new business, and maintain its lead over would-be competitors. We anticipate share gains from more products per client, new client adds, and expansions into new regions and adjacent businesses. There are also opportunities for cost efficiencies from client transitions to the cloud, automation of manual functions, and hiring in emerging economies. We expect Fineos to self-fund its future growth.
Price	**Fair Value**	**Uncertainty**	
AUD 2.11	AUD 3.30	Very High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 0.7	Wide	Standard	

Name/ Ticker		Rating	
Megaport (MP1)		★★★★	The market downturn, dissatisfaction from the chairman with Megaport's execution, and management uncertainty led to Megaport's stock getting crushed earlier this year, despite sales growth remaining high and a continuing trend of significant margin expansion. Stabilization on all fronts has led to a huge stock rebound and should only accelerate business performance. Megaport should benefit from increasing global reliance on data traffic. With its software-defined network offering, it facilitates connections between data centers and/or premises for enterprises to integrate their architecture and connect to cloud providers. We expect sales growth to remain high and for EBITDA profitability from 2023. More importantly, we expect further profit growth and positive free cash flow by 2024.
Price	**Fair Value**	**Uncertainty**	
AUD 10.96	AUD 17.00	Very High	
Market Cap (bil)	**Economic Moat**	**Capital Allocation**	
AUD 1.8	None	Exemplary	

Source: Morningstar. Data as of Sept. 22, 2023.

Utilities

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Rising Electricity Prices Support Utility Earnings

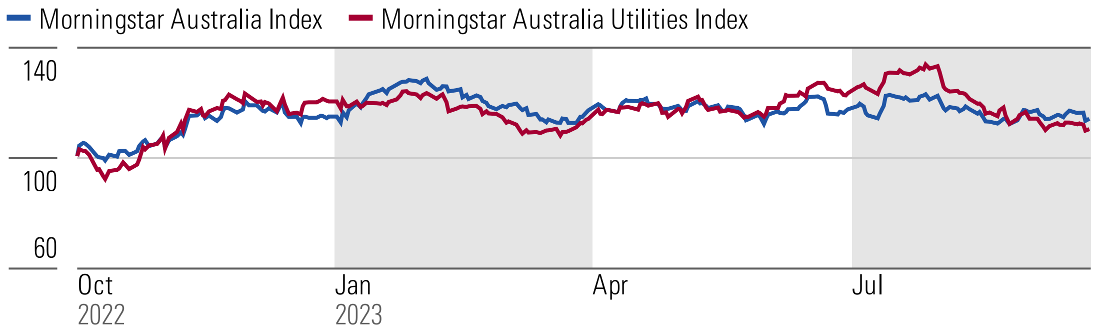
Australian and New Zealand utilities have solid outlooks. Power producers are increasing retail electricity prices to recoup stubbornly high wholesale prices, while gas pipeline owner APA Group benefits from CPI-linked revenue and a large development pipeline. These positives should outweigh headwinds from higher interest rates and cost inflation. We see best value in Manawa Energy, APA Group, and AGL Energy.

APA Group's share price fell after it raised equity to overpay for some middling assets in remote Western Australia, but it is a good-quality business overall and now screens as slightly undervalued.

The outlook for Australian power producers is positive. Energy Minister Chris Bowen explained why nuclear power is too expensive to replace aging coal power stations in the same week the cost of Snowy 2.0 blew out to AUD 12 billion, from AUD 2 billion originally. The energy transition will be expensive and difficult regardless of energy source, likely supporting wholesale electricity prices for the foreseeable future. Utilities with cheap coal and gas supply are well placed but cost advantages will erode over time as legacy fuel supply contracts end and low-cost power stations close.

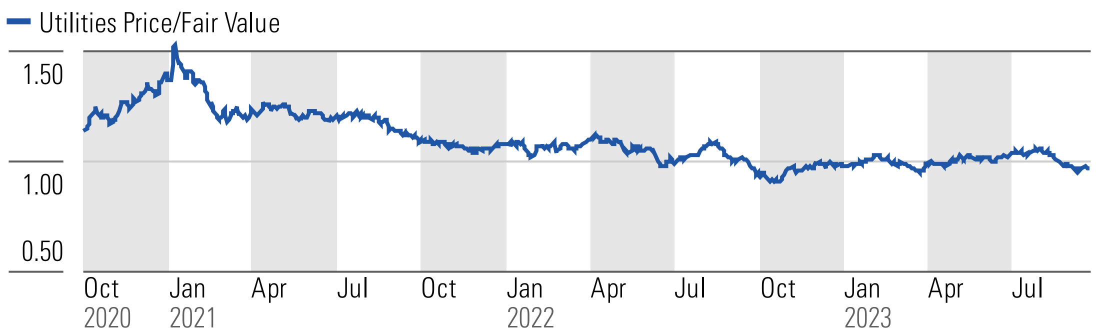
The outlook for NZ power producers is even better. They too benefit from high wholesale electricity prices but instead of aging coal- and gas-fired power stations, they primarily own irreplaceable hydroelectric schemes. These long-life assets produce cheap electricity, have flexible output, and are environmentally friendly. But the positive outlook is priced in, and most NZ utilities are overvalued.

Australian Utilities Performed in Line



Source: Morningstar. Data as of Sept. 22, 2023.

ANZ Utilities are Fairly Valued on Average



Source: Morningstar. Data as of Sept. 22, 2023.

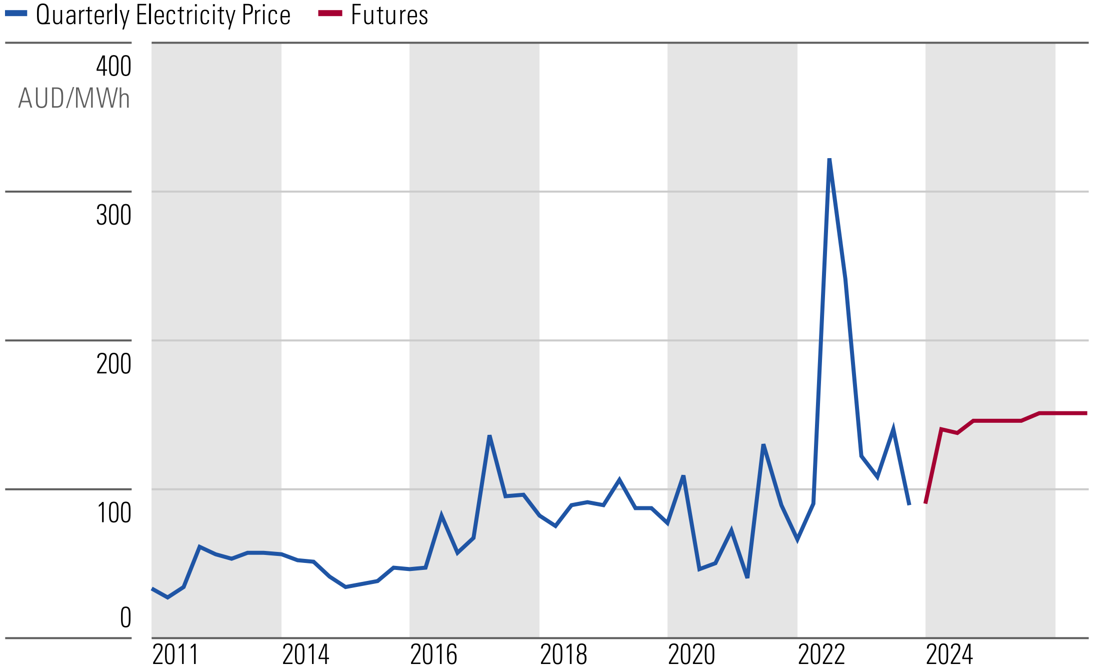
Rising Electricity Prices Support Utility Earnings

After a volatile couple of years, Australian wholesale electricity prices appear to be stabilizing at elevated levels. High wholesale prices flow through to mass market and corporate customers progressively, with the bulk of upside to utility profits likely in fiscal 2024.

Domestic gas prices are likely to remain elevated because of depleting gas fields in offshore Victoria and solid demand. This boosts profits for utilities with cheap legacy gas supply contracts and supports wholesale electricity prices.

Electricity Prices To Stay Up Given High Fuel Costs

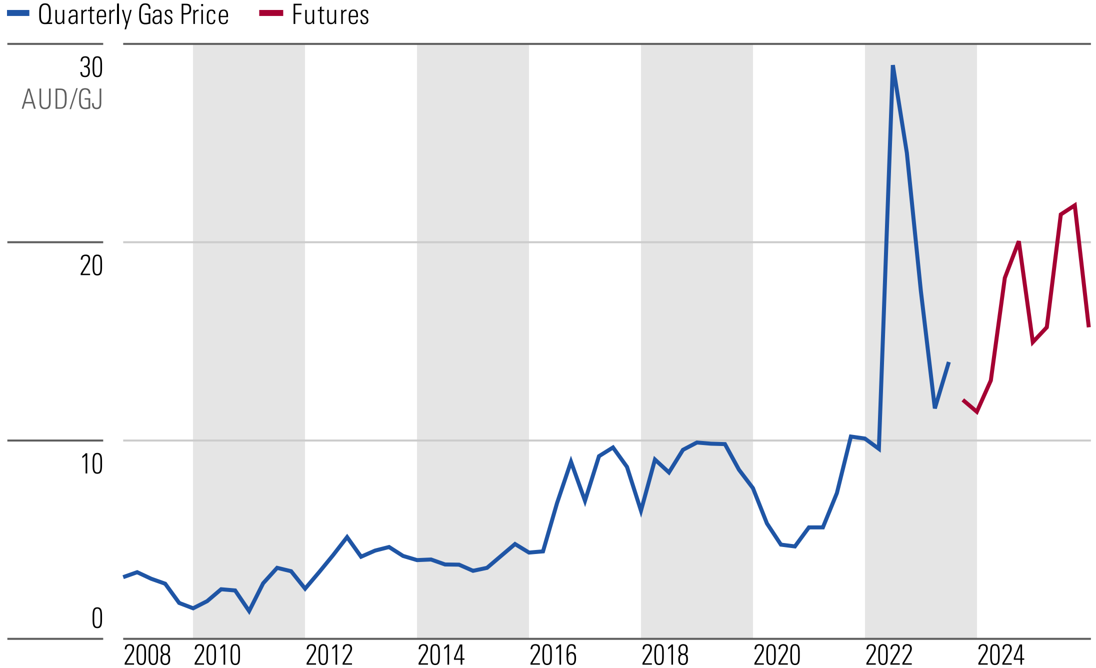
New South Wales wholesale electricity prices (AUD per megawatt hour).



Source: Morningstar, ASX Energy. Data as of Sept.25, 2023.

Gas Prices are Supported by Depleting Gas Fields

Victorian wholesale gas prices (AUD per gigajoule).



Source: Morningstar, ASX Energy. Data as of Sept. 25, 2023.

Utilities

Company (Ticker) Manawa Energy (MNW)		**Rating** ★★★★	Narrow-moat Manawa Energy, a New Zealand renewable energy producer, owns a fleet of small hydroelectric generators and, with a strong balance sheet, is well-positioned to grow via the development of wind and solar farms. It sells most power to Mercury NZ under long-term CPI-linked contracts, with earnings to benefit from elevated inflation. We also expect earnings to benefit from diverting more sales to tight wholesale markets as contracted volumes progressively reduce in the medium term. The stock offers a decent yield, fully imputed for New Zealand residents.
Price NZD 4.69	**Fair Value** NZD 6.30	**Uncertainty** Medium	
Market Cap (bil) NZD 1.47	**Economic Moat** Narrow	**Capital Allocation** Standard	
Name/ Ticker APA Group (APA)		**Rating** ★★★	Narrow-moat APA Group trades near our fair value estimate but is a good-quality company with an attractive yield. We expect revenue growth to pick up in the near term as elevated inflation boosts CPI-linked tariffs, and on completion of developments. APA Group should benefit from the transition to renewable energy. We expect ongoing investment in wind and solar farms while its core gas transmission networks benefit from growing gas use to backup intermittent renewable power supply. APA is also set to help remote mines in Western Australia replace diesel generators with a mix of solar panels, batteries, and gas turbines. This should reduce the mines' carbon emissions and operating costs.
Price AUD 8.42	**Fair Value** AUD 9.50	**Uncertainty** Medium	
Market Cap (bil) AUD 10.6	**Economic Moat** Narrow	**Capital Allocation** Standard	
Name/ Ticker AGL Energy (AGL)		**Rating** ★★★	Narrow-moat AGL Energy's recovery is gaining traction and the rebound in electricity prices in the past two years should underpin a strong earnings recovery in fiscal 2024. Risk is receding as the earnings outlook improves. Also, the planned early closure of coal power stations has alleviated ESG concerns and allowed continued bank support. As one of Australia's largest generators and retailers of electricity, we see substantial long-term value in the business. We expect slowing renewable energy supply additions, the closure of aging coal power stations, and high gas costs to support electricity prices, which benefits earnings. Government caps on domestic gas and coal prices have reduced electricity futures prices, but they're still conducive to a strong earnings rebound.
Price AUD 10.71	**Fair Value** AUD 12.80	**Uncertainty** High	
Market Cap (bil) AUD 7.2	**Economic Moat** Narrow	**Capital Allocation** Poor	

Source: Morningstar. Data as of Sept. 22, 2023.

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