



WILSONS

Q2 Focus List Outlook

Our weekly view on Australian equities.

06 April 2022

What to Watch

This week we share our second quarter outlook for companies within the Wilsons Australian Equity Focus List.

While buoyant resources and energy prices are helping index earnings for the most part, industrial earnings can continue to hold up, even in the face of higher input costs across almost everything. That is because companies are exercising pricing power. To date, there has been little evidence of higher prices resulting in demand destruction. We expect the pattern to hold for much of 2022, allowing companies to hold profit margins steady.

Key local market events over the next quarter include a Federal Election, navigating the May 'conference and earnings season', and the possibility of a rate hike from the RBA in June.

Offshore events to watch include development in Russia/Ukraine for signposts of a resolution, the actions from the Federal Reserve (May and June meetings), and the global earnings season starting next week.

Read [Looking Through a Volatile Start to the Year](#)

Updates from Focus List members Aristocrat (**ALL**), CSL (**CSL**), James Hardie (**JHX**), Macquarie (**MQG**), NAB Bank (**NAB**), News Corp (**NWS**), Silk laser Australia (**SLA**), Block Inc (**SQ2**), Santos (**STO**), Telix Pharmaceuticals (**TLX**), Westpac (**WBC**), and Xero (**XRO**) across the quarter, look to be underappreciated by the market at current prices.

Focus List: Q1 in Review

The Focus List underperformed during the quarter, primarily due to earnings multiples derating for several companies given the rise in global yields. Growth-orientated companies in sectors like healthcare and information technology are vulnerable to higher bond yields. This is particularly the case in the initial phases of a move higher in bond yields, which we saw during the quarter.

Long bond yields typically peak early in the tightening phase of a central bank rate cycle. So, while we cannot be certain all the damage has been done to high growth stocks, our sense is that value is emerging. This is particularly the case if earnings can continue to grow as higher interest rates begin to impact economic growth as the cycle matures.

Figure 1: Focus List performance relative to market

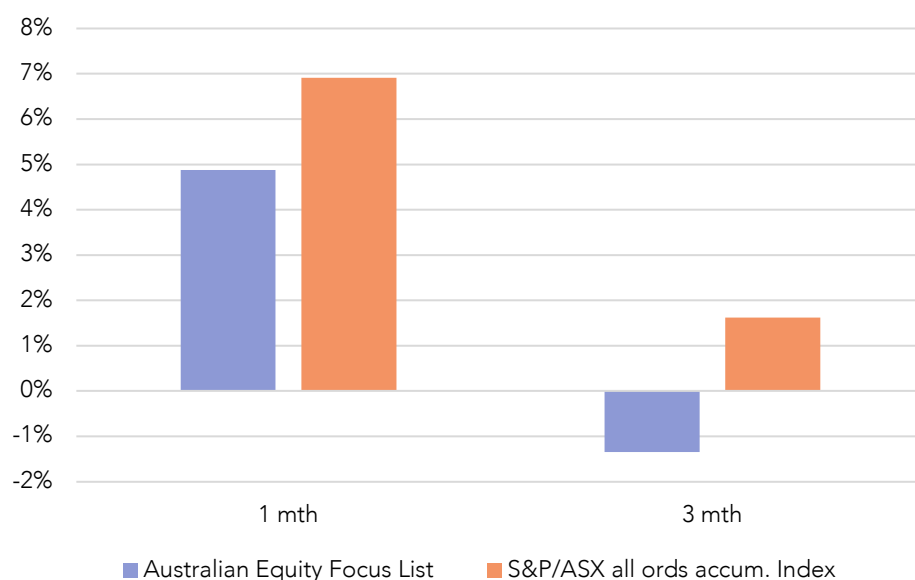
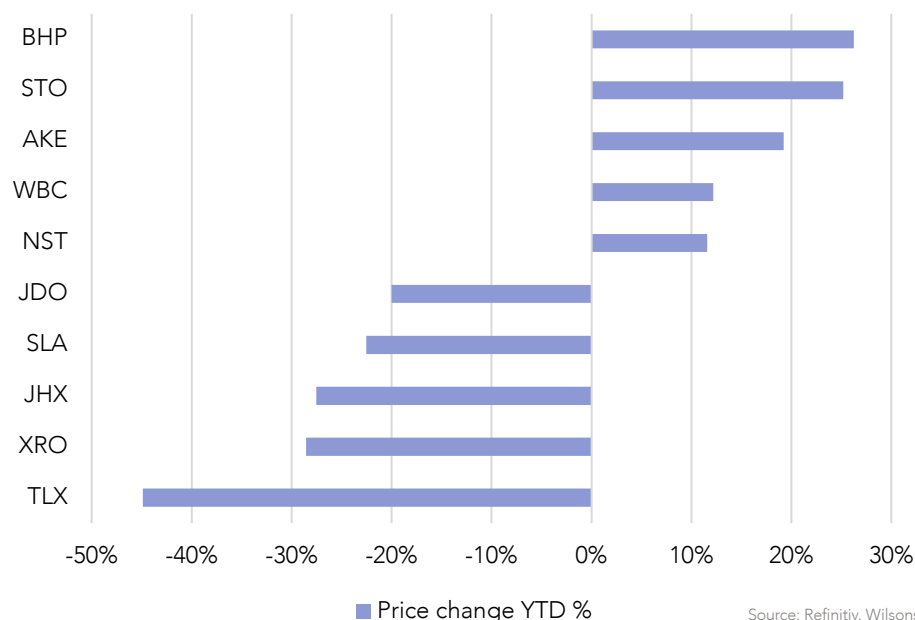


Figure 2: Focus List top 5/ bottom 5 performance in 1Q22



Across the Focus List 20 out of the 26 companies saw consensus earnings upgraded through the quarter. While resource and energy-related exposures saw the bulk of the earnings upgrades, there was a good showing from financials, healthcare, and industrials. Even technology-related companies like SEEK (SEK) and Xero (XRO) saw upgrades. The largest earning downgrades across the Focus List was from Block (SQ2). Whilst EPS revisions were negative (largely due to stock-based compensation), revenue estimates have been upgraded for both FY22E and FY23E after earnings growth accelerated in the last quarter.

Figure 3: Q1 sector performance

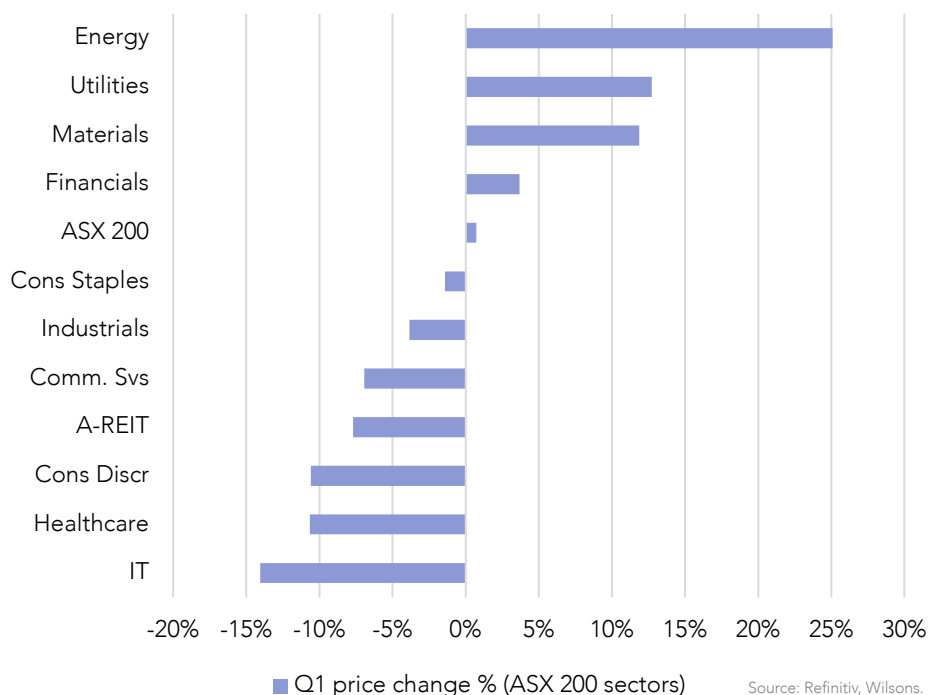
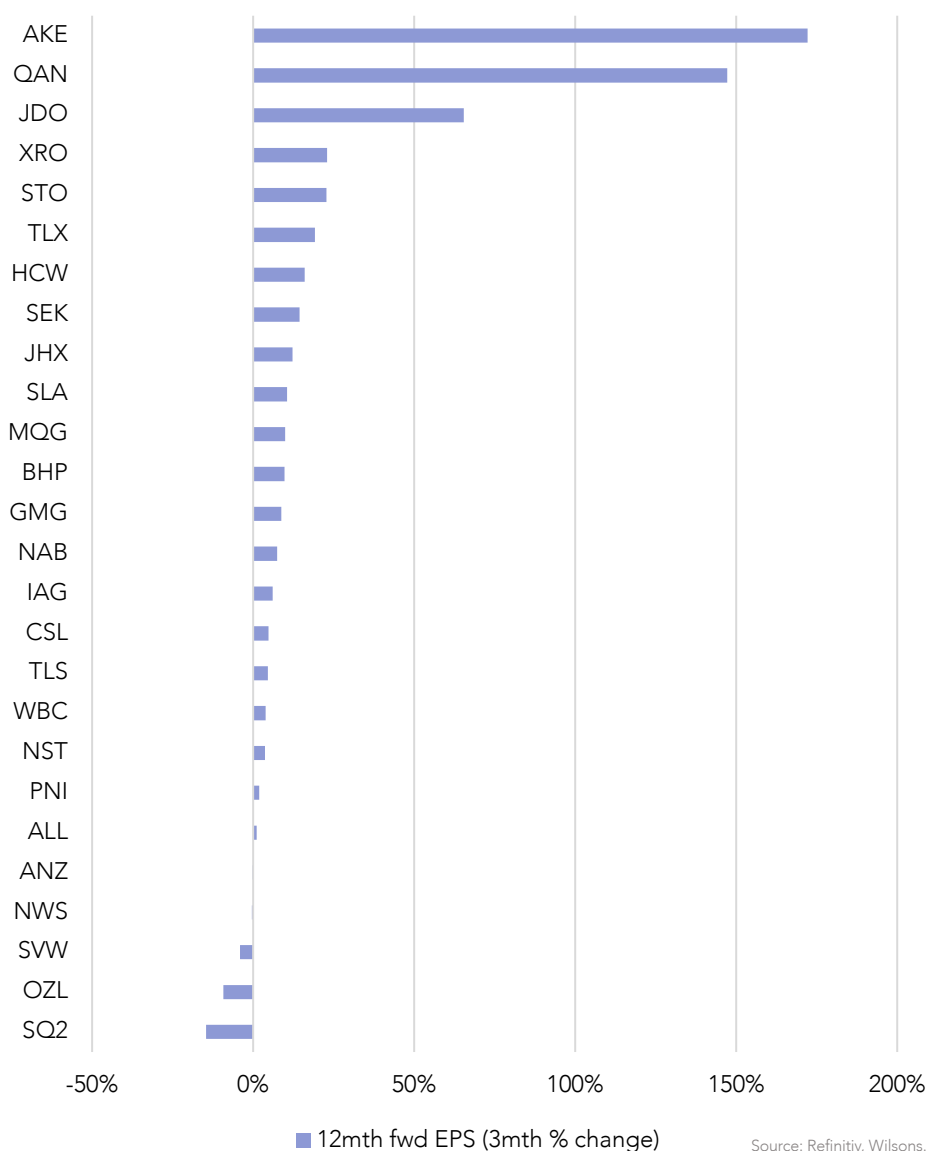
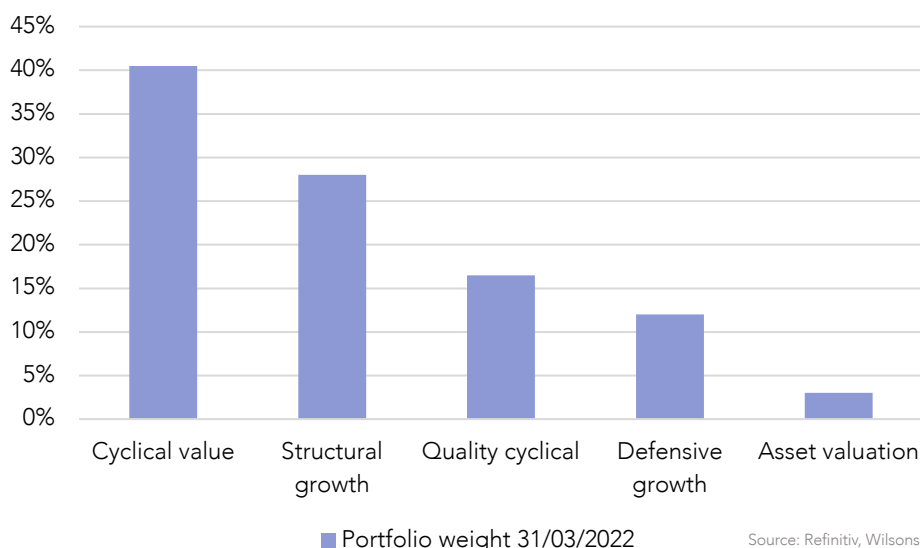


Figure 4: Focus List EPS revision during Q1



The Focus list continues to be positioned to companies that will benefit from the cycle in the second quarter. Cyclical value and quality cyclicals represent ~55% of the Focus List (this weighting peaked at ~65% in 2H21). We added more exposure to structural growth during Q1 with the addition of Allkem (AKE) and Pinnacle Investment Management (PNI) to the Focus List. The more defensive areas of the Focus List - defensive growth and asset valuation - remain unchanged during the quarter at ~20%.

Figure 5: Focus List current positioning



Telix Pharmaceuticals (TLX)

Focus List 2%

A difficult quarter for TLX following the United States Food and Drug Administration (FDA) approval in December. The significant underperformance of TLX is down to three reasons; 1) global sell-off in non-profitable growth companies; 2) larger than anticipated capital raising in January/director selling; 3) news of potential competitor product to Illucix from Novartis.

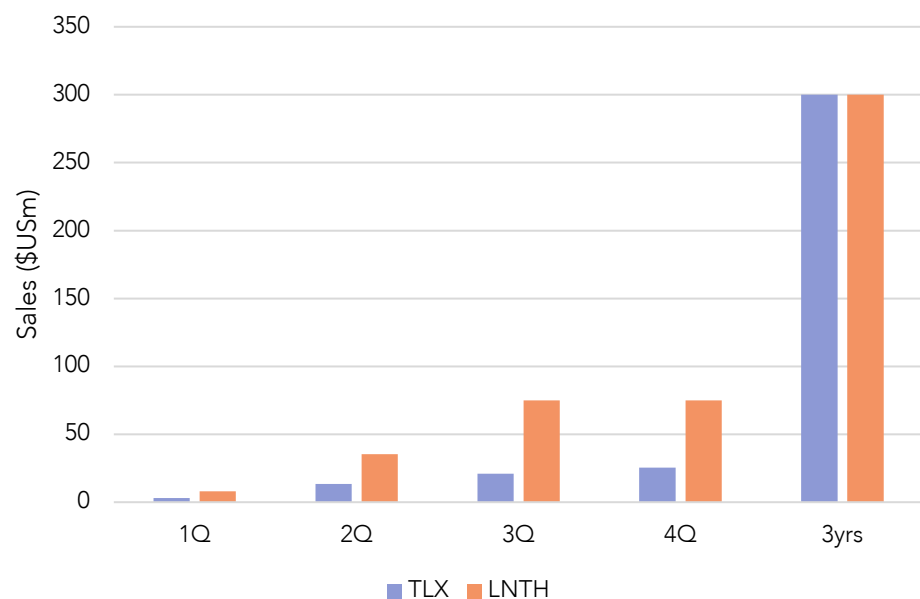
The price-performance of TLX is mid-pack relative to emerging US radiopharmaceutical-focused biotech's like Y-mAb Therapeutics (YMAB.US, \$US570 market cap), Point Biopharma Global (PNT.US, \$US600 market cap), and Fusion Pharmaceuticals (FUSN.US, \$US325 market cap) that have fallen between 40-80% since 3Q21.

In contrast, TLX's closet peer Lantheus (LNTH.US, \$US3.9bn), which has an approved in-market therapy similar to TLX, saw its market capitalisation double to \$US4bn over the quarter. February, Lantheus suggested sales for its therapy product could reach >\$US300m this year, in its first full year of sales. Lantheus is due to provide an update on sales in the second quarter.

We remain bullish on the outlook for TLX. Sales of Illucix will begin in the US this month, which could accelerate very quickly this year in our view. We expect additional news flow on other product developments through 2022.

Our Wilsons research team value TLX at \$A8.50, implying a \$A2.7bn market cap, in-line with Novartis' takeover of Endocyte in \$US terms. It is now down to TLX to show evidence of revenue growth.

Figure 6: Telix vs Lantheus forecasts sales per quarter post-launch. Both companies are expected to get ~33% of market in the US



*Quarterly sales rebased on first quarter of sales. Lantheus is currently in the 4Q post-launch.

Allkem (AKE)

Focus List 2%

Strong lithium prices continue to support AKE. Throughout the quarter prices continued to rise as the switch to auto EVs continued to gather pace. Last week AKE upgraded pricing guidance which implied ~20% earnings upgrades for FY22E. AKE has strong leverage to the lithium price given its move from contract to spot pricing. The earnings potential remains significant, with current pricing likely to produce ~\$500m EBITDA in FY22E, then doubling to >\$1bn in FY23E. Spot prices would imply still further upside.

The first strategy day for AKE took place yesterday after the merger of GXY and ORE. Management announced an increase in its production capacity for its operation, which should grow by x3 into 2026. The company announced an increase in capacity of its wholly-owned Sal de Vida Project, located in Argentina. The updated resource estimate of 6.85m tonnes of lithium carbonate equivalent is a 10% increase from 2021 estimates. AKE also announced an upgrade to the 66.6% Olaroz resource from 6.4m tonnes

to 16.2m tonnes of lithium carbonate equivalent, a 2.5x increase.

From a valuation perspective, AKE still looks very cheap relative to peer global diversified lithium producers. Albemarle Corporation (ALB. US) and Sociedad Química y Minera de Chile (SQM. US) both have ~\$US25bn market caps and trade at 22x and 9x EV/EBITDA respectively. In contrast, AKE has a market cap of \$A8bn, and trading on a 5x EV/EBITDA multiple.

Judo Bank (JDO)

Focus List 3%

Judo's share price has underperformed this year as the bank has been lumped together with other high-growth stocks by investors. The underperformance vs large-cap business bank NAB has been stark. In our view, JDO continues to look mispriced.

JDO is likely to reach its \$6bn AUM target by the end of FY22, given the credit growth environment and headcount 1H22.

We do not see a requirement for JDO to need additional equity to grow this side of its loan book reaching \$A10bn. JDO in the 1H22 delivered its maiden statutory profit. We think concerns around JDO's ability to fund and grow are mispriced.

James Hardie (JHX)

Focus List 4%

Over this quarter mortgage rates have risen rapidly in the US, explaining the poor performance of JHX. The 30-year fixed mortgage rate has risen by almost 2% points to 4.7% in 2022. As a result, there has been a headwind for US homebuilding-related stocks.

We continue to think fundamentals remain constructive for the US housing market outlook, which still looks tight. Housing inventories have been low since the GFC.

Despite the rise in mortgage rates, they are still low compared to history. While housing affordability has deteriorated as rates have increased, we do not think it signals a risk to demand in such a tight market where demand remains elevated. Both US housing permits and housing starts have surged in 2022, both are currently at cycle highs.

JHX is forecast to grow earnings 17% CAGR into 2025, whilst trading on a P/E ratio of ~17x. JHX has twice upgraded earnings over the past 6 months.

The company still has several structural growth levers including the push into B2C channels, which is in its infancy.

Figure 7: Focus List Q2 company catalysts

Company	Ticker	Portfolio Weight %	2Q Comment
Communication Services			
News Corporation	NWS	3.0%	Q3 Results 07 May. Earnings risks remain to upside driven by strong US economy and ad-cycle in the US. Strategic reset remains a waiting game, which could unlock significant shareholder value.
Telstra Corporation	TLS	3.0%	TLS generally provide a business update during May conference season. Earnings risks remain skewed to upside given performance in mobile.
Consumer Discretionary			
Aristocrat Leisure	ALL	4.5%	H1 Results 19 May. Focus will be on capital allocation/strategic direction with net cash balance sheet. Earnings risk remains to upside.
Silk Laser	SLA	2.0%	Look for reconfirmation of earnings ahead of balance date. Feedback we have suggests activity levels are improving post C19 impacted summer.
Energy			
Santos	STO	5.0%	Asset divestments the key near-term catalyst, which is re-rating catalyst on back of materially higher dividend. Mar production report 15 April likely to be a non event.
Financials			
NAB	NAB	7.5%	H1 Results 05 May likely to contain upside earnings risk. Bullish medium-term growth prospects do not look to be fully reflected in market estimates.
Macquarie Group	MQG	6.0%	H1 Results 05 May likely to contain upside earnings risk. Bullish medium-term growth prospects do not look to be fully reflected in market estimates.
Westpac	WBC	4.5%	H1 Results 09 May. Look for further evidence of lower costs, and improved execution in home lending.
ANZ	ANZ	3.5%	H1 Results 4 May. Key issue remains process on restoring operational momentum into the bank.
IAG	IAG	3.0%	Potential for further news on Business Interruption (BI) Insurance, potentially leading to a release of the BI provision.
Judo Capital	JDO	3.0%	Update on loan book expected every month. Guidance of \$6bn loan book by 30 June 2022.
Pinnacle Investment Group	PNI	2.0%	Funds under management (FUM) remains the focus, with potential for further M&A remains.
Healthcare			
CSL	CSL	8.0%	CSL generally provide a business update during May conference season. With foot traffic returning to US blood collection centres (Paysign recent results demonstrate) upside earnings risks for FY23E could be building.
Telix Pharmaceuticals	TLX	2.0%	Q3 4C cash report release due late April. Unlikely to show any sales Illucix given timing of sales. US peer Lantheus reports sales numbers 2 May.
Industrials			
Qantas Airways	QAN	4.0%	Likely to provide trading updates through May's conference season.
Seek	SEK	3.0%	Job ads numbers still expected to be strong over the quarter.
Seven Group Holdings	SVW	3.0%	Look for earnings update in late May/June. SVW upgraded earnings in February.
Information Technology			
Block	SQ2	2.0%	Block strategy day 17 May. Look for big focus on the Cash App and the Afterpay acquisition, which is not yet fully reflected in Street numbers.
Xero	XRO	2.0%	FY22 Results 12 May. Revenue unlikely to disappoint give new vol of new business creation, and lack of business failures. Key will be around level of cost growth and business re-investment.
Materials			
BHP Group	BHP	10.0%	After a strong Dec Q, Mar Q is typically weaker given weather. Updates on Potash, Coal/Petroleum divestments and any change to cost guidance given inflationary backdrop.
James Hardie	JHX	4.0%	Key peer LPX.US results 02 May. JHX 4Q 16 May. Operating environment still likely to be strong despite higher mortgage rates.
Northern Star Resources	NST	3.0%	Q3 production report due 23 April. FY22 guidance relies on a strong 2H bias, after a weak 2Q on softer vols and higher costs.
Oz Minerals	OZL	3.0%	Q1 Production 29 April. Typically a less important quarter. Keep an eye on costs guidance (OZL flagged cost pressures at Q4) and guidance implications for FY22. West Musgrave nickel project likely to be approved this Q.
Allkem	AKE	2.0%	Pre-released Q3 vols and pricing. The focus now remains on the direction the Li price, and execution of growth projects.
Real Estate			
Goodman Group	GMG	4.0%	Q3 16 April. Focus on pipeline into FY23E given two upgrades to FY22E have already occurred, reflective of development and very strong operating environment.
Healthco Healthcare and Wellness REIT	HCW	3.0%	Expecting news on capital allocation after IPO last year. Deployment of balance sheet could significantly lift distributions.

Source: Refinitiv, Wilsons.

Figure 8: Focus List metrics

Company Name	Ticker	Weighting	Share Price	Market Cap (A\$b)	Forecast Multiples		EPS	EPS	EPS	EPS CAGR %	Dividend Yield %	ROE	Net Debt/ EBITDA	Consensus Recommendation Mean (5 = Strong Sell, 1 = Strong Buy)
					12mth fwd PE	12mth fwd EV/EBITDA	FY1	FY2	FY3	(FY1-FY3)	12mth fwd	(FY1)	(FY1)	
Communication Services														
Telstra Corporation	TLS	3.0%	3.93	46.2	24.0	8.0	0.14	0.17	0.19	14%	4.1%	11%	1.6	2.2
News Corp	NWS	3.0%	30.09	17.3	22.6	7.8	0.93	1.02	1.18	13%	0.9%	7%	-0.2	2.0
Seek	SEK	3.0%	28.89	10.2	38.0	21.7	0.69	0.77	0.88	13%	1.7%	14%	2.3	2.4
Consumer Discretionary														
Aristocrat Leisure	ALL	4.5%	36.19	24.2	21.2	13.3	1.56	1.81	2.00	13%	1.8%	21%	0.2	2.1
Silk Laser Australia	SLA	2.0%	3.30	0.2	14.6	7.5	0.15	0.24	0.28	38%	0.0%	9%	1.3	1.3
Energy														
Santos	STO	5.0%	7.90	26.8	8.4	4.8	0.75	0.62	0.53	-16%	2.9%	16%	0.6	2.0
Financials														
National Australia Bank	NAB	7.5%	32.33	104.0	15.1		2.03	2.22	2.38	8%	4.6%	11%		2.1
Macquarie Group	MQG	6.0%	206.00	79.0	19.1		11.43	10.73	11.35	0%	3.1%	17%		2.0
Westpac Banking Corp	WBC	4.5%	23.95	83.9	13.9		1.54	1.86	2.07	16%	5.3%	8%		2.8
Australia and New Zealand Banking Group	ANZ	3.5%	27.18	75.9	12.4		2.07	2.27	2.48	9%	5.6%	9%		2.3
Insurance Australia Group	IAG	3.0%	4.37	10.8	15.1	10.5	0.20	0.31	0.32	26%	5%	8%		2.4
Judo Capital Holdings	JDO	3.0%	1.70	1.9	33.6		0.01	0.06	0.11	272%	0.0%	1%		2.5
Pinnacle Investment Management Group	PNI	2.0%	10.66	2.1	21.7	20.6	0.43	0.50	0.59	17%	3.8%	24%	-0.4	2.0
Healthcare														
CSL	CSL	8.0%	266.28	128.3	34.9	22.0	4.95	5.88	6.84	18%	1.2%	20%	2.2	1.8
Telix Pharmaceuticals	TLX	2.0%	4.27	1.3			-0.15	0.11	0.34		0.0%	-51%	3.5	1.6
Information Technology														
Qantas Airways	QAN	4.0%	5.24	9.9	32.7	6.1	-0.77	0.35	0.67		1.6%	-716%	62.0	2.2
Seven Group Holdings	SVW	3.0%	21.25	7.7	11.6	8.7	1.60	1.88	2.07	14%	2.4%	17%	2.7	2.1
Information Technology														
Xero	XRO	2.0%	101.04	15.1	229.9	59.7	0.05	0.45	0.79	289%	0.0%	2%	-0.8	2.3
Block	SQ2	2.0%	180.50	103.4	82.5	76.4	1.35	2.22	2.93	47%	0.0%	12%	-2.4	2.0
Materials														
BHP Group	BHP	10.0%	52.39	265.2	11.2	5.7	4.12	3.38	2.52	-22%	6.7%	40%	0.1	2.4
James Hardie Industries	JHX	4.0%	40.07	17.8	16.9	11.2	1.40	1.76	1.92	17%	3.6%	47%	0.7	2.2
OZ Minerals	OZL	3.0%	26.94	9.0	15.5	7.8	1.79	1.63	1.38	-12%	1.2%	15%	0.4	2.9
Northern Star Resources	NST	3.0%	10.50	12.2	21.3	6.2	0.34	0.52	0.60	33%	2.8%	4%	-0.1	1.7
Allkem	AKE	2.0%	12.40	7.9	11.6	7.2	0.41	0.88	0.88	47%	0.0%	16%	-0.2	1.9
Real Estate														
Goodman Group	GMG	4.0%	22.87	42.7	25.3	23.7	0.81	0.92	1.03	13%	1.4%	11%	0.8	1.9
Healthco Healthcare and Wellness Reit	HCW	3.0%	1.92	0.6	24.1		0.05	0.09	0.10	42%	4.4%	4%	6.4	2.0

*All currencies are AUD

Source: Refinitiv, Wilsons.

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Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

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