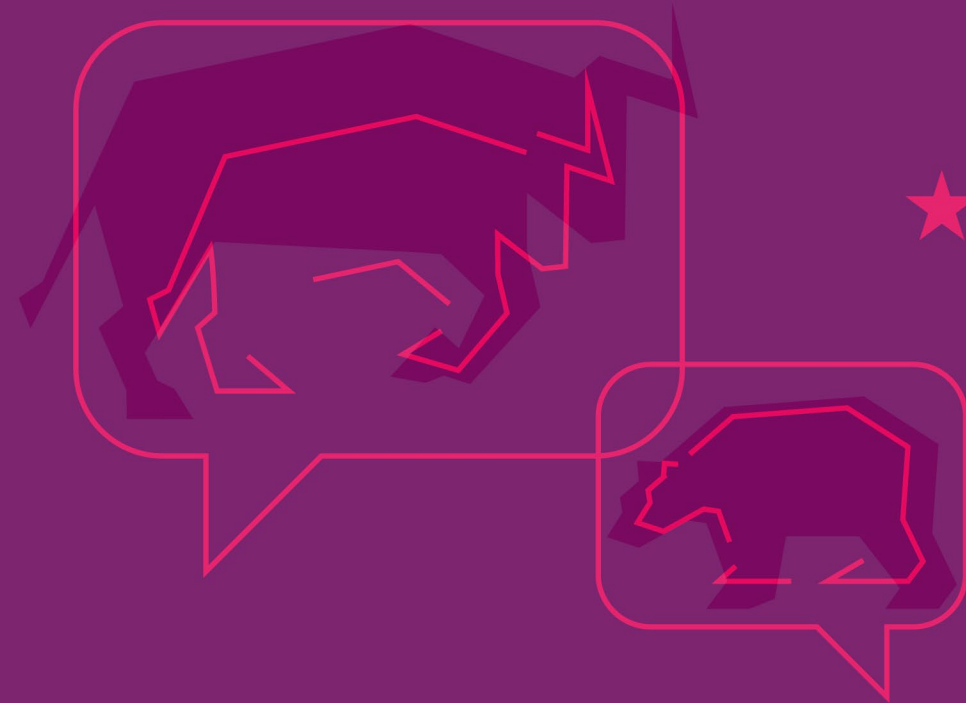
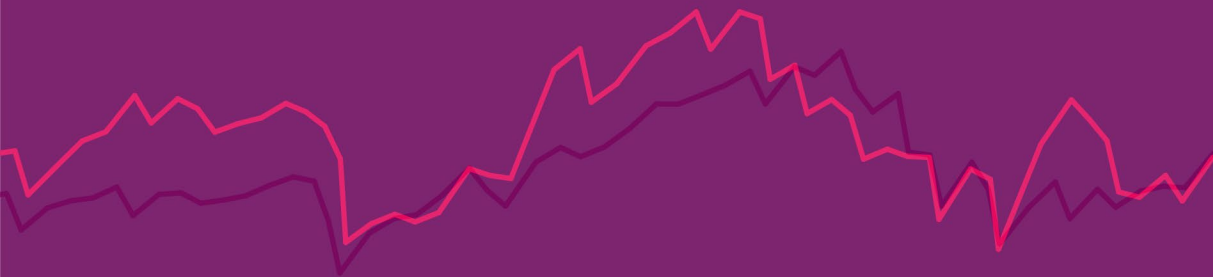


# Australian Equity Market Outlook: Q1 2025

Market is extended but opportunities remain.



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### **Important Disclosure**

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# Market Outlook

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# Valuations Look Stretched Against Weak Economic Fundamentals

The local market continues to press higher in the final quarter of 2024. Quarter-to-date, the S&P/ASX 200 index is up 2% and a touch below a record high of 8,495 set in early December. On an unweighted basis, our coverage traded 8% above fair value on Dec. 6. While considering this “overvalued” territory, the premium isn’t extreme. We’ve seen valuations at such levels 40% of the time over the past 10 years.

Since the presidential election, our equity market has largely mirrored the US, with the S&P 500 and S&P/ASX 200 up roughly 4%. Trump has promised corporate tax cuts and deregulation, so the US rally is understandable. It’s harder to see how our economy stands to benefit from Trump’s America-first, anti-China agenda.

Granted, pockets of our market may emerge winners. Companies with US-based supply chains and operations, such as BlueScope, James Hardie, and Pro Medicus, look like the more obvious candidates. But the bigger question lies with the iron ore miners—BHP, Rio Tinto, and Fortescue—which account for roughly 15% of the S&P/ASX 200 index. Their fortunes are inextricably linked to China’s prospects.

The Chinese economy, already struggling before the US election, could come under more pressure if another trade war breaks out. If China’s growth slows, so too would steel production, driven largely by demand from the domestic construction sector. The market seems unfazed, with iron ore holding at roughly USD 105 per metric ton since the election, well above our midcycle assumption of USD 70.

## ‘Trump Bump’ Pushes Market to Record Highs

S&P/ASX 200 Price Return index.



# Valuations Look Stretched Against Weak Economic Fundamentals

Perhaps investors hope a US-China trade war may portend another, more substantive, round of stimulus from the Chinese authorities. The first package, announced in late September, was initially met with exuberance, but enthusiasm gradually waned. A statement from China’s politburo in early December, pledging more support for the economy, suggests there is more to come. However, this is unlikely to manifest until Trump’s policy priorities are made clear.

With an overvalued market and geopolitical uncertainties looming, where does this leave investors? Fortunately, we still see many opportunities. More than a third of our coverage trades in 4 or 5-star territory, a higher proportion than average over the past decade. Value abounds in the energy sector, which continues to screen as the cheapest under coverage. We also see greater value in small caps, which have missed out on the gains of larger peers.

Meanwhile, the large caps have run hard, and valuations look stretched. The S&P/ASX 20 has returned roughly 25% since mid-2023, but aggregate earnings fell modestly in fiscal 2024, and we only expect a low single-digit increase in fiscal 2025. Eventually, something’s got to give: either earnings growth improves to justify higher valuations, or valuations adjust to reflect lower earnings. These things can take time, but in the long run, stock market growth is dictated by economic growth. Presently, stocks in the S&P/ASX 20 trade roughly 20% above fair value, on a market-cap-weighted average. Whether these valuations can be maintained is a big question heading into 2025.

## Large Caps at an Abnormal Premium

Price/fair value estimate ratio of S&P/ASX 20, market-cap-weighted.



# Economic Outlook

Lochlan Halloway | [lochlan.halloway@morningstar.com](mailto:lochlan.halloway@morningstar.com)

# Rate Cuts in Sight, but We're Not There Yet

Australia was late to the rate-hike party, and it looks like we'll be one of the last to leave. Global peers, including the United States, United Kingdom, and EU, have started easing, but the Reserve Bank of Australia looks several months away from a cut. Sticky inflation remains the culprit. Trimmed mean inflation, the RBA's preferred measure, was 3.5% year on year in the September 2024 quarter. This is well below a peak of 7% in 2022 but stubbornly above the RBA's 2%-3% target band.

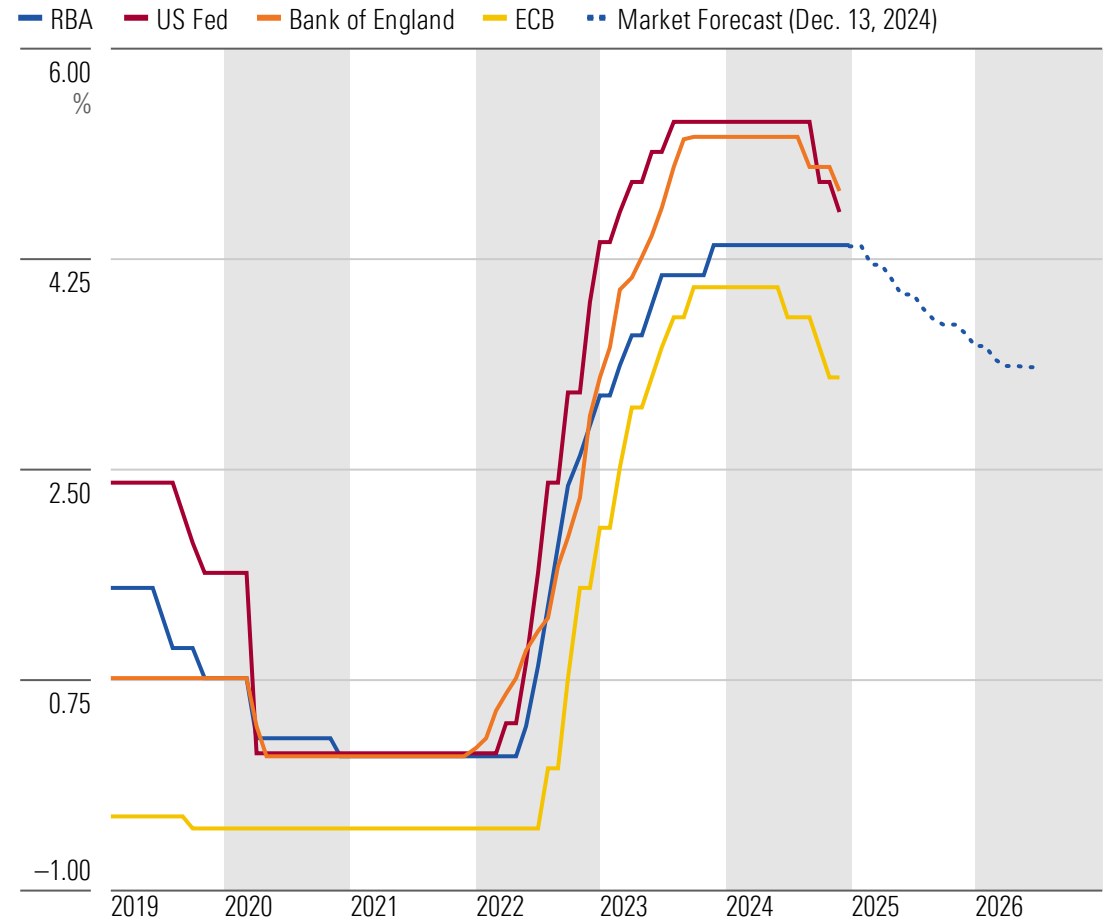
A tight labor market is also delaying monetary easing. At 3.9% in November 2024, the unemployment rate has increased only modestly since the RBA began hiking in 2022. Wage growth remains above trend, at 3.5% year on year in September 2024, though this is 80 basis points below the recent peak in December 2023. Cooling wage growth will comfort the RBA: it suggests that sticky wages are not entrenched, which should help keep inflation expectations anchored.

While the labor market is proving resistant to rate hikes, the broader economy is not. GDP eked out annual growth of only 0.8% in September 2024, the slowest pace since the pandemic and otherwise, since the early 1990s. GDP is growing well below population, resulting in the seventh consecutive quarterly decline in per capita output.

Responding to dovish rhetoric from the RBA at the December board meeting, bond markets now think the first cut will come in April 2025. That seems like a reasonable timeframe, assuming inflation continues to moderate in the December 2024 update. Roughly 100 basis points of cuts are priced by the end of 2025.

## RBA Back of the Pack on Rate Cuts

Central bank policy rates.



## Rate Cuts in Sight, but We're Not There Yet

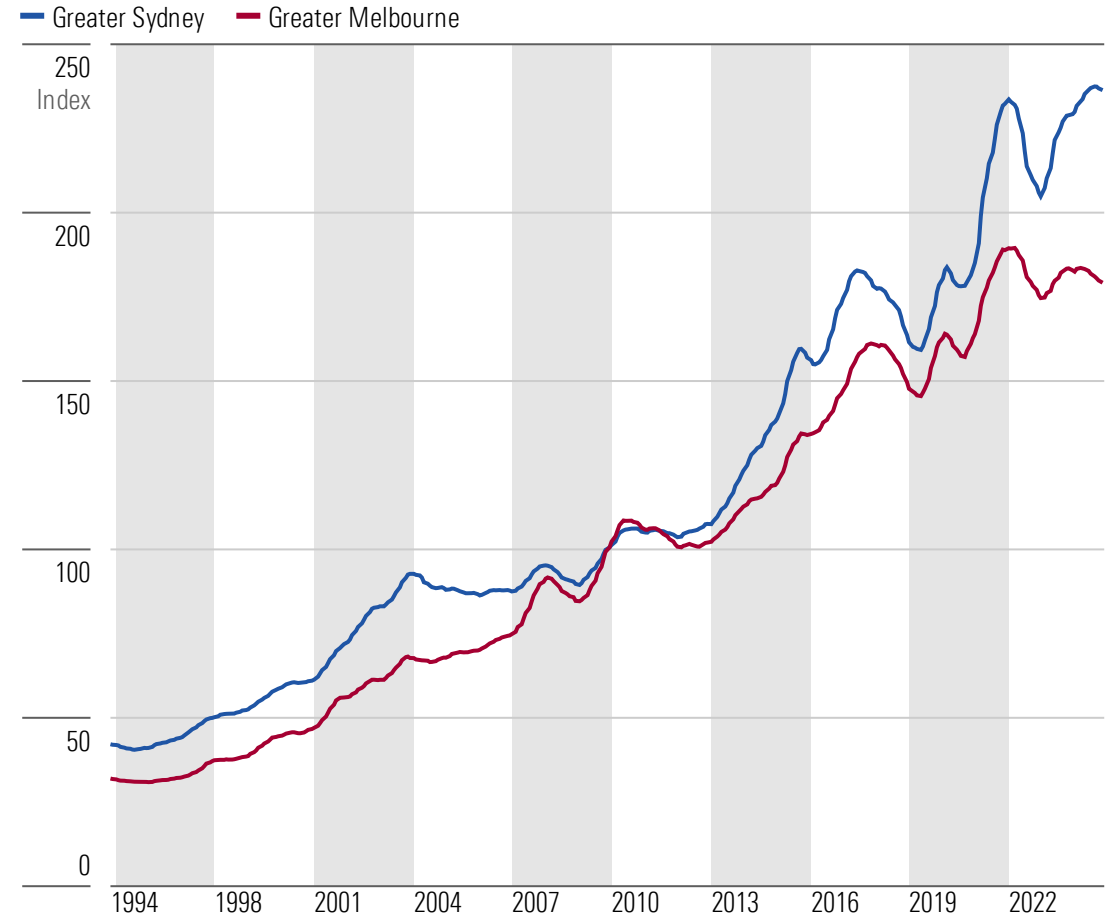
However, inflation containment is not yet assured. One risk is the federal election, which will be called sometime before May 2025. The Treasurer has promised restraint, but some degree of pre-election cost-of-living relief seems a given. Any further support must remain modest and targeted.

We can find disinflationary risks on the horizon, too. Should they come to pass, Trump's proposed tariffs could profoundly affect global trade. The US imported more than USD 400 billion of goods from China in fiscal 2024. If Trump slaps a big tariff hike on China, consumers will need to pay more, and demand should fall. In the long run, China can resize its manufacturing base to account for the loss of its biggest global customer. But these goods will need to find a home elsewhere in the short term. Australia is a potential buyer, and a glut of discounted goods from China may put downward pressure on our inflation rate. China accounted for roughly 25% of Australia's goods imports in 2023, according to the Department of Foreign Affairs and Trade.

House prices are also worth keeping an eye on in 2025. Rate hikes and unprecedented unaffordability are damping property price growth, albeit modestly. For the first time since early 2023, Sydney's monthly house price growth turned negative, off 0.5% between August and November 2024. In Melbourne, house prices have fallen a touch over 2% in the 12 months to November. Of particular importance are potential spillover effects on household consumption, given the strong historical correlation between house prices and spending.

### House Price Growth Arrested

CoreLogic Hedonic Home Value index.



# Valuation Overview and Top Picks

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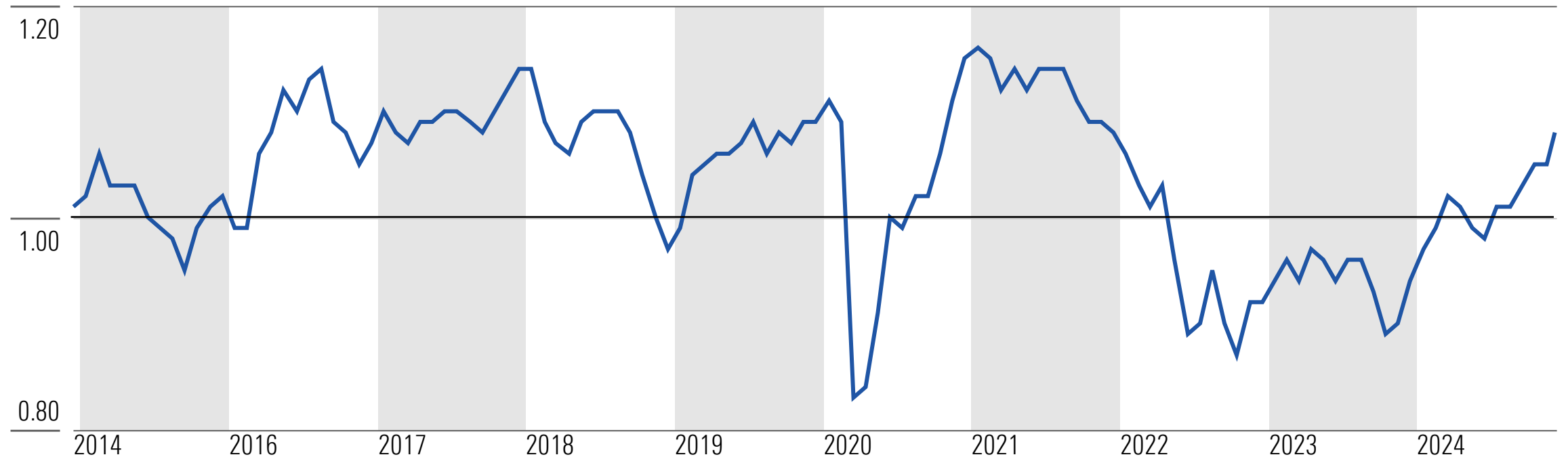
# Market Is Extended but Opportunities Remain

Australian and New Zealand stocks rallied strongly in the past year. As of Dec. 6, 2024, our Australia and New Zealand coverage was at an 8% premium to fair value on an unweighted average, compared with a 10% discount in the October 2023 dip. If history is any judge, markets can remain overvalued for prolonged periods, and we still see plenty of undervalued ideas.

## Stocks Overvalued on Average

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

— Average Price/Fair Value

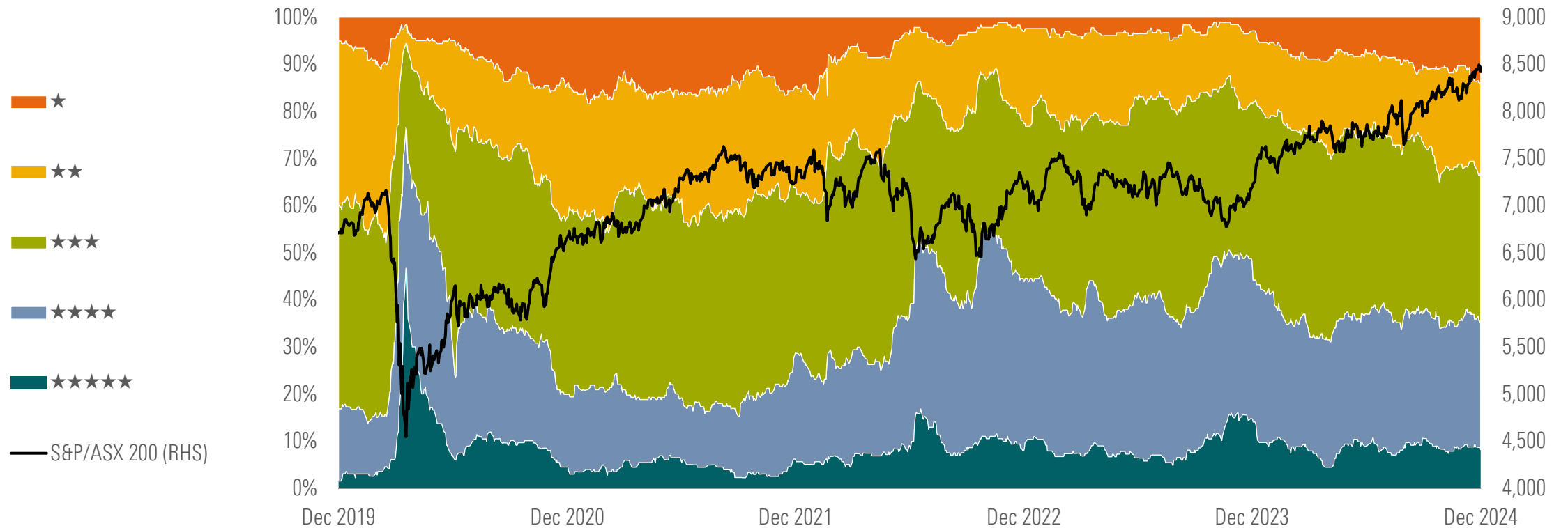


# Still Plenty of 4 and 5-Star Ratings Despite the Rally

About 36% of Australian and New Zealand stocks under coverage are 4 or 5-star-rated, well above the trailing 10-year average of 25%. Opportunities are most abundant in smaller stocks—about 60% of our 4 and 5-star-rated stocks are outside the S&P/ASX 100 index. Despite being lesser known, many of these stocks have strong competitive advantages and solid outlooks and can be found in the top picks list in this report.

## Positive Ratings Remain Plentiful

Star rating distribution over time.



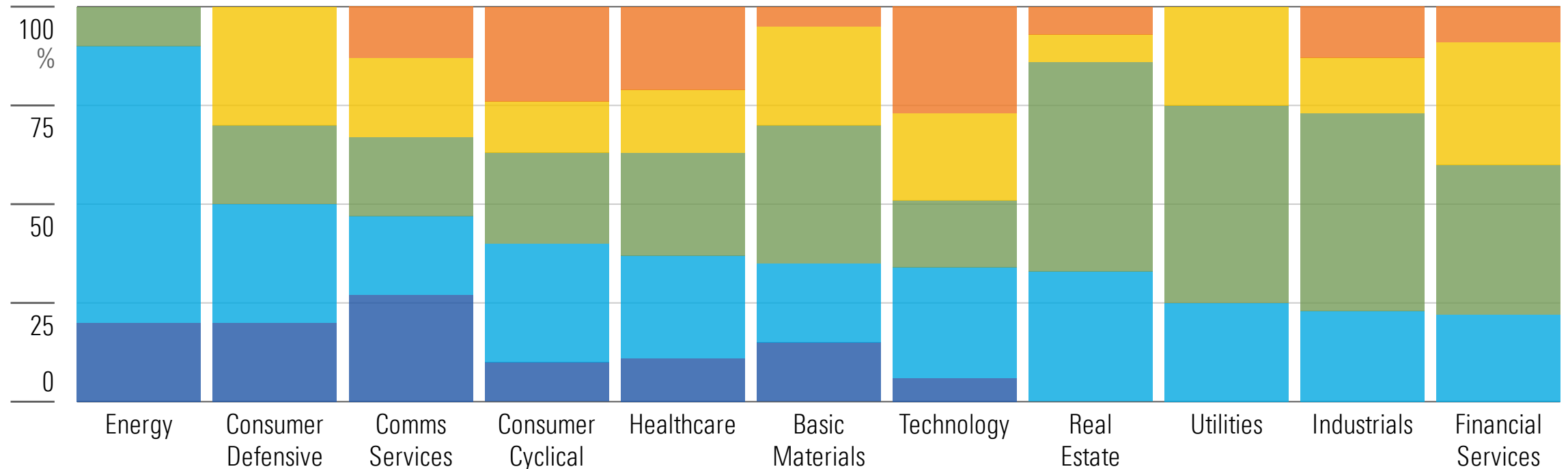
# Many Sectors Look Attractive

Energy is most undervalued on our estimates as the market frets about demand amid slowing global economies. While concerns are valid, the long-term outlook is favorable, and the biggest and best stocks in the sector are trading at attractive prices. We also see a lot of opportunities in the consumer and communication services sectors. Opportunities are less abundant in the financial services and real estate sectors, which have rallied strongly in the past year on the softening interest rate outlook.

## Plenty of Positive Ratings in Most Sectors

Star rating distribution by sector.

1 Star 2 Star 3 Star 4 Star 5 Star



## 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)
<b>Basic Materials</b>							
Nufarm (NUF)	★★★★★	AUD 7.70	AUD 3.83	High	None	0.50	AUD 1.47
Iluka Resources (ILU)	★★★★★	AUD 9.50	AUD 5.48	High	None	0.52	AUD 2.11
IGO (IGO)	★★★★	AUD 7.00	AUD 5.03	High	Narrow	0.72	AUD 3.81
<b>Communication Services</b>							
Nine Entertainment (NEC)	★★★★★	AUD 2.50	AUD 1.28	High	None	0.51	AUD 2.02
Spark New Zealand (SPK)	★★★★★	AUD 3.90	AUD 2.64	Medium	Narrow	0.68	AUD 4.84
TPG Telecom (TPG)	★★★★	AUD 6.40	AUD 4.49	Medium	None	0.70	AUD 8.35
<b>Consumer Cyclical</b>							
SKYCITY Entertainment Group (SKC)	★★★★★	AUD 2.70	AUD 1.28	High	Narrow	0.47	AUD 0.98
Domino's Pizza Enterprises (DMP)	★★★★★	AUD 58.00	AUD 32.48	High	Narrow	0.56	AUD 3.00
Bapcor (BAP)	★★★★	AUD 7.30	AUD 4.58	High	Narrow	0.65	AUD 1.60
<b>Consumer Defensive</b>							
IDP Education (IEL)	★★★★★	AUD 23.00	AUD 12.89	High	Narrow	0.56	AUD 3.59
Endeavour Group (EDV)	★★★★★	AUD 6.10	AUD 4.36	Low	Wide	0.71	AUD 7.79
a2 Milk (A2M)	★★★★	AUD 7.20	AUD 5.71	High	Narrow	0.79	AUD 4.13

## 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)
<b>Energy</b>							
Woodside Energy (WDS)	★★★★★	AUD 40.00	AUD 24.06	Medium	None	0.60	AUD 45.68
Santos (STO)	★★★★	AUD 10.00	AUD 6.59	High	None	0.66	AUD 21.40
Whitehaven Coal (WHC)	★★★★	AUD 9.30	AUD 6.42	Very High	None	0.69	AUD 5.34
<b>Financials</b>							
Perpetual (PPT)	★★★★	AUD 24.50	AUD 21.86	Medium	Narrow	0.89	AUD 2.50
ASX (ASX)	★★★★	AUD 75.00	AUD 68.36	Low	Wide	0.91	AUD 13.25
NIB Holdings (NHF)	★★★★	AUD 7.20	AUD 5.61	Medium	Narrow	0.78	AUD 2.73
<b>Health Care</b>							
Nanosonics (NAN)	★★★★	AUD 4.00	AUD 3.27	High	Narrow	0.82	AUD 0.99
Ramsay Health Care (RHC)	★★★★★	AUD 62.00	AUD 40.25	Medium	Narrow	0.65	AUD 9.27
Sonic Healthcare (SHL)	★★★★	AUD 32.00	AUD 28.57	Medium	Narrow	0.89	AUD 13.73
<b>Industrials</b>							
Aurizon Holdings (AZJ)	★★★★	AUD 4.50	AUD 3.35	Medium	None	0.74	AUD 6.17
Brambles (BXB)	★★★★	AUD 22.00	AUD 19.49	Medium	Wide	0.89	AUD 27.01
Amcor (AMC)	★★★★	AUD 17.80	AUD 15.94	Medium	Narrow	0.90	AUD 22.81

## 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)
<b>Real Estate</b>							
Dexus (DXS)	★★★★	AUD 9.60	AUD 6.98	Medium	None	0.73	AUD 7.51
The GPT Group (GPT)	★★★★	AUD 5.70	AUD 4.66	Medium	None	0.82	AUD 8.93
Charter Hall Group (CHC)	★★★	AUD 16.60	AUD 14.91	Medium	Narrow	0.90	AUD 7.05
<b>Technology</b>							
Fineos (FCL)	★★★★	AUD 3.10	AUD 1.91	Very High	Wide	0.62	AUD 0.65
SiteMinder (SDR)	★★★★	AUD 10.00	AUD 6.13	High	Narrow	0.61	AUD 1.71
Pexa Group (PXA)	★★★★	AUD 17.25	AUD 12.90	Medium	Wide	0.75	AUD 2.29
<b>Utilities</b>							
Manawa Energy (MNW-NZ)	★★★★	NZD 6.10	NZD 5.36	Medium	Narrow	0.88	NZD 1.68
APA Group (APA)	★★★★	AUD 9.30	AUD 7.27	Medium	Narrow	0.78	AUD 9.41
AGL Energy (AGL)	★★★	AUD 12.00	AUD 11.05	High	None	0.92	AUD 7.43



# Basic Materials

Jon Mills | [jon.mills@morningstar.com](mailto:jon.mills@morningstar.com)

# Disappointing China Stimulus Drives Sector Closer to Fair Value

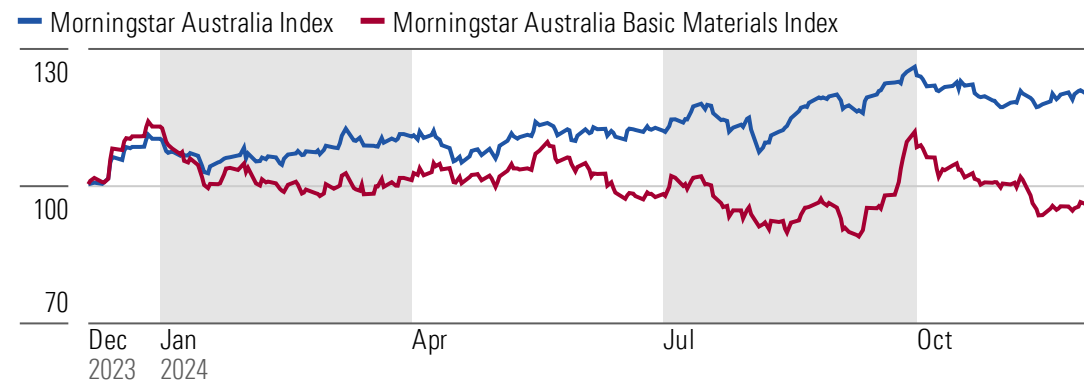
Our basic materials coverage is close to fairly valued on average. Optimism for a larger China stimulus drove iron ore and metallurgical coal prices up early in the quarter, but both have softened as stimulus disappoints. Copper is also lower on worries over China demand. In the longer term, structural headwinds in China, including its likely transition to a less commodity-intensive economy, a falling population, a housing oversupply, a mature stock of infrastructure, and rising trade frictions, are bearish for demand.

After reaching historical highs, gold has softened and is broadly stable, albeit still elevated. With the exception of Newmont, our gold mining coverage is expensive. Mineral Resources is cheap on a long-term view, driven by high debt levels and subdued lithium prices. The latter also means Deterra is cheap. While BHP and Rio Tinto are fairly valued, and Fortescue remains materially overvalued.

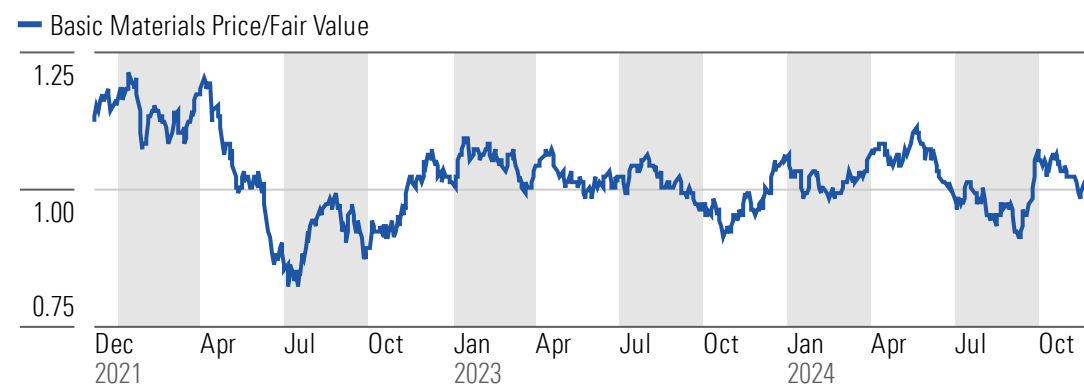
Slow China and global property markets drive mineral sands miner Iluka's material undervaluation. But we think demand will likely recover, assisted by long-term structural supply challenges in high-grade titanium dioxide and zircon markets.

Technology-based productivity solutions are lifting EBITDA margins for explosives providers Orica and IncitecPivot, with discipline and portfolio optimization complementing. Efficiency improvements include new electronic blasting system production lines and automation. Inflationary pressures, higher energy costs, supply chain disruptions, and geopolitical risks remain, but increased earnings from higher-margin premium products counters.

## Basic Materials Sector Weaker as China Stimulus Disappoints



## Sector Close to Fairly Valued

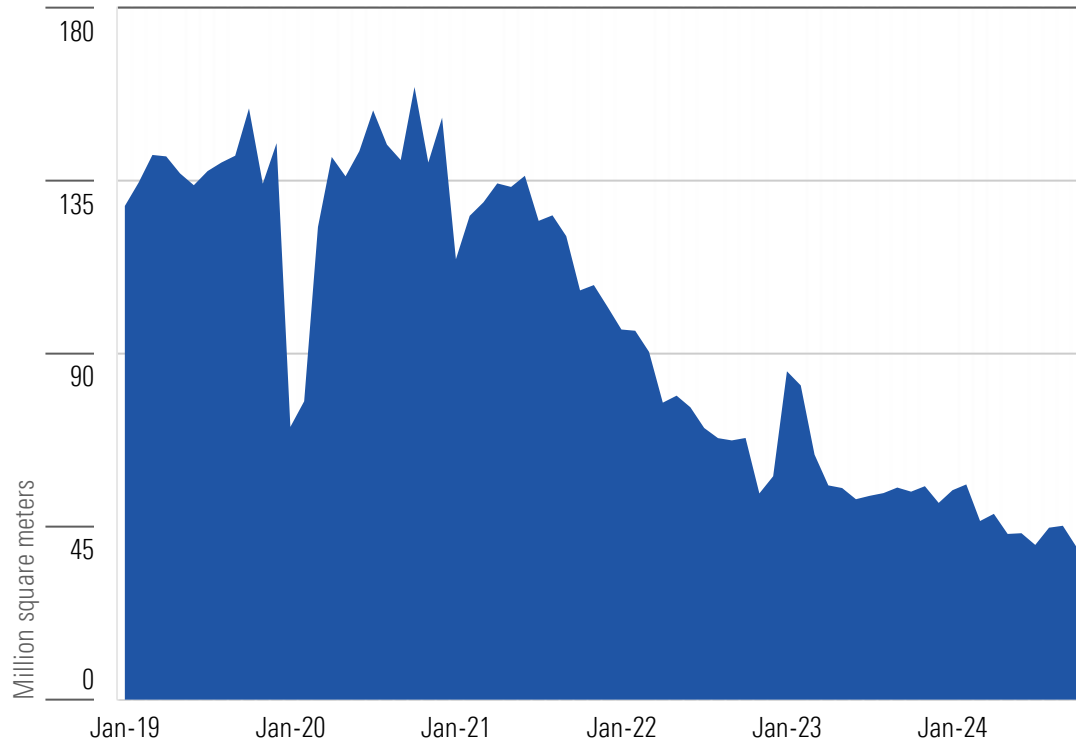


# Disappointing China Stimulus Drives Sector Closer to Fair Value

Iron ore prices are elevated due to weaker but still solid China steel production, which is again on track to exceed 1 billion metric tons in 2024. China comprises around 75% of the seaborne iron ore trade and drives the earnings of the Australian iron ore majors.

## Iron Ore Prices Still Elevated Despite Tottering Residential Real Estate Sector

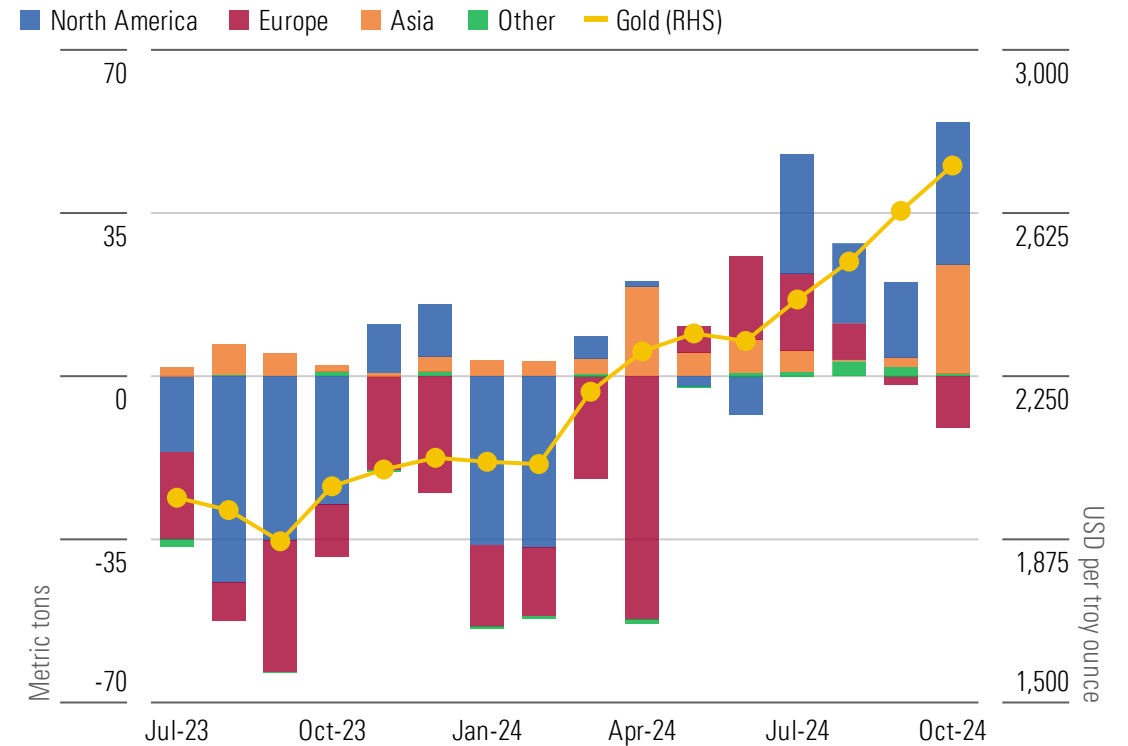
China residential housing new starts.



While jewelry is the biggest source of gold demand, exchange-traded funds tend to be the marginal buyers of gold and often the key drivers of near-term gold prices. Rising ETF flows from Western buyers have helped propel gold close to historical highs.

## Gold Prices Supported by Western ETF Flows Turning Positive

ETF flows.



Source: Chicago Mercantile Exchange / Haver Analytics (left). World Gold Council (right). Data as of Oct. 31, 2024.

See Important Disclosures at the end of this report.



## Basic Materials

<b>Company (Ticker)</b> Nufarm (NUF)	<b>Rating</b> ★★★★★	<p>Australian agricultural innovator Nufarm is on track to meet fiscal 2026 revenue aspirations of more than AUD 4.6 billion, up 30% on fiscal 2023's AUD 3.5 billion. This captures new crop protection product introductions and accelerated seed technology growth via Omega-3 canola and bioenergy developments. Nufarm's modest dividend doesn't particularly appeal, but the stock is a growth story. We project a five-year earnings per share compound annual growth rate of 22% for an attractive prospective mid-single-digit P/E by fiscal 2028. 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 planting for biofuel offtake is agreed with BP.</p>	
<b>Price</b> AUD 3.83	<b>Fair Value</b> AUD 7.70		<b>Uncertainty</b> High
<b>Market Cap (bil)</b> AUD 1.47	<b>Economic Moat</b> None		<b>Capital Allocation</b> Standard
<b>Company (Ticker)</b> Iluka Resources (ILU)	<b>Rating</b> ★★★★★	<p>While Iluka has succeeded in obtaining increased government support to help fund the blowout in capital expenditure to build its rare earths refinery at Eneabba, it will also have to contribute an additional AUD 215 million as part of the deal, about double what we previously expected. Along with concerns over reduced mineral sands demand due to slower global property markets, this is likely why shares trade at around half fair value. However, we think mineral sands demand will recover, while Iluka's increased capital contribution is also manageable. The refinery could be valuable if rare earths prices increase. With net cash of around AUD 150 million as of the end of June 2024, its solid balance sheet means Iluka can ride out what we see as a cyclical downturn.</p>	
<b>Price</b> AUD 5.48	<b>Fair Value</b> AUD 9.50		<b>Uncertainty</b> High
<b>Market Cap (bil)</b> AUD 2.11	<b>Economic Moat</b> None		<b>Capital Allocation</b> Exemplary
<b>Company (Ticker)</b> IGO (IGO)	<b>Rating</b> ★★★★★	<p>We think the market takes a different view on the outlook for lithium prices, the key valuation driver for IGO. We believe lithium prices are near a cyclical bottom, and this offers an attractive entry point for investors. Lithium trades well below our estimate of the marginal cost of production, and we expect prices to recover as end-market demand grows and higher-cost supply exits. IGO's primary asset is its minority stake in Greenbushes, one of the world's highest-quality and lowest-cost hard rock lithium mines. This asset underpins its narrow economic moat. We expect lithium demand to nearly triple by 2030 from levels in 2023, largely driven by electric vehicle sales. To support this, IGO plans to expand capacity at Greenbushes by about two-thirds by the end of the decade.</p>	
<b>Price</b> AUD 5.03	<b>Fair Value</b> AUD 7.00		<b>Uncertainty</b> High
<b>Market Cap (bil)</b> AUD 3.81	<b>Economic Moat</b> Narrow		<b>Capital Allocation</b> Standard



# Communication Services

Brian Han | [brian.han@morningstar.com](mailto:brian.han@morningstar.com)

## In Mobile, Telcos Rest While Costs Need to Fall Further in Media

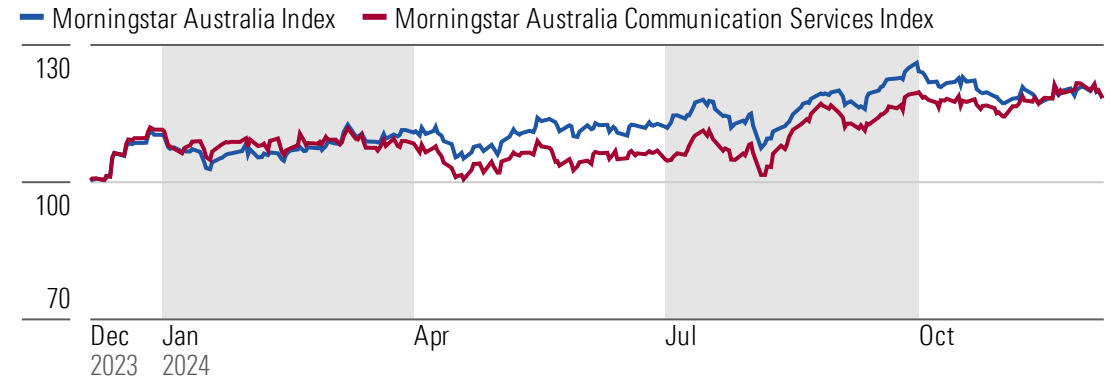
The telecommunication sector is not immune to a softening economy. However, the medium-term outlook is solid, especially as it relates to mobile. Average revenue per user continues to increase, driven by a growing focus on generating appropriate returns on recent heavy 5G-related investments. Cost cuts and efficiency improvements are also now a way of life for all telcos.

The positive mobile outlook underpins our expectations for mobile margins to largely plateau following significant improvement in recent periods. As mobile accounts for around half of the earnings of telecommunications companies under our coverage, this augurs well for the maintainability of dividends in the sector. At current prices, yields in the sector are 4% to 6%, with franking credits attached to most.

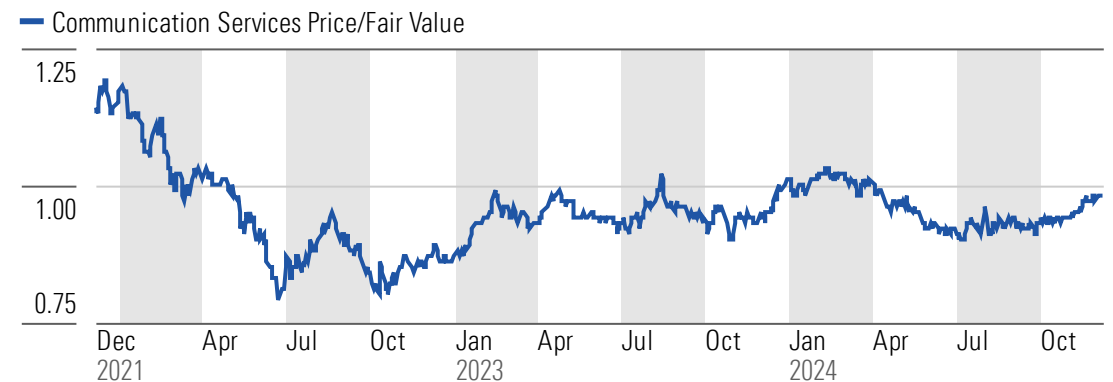
In media, the debate rages on whether the shares are fundamentally cheap or cheap for good reasons. We are in the former camp, as investor sentiment invariably overshoots to the downside during cyclical downturns in advertising. We are cognizant of the structural challenges. However, trading at 3 to 4 times our EBITDA forecasts, almost all media stocks are trading as if they are in terminal decline.

The pessimistic consensus ignores growth in the media companies' digital assets and the strategic pivots to reduce dependence on traditional advertising. The next step to restoring investor confidence is on the cost side. We believe costs, especially staff and content, still need to fall to reflect the structural step-down in traditional advertising.

### Sector Performance Weighed Down by Media



### Value in Defensive Telcos but Media Names Even Cheaper



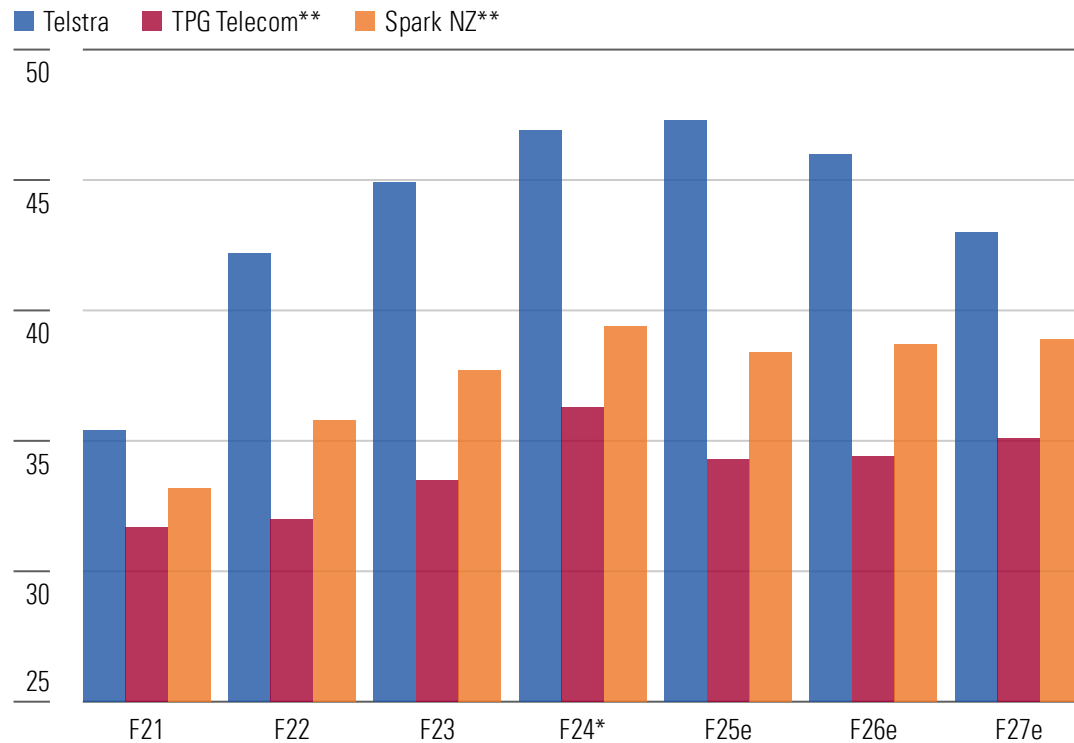
## In Mobile, Telcos Rest While Costs Need to Fall Further in Media

Rational competition, motivated by a growing desire to generate adequate returns from 5G capital investment, is lifting average mobile revenue per user. Coupled with continuing improvement in cost efficiency, this is underpinning elevated mobile margins.

There is more media companies can do on costs. For instance, employee costs still need to be readjusted to reflect the structural decline in traditional advertising revenue. The same can be said for programming or content costs.

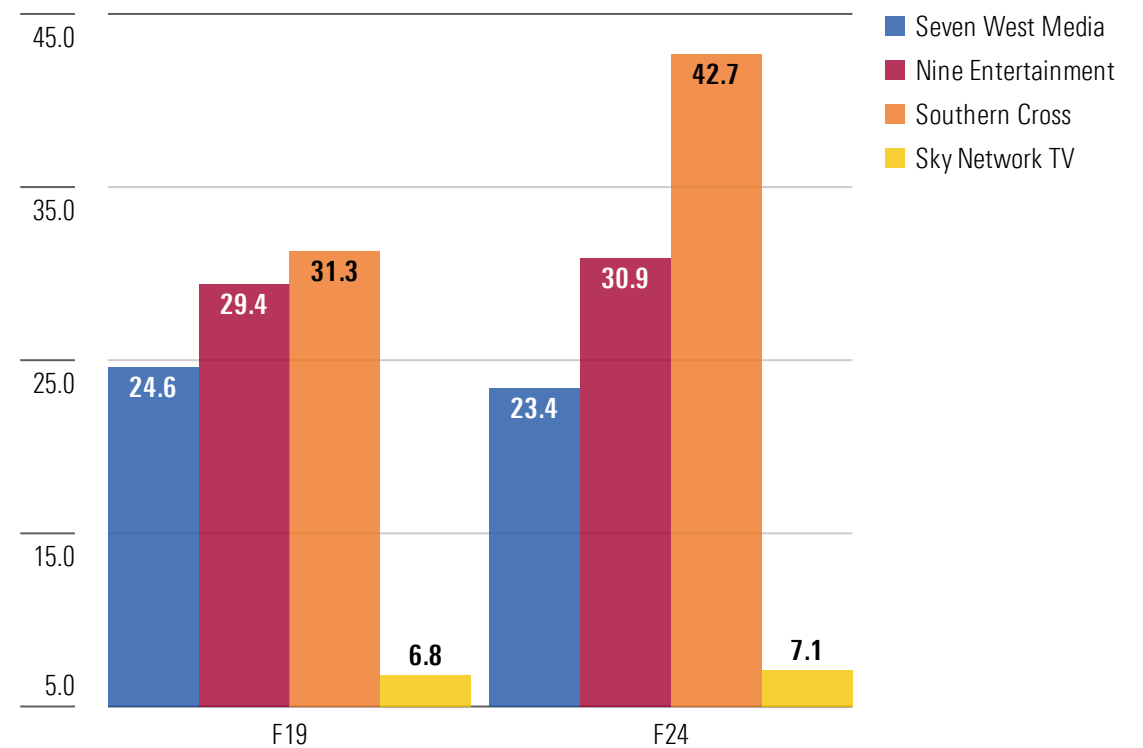
### Improved Mobile Profitability Set to Underpin Telco Cash Flows and Dividends

Mobile EBITDA margins by operator (%).



### More Staff Cost Cuts Needed in Media to Reflect Traditional Revenue Step-Down

Employee cost as a percentage of revenue (%).



\* TPG Telecom is December-year end, so F24 is our forecast for TPG Telecom. \*\* Our estimate as TPG Telecom and Spark NZ don't disclose divisional EBITDA. Source: Company reports and Morningstar estimates. Data as of December 2024,



## Communication Services

**Company (Ticker)**  
Nine Entertainment (NEC)

**Rating**  
★★★★★

**Price**  
AUD 1.28

**Fair Value**  
AUD 2.50

**Uncertainty**  
High

**Market Cap (bil)**  
AUD 2.02

**Economic Moat**  
None

**Capital Allocation**  
Standard

No-moat Nine Entertainment spans advertising and entertainment in Australia. Exposure to the structurally challenged free-to-air television advertising market is offset by a broadcast streaming offering, a subscription video-on-demand service, and 60% ownership of the 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 advertising downturn. 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. While the persistent advertising recession hurts group earnings and investor concerns about structural headwinds hurt earnings multiples, the risks are more than reflected in the current bargain basement stock price.

**Company (Ticker)**  
Spark New Zealand (SPK)

**Rating**  
★★★★★

**Price**  
AUD 2.64

**Fair Value**  
AUD 3.90

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 4.84

**Economic Moat**  
Narrow

**Capital Allocation**  
Standard

Challenging economic conditions in New Zealand exert revenue pressure on narrow-moat Spark, particularly for business spending on communications and IT-related projects. This saw a 3% decline in fiscal 2024 EBITDAI, the first fall in eight years, and exposed structural cost issues in Spark's IT businesses. But cost reductions and efficiency improvements are kicking in with management focused on free cash flow maximization via greater capital expenditure discipline. As such, we see the current 8% yield as maintainable and attractive as investors wait for cost-outs and the economic recovery to come through.

**Company (Ticker)**  
TPG Telecom (TPG)

**Rating**  
★★★★★

**Price**  
AUD 4.49

**Fair Value**  
AUD 6.40

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 8.35

**Economic Moat**  
None

**Capital Allocation**  
Standard

TPG Telecom's benefits from a more rational mobile market are coming through. In a three-player mobile network market with each increasingly more focused on return on their vast capital investments, especially in rolling out 5G, we believe rational competitive behavior will continue. This is likely to be augmented by continuing growth from fixed wireless. Pending completion of the AUD 5.3 billion corporate telecom unit sale will further accentuate the benefits of being a mobile-focused entity, while the sales proceeds will wipe out any lingering market concerns about TPG's balance sheet. Benefits of cost-out and business simplification initiatives are already emerging, just as the current capital expenditure hump from 5G and IT modernization is beginning to moderate. The overhang of major shareholders whose holdings are now out of escrow after the Vodafone merger may be causing some investor consternation. However, these concerns are more than reflected in the share price, especially given the longer-term tailwinds for the telecom industry as it makes the transition to 5G.



# Consumer Cyclical

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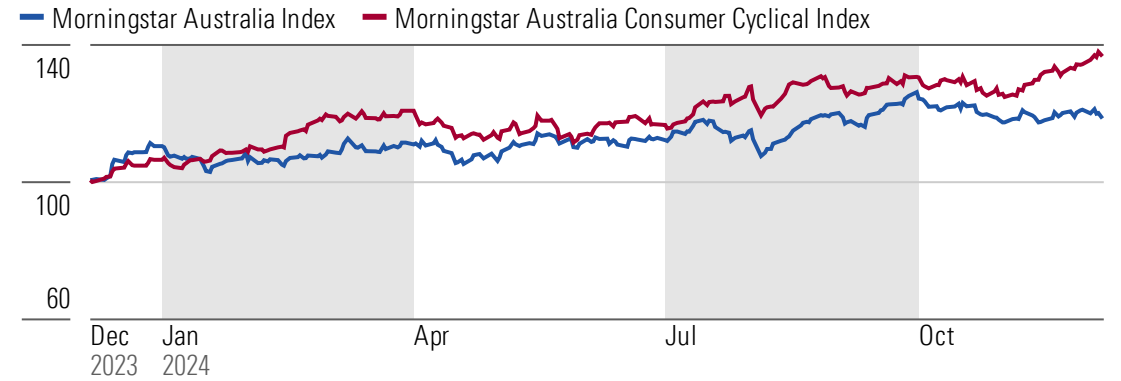
# Discretionary Sales Momentum Strengthening

Following a challenged discretionary spending environment in fiscal 2024, we forecast a broad rebound in fiscal 2025—owing to a larger workforce, higher wages, and meaningful tax cuts. Many discretionary retailers are already enjoying strengthening sales momentum. However, investors seemingly expect a more pronounced medium-term recovery, and valuations look stretched. But pockets of value exist. Fast-food operators Domino’s and Collins Food are undervalued.

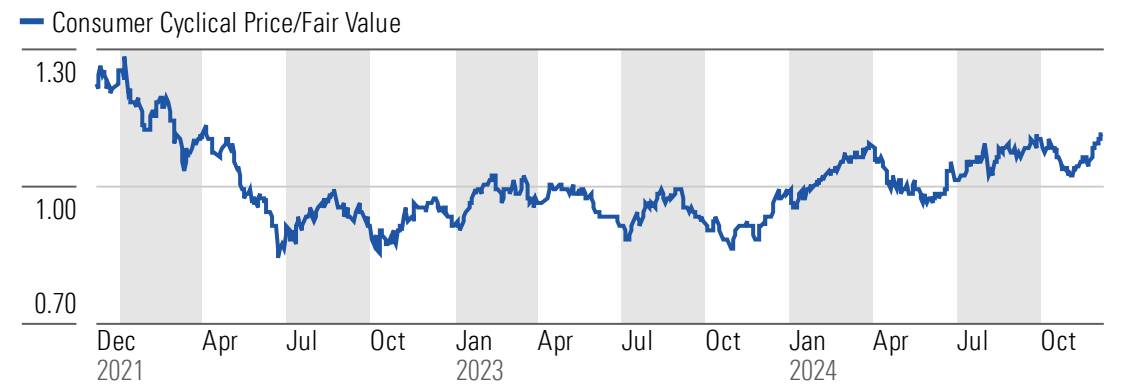
The structural migration of shoppers online is truly back after a brief hiatus following the reopening of the economy after the pandemic. Operating margins of discretionary retailers are typically less affected by the shift to online from in-store. Smaller retailers often depend on marketplaces like Amazon, which take a clip of the sales ticket. While we expect larger retailers with proprietary online platforms to retain their margins, we expect mature brands to gradually reduce physical footprints as more sales move online.

Bapcor’s Autobarn is losing market share in do-it-yourself auto parts retailing. Genuine Parts’ Repco and Super Retail Group’s Supercheap Auto have capitalized on management turmoil at Bapcor amid cyclically weak discretionary sales. Low-single-digit revenue declines at Autobarn during fiscal 2024 trailed Repco and Supercheap Auto at low-single-digit growth, and this momentum appears to have continued into the first half of fiscal 2025. But we think negative sentiment amid short-term headwinds overlooks Bapcor’s fundamental resilience, as outlined in our top picks below. We expect demand for discretionary goods to revert to trend levels in the longer term and underlying automotive spare parts demand—the bulk of earnings—to remain resilient.

## Cyclicals Have Outperformed the Market



## Valuations Stretched on Average, but Some Opportunities

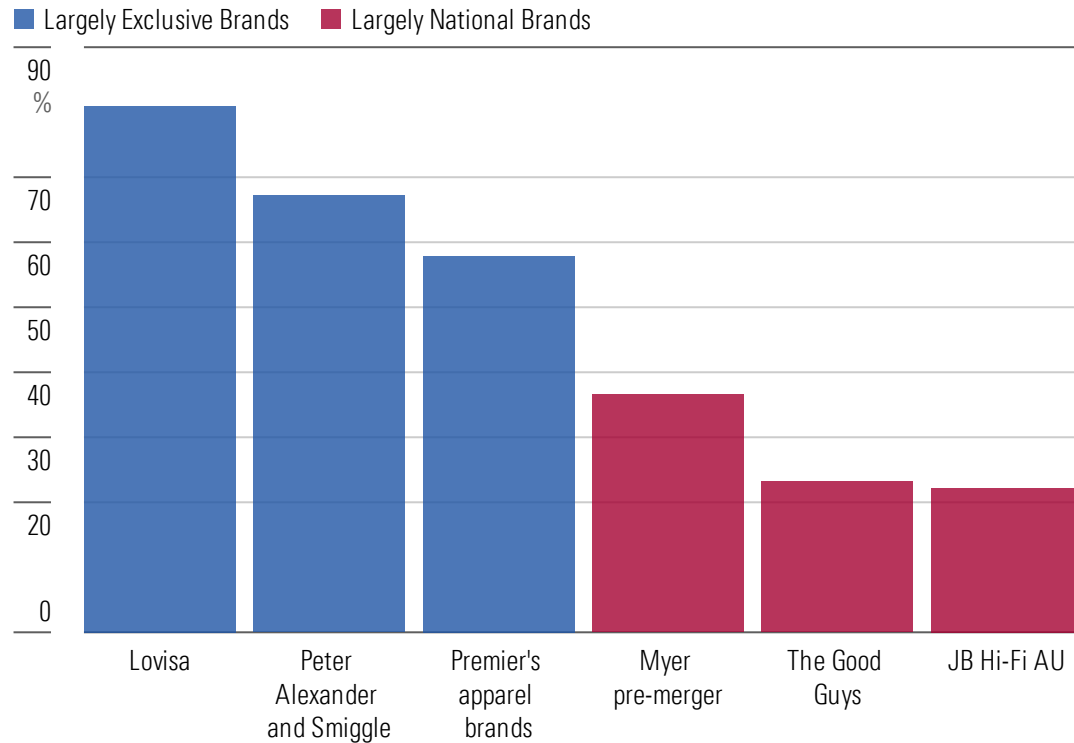


# Discretionary Sales Momentum Strengthening

Retailers are looking to boost profit margins by selling more higher-margin private-label goods. Myer’s proposed merger with Premier’s apparel brands is a case in point, aiming to better monetize the combined group’s expansive store network and online business.

## Materially Increasing Exclusive Brand Sales Should Boost Myer’s Gross Margin

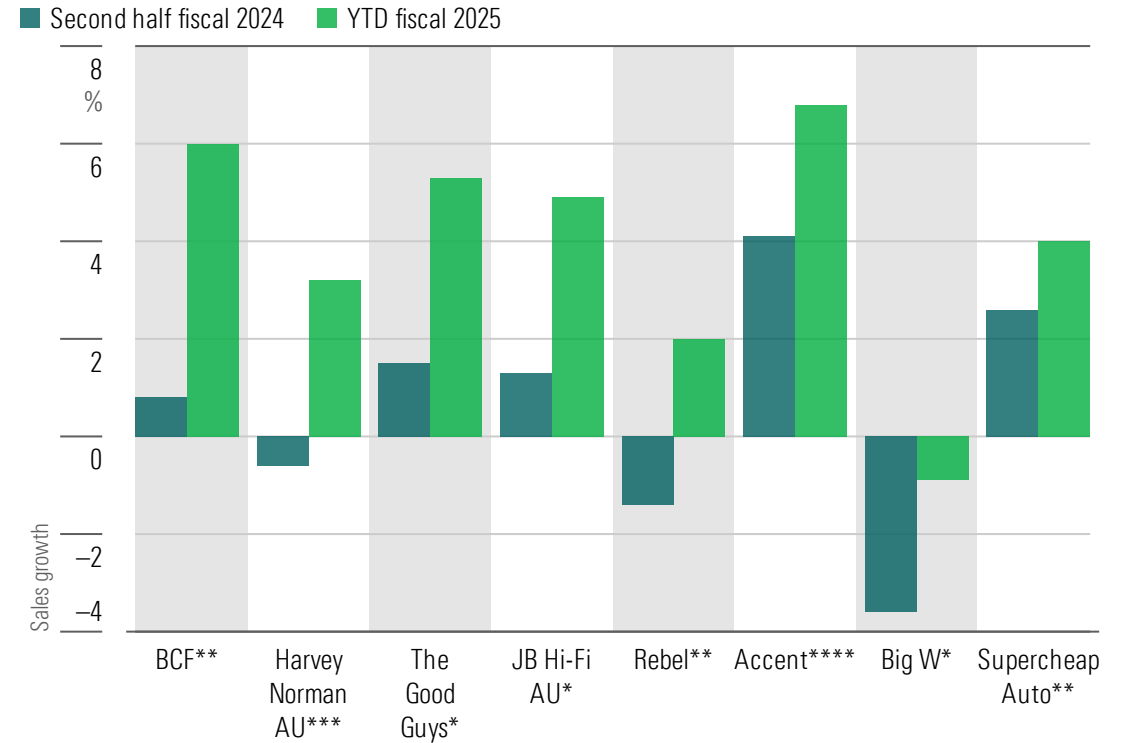
Gross profit margin in fiscal 2024.



Sales momentum is building across the discretionary retailing sector. The Australian Bureau of Statistics estimates nonessential goods retailing sales increased by 3% in the September quarter of 2024 compared with only 1% sales growth in the June half of 2024.

## Large Retailers Seeing Much Stronger Sales Momentum in Early Fiscal 2025

Sales growth rate in fiscal 2025 to date and second half of fiscal 2024 vs the PCP.



Source: Company filings. Note: Big W, JB Hi-Fi, and The Good Guys second-half fiscal 2024 sales growth compared with September-quarter 2024 trading; Supercheap Auto, Rebel, and BCF compared with first 16 weeks of fiscal 2025; Harvey Norman compared with first four months to October 2024; Accent first 20 weeks of fiscal 2025.

See Important Disclosures at the end of this report.

 Consumer Cyclical

<b>Company (Ticker)</b> SKYCITY Entertainment Group (SKC)		<b>Rating</b> ★★★★★	Regulatory headwinds and weaker earnings weigh on SkyCity shares. Regulatory and compliance costs are up sharply—much of which we expect to be permanent, and the weaker discretionary environment is weighing on both the mass market and premium consumers. However, we think pessimism is overblown. We expect a recovery from the current cyclical downturn and for the core Auckland property to capitalize on the continued recovery in New Zealand tourism. We expect a sharp uptick in profitability from fiscal 2026 as one-off costs roll-off, a full year of earnings from Horizon Hotel, and the New Zealand International Convention Centre comes online during the period. Capital spending is also set to ease materially as about NZD 1 billion in major projects near completion.
<b>Price</b> AUD 1.28	<b>Fair Value</b> AUD 2.70	<b>Uncertainty</b> High	
<b>Market Cap (bil)</b> AUD 0.98	<b>Economic Moat</b> Narrow	<b>Capital Allocation</b> Standard	
<b>Company (Ticker)</b> Domino's Pizza Enterprises (DMP)		<b>Rating</b> ★★★★★	Domino's Pizza is a high-quality company with a long growth runway. We forecast a 20% 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 improving store economics. However, we believe the market is overly discounting Domino's intact and significant long-term growth potential. We forecast the network to approach 6,000 stores by fiscal 2034, from around 3,800 as of June 2024, below management's long-term ambition of 7,100.
<b>Price</b> AUD 32.48	<b>Fair Value</b> AUD 58.00	<b>Uncertainty</b> High	
<b>Market Cap (bil)</b> AUD 3.00	<b>Economic Moat</b> Narrow	<b>Capital Allocation</b> Exemplary	
<b>Company (Ticker)</b> Bapcor (BAP)		<b>Rating</b> ★★★★	Negative sentiment amid short-term headwinds, management turmoil, and structural changes facing the automotive industry have left the fundamental strength and resilience of Bapcor's automotive parts business underappreciated. A slowdown in discretionary spending weighs on retail in the near term, a new management team will need to prove itself, and the proliferation of electric vehicles is a long-term obstacle for the trade business. However, we think near-term pessimism overlooks fundamental resilience in automotive spare parts, and Bapcor is likely to successfully adapt to the gradual technological transition.
<b>Price</b> AUD 4.58	<b>Fair Value</b> AUD 7.30	<b>Uncertainty</b> High	
<b>Market Cap (bil)</b> AUD 1.60	<b>Economic Moat</b> Narrow	<b>Capital Allocation</b> Exemplary	



# Consumer Defensive

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# Supermarket Operating Margins Under Pressure

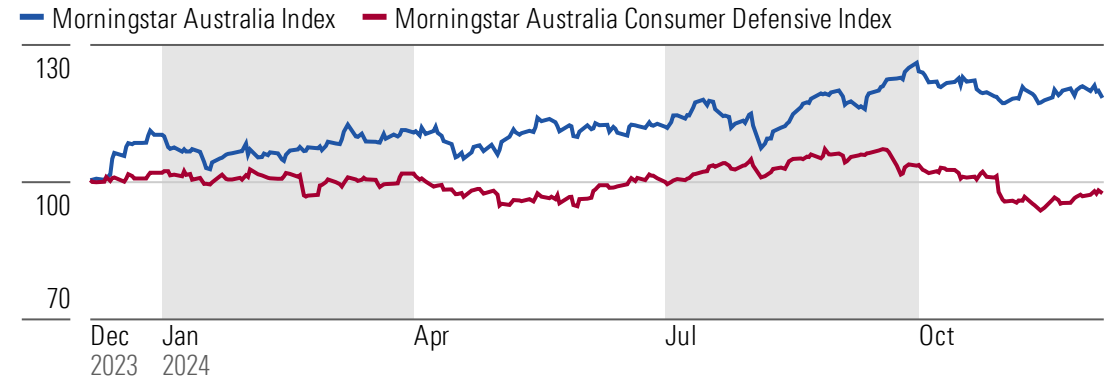
Consumers are seeking savings, and supermarkets are offering more promotions. Woolworths' average shelf prices fell for the third consecutive quarter. Coles is also extending its private label range to offer better value for money to increasingly thrifty consumers.

Grocers' operating margins are under pressure. Shoppers are shifting to cheaper products, volume growth is soft, shelf prices are easing, and cost inflation is lingering. The structural shift to e-commerce is exacerbating those margin pressures. With online sales margins lower than in-store, e-commerce in food is margin-dilutive. We expect strong online growth to persist in the medium term, with Coles' significant online fulfillment capacity expansion ramping up.

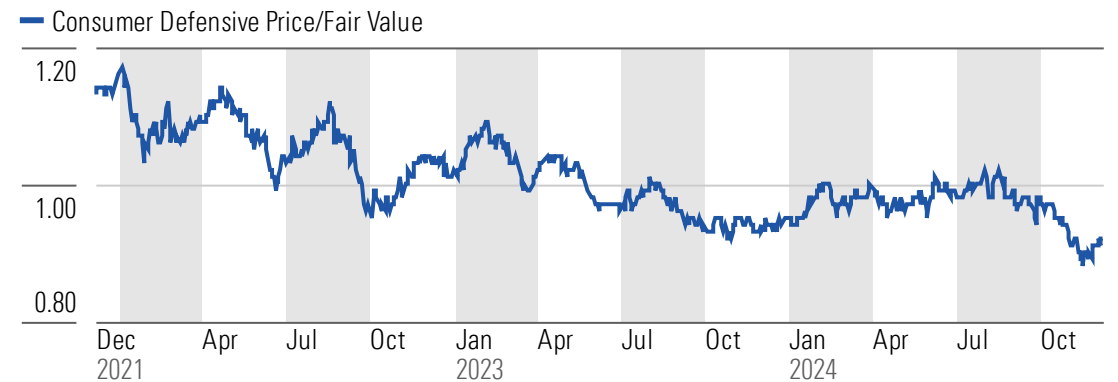
Coles and Woolworths are investing heavily in supply chains. The new generation of automated distribution centers, which store and pack products for supermarkets, is much less labor-intensive. The RBA surely rejoices in the positive impact on Australia's labor productivity. However, with both major chains improving their cost structure, we expect efficiency gains to be lost and the impact on operating margins to be immaterial.

Australians are also cutting back on their liquor spending, and liquor retailers are reacting to cyclically soft demand by offering more promotions. Nevertheless, shares in Endeavour screen as undervalued. We believe current retailing performance reflects a cyclically weak trading environment due to elevated cost-of-living pressures.

## Defensives Have Gone Nowhere in the Last Year



## Average Defensive Valuations Are Undemanding

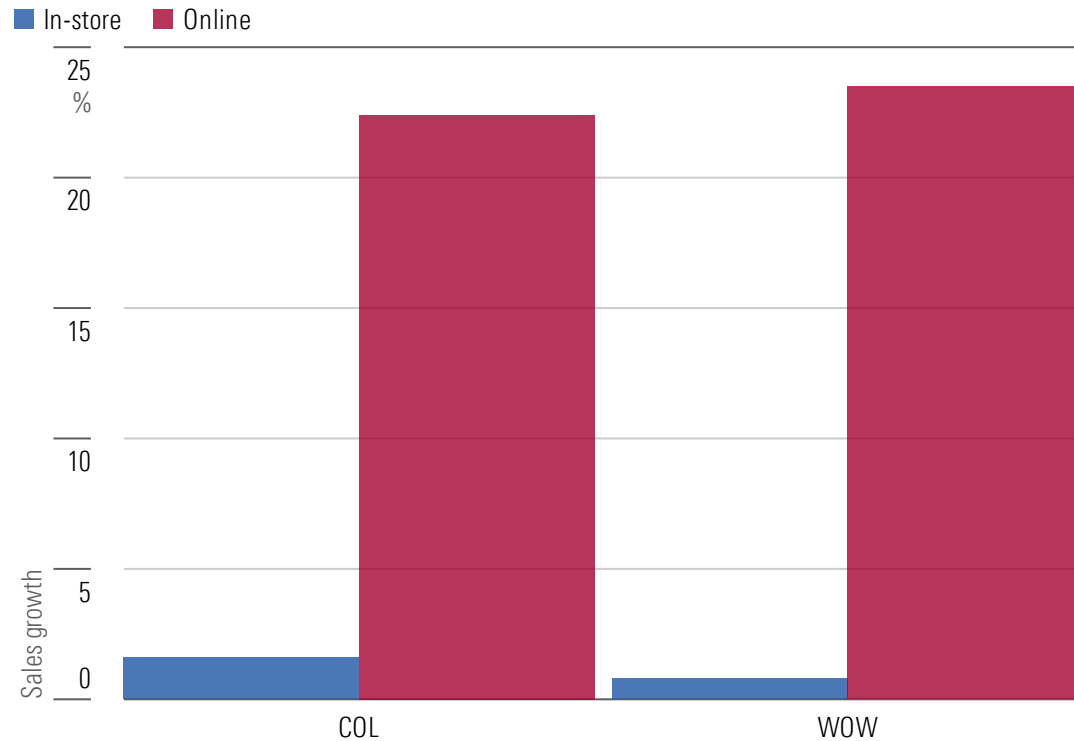


# Supermarket Operating Margins Under Pressure

Grocery store closures are likely on the table as shoppers flock to the majors' online channels. Lower-margin online sales weigh on group margins, and in-store sales growth below the recent 4% increase in hourly wages stresses store economics.

## Online Grocery Sales Growth Dwarfs In-Store

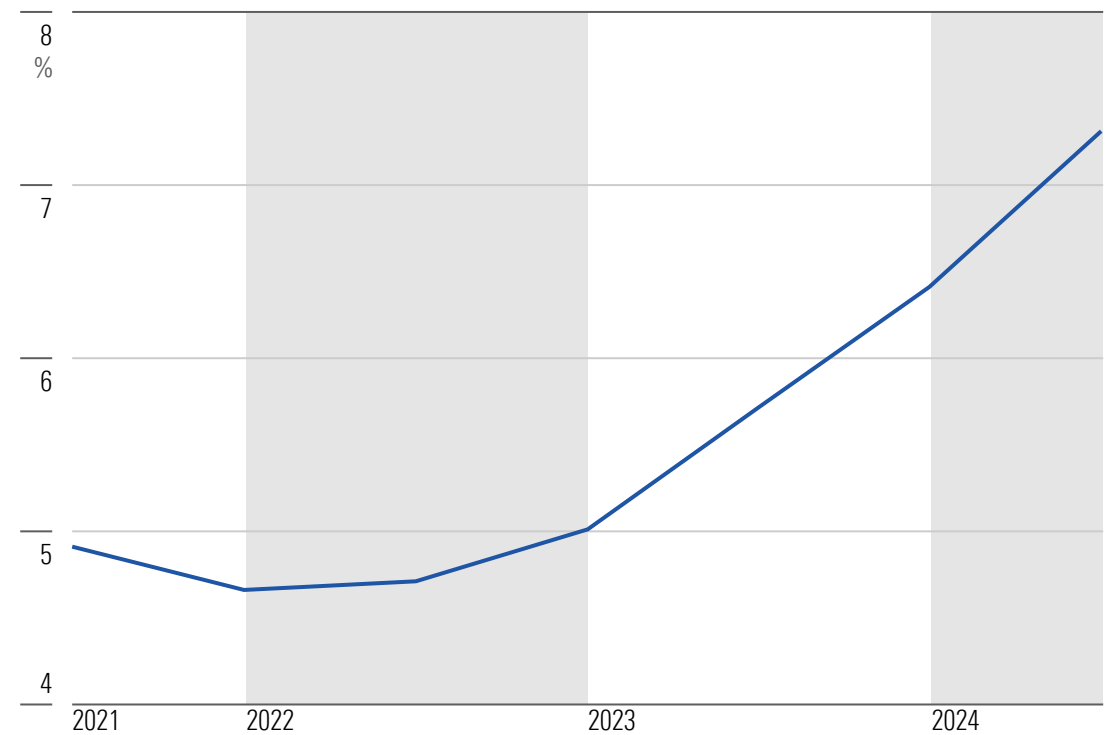
Sales growth by channel in September quarter 2024 vs PCP.



Given more muted overall market growth, a2 Milk's opportunity primarily lies in gaining share in Chinese infant formula. Product metrics are strengthening, and we expect the a2 brand to resonate in China in the long term.

## Despite Falling Births in China, A2 Milk Continues to Capture Market Share

A2 Milk value share of the Chinese infant formula market



Source: Company filings, Kantar.

See Important Disclosures at the end of this report.

 Consumer Defensive
**Company (Ticker)**

IDP Education (IEL)

**Rating**

★★★★★

**Price**

AUD 12.89

**Fair Value**

AUD 23.00

**Uncertainty**

High

**Market Cap (bil)**

AUD 3.59

**Economic Moat**

Narrow

**Capital Allocation**

Exemplary

The market has a short-sighted view of IDP Education, driven by recent declining volumes and regulatory uncertainty. We agree that the short-term outlook is soft, and we forecast IDP's earnings to fall in fiscal 2025. However, we expect the firm to outperform broader industry declines as the industry preferences high-quality operators like IDP. We see compelling long-term value given that proposed foreign-student caps are temporary and in response to transitory cyclical concerns. The pricing outlook is positive in the near term, with IDP negotiating improved terms and universities looking to raise tuition fees given soft student volumes. We expect IDP to benefit from long-term macroeconomic drivers that underpin international education. See our [IDP Education Stock Pitch](#), published in November 2024, for more details.

**Company (Ticker)**

Endeavour Group (EDV)

**Rating**

★★★★★

**Price**

AUD 4.36

**Fair Value**

AUD 6.10

**Uncertainty**

Low

**Market Cap (bil)**

AUD 7.79

**Economic Moat**

Wide

**Capital Allocation**

Exemplary

Endeavour shares trade at an attractive valuation and fully franked yield. The market underappreciates the defensive long-term earnings outlook as consumers curtail nonessential spending. We believe current retailing performance reflects a cyclically weak trading environment due to elevated cost-of-living pressures. However, we expect liquor sales momentum to improve during fiscal 2025 and sales growth to reach durable levels in the mid-single digits from fiscal 2026. In the long term, liquor demand is defensive and underpinned by inflation and population growth, and we expect the structural premiumization trend to counterbalance declines in per-person liquor consumption.

**Company (Ticker)**

a2 Milk (A2M)

**Rating**

★★★★★

**Price**

AUD 5.71

**Fair Value**

AUD 7.20

**Uncertainty**

High

**Market Cap (bil)**

AUD 4.13

**Economic Moat**

Narrow

**Capital Allocation**

Standard

There is much to like about a2 Milk, notably in China, the key battleground. A2's share of Chinese-language-labeled infant formula is growing, 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 further premiumization and for a2 Milk to capture market share. We forecast 8% annual revenue gains to fiscal 2029 as channel inventory levels normalize and market share increases. We also see improved sales of higher-margin English-label products and operating leverage from higher revenue.

 **Energy**

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## Energy Transition Fears Overblown

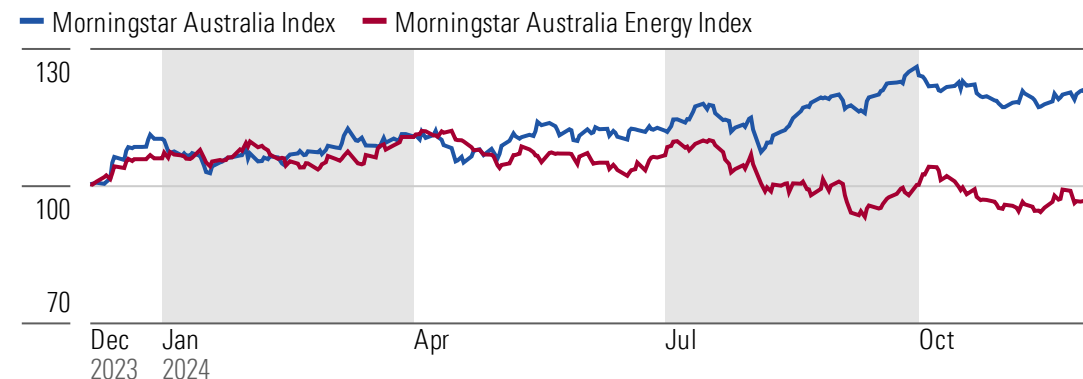
Some think the end of hydrocarbons is nigh. However, oil and gas demand is growing, with predictions of a near-term peak followed by rapid decline likely premature. Significant hydrocarbon investment is required in most demand scenarios to backfill a natural supply decline of 5% to 6% per year.

It is not feasible to eradicate all oil demand, which contributes to our forecast for a gradual, rather than sudden, decline in demand. Road transport accounts for just under half of total oil demand and is the most vulnerable, given the advent of electric vehicles. But even here, it may not be practicable to supplant all internal combustion engines, particularly in heavy haulage.

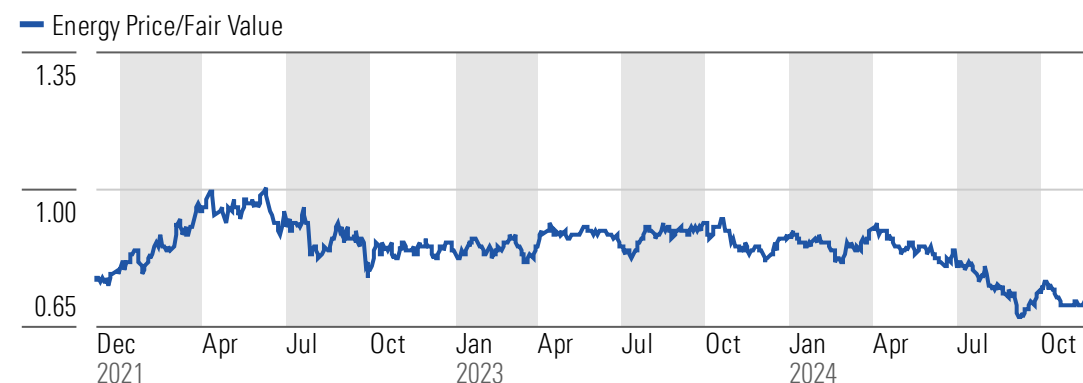
In aviation, the weight makes using batteries over any meaningful distance nonviable. In other sectors, there simply are often no alternatives. Nonfuel/noncombustion uses for oil, including petrochemicals, plastics, and bitumen, are important and sometimes overlooked. These account for just over one-fourth of each barrel of oil consumed.

The outlook for liquefied natural gas is particularly positive, given the increasing GDP per capita in regions short of gas deposits, with an opportunity for LNG to displace coal in emerging markets and for gas as firming power (backup) for renewables. LNG demand is expected to increase by almost 60% over the next 10 years, according to Wood Mackenzie.

### Energy Sector Still Struggling Despite Favorable Outlook



### The Energy Sector Is Materially Undervalued

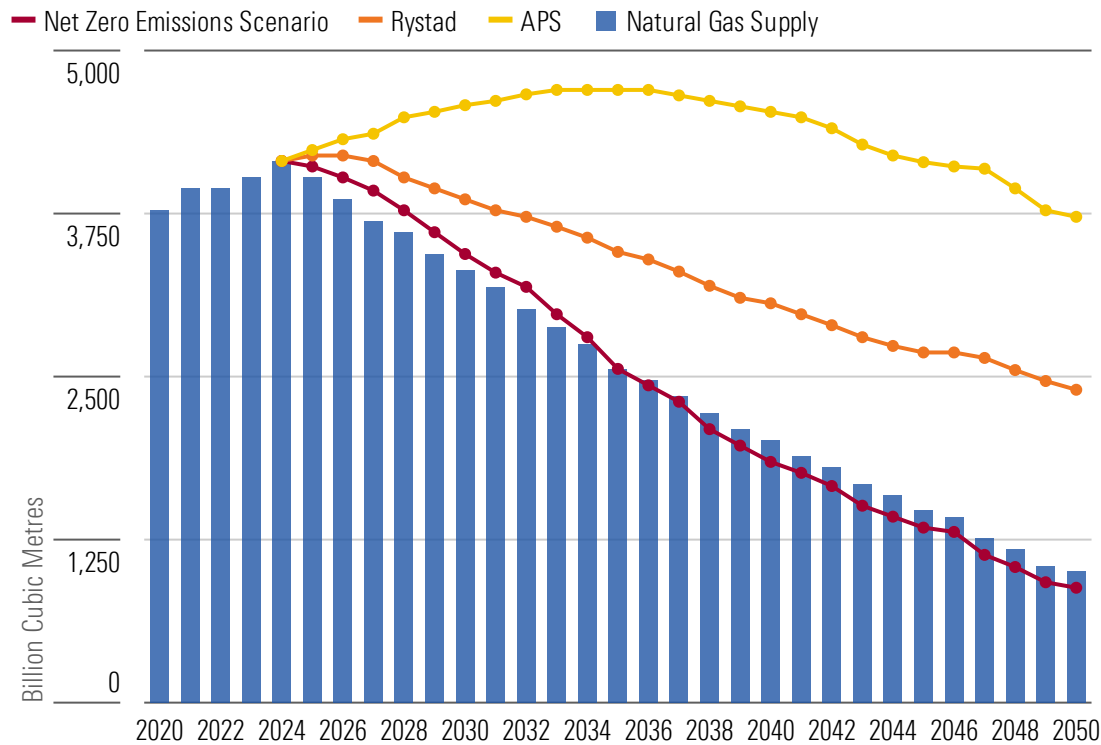


# Energy Transition Fears Overblown

Developing countries looking for cheap, reliable power will likely need to install gas generation along with renewables, which provides a strong demand tailwind to offset European efforts to reduce gas consumption.

## Outlook for Natural Gas Demand Secure

Natural gas demand and supply forecasts.

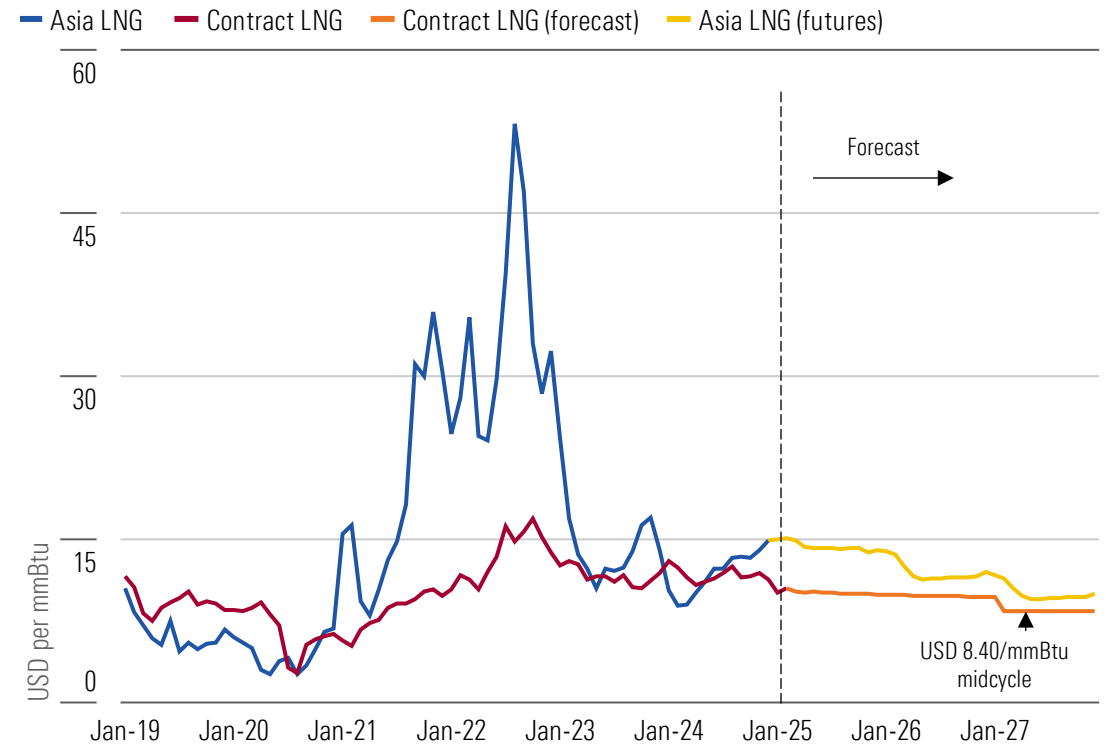


Source: Rystad Energy, IEA, Morningstar. APS = IEA's announced policy scenario.

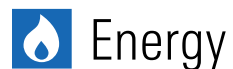
From a valuation perspective, we see limited downside from current energy company share price levels even if oil prices fall. Our midcycle Brent price assumption of USD 60/barrel is already below the trailing five-year average of just above USD 80/barrel.

## LNG Futures Now Exceed the Brent-Referenced Contract

LNG Price – USD per mmBtu.



See Important Disclosures at the end of this report.



<b>Company (Ticker)</b> Woodside Energy (WDS)			<b>Rating</b> ★★★★★	<p>Woodside has meaningful development underway, including Scarborough/Pluto T2 LNG, and new Sangomar oil production is now ramped up. While net production growth is less than for Santos, the increase is regardless material for returns given capital efficiency. We expect returns on invested capital to improve after 2026 with the start of Pluto T2 and to approach WACC by 2033. We credit group production growing 15% by 2028 versus 2023. Woodside's balance sheet is conservatively geared in support of a strong 80% dividend payout ratio and healthy, fully franked yield, despite capital expenditures. To some extent, Woodside can be viewed as an infrastructure play, given that LNG processing trains can treat third-party gas if needed. Enterprise value at our fair value estimate is approximately USD 53 billion. LNG infrastructure replacement cost underwrites 95% of enterprise value at our fair value even though it accounts for less than two-thirds of group production.</p>
<b>Price</b> AUD 24.06	<b>Fair Value</b> AUD 40.00	<b>Uncertainty</b> Medium		
<b>Market Cap (bil)</b> AUD 45.68	<b>Economic Moat</b> None	<b>Capital Allocation</b> Standard		
<b>Company (Ticker)</b> Santos (STO)			<b>Rating</b> ★★★★	<p>We don't think Santos is being sufficiently credited for new oil and gas developments underway. A solid balance sheet and competitive cash operating costs, including a modest freight advantage to Asia, mean the company is well placed in cyclical price downturns. That said, less favorable capital costs preclude a moat. But crude and LNG prices are healthy now, and gas has a growing role in fueling the world, including complementing increasing renewable energy production. We forecast group hydrocarbon volume growth of 60% by 2028 from 2023, chiefly from the Pikka oilfield development in Alaska, reinvigoration of Darwin LNG's output with the Barossa gas field development, and development of the Dorado oil project. We forecast a strong five-year EBITDA CAGR of 8.2% to USD 5.6 billion by 2028 versus 2023.</p>
<b>Price</b> AUD 6.59	<b>Fair Value</b> AUD 10.00	<b>Uncertainty</b> High		
<b>Market Cap (bil)</b> AUD 21.40	<b>Economic Moat</b> None	<b>Capital Allocation</b> Standard		
<b>Company (Ticker)</b> Whitehaven Coal (WHC)			<b>Rating</b> ★★★★	<p>Whitehaven continues to be penalized for ESG concerns. We think its purchase of two metallurgical coal mines from BHP is a good one, diversifying its production to roughly half thermal coal and half metallurgical coal. Debt to help finance the purchase is manageable. New coal supply is restrained, affected by ESG concerns and opposition from regulators, which could bring longer-term price upside. Demand for metallurgical coal for use in steelmaking is likely to persist, with alternative green steel technologies unlikely economic at scale for decades. We also think demand for Whitehaven's high-quality thermal coal is likely to be strong for at least the next decade, especially from Southeast Asia. High-quality thermal coal meets the energy needs of countries such as Japan and South Korea while meeting emissions targets under various international agreements.</p>
<b>Price</b> AUD 6.42	<b>Fair Value</b> AUD 9.30	<b>Uncertainty</b> Very High		
<b>Market Cap (bil)</b> AUD 5.34	<b>Economic Moat</b> None	<b>Capital Allocation</b> Standard		



# Financial Services

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Shaun Ler | [shaun.ler@morningstar.com](mailto:shaun.ler@morningstar.com)

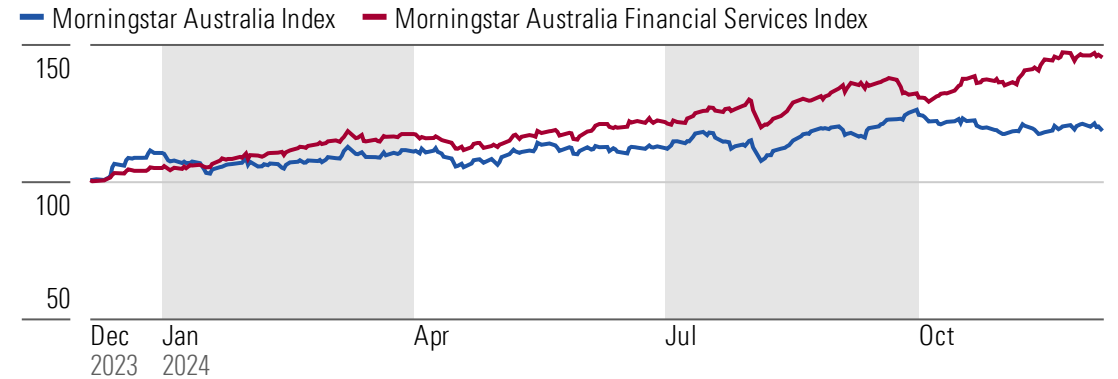
# Resilient Earnings but Valuations Look Stretched

Major banks and insurers are mostly overvalued, with shares performing strongly despite markets flip-flopping on cash rate expectations. We do not expect lower rates in Australia to materially impact bank earnings. Broader economic conditions and competition impact margins more materially. Bank results showed a stabilization of margins, and despite more borrowers falling behind on payments, equity buffers, rising house prices, and low unemployment, mean this is not translating into a rise in loan losses. Across the sector, we expect credit growth, modest margin improvement, and cost savings to underpin mid-single-digit EPS growth for the next five years. Dividends are well supported by surplus capital, with further buybacks likely.

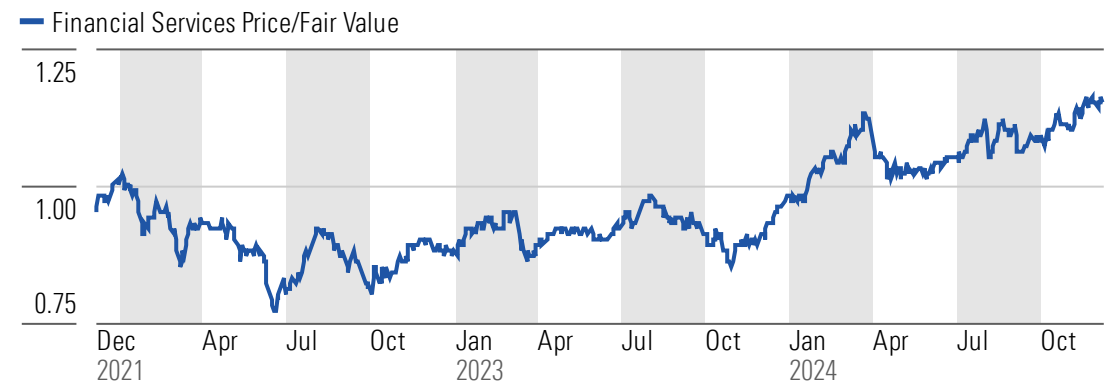
The earnings outlook for general insurers, IAG Group and Suncorp is positive. Higher claims are being matched with higher premium rates, and while investment income on policyholder and shareholder funds is likely to decline, it should stay well above the 2020 to 2022 period of extremely low cash rates.

Average earnings growth for the asset managers we cover will likely improve through to fiscal 2025, driven by better fund flows compared with fiscal 2022-23. However, we expect earnings growth to moderate starting fiscal 2026. External conditions remain favorable for flows into risk assets, with the prospect of lower interest rates in fiscal 2025, reduced volatility, and conducive sentiments compared with the past two and a half years. However, most of the firms we cover lack the strong performance needed to attract significant inflows. As a result, we expect them to continue losing market share to exchange-traded funds and industry super funds.

## Financials Rally Not Justified by Earnings Outlook



## Financial Services Overvalued on Average

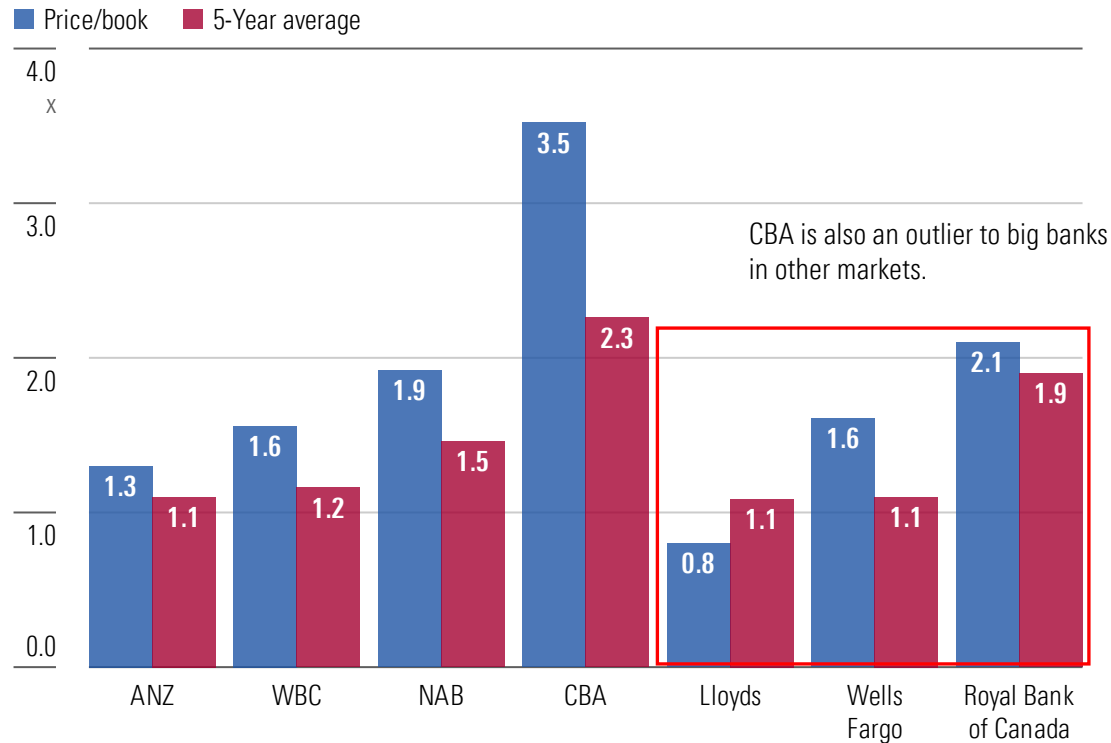


# Resilient Earnings but Valuations Look Stretched

Price/book multiples are high across the major banks, particularly so on our expectation of modest earnings and dividend growth over the next five years. Commonwealth Bank deserves a premium to peers given the strength of its moat, but the gap is extreme.

## Price/Book Above Long-Term Averages Across Australian Major Banks

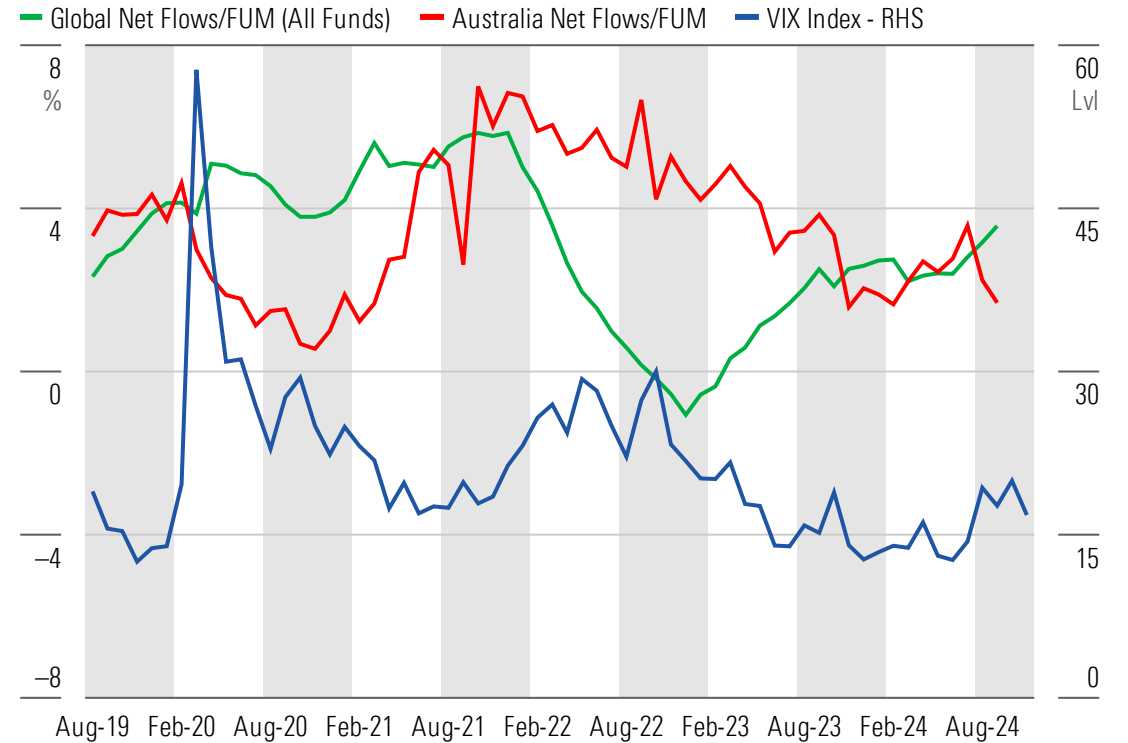
The five-year average is based on year-end share prices.



Fund flows are inversely correlated with expectations of market stress and volatility. The outlook for flows into asset managers in general is presently constructive. The VIX Index—an indicator of anticipated stock market volatility—is below long-term averages.

## Volatility Expectations Recently Crept Up but Still Benign

VIX Index and net flows.



 Financial Services

<b>Company (Ticker)</b> Perpetual (PPT)	<b>Rating</b> ★★★★	We believe the market is pricing in an excessive deterioration in Perpetual's future cash flow generation. The proposed acquisition of Perpetual's wealth management and corporate trust businesses by KKR vindicates our view that their values are not reflected in the current stock price. A successful sale of these assets would allow full repayment of Perpetual's borrowings, leaving the asset management business debt-free. While the asset management business is in net outflow, potentially lower interest rates should help reduce redemptions, which are presently elevated. There is room to centralize operations and remove duplication from the Pandal acquisition, while its balance sheet also holds considerable surplus cash that could be returned to shareholders. The acquisition by KKR is to be conducted via a scheme of arrangement, with a scheme meeting currently scheduled for January 2025.		
<b>Price</b> AUD 21.86	<b>Fair Value</b> AUD 24.50			<b>Uncertainty</b> Medium
<b>Market Cap (bil)</b> AUD 2.50	<b>Economic Moat</b> Narrow			<b>Capital Allocation</b> Standard
<b>Company (Ticker)</b> ASX (ASX)	<b>Rating</b> ★★★★	We view ASX as a natural monopoly providing essential infrastructure to Australia's capital markets. Despite the deteriorating regulatory environment, we believe the business is well supported by its wide economic moat based on network effects and intangibles. We also believe the energy transition is an underappreciated tailwind. We expect it to spark demand for resources in which Australia holds strong natural endowments, to deliver new listings and a long tail of revenue from trading and clearing activity.		
<b>Price</b> AUD 68.36	<b>Fair Value</b> AUD 75.00			<b>Uncertainty</b> Low
<b>Market Cap (bil)</b> AUD 13.25	<b>Economic Moat</b> Wide			<b>Capital Allocation</b> Poor
<b>Company (Ticker)</b> NIB Holdings (NHF)	<b>Rating</b> ★★★★	NIB Holdings is the fourth-largest private health insurer in Australia and New Zealand, with a strong track record of policyholder growth. With private hospitals easing the burden on the public system, we do not expect taxation benefits encouraging participation to change, allowing NIB to deliver consistent underwriting profits and returns on equity. The sudden decline in margins in second half fiscal 2024 spooked investors, but NIB has been overearning in recent years, thanks to fewer hospital admissions and dental claims during and after the pandemic. Claims are now trending back to normal levels. NIB and the industry have consistently been able to recoup claims inflation with premium rate increases, so we don't think this downward margin pressure will worsen materially. In the short term, demand from foreign students will likely dip as the government introduces new student caps, but we expect growth in foreign workers and premium rate increases to support medium-term growth.		
<b>Price</b> AUD 5.61	<b>Fair Value</b> AUD 7.20			<b>Uncertainty</b> Medium
<b>Market Cap (bil)</b> AUD 2.73	<b>Economic Moat</b> Narrow			<b>Capital Allocation</b> Standard

# Healthcare

Shane Ponraj, CFA | [shane.ponraj@morningstar.com](mailto:shane.ponraj@morningstar.com)

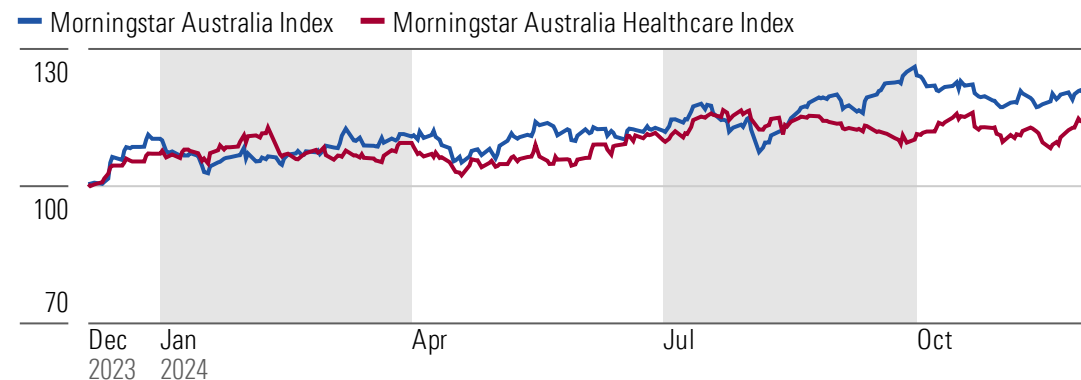
## Buying Opportunities in High-Quality Healthcare Names

We view the healthcare sector as overvalued on average, but roughly a third of our coverage still trades in 4 or 5-star territory. The sector outperformed the Morningstar Australia Index in the December quarter of 2024. The most attractive names are Ramsay and Sonic, where we see margins expanding, and Nanosonics, where we expect revenue growth to accelerate. Meanwhile, Pro Medicus, Polynovo, Sigma, and Fisher and Paykel are the most overvalued.

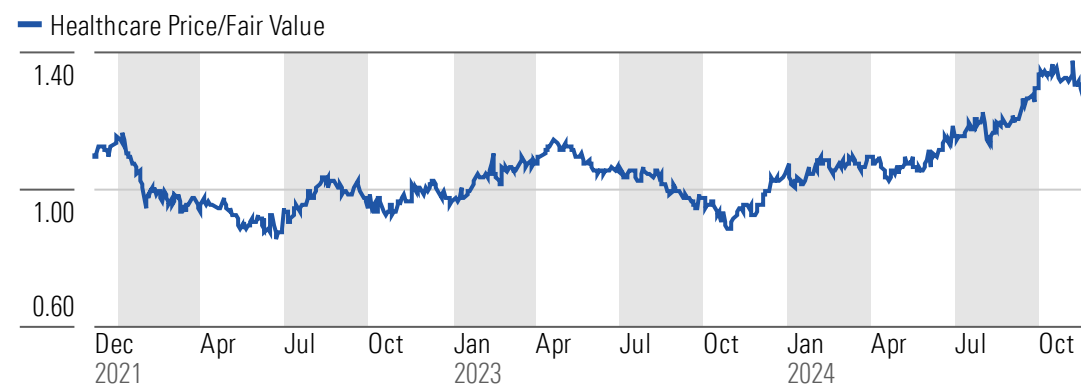
The big news in the December quarter was Sigma Healthcare's regulatory approval for its acquisition of Chemist Warehouse based on the undertaking it provided. Sigma agreed to allow independent pharmacies to readily switch suppliers with no penalty and prevent the misuse of commercially sensitive data. We think Sigma will gain material cost advantages from efficiency gains in its supply chain and economies of scale as costs like distribution, IT, and administration can be leveraged. It would also likely lend greater buying power for nonprescription medicine, given its significantly superior scale. We think it allows the group to potentially offer a lower wholesale markup price to independent pharmacies and its own stores than competitors can afford.

While a great deal for Sigma, shares appear materially overvalued at current levels. The current share price implies a market cap bigger than Coles of close to AUD 30 billion. While our EPS forecasts for fiscal years 2027 to 2029 increased by 67% on average, the current share price implies a P/E of 36 on our fiscal 2029 forecast, bringing the risk of earnings disappointment if there is a failure to achieve expected growth in store rollouts.

### Healthcare Outperformed the Broader Market



### Several Names Still Attract Despite Sector Overvaluation

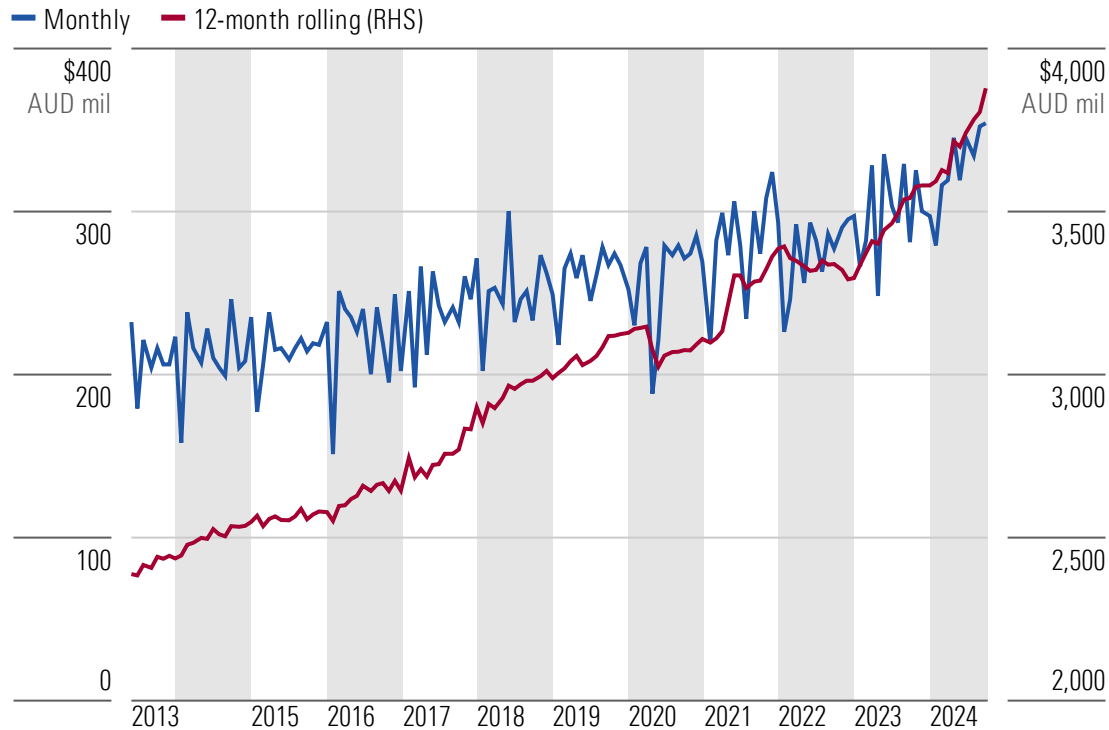


# Buying Opportunities in High-Quality Healthcare Names

Despite the pandemic causing disruption to routine pathology testing, underlying demand is defensive and underpinned by population growth, aging demographics, higher incidence of diseases, wider adoption, and a higher number of tests available.

## Core Pathology Revenue Growth Recovering

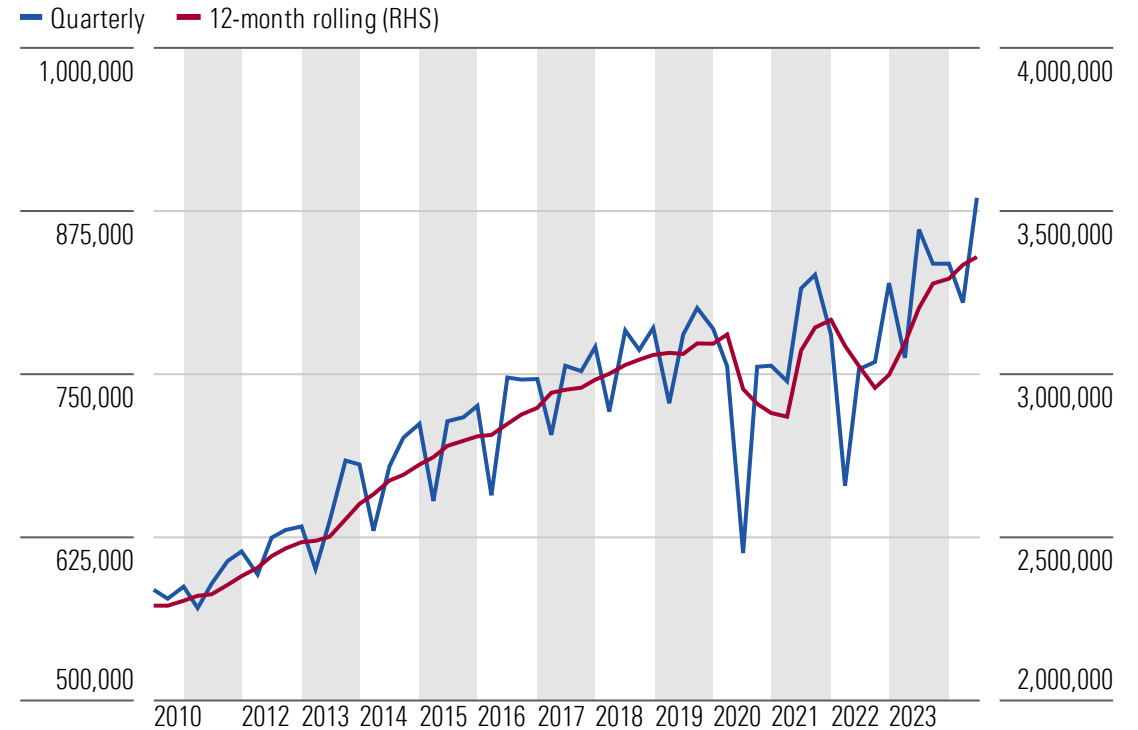
Total pathology industry benefits paid, excluding coronavirus Medicare items.



We expect Ramsay Australia to benefit from the volume recovery driven by improved staff availability. The growth drivers of increasing private health insurance membership, demographic factors, and chronic disease and hospitalization rates are intact.

## Recovery in Hospital Visits to Support Ramsay's Top Line

Australian private hospital episodes.



Source: Medicare. Data as of Sept. 30, 2024 (left). Australian Prudential Regulation Authority. Data as of June 30, 2024 (right).

See Important Disclosures at the end of this report.

 Healthcare
**Company (Ticker)**

Nanosonics (NAN)

**Rating**

★★★★

**Price**

AUD 3.27

**Fair Value**

AUD 4.00

**Uncertainty**

High

**Market Cap (bil)**

AUD 0.99

**Economic Moat**

Narrow

**Capital Allocation**

Standard

Nanosonics appears undervalued as we think recent earnings headwinds such as hospital capital budgetary constraints, abnormally low ultrasound procedural volumes, and investment for its pipeline product, Coris, are largely temporary. The firm's sales outlook is positive, and a long runway of growth exists outside the US. The company is beginning to make inroads, recently partnering with Ecolab as its distributor in France. The firm's next major product, Coris, aims to automate flexible endoscope cleaning. We assume the first launches will be in Australia and Europe in late fiscal 2025 and the US in early fiscal 2026. The firm published positive results from a clinical study in June 2024, demonstrating Coris outperforms manual cleaning in biofilm removal in endoscopes.

**Company (Ticker)**

Ramsay Health Care (RHC)

**Rating**

★★★★★

**Price**

AUD 40.25

**Fair Value**

AUD 62.00

**Uncertainty**

Medium

**Market Cap (bil)**

AUD 9.27

**Economic Moat**

Narrow

**Capital Allocation**

Exemplary

Ramsay is delivering strong patient revenue growth, but group profitability is hampered by inflationary pressures, lower government support, and accelerated investment in digital. However, we expect margins to expand long-term as Ramsay uses fewer agency employees, as case mix and volumes normalize for nonsurgical services, as capacity utilization improves, and as digital investment efficiencies are realized. Importantly, labor shortages are easing, and Ramsay continues to invest in recruiting and training. The firm negotiated higher reimbursement rates to meet cost inflation and has deleveraged its balance sheet by selling its share of Ramsay Sime Darby. See our Ramsay Stock Pitch, published in December 2023, for more details.

**Company (Ticker)**

Sonic Healthcare (SHL)

**Rating**

★★★★

**Price**

AUD 28.57

**Fair Value**

AUD 32.00

**Uncertainty**

Medium

**Market Cap (bil)**

AUD 13.73

**Economic Moat**

Narrow

**Capital Allocation**

Standard

Sonic is recording strong organic sales growth in Australia and Europe and margins are improving despite recent acquisitions and cost pressures weighing on group profitability. Longer-term, we expect further margin expansion on increased operating leverage from higher volumes, synergies from recent acquisitions, and improved labor productivity as digitization and newer artificial intelligence tools expedite diagnoses. With inflation easing, the main cost pressures in labor and rent are stabilizing. We also expect average fee increases through increased pricing, additional government funding, and favorable mix benefits. Sonic is well placed to service known underdiagnosis for routine healthcare services. See our Pathology Special Report, published in May 2024, for more details.

 **Industrials**

Esther Holloway | [esther.holloway@morningstar.com](mailto:esther.holloway@morningstar.com)

## Looking Beyond Construction-Exposed Stocks for Better Value Buys

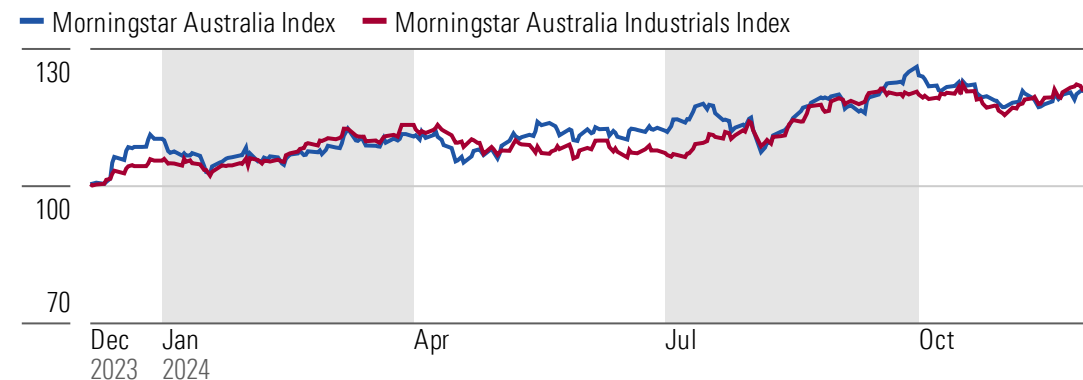
Although our construction-exposed coverage is largely trading at fair value, pockets of value remain in our less discretionary industrial stocks. Four-star stocks include narrow-moat Amcor and wide-moat Brambles. Amcor, in plastic packaging, and Brambles, in pallets, have diversified customer bases in fast-moving consumer goods, mostly in the defensive food and beverages sector. We expect mid-single-digit revenue growth in fiscal 2025 for both businesses, underpinned by population increases, retail spending, and inflationary price growth.

We expect Amcor's proposed acquisition of Berry, a plastic packaging manufacturer, to go ahead. We estimate combined business revenue and adjusted EBITDA to almost double from fiscal 2026, underpinned by tremendous cost synergies. But we view the all-scrip acquisition as value-neutral, adding a significant 856 million shares, a 59% expansion to Amcor's share count.

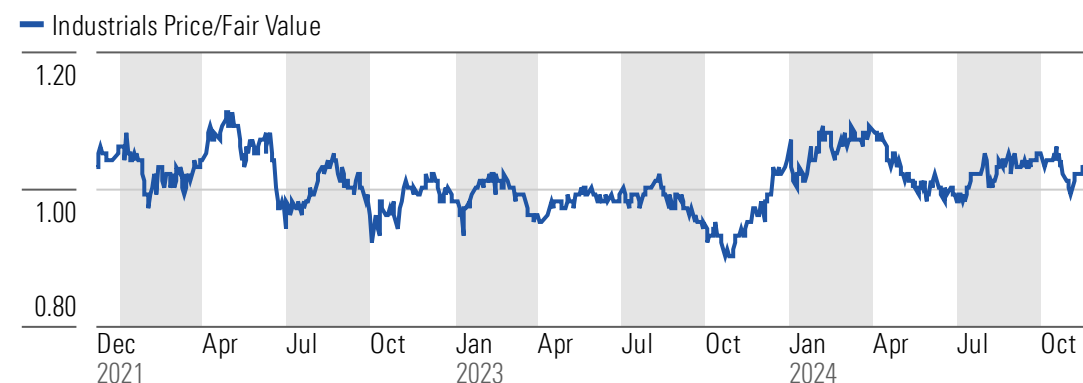
President-elect Trump's mooted tariffs could benefit Bluescope Steel, owner of the Ohio steel mill, North Star. A rise in tariffs could discourage cheap imports and support a recovery in the US steel industry's sales volumes and prices. However, none of this affects our long-term view as higher prices encourage new entrants, and steel supply can be added.

Logistics and toll road companies have solid outlooks. We expect modest earnings growth for the group in 2025, which is a good outcome considering softer economies and higher debt costs. Aurizon is the cheapest of these.

### Industrials Tracking Broader Market



### Industrial Stocks Generally Trading at a Small Premium

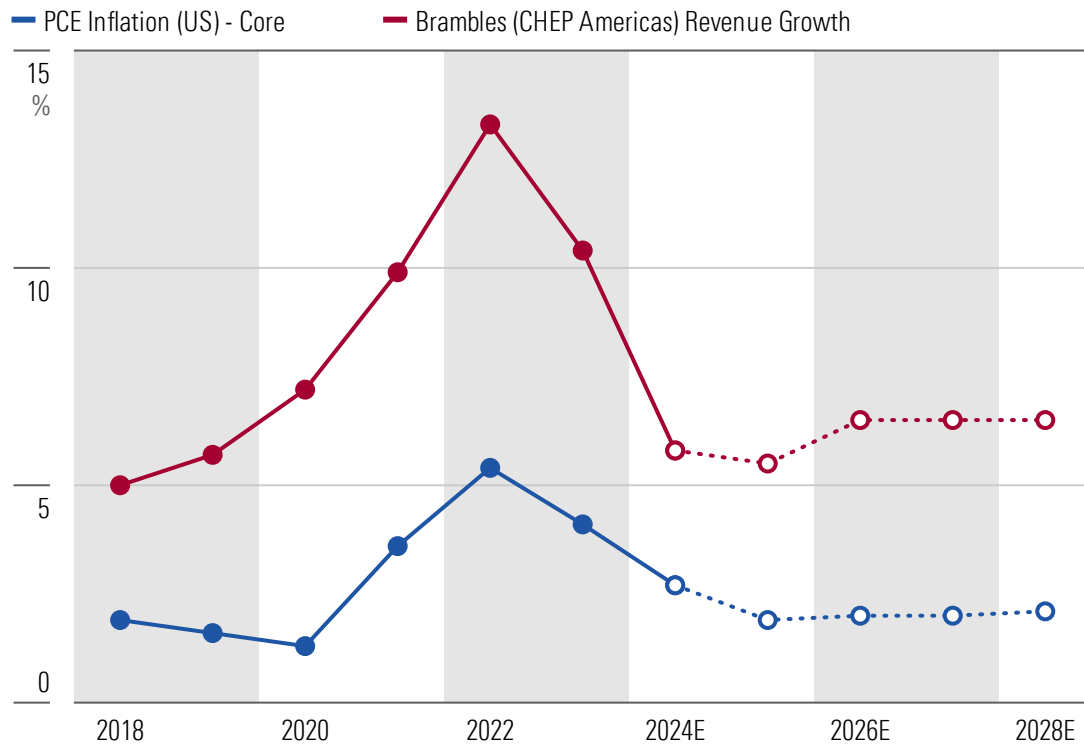


# Looking Beyond Construction-Exposed Stocks for Better Value Buys

With about 85% of revenue derived from fast-moving consumer goods, Brambles' revenue and earnings streams are resilient to the economic cycle. Revenue reflects price, volume, and new business growth, while EBIT growth is driven by efficiency.

## Brambles US Revenue Growing Above Inflation

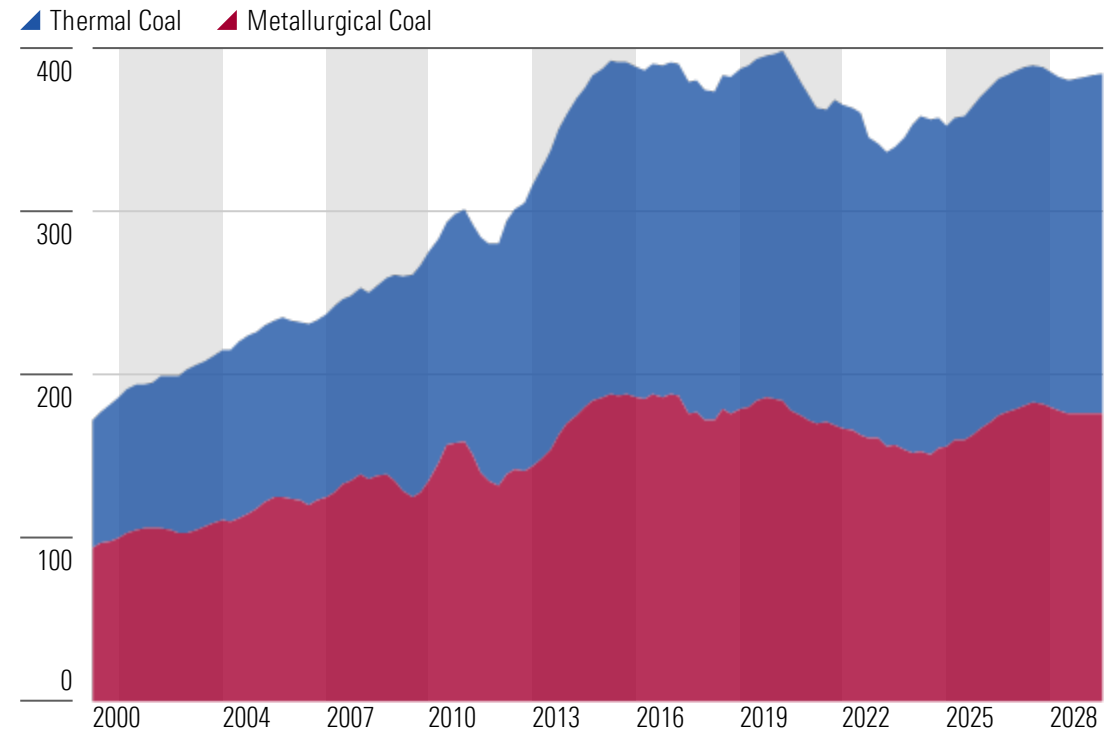
Chep Americas revenue growth versus personal consumption expenditure inflation.



Australian coal exports are forecast to recover close to peak levels in the next few years. We think the market underestimates the impact on Aurizon's earnings, which should benefit from higher volumes and profit margins as asset utilization improves.

## Coal Exports to Recover

Australian coal exports (trailing 12-months, million metric tons).



Source: US Bureau of Economic Analysis, Company Filings, Morningstar Estimates. Data as of Sept. 30, 2024 (left). Department of Industry, Science and Resources - Resources and Energy Quarterly. Data as of Sept. 30, 2024 (right).

See Important Disclosures at the end of this report.


**Industrials**

**Company (Ticker)**  
Aurizon Holdings (AZJ)

**Rating**  
★★★★

**Price**  
AUD 3.35

**Fair Value**  
AUD 4.50

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 6.17

**Economic Moat**  
None

**Capital Allocation**  
Standard

Aurizon shares offer an attractive yield underpinned by defensive rail infrastructure and haulage operations. Considerable downside is priced into the shares, and our analysis suggests that risks skew to the upside for investors. Haulage volumes were weak in recent years because of wet weather, but the outlook is for volumes to recover and haulage tariffs to rise with the Consumer Price Index. We think concerns around the demise of coal exports are overblown, providing an opportunity. Aurizon largely hauls coking coal from globally competitive mines, and a large-scale commercial alternative to coking coal for virgin steelmaking is a long way off. See our [Aurizon Stock Pitch](#) for more details.

**Company (Ticker)**  
Brambles (BXB)

**Rating**  
★★★★

**Price**  
AUD 19.49

**Fair Value**  
AUD 22.00

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 27.01

**Economic Moat**  
Wide

**Capital Allocation**  
Exemplary

As the world's largest supplier of reusable wooden pallets, Brambles is generally the market leader in the markets in which it operates. We believe this is due to its scale and first-mover advantage, limiting competition. This underpins a cost advantage, leading to our wide moat rating. Most of the firm's earnings are derived from large FMCG companies, which we consider mostly defensive, dampening Brambles' correlation to the economic cycle. As such, we forecast steady revenue growth with a CAGR of 6% over the next decade. Earnings are further lifted by operating margin improvements, driven by the firm's efficiency projects in pallet repairs and transportation and the integration of new digital technology.

**Company (Ticker)**  
Aurizon Holdings (AZJ)

**Rating**  
★★★★

**Price**  
AUD 15.94

**Fair Value**  
AUD 17.80

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 22.81

**Economic Moat**  
Narrow

**Capital Allocation**  
Standard

We think investors fail to appreciate the underlying defensiveness of Amcor's mainly food and beverage customer exposure. While our short-term outlook is for cyclically soft volumes, we are positive for the longer term. We expect the company to incrementally improve future returns on invested capital. This reflects strong single-digit organic sales growth through the reinvestment of free cash flows into emerging markets and higher-margin differentiated products. The Bemis deal in 2019 cemented the firm's position as the largest plastic packaging supplier in North America, with more than twice the market share than its nearest competitor.



# Real Estate

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# Quality A-REITs Attractive Despite Rate Cut Delay

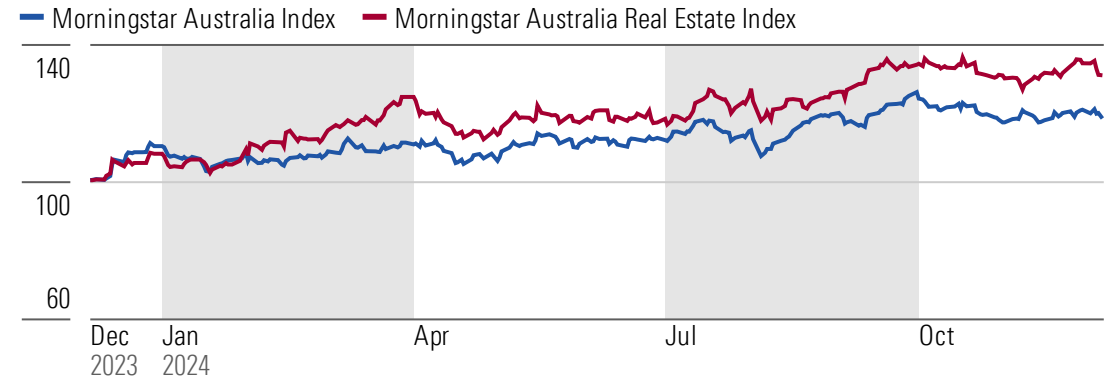
Solid recent employment and inflation figures dashed hopes for an early rate cut. Australian government bond yields rose sharply, pressuring REIT security prices before yields eased lower more recently. Our real estate sector coverage trades modestly below fair value estimates, although Goodman looks overvalued, possibly due to data center enthusiasm. We are more cautious, doubting that data centers can maintain excess returns in the longer term as new supply enters.

Employment growth underpins office demand. Despite more jobs being added and more employees returning to the office, little new supply is expected by 2027. We believe office landlords like GPT and Dexus are set to benefit. Nearly all their offices are premium or A-grade, and the vast majority are in Sydney or Melbourne’s central business districts.

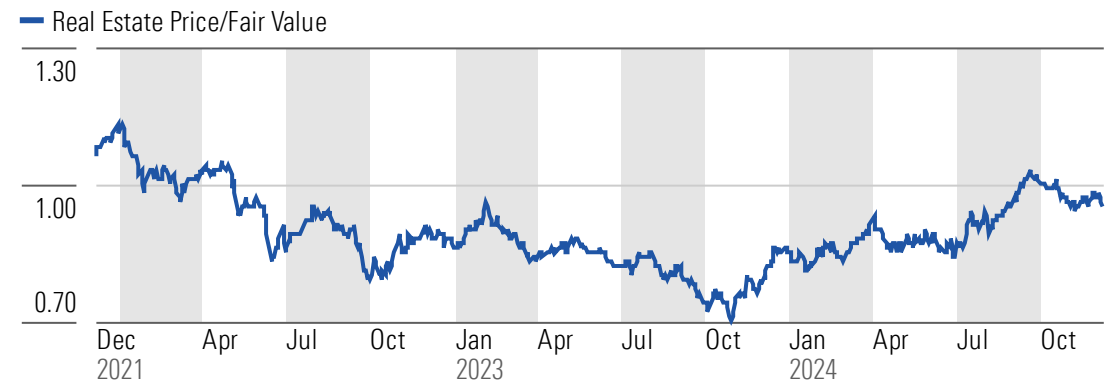
Retail REITs Scentre and Vicinity had solid tenant retail sales in the September quarter, although sales growth moderated under cost-of-living pressures. Sticky inflation could further dampen consumer spending, but both Scentre and Vicinity have reasonably long average lease terms and near-full occupancy, which should mitigate downside risks.

Mirvac and Stockland’s residential businesses look well-placed against the dwelling shortage—Mirvac’s security price has more value to be extracted. Normalization of construction cost inflation should see a recovery of residential development margins.

## Real Estate Performed Well in 2024



## But There Is Still Value

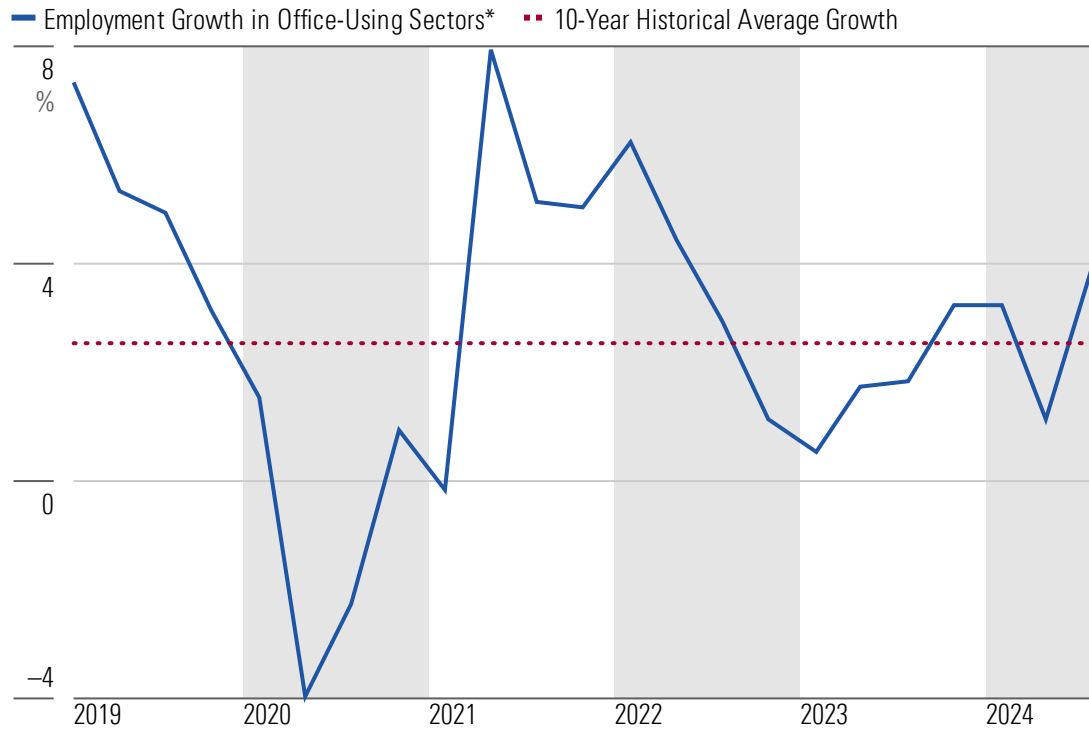


# Quality A-REITs Attractive Despite Rate Cut Delay

Office demand should benefit from strong job gains in government and business services sectors. At the end of August 2024, white-collar jobs rose 4% over the last 12 months, the strongest growth since May 2022, and above the 10-year average of 2.5%.

## Strong White-Collar Job Gains Should Drive Office Demand

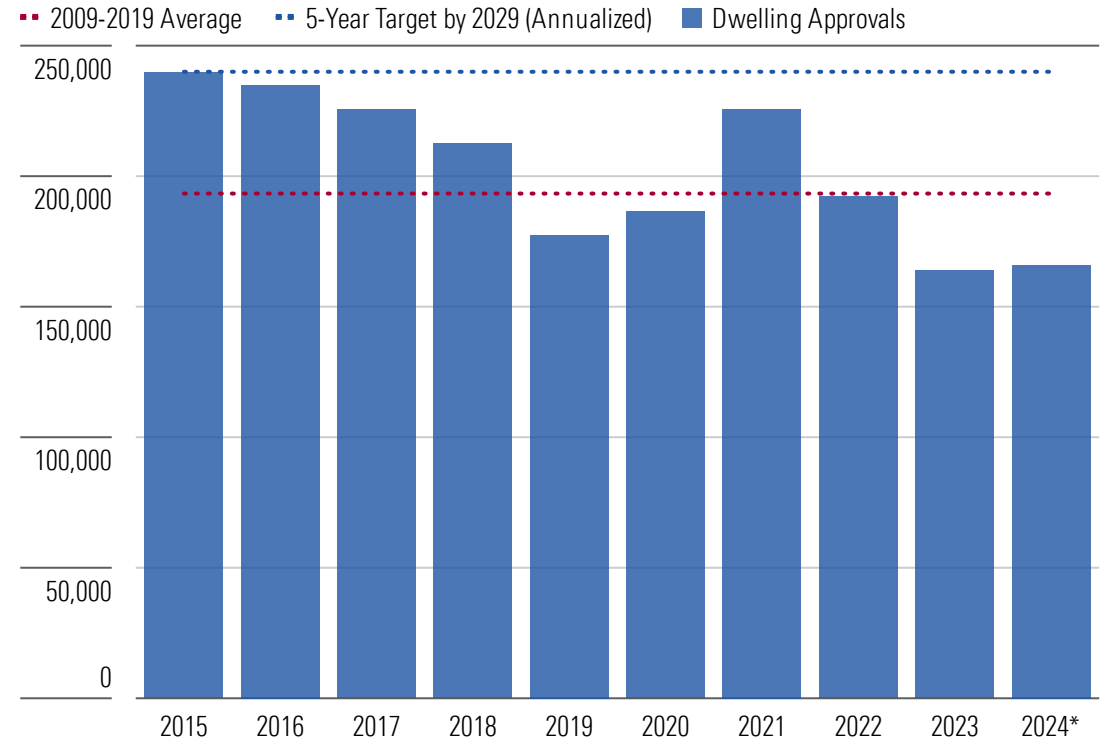
Employment growth in office-using sectors and 10-year historical average.



Dwelling approvals are still far below pre-covid levels. Mirvac’s and Stockland’s master planned communities, medium and high-density housing, and build-to-rent solutions can bring stock to the market quicker in an environment of constrained affordability.

## Housing Shortage Unlikely to be Resolved Soon

Annual dwelling approvals versus historical level and five-year national target.



Source: Australia Bureau of Statistics. Data as of Aug. 31, 2024 (left). Australia Bureau of Statistics. Data as of Sept. 30, 2024 (right).

\* (Left) Office-using sectors include information media and telecom; financial and insurance services; rental, hiring, and real estate; professional, scientific, and technical services; admin and support services; public admin and safety; education and training; and other services. (Right) 2024 figure is annualized based on nine months of available data up to September 2024.

 Real Estate

<b>Company (Ticker)</b> Dexus (DXS)	<b>Rating</b> ★★★★	Dexus' securities are trading well below the firm's net tangible assets and are on an attractive fiscal 2025 distribution yield of about 5%. We think investors are being paid to wait for a recovery in office markets. Dexus' office portfolio is high-quality, and the shift toward hybrid working adds to the appeal. Nearly all its office towers are premium or A-grade and mostly located in the central business districts of major Australian capital cities. The portfolio is Sydney-skewed. As the flight to quality continues, high-grade, well-located buildings like Dexus' are likely to remain sought after. Furthermore, the industrial portfolio is currently underrented. Dexus is likely to be able to implement large price increases when current leases expire. We also expect the funds management segment to continue attracting investor inflows, given its scale, management expertise, and record.	
<b>Price</b> AUD 6.98	<b>Fair Value</b> AUD 9.60		<b>Uncertainty</b> Medium
<b>Market Cap (bil)</b> AUD 7.51	<b>Economic Moat</b> None		<b>Capital Allocation</b> Standard
<b>Company (Ticker)</b> The GPT Group (GPT)	<b>Rating</b> ★★★★	GPT Group offers a distribution yield comfortably above the Australian 10-year bond yield. Tenant incentives such as fit-out payments weigh on near-term cash flow, but GPT's office occupancy was 92.4% at June 2024, including nonbinding tenant agreements, up from 88.5% in June 2023. Its retail and industrial portfolios are nearly 100% occupied, with first-half rental growth strong. We believe GPT's industrial rents are below market, and in retail, GPT's shopping centers achieved strong first-half sales growth, implying scope for more rent in both segments. GPT trades at about a material discount to net tangible assets, which ignores the value of the fund management business. Funds under management grew to AUD 22 billion in June 2024, up from AUD 13 billion in 2019.	
<b>Price</b> AUD 4.66	<b>Fair Value</b> AUD 5.70		<b>Uncertainty</b> Medium
<b>Market Cap (bil)</b> AUD 8.93	<b>Economic Moat</b> None		<b>Capital Allocation</b> Standard
<b>Company (Ticker)</b> Charter Hall Group (CHC)	<b>Rating</b> ★★★	About half of Charter Hall's EBITDA is from funds management. Higher interest rates hurt performance and transaction fees, which more than halved in fiscal 2024 while base management revenue fell slightly on negative revaluations. However, we expect Charter Hall to reap longer-term inflows given its focus on long-lease assets, strong track record, and as international investors seek local expertise. Its property funds under management grew 20% per year between fiscal 2019 and fiscal 2024, and the development pipeline is likely to add more growth. Charter Hall has minimal debt on its own balance sheet. Look-through gearing — net debt/assets including debt in its funds — is higher at 38% and while near-term conditions look tough, we think Charter Hall is well-prepared.	
<b>Price</b> AUD 14.91	<b>Fair Value</b> AUD 16.60		<b>Uncertainty</b> Medium
<b>Market Cap (bil)</b> AUD 7.05	<b>Economic Moat</b> Narrow		<b>Capital Allocation</b> Exemplary

# Technology

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Shaun Ler | [shaun.ler@morningstar.com](mailto:shaun.ler@morningstar.com)

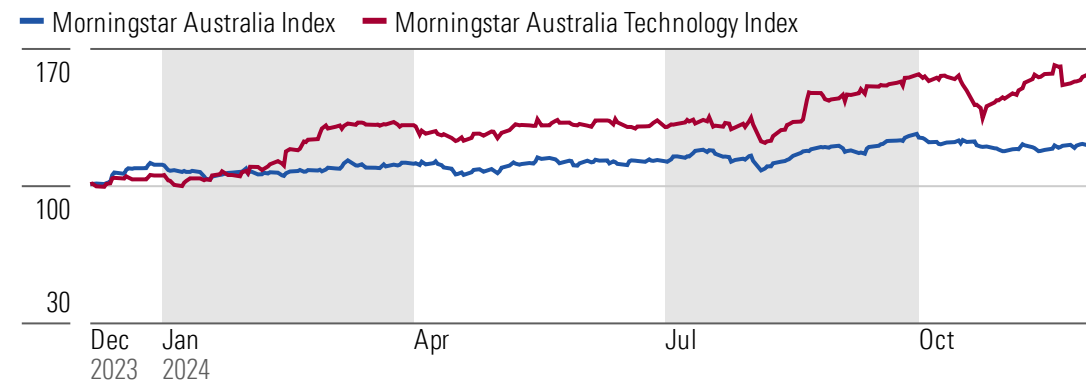
# Technology Sector Materially Overvalued on AI Hype and Trump Re-election

The technology sector has risen strongly and now screens as materially overvalued. We see two potential drivers.

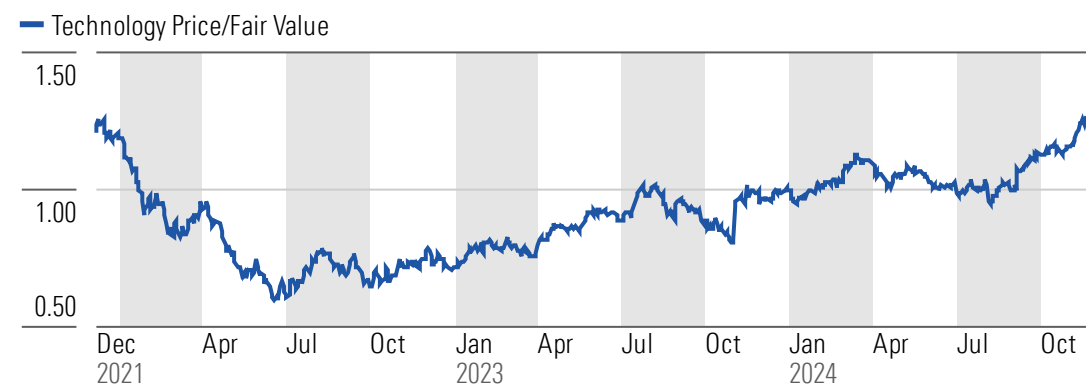
First, with Chat-GPT's explosion since late 2022, investors' imaginations are filled with the potential of generative artificial intelligence. Some of these investments will prove little more than dreams. Microsoft's Copilot, the company's AI chatbot, has been likened by Marc Benioff, founder and CEO of Salesforce, to Clippy 2.0. But equally, Salesforce, which had been looking to offer a chatbot to automate salespeople with its Agentforce product, recently announced a new hiring spree of salespeople. Both software behemoths are demonstrating that creating new products with AI is hard. Yet, software stocks have still outperformed broader indexes. The second driver appears to be the re-election of Donald Trump, which has generally benefited technology companies given increased optimism about future prospects and earnings.

Our approach is to be disciplined and value technology companies based on their performance through economic and technological hype cycles. Few companies still screen as attractive based on our valuations, but exceptions exist. The market views SiteMinder as a consumer discretionary company rather than the industry-leading software company it really is. Fineos is still pushing the secular transition toward SaaS in the life insurance industry, which, once the tipping point is reached, should benefit the company's revenue and margin growth.

## Technology Stocks Outperforming the Broader Market



## Shares Generally Overvalued



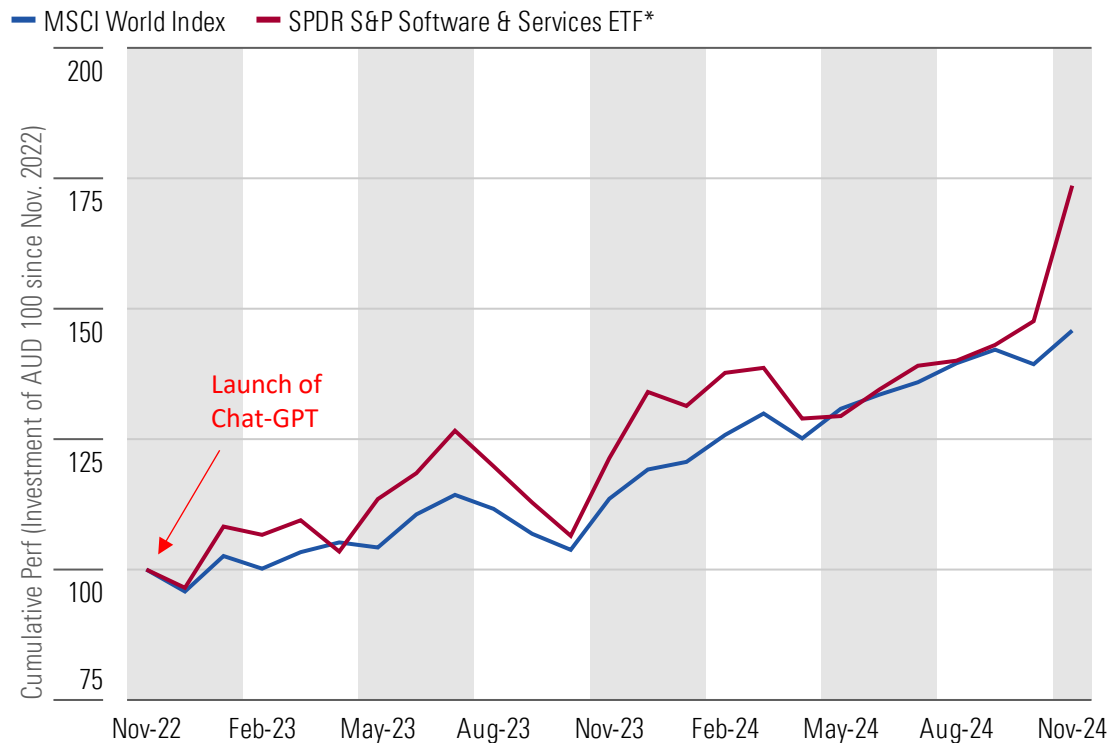
# Technology Sector Materially Overvalued on AI Hype and Trump Re-election

Chat-GPT sparked investor imaginations about the potential for AI. This benefited not just chip makers, but also software companies with large data sets, which investors hope can now be monetized.

As Trump’s election odds started increasing, investors started banking on deregulation, and fiscal stimulus, which could reaccelerate demand for technology and thus benefit software companies.

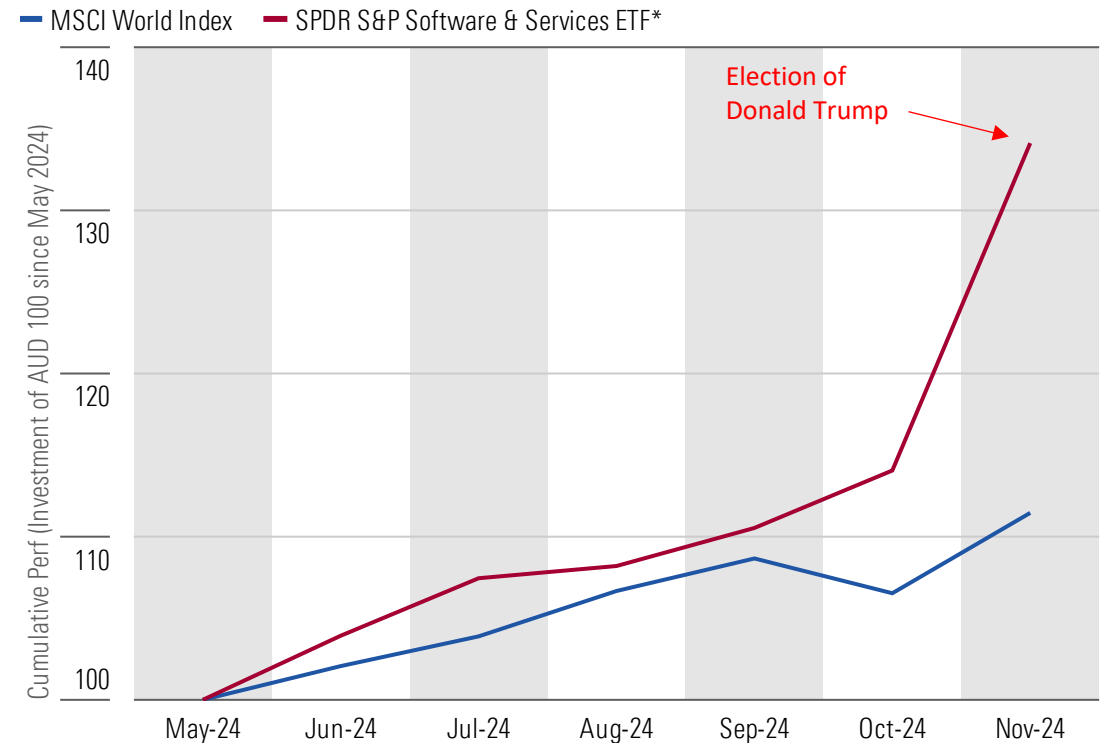
## Software Indexes Outperformed the Broader Market Since Chat-GPT’s Arrival

Software stocks vs World Index since launch of Chat-GPT in November 2022.



## Software Indexes Have Outperformed with the Election Odds of Donald Trump

Software stocks vs Trump election odds over the six months to November 2024.



Sources: Morningstar. Data as of Nov. 30, 2024. \* A proxy for software and services stocks.

See Important Disclosures at the end of this report.


**Technology**

**Company (Ticker)**  
FINEOS Corporation (FCL)

**Rating**  
★★★★

**Price**  
AUD 1.91

**Fair Value**  
AUD 3.10

**Uncertainty**  
Very High

**Market Cap (bil)**  
AUD 0.65

**Economic Moat**  
Wide

**Capital Allocation**  
Standard

We think the market underestimates wide-moat Fineos' potential for revenue growth, margin expansion, and resilience to cyclical earnings risks. Earnings growth prospects are strong with insurers' growing adoption of cloud software. The firm now has an established product suite that can be deployed to insurers with minimal incremental costs, enabling scalable revenue and earnings growth. Further product up and cross-sells generate incremental revenue while also strengthening switching costs. Successful project implementations for large clients validate its platform's reliability and help attract new business. Cost efficiencies also support revenue growth. Product development, cloud infrastructure, and general administration costs as a proportion of revenue are set to fall as business volumes grow and offshoring to emerging economies increases.

**Company (Ticker)**  
SiteMinder (SDR)

**Rating**  
★★★★

**Price**  
AUD 6.13

**Fair Value**  
AUD 10.00

**Uncertainty**  
High

**Market Cap (bil)**  
AUD 1.71

**Economic Moat**  
Narrow

**Capital Allocation**  
Exemplary

We believe SiteMinder is a well-positioned industry leader, likely to win its large market opportunity. We expect the channel manager industry to consolidate around scaled providers, like SiteMinder, who can fractionalize large fixed technological and regulatory costs over a larger customer base than competitors. We also believe SiteMinder's new Channels Plus product will help evolve the company from a middleware software provider, where it bears all the costs to create the value of its products, to a platform, where third parties build some of the product value. We think the market underestimates the adoption of Channels Plus and overestimates the strength of competitors.

**Company (Ticker)**  
Pexa Group (PXA)

**Rating**  
★★★★

**Price**  
AUD 12.90

**Fair Value**  
AUD 17.25

**Uncertainty**  
Medium

**Market Cap (bil)**  
AUD 2.29

**Economic Moat**  
Wide

**Capital Allocation**  
Exemplary

We believe the market is overly focused on wide-moat Pexa's costly expansion into the United Kingdom and overlooks the strength of Pexa's Australian exchange business. Pexa's Australian exchange business shows potential for exceptional margins and profits, in line with other financial exchange businesses, such as the ASX. Moreover, this is becoming evident despite subdued property market turnover and elevated costs as the company develops and rolls out its exchange infrastructure across additional regions and use cases. We expect the UK business to either become profitable or be abandoned in the next few years.

 **Utilities**

Adrian Atkins | [adrian.atkins@morningstar.com](mailto:adrian.atkins@morningstar.com)

## Softer Performances in 2025 for Most, but Medium Term Is Favorable

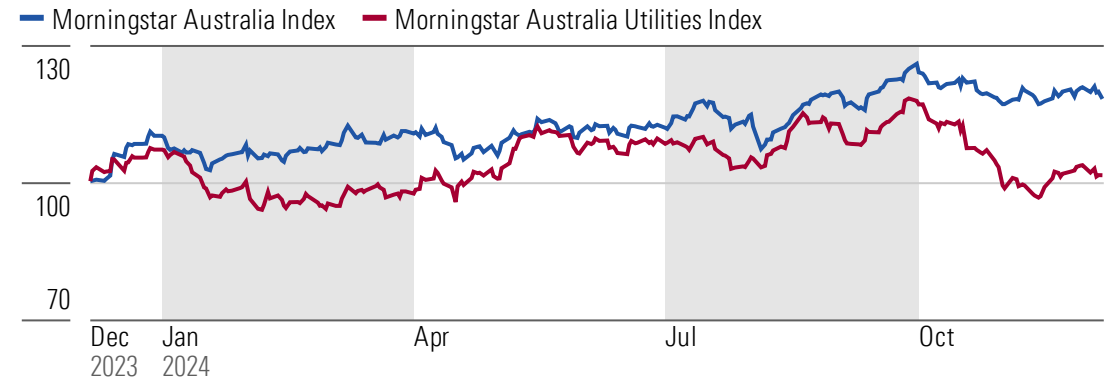
Utilities performed poorly in the quarter and are slightly undervalued on average. Our top pick is APA Group. We also like New Zealand-listed Manawa Energy and, with a few undervalued options, AGL Energy.

We think the impressive earnings recovery for Australian utilities is largely over. We expect earnings to soften in the next couple of years before stabilizing, but this will depend on wholesale electricity prices. Hot weather and power station outages pushed prices higher in early summer, and futures prices have lifted in sympathy. We don't expect high prices to continue though as the renewable energy buildout is gaining momentum after a post-covid lull. This supply should help moderate electricity prices.

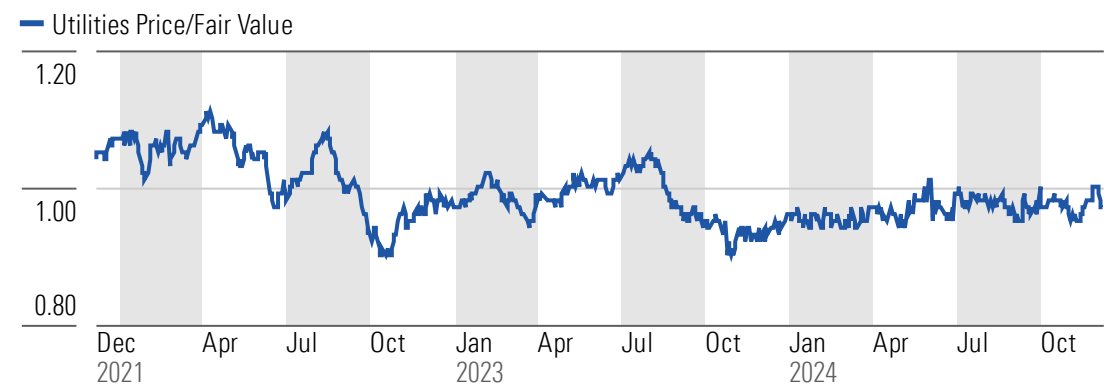
Operating conditions and wholesale electricity prices in New Zealand have normalized with the end of the drought. Heavy rainfall in recent months boosted hydroelectric generation and replenished lake storage. The drought hurt most utilities' fiscal 2025 earnings prospects, but the medium-term outlook is favorable because of high electricity futures prices, which reflect a tight electricity market and high gas and coal fuel costs.

Gas pipeline owner APA Group's security price has been down about 40% in the past couple of years. But we think headwinds from rising operating and interest costs are likely to moderate, allowing earnings growth to improve. APA looks undervalued, offering a monster yield of about 8%. Directors have been buying on the market, which is potentially a good sign.

### Australian Utilities Underperform



### ANZ Utilities Are Slightly Undervalued on Average



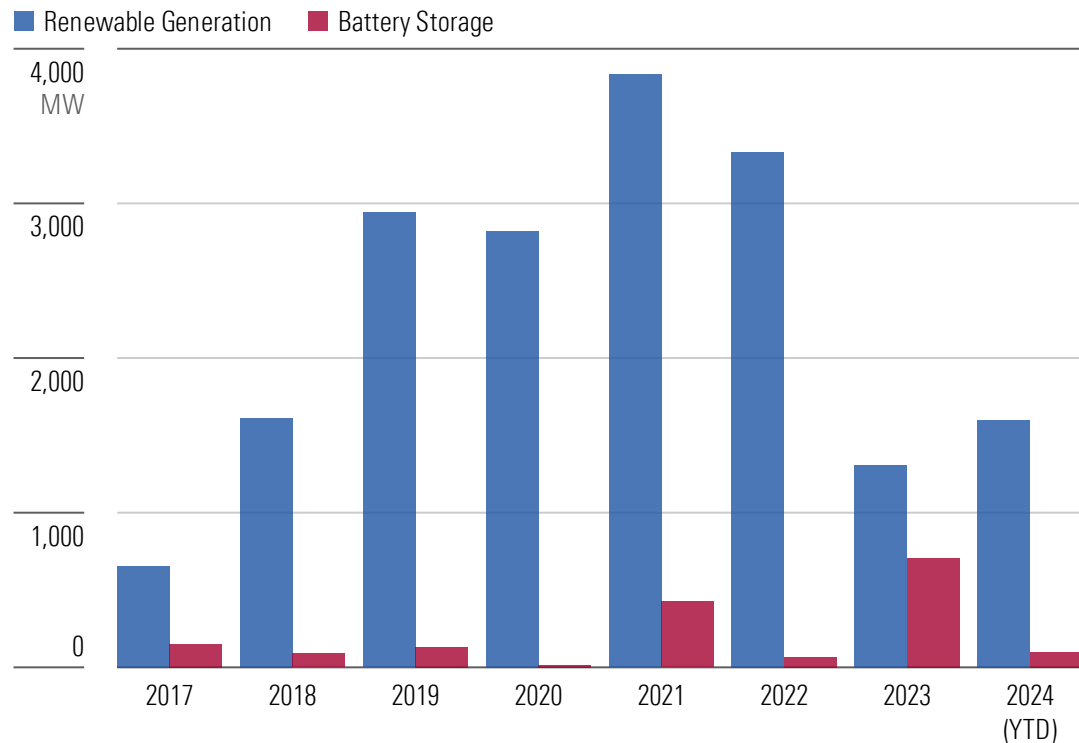
## Softer Performances in 2025 for Most, but Medium Term Is Favorable

The renewable energy buildout is gaining momentum after a post-covid lull. Financial commitments to wind and solar farm projects picked up strongly in the September quarter despite high debt costs, signaling increased supply additions in coming years.

Gas shortages and a tight electricity market are keeping electricity futures prices high in New Zealand. Utilities will make strong returns from their hydroelectric schemes and other renewable generation assets, which produce power cheaply.

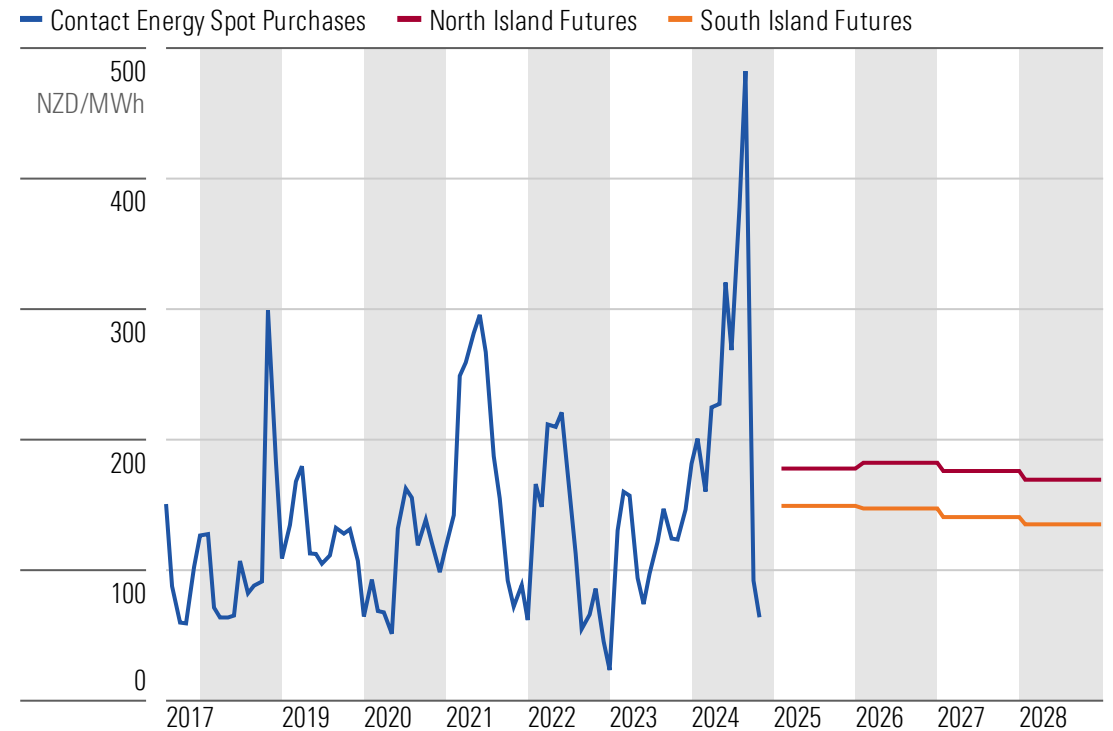
### Renewable Buildout Picking Up Again

Capacity of renewable generation and battery projects completed per year (megawatts).



### High Electricity Futures Prices Underpin Favorable Outlook

Electricity prices (NZD per megawatt hour).



Source: Clean Energy Council. Data as of Sept. 30, 2024 (left). Contact Energy, ASX Energy. Data as of Nov. 20, 2024 (right).

 Utilities

<b>Company (Ticker)</b> APA Group (Australia) (APA)			<b>Rating</b> ★★★★★	<p>Narrow-moat APA Group is a good-quality company with an attractive yield. We expect near-term revenue growth to pick up 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 back up 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.</p>
<b>Price</b> AUD 7.27	<b>Fair Value</b> AUD 9.30	<b>Uncertainty</b> Medium		
<b>Market Cap (bil)</b> AUD 9.41	<b>Economic Moat</b> Narrow	<b>Capital Allocation</b> Poor		
<b>Company (Ticker)</b> Manawa Energy (MNW-NZ)			<b>Rating</b> ★★★★★	
<b>Price</b> NZD 5.36	<b>Fair Value</b> NZD 6.10	<b>Uncertainty</b> Medium	<p>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 expand via wind and solar farm developments. It sells most of its power to Mercury NZ under long-term CPI-linked contracts, with earnings benefiting from elevated inflation. We also expect earnings to benefit from diverting more sales to tight wholesale markets as lower-priced contracted volumes progressively reduce in the medium term. The stock offers a decent yield, fully imputed for New Zealand residents.</p>	
<b>Market Cap (bil)</b> NZD 1.68	<b>Economic Moat</b> Narrow	<b>Capital Allocation</b> Standard		
<b>Company (Ticker)</b> AGL Energy (AGL)				<b>Rating</b> ★★★
<b>Price</b> AUD 11.05	<b>Fair Value</b> AUD 12.00	<b>Uncertainty</b> High		
<b>Market Cap (bil)</b> AUD 7.43	<b>Economic Moat</b> None	<b>Capital Allocation</b> Poor	<p>AGL Energy screens as fairly valued, trading on a low-teen P/E ratio. Earnings have recovered and the long-term outlook is relatively stable as investment in renewables and batteries offsets headwinds from closing coal-fired power stations. We expect electricity prices to remain elevated, supported by closure of coal power stations, high gas prices and growing electricity demand as transport and other industries electrify. These factors support a solid earnings outlook. Financial health is sound, and management is doing a good job navigating ESG threats.</p>	

## General Disclosure

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