

# Quality companies produce positive results despite COVID-19

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ASX: QVE

*In a reporting season where most companies reporting were materially impacted by the disruption caused by COVID-19 and a change in consumer patterns – some positively and some negatively – it was reassuring to see the vast majority of the core holdings in QVE's portfolio reported positive results for the first half of the 2021 financial year. This once again reinforced our belief in the benefits of owning good quality, well-established businesses that generate real cashflows, real earnings, and real income from dividends, and which trade on reasonable valuations.*

## **Amcor**

**Amcor** is one of the largest packaging suppliers with diversified operations around the world and with the majority of its sales to defensive fast-moving consumer goods companies. This enables Amcor to produce relatively steady and predictable earnings even in times of economic uncertainty.

Amcor had a strong first half 2021 result as it reported a 12% increase in net profit after tax (NPAT), driven by better than expected volume growth (particularly in rigid plastic packaging), synergies flowing through from the Bemis acquisition, and lower interest costs. Amcor continues to execute well and is on track to achieve its sustainability goal of a fully recyclable or reusable portfolio by 2025. While growth into 2022 is expected to moderate, Amcor has a strong balance sheet, is paying a good dividend, is using its strong cashflows to undertake a US\$350 million share buyback, and is trading on a reasonable 15 times earnings.

## **Aurizon**

**Aurizon** owns and operates essential rail infrastructure assets in Queensland and an above-rail business hauling coal and other freight. Aurizon had a reasonably positive first half 2021 result which was a very good outcome in a difficult environment given the coal import bans imposed by China. Aurizon generated a net profit after tax of A\$267 million and declared a 14.4 cents dividend per share, 70% franked. The Australian coal industry is recovering strongly as it has been able to diversify destinations for Australian coal away from China, thereby overcoming the effects of the Chinese embargo.

Aurizon remains a very well-managed company whose Board and management are using the strength in cashflows from its existing coal business to invest and grow the company's non-coal haulage operations. These investments will make a substantial contribution to Aurizon's future earnings, offsetting any deterioration from its coal haulage operations, which seem likely to diminish progressively in the next 20 or 30 years. Aurizon continues to produce substantial free cashflows, and continues to reward patient shareholders with healthy dividends while also using its surplus cashflow to fund new investments and a share buyback.

## ***Integral Diagnostics***

**Integral Diagnostics** is a leading provider of diagnostic imaging in Australia. Integral's result for the six months to 31 December 2020 was very positive, with NPAT of A\$23.2 million and A\$52.0 million in EBITDA, on the back of solid volume growth and strong increases in the average fee per test. The result demonstrated the benefits of the company's geographical diversification across Australia and New Zealand, as well as the move towards increased specialisation, a focus on higher end scans sustaining demand for radiology services during the COVID-19 environment and generating higher fees.

Integral should continue to benefit from the long-term growth drivers of Australia's ageing population and from advances in technology enabling earlier screening, diagnosis, and treatment of cancers and other medical issues. The company's management team continues to grow its business' margins effectively by optimising staff to patient demand, using technology to improve the patient and referrer experience, as well as through greater use of scanning technology. We also expect Integral Diagnostics to maintain its effective track record of acquisitions which are strategically aligned and earnings-accretive.

## ***Nine Entertainment***

**Nine Entertainment** is the largest media company in Australia spanning the television, streaming video, online real estate, newspaper publishing, radio and digital media sectors. Nine grew its net profit after tax by 79% to A\$181.9 million for the first half of the 2021 financial year, an extremely commendable result given the challenging conditions for advertising in the COVID-19 environment. While a sharp rebound in television advertising has driven near-term earnings growth, long-term value creation is being driven by the continued strong growth of the company's digital assets. Digital earnings grew 53% year-on-year and now account for 41% of earnings, which we expect to rise to around 60% over the next three years.

The Stan streaming business' subscriber growth accelerated in 2020, with 2.3 million subscribers now signed on, making Stan the clear number two to Netflix in Australia. The long-term deal with NBC Universal also secures premium content for many years. Between Stan and digital subscriptions at the mastheads, Nine has an increasing proportion of high-quality recurring digital revenue. Domain's ongoing listings recovery and the expectation of carriage fee agreements with Facebook and Google should also provide earnings tailwinds. Nine has a solid balance sheet, low debt, and is trading at around 15 times earnings, with an increased payout ratio or share buyback a possibility.

## ***Pact Group***

**Pact Group** is a leading manufacturer and supplier of rigid plastic and metal packaging in Australia, New Zealand, and increasingly internationally. Pact reported a very strong result for the first half of the 2021 financial year, reporting an A\$52.0 million net profit after tax, up 59% on the first half of the 2020 financial year. This was largely the outcome of strong volume growth, in particular from the materials handling and contract manufacturing businesses, as well as strong cost management and lower interest expense. The strong cashflow generated over the previous 12 months helped Pact's balance sheet improve markedly, and enabled the company to return to paying dividends to shareholders.

Pact has increasing earnings exposure to the growing plastics re-use and circular economy (such as returnable plastic crates and garment hangars), which creates a genuine competitive advantage for the firm's core packaging business. The reorganisation of the packaging segment should produce continued efficiency improvements and the opportunity to improve margins in the years ahead. The refreshed and excellent management team at Pact is bringing improved capital allocation discipline, while the focus on sustainable solutions will provide a source of sustainable competitive advantage. Pact remains an attractive business with predictable recurring cashflows and a very reasonable valuation.

### ***Pro-Pac Packaging***

***Pro-Pac Packaging*** is the number two player in the flexibles packaging sector in Australia behind Amcor. Pro-Pac produced a very positive result for the first half of the 2021 financial year, reporting a net profit after tax of A\$6.2 million off the back of robust operating performances from all the company's divisions.

Pro-Pac has strong recurring earnings from its packaging operations, a much improved balance sheet, and a focused, highly-motivated and very capable management team. The company is also proceeding with substantial cost savings from factory site consolidations and is deploying a new information technology system which will benefit the company greatly in the years ahead. Pro-Pac recently completed the acquisition of Melbourne flexibles manufacturer Supreme Packaging, and will continue to use its healthy balance sheet for further accretive acquisitions.

### ***Sonic Healthcare***

***Sonic Healthcare*** is a global pathology company which holds market leadership positions in Australia, Germany, the United Kingdom, and Switzerland, and is the number three player in the United States. Sonic had a very strong result for the first half of the 2021 financial year, generating a net profit after tax of A\$678 million. The company was a major beneficiary of COVID-19 testing, and while these revenues will taper off going forward, there will be continuing demand for COVID-19-related testing and diagnostics for international travel. Importantly, Sonic's underlying non-COVID-19 revenue also showed very good momentum.

The strength of Sonic's cashflows combined with the company's extremely low level of debt means that Sonic's balance sheet is in its healthiest state in 20 years. This has positioned Sonic to emerge in a much better position than many of its smaller or more leveraged competitors. Given that Sonic's balance sheet is now under-gearred, we expect further earnings-accretive acquisitions in the year ahead, with Sonic's highly-capable and experienced management team continuing to build the company's global platform as the company has done very successfully for the last two decades.

### ***Tabcorp***

***Tabcorp*** owns valuable gaming licenses across the lotteries and wagering sectors in Australia. Tabcorp had a reasonable overall result for the first half of the 2021 financial year, producing an A\$207 million net profit after tax with very strong free cashflow. Tabcorp's lotteries division continues to perform well, with increased earnings and margins from new and enhanced games and increased digital penetration. The wagering division, as expected, was affected by COVID-19 venue shutdowns, but this was partly offset by stronger digital growth and better cost control.

We welcomed the recent announcement of a new incoming Chairman and CEO. Tabcorp also appears to be making good progress on the potential sale or demerger of its wagering business, which we believe is likely to unlock significant value for shareholders. In our view, a standalone lotteries division would be a very attractive business and would trade at a significant premium to the sharemarket, given the very strong cashflows and steady growth expected from this division.

## **Conclusion**

The positive results from many of the core shareholdings in QVE's portfolio for the first half of the 2021 financial year reiterates the rationale for continuing to invest in good quality, well-established businesses which produce real cashflows, earnings, and dividends.

We continue to stay disciplined, looking to select the right companies for QVE at attractive prices to enable us to deliver positive long-term outcomes for our investors.

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