UNIVERSITY OF AUCKLAND
INVESTMENT
CLUB

INVESTMENT BULLETIN

STUDENT WRITERS · STUDENT OPINIONS

SHORT-TERM PAIN, LONG-TERM GAIN:

THE SILVER LININGS OF A GLOBAL RECESSION

BY SKIP GEE

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SANDY GUO

08 AUG 2022 | ISSUE NO.38

SUPPORTED BY: myob & FORSYTH BARR

The University of Auckland Investment Club
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An update from the fund

A RUNDOWN OF THIS WEEKS PITCHES WRITTEN BY OUR INVESTMENT COMMITTEE ANALYSTS

ELDERS (ASX: ELD)

Elders Limited (ASX:ELD) is Australia's leading agricultural product and service provider. Their competitive advantage lies in their complete supply chain and strong consumer relationship.

Firstly, Elders is a one-stop-shop for all farming products including fertilisers, feed outs, sprays and tools etc. However, they also provide numerous rural services including financial advisory, real estate services, and cattle management and sale services. This one-stop supply chain has been constructed through acquisition style growth, with their most notable acquisition being AIRR in 2020, which came with 340 stores across Australia.

With their business model and scope, plus their 30 year R&D pipeline, Elders has the capability to capitalise on the fragmented Australian agricultural industry over the coming years. Although the agricultural industry tends to be fixed onto crop prices, by adopting a quantity driven pricing system, Elders mitigate themselves from this risk.

The Investment Committee passed ELD to the valuation stage by a vote of 13/16. Daniel Mar, Freddie Clementson and Daniel Yang will run the valuation.

> *Agriculture doesn't do much but grow*
>
> *- Daniel Mar*

ECONOMY

Short-term pain for long-term gain: The silver linings of a global recession

BY SKIP GEE

Doom and gloom is the general media approach to a recession. Certainly, names like the Global Financial Crisis and the Great Depression do little to alleviate this negative outlook. Such periods often warrant this level of dejection – millions of people defaulting on home loans and losing jobs is hardly cherry. Nevertheless, given the current global climate - a quasi-calm before the storm - it pays to assess what the real long-term implications of a recession could be. Newsflash: it's not all terrible.

A recession is broadly defined as two consecutive quarters of negative economic growth (measured using GDP). I prefer Harry S Truman's definition for its simplicity; "it's a recession when your neighbour loses his job; it's a depression when you lose yours". The world cannot truly be said to have plunged into a recession under either of these definitions just yet.

Even so, inflation is on the up globally primarily due to rising food and energy prices. Europe is in perhaps the greatest danger of prolonged economic underperformance as gas and oil shortages caused by a certain Russian war have no immediate resolution in sight. Global-supply chain issues add to the problem by increasing the costs of imported goods and prolonging existing supply shortages.

In view of rising inflation, countries like the United States and New Zealand are flexing their monetary policy muscles and tightening interest rates. The American Fed is perhaps leading the way in terms of imposing this tightened grip with interest rates up more than two percentage points since the start of 2022. In New Zealand the story is very similar; predicted inflation rates as high as 7% are on the horizon and as such there will continue to be a rise in rates to combat this.

Both lower consumer confidence resulting from inflation and reduced money supply resulting from increased interest rates will contribute to economic downturn. Though a recession is not technically here yet, it is a safe bet that it will be soon.

So, 'where are the positives?' I hear you ask. Well, recessions do not always catch economies cold turkey. Most recessions, as with this one, are not grand crashes like the GFC but instead a necessary evil resulting from central banks squeezing the money supply. In this way, a recession is essentially the planned-for occurrence of a contractionary monetary policy with the hopes of lowering inflation and in some cases increasing unemployment levels.

While the prospect of increasing unemployment does not sound all too positive, it is a necessary fact of life when a country exceeds its maximum sustainable employment level. In New Zealand unemployment is the lowest it has been since the 1980s and well below maximum sustainable employment. As Mark Lister of Craig Investments has pointed out, this raises the risk of a wage-price spiral and out of control inflation.

So, while the bull market since the GFC (not-withstanding a Covid size blip) has been highly enjoyable, it is now high-time a recessionary correction took hold to wrangle inflation back into the 1-3% sweet spot. As Nigel Lawson once said under remarkably similar circumstances, "It's all been just a bit too much of a good thing."

Economic indicators also reflect this almost-positive stance on

recession. Though reserve banks are squeezing interest rates and a downturn seems inevitable, there is little evidence to suggest that the coming recession will feed off itself. I refer to the situation where a struggling household negatively changes its spending pattern to help ease the burden of a recession. The Economist has pointed out recently that the bank balances of the poorest American households are 70% greater than in 2019. The story is much the same in New Zealand where bank balance sheets reached their all-time peak in June. As such, the economy is in as prepared a state as any to fall into a recessionary hold for a time.

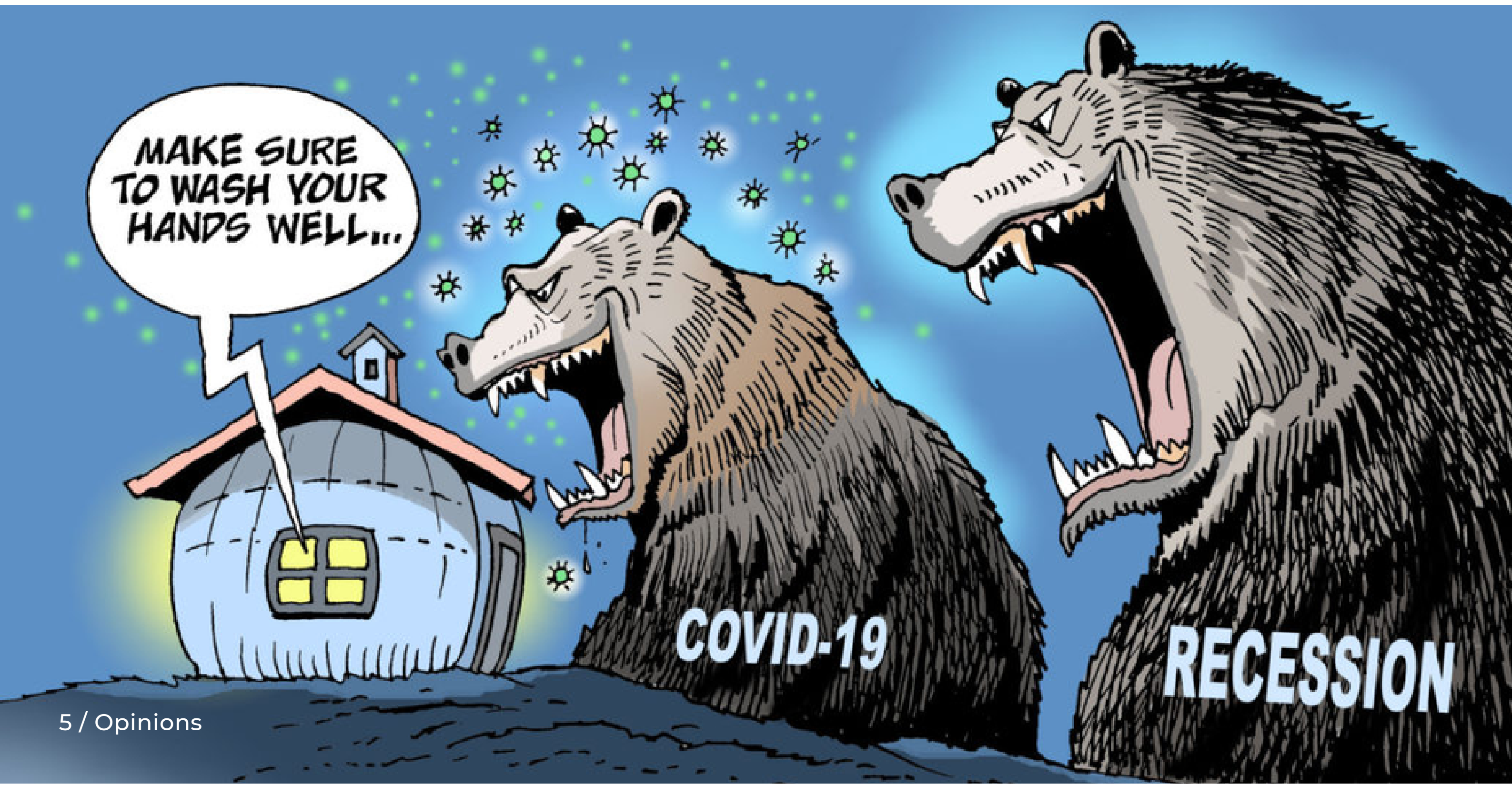
The European situation is not so easily discounted. Europe faces serious oil and gas shortages as Russia turns off the taps, creating an inflationary problem for industry and households. A recessionary downturn in economic activity could be seriously consequential to countries where industry is already hamstrung by high energy prices.

The silver lining? A diminished reliance on autocratic energy-producing nations cannot be a bad thing in the long run. The Russian invasion of Ukraine has exposed many countries for being over-reliant on one energy source. This has prompted a fast-tracked clean-energy push in many European nations. Germany, which relied on Russia for the majority of its oil and natural gas, has brought forward its goal of 100% renewable power by more than a decade to 2035.

This is a shift borne out of necessity, but nevertheless could spell the ushering in of a new era of greater reliance on renewable energies. If Europe can make this shift quickly, then a coming recession will not be so taxing on industry and households.

Michael Burry became a household name for investors and finance-bros alike for his single-handed prediction of the GFC. Today, you will be hard pressed to find an analyst not singing the likelihood of a coming recession. With good reasoning, the crack-down on inflation and slowdown of spending worldwide makes a recession almost inevitable. Nevertheless, governments are better equipped for the coming downturn and a recession could be just the antidote to deal with rising inflation.

Countries also affected by energy shortages will face the most immediate challenge amid a recessionary landscape. However, it may not be time to stock up on blankets just yet as there is a serious push worldwide to reduce reliance on unrenewable energy. Coming out the other side of a recession, the nations which made this push should find themselves better off in the long term.



INVESTING

Dynamics of an Earnings Call

BY ZAC BALLANTYNE

A corporate dance with billion-dollar consequences that has everyone on the edge of their seats. Hedge funds hovering over buy and sell executions, PR hoping the CEO won't go off script, and analysts offering a barrage of tough questions. All in the space of a 60-minute phone call.

The dynamics of an earnings call is an interesting one. So much rides on them with the outcome likely to swing a stock by 5% or more either way. With earnings season well and truly underway in the US, there is a lot to unpack as companies release their numbers and results for the quarter that has just been.

They start with the usual scripted preamble. The vice-president of Investor Relations introduces the C-suite and a couple of legal disclaimers. Then it's over to the big cheese for their spiel and justification of results. But the most intriguing part is undoubtedly question time. Analysts line up and take turns posing questions and picking brains. Some notorious earnings calls have turned south here, including that of Enron's in 2001, where CEO Jeff Skilling let loose on a sceptical analyst who rightly worked out their fraudulent act.

Listening to Apple's recent earnings call, one thing is noticeably apparent; every word and every sentence is carefully constructed and delivered to portray encouraging sentiment, whilst being careful not to over-promise on future deliverables and guidance. A fine line.

Reporting results are obviously important, but these aren't limited to just financial numbers. One that took *everyone* by surprise last quarter was Netflix, who sheepishly admitted they had taken a step backwards in the subscriber numbers for the first time ever, to the tune of 200,000. The gasps from listeners were (not quite) audible. In the majority of analyst's models, subscriber growth would have been a key assumption, likely increasing in line with something like population growth or industry projections. And most would have never thought this would go backwards. Alas, valuations were slashed, the stock fell over 30% wiping off $54 billion in market cap. Yikes - talk about a tough phone call.

Whether or not earnings calls will still be around in 10 years' time is a good question. A lot of companies these days tend to do webcasts or video conferences, rather than the traditional phone line complete with an operator. Financial numbers are usually released before the call, therefore everything else is supplementary and probably could be made into a smooth video package to be released simultaneously. Make no mistake – a live question time is vital to combat information asymmetry, however, I'd be surprised if the formal setting of a phone call is the way of the future.

I'll leave you with a slightly testy exchange on the recent J.P. Morgan earnings call with CEO Jamie Dimon, whose no bullsh*t approach is revered by many. Recently, he famously warned that a "hurricane" of a recession was approaching us. A gutsy analyst, Mike Mayo, questioned the unchanged expense guidance of the firm despite the impending doom Dimon suggested.

Mike Mayo
Analyst, Wells Fargo Securities LLC
Hi. Good morning.

Jamie Dimon
CEO J.P. Morgan
Hey, Mike.

Mike Mayo
Analyst, Wells Fargo Securities LLC
Could you help me reconcile your words with your actions? After Investor Day, Jamie, you said a hurricane is on the horizon. But today, you're holding firm with your $77 billion expense guidance for 2022. I mean, it's like you're acting like there's sunny skies ahead, you're out buying kayaks, surfboards, wave runners just before the storm. So are they tough times or not?

Jamie Dimon
CEO J.P. Morgan
No, let me – first of all, we run the company – we've always run the company consistently, investing, doing stuff through storms. We don't like to pull in and pull out and go up and go down and go into markets and out of markets through storms. We manage the company, and you've seen us do this consistently, since I've been at Bank One. We invest, we grow, we expand, we manage through the storm and stuff like that.... We're quite careful about how we run the risk of the company, and if there was a reason to cut back on something, we would.

PROPERTY

Making sense of China's financial crisis

BY KEEGAN MACDONALD

In the widely publicised protest that took place on the 10th of July, over a thousand upset and irate bank depositors gathered in the City of Zhengzhou, China. The protesters carried banners with messages including, "no savings, no human rights", and "against the corruption and violence of the Henan government". In response, the governing Chinese Communist Party (CCP) deployed large numbers of police, who ordered the protesters to disband. Further, in a dark turn of events, a group of unidentified assailants wearing white shirts violently beat and dragged the protesting group of bank depositors. Meanwhile, the police stood aside and observed the situation unfold. News agencies are comparing the situation to the 2007-08 global financial crisis (GFC) and the Tiananmen Square protest. So, why is this happening?

A brief history lesson is important in order to understand the context. You may have heard of Evergrande, the giant Chinese property development company. Well, similar to NZ's property market, every man, woman, and dog wanted to own property in China between 2010-2021. Evergrande capitalised on this roaring trend and over time expanded to become Asia's largest property development company.

To illustrate how keen people were to invest in property, people were buying them off the plan, prior to construction commencement. Further, a large proportion of these properties were left vacant because their owners believed their capital gains (appreciation in value over time) would generate sufficient profits.

However, below the surface, Evergrande was engaging in deceitful behaviour. This included recording the total value of paid-for properties as assets owned by Evergrande (not the investors, to which they truthfully belonged). Further, Evergrande leveraged investors' deposits to fund the construction of other projects. This should not have been allowed. So, what happened? Similar to the 2007-08 GFC, the trouble began with an agency problem.

In this case, the CCP should have been responsible for regulating the real estate industry, and by association, Evergrande. However, the CCP decided that local governments were better suited for this responsibility. The only issue with this was that local governments were profiting from Evergrande's success, as these authorities had a substantial vested interest in the continued growth in value of local land and property. In effect, these local governments turned a blind eye to the malpractices of Evergrande.

As was the case with the 2007-08 GFC, the undoings of the situation became apparent when property prices began to fall. These fell as a result of slowing disposable income growth, which impeded the ability of homebuyers to service their debts. The turning point was when, in December of 2021, Evergrande missed the deadline for their bond coupon payments. Investors were shocked and began to claw away at Evergrande's highly polished surface to uncover the upsetting truth beneath. On the discovery that Evergrande was engaged in fraudulent, amoral activities, investors began to lose faith in their real estate investments and mortgages. The kicker was that the majority of these loans were collateralised by properties not yet built.

Some began to boycott their mortgage repayments with their local banks and tried to withdraw the funds that they had saved with their banks, too. According to S&P Global Ratings, ~6.4% (2.4 trillion yuan, $355 billion USD) of home loans are in danger. So far, listed banks have announced only 2.1 billion yuan in defaulted mortgages as impaired by the boycotts. Further, the village banks kept fractional reserves on hand to service withdrawals, and


Chongqing, China

before long these funds were exhausted. Earlier this year, several local banks declared that customers could no longer withdraw their own savings. Thus, the bank run began.

The result? Upset depositors without access to their funds angrily protested outside their banks. However, these depositors were not only frustrated with the banks for not fulfilling their withdrawal requests, but they also had a bone to pick with the CCP and their local governments for not fulfilling their regulatory responsibilities. The protestors raised awareness of the abuse of power and ignorance of the CCP and the other associated organisations. In response, the CCP sent tanks and the police in an effort to maintain “order”.

To date, over 300 projects have joined the mortgage boycott, pledging to not pay any amount until construction resumes. These 300 projects represent more than $100 billion in debt that China’s banks are holding. Put lightly, this is not a promising sign of financial health for China’s financial institutions.

Further, real estate represents ~30% of China’s GDP, and S&P Global forecasts home sales could drop as much as 33% in 2022. This would further inhibit the liquidity of developers and increase the number of defaulted mortgages. In damage control efforts, the CCP has framed the protests as politically driven and has advised several banks to cease publishing media relating to the mortgage boycotts. However, the CCP is also considering injecting more than a trillion dollars into the affected property development companies in an effort to untangle this mess.


Beijing, China

CONVERSATIONS WITH UAIC ALUMNI

SANDY GUO

Investment Banking Analyst | Deutsche Bank (Sydney)
Investment Committee Analyst 2021 | UAIC Co-President 2019
LLB (Hons)/BCom | Economics and Finance

This new instalment of our Conversations series sees us joined by Sandy Guo, a former UAIC Co-President and Investment Committee Analyst. Having graduated from the University of Auckland in 2021 with a Law Honours degree and a Bachelor of Commerce, Sandy has undertaken a graduate role in Sydney as an Investment Banking Analyst at Deutsche Bank. She recently shared her reflections on university and her experiences working in banking overseas with us.

INTERVIEW & ARTICLE BY ROHAN BHATT

UNIVERSITY LIFE

During her time at university, Sandy was heavily involved with numerous student clubs, including Social Innovation New Zealand (SINZ), Auckland University Law Students' Society (AULSS), UN Youth, Management Consulting Club (now UACC) and UAIC. Sandy sees immense social value in joining student clubs during university, regardless of one's degree background or year level.

"As a first year or second year, clubs are extremely valuable in terms of meeting people. It's a good way to meet like-minded people and people who are further along in the same degree as you.

"Joining any club – even if it's a sports club – meeting those people and calling them your friends is what you hold onto when you leave university."

Looking back on her time at university, Sandy's appreciation of the flexibility and freedom that comes with being a university student has only grown. She encourages students to take things as they come and to remain open to opportunities and changes.

"University is a platform, and you can do anything with it. Don't feel like the degree you initially chose has to be what you do. Do what you're passionate about and try new things. Whilst it's really good to get amongst the business school clubs, I wish I did more sports clubs and tried other things that were out there because it's harder to do that once you're working. Take every opportunity that comes your way, and you never know you might be quite surprised."

WORKING IN INVESTMENT BANKING

Sandy's day-to-day as an Investment Banking Analyst involves a mixture of valuation and modelling, company research, client-specific duties and assisting her seniors in the preparation of presentation materials.

"There's live work and non-live work (which can be called pitching or marketing). The live deal side is more execution based and involves e.g. onboarding a client, and helping coordinate and liaise with the client and the target company.

The fundamentals of being an investment banking analyst are very similar and transferable. You're learning to have good attention to detail, become proficient in Excel and PowerPoint and understand how internal processes and deal management works."

A notable difference between banking in New Zealand and Australia is the division of bankers into product and coverage teams.

"In New Zealand, bankers would be called a 'generalist' and cover all companies listed on the NZX. In Australia, bankers are in coverage and product teams due to the vast nature of the ASX. For example, I am a coverage banker and am specialised in a particular sector – for example, natural resources. A product banker might focus on products such as Equity Capital Markets (ECM) or Mergers and Acquisitions (M&A). In that sense, you become more specialised in one area than you would in New Zealand."

Comparing working life to university, Sandy says the biggest difference lies within the collectivistic nature of professional work, in contrast to the rather individualistic nature of university responsibilities.

"You're now working in a team; you're contributing to something bigger than yourself... the outcome of which doesn't just impact you – it impacts your team and your clients."

However, Sandy reminds herself of the importance of maintaining a holistic outlook on one's life, both as a student and as a working professional.

"Having an open mind and the willingness to trust in the process is important for your own mental health. I almost didn't major in finance, but I went along with it and happened to enjoy it. Go with the flow and trust the process.

"Even after you graduate, you can change jobs. Nothing is fixed, although it seems like that's what you do university for, to get a particular graduate role, but you've got the rest of your life ahead of you."

Note: Some of Sandy's quotes have been edited for clarity. This interview was conducted via Zoom on the 4th of May 2022 by Rohan Bhatt with help from Zac Ballantyne and Andrew Meng.

MYOB Column

MYOB SME Mental Health Report 2022 – Time to talk about mental health

The lingering impacts of the COVID-19 pandemic have led to a surge in the number of local SME owners and operators experiencing stress and anxiety.

New insights from the MYOB 2022 Business Monitor has revealed around a third (32%) of New Zealand SME owners and operators have experienced a mental health condition since starting or taking over their business.

Of those who have experienced a mental health condition, 85% reported being affected by stress, while 71% said they have experienced anxiety and 39% have experienced depression.

In contrast to last year, the latest figures show a significant increase in the proportion of SMEs experiencing stress – up nine percentage points (76% in 2021), while the number of SMEs affected by anxiety rose seven percentage points (64% in 2021), on last year.

Read the full report here.

Forsyth Barr FOCUS

Sunny side up

Solar is about to become part of New Zealand's generation mix. One hundred and seventy three thousand terawatts of solar energy strikes the Earth continuously — more than ten thousand times the world's total energy use.

But, when it comes to New Zealand's electricity market's transition away from fossil fuels, solar has long been spurned in favour of alternatives such as geothermal and wind.

However, over the past 18 months there has been a tectonic shift in view. We've seen a flurry of announcements of intentions to build grid-scale solar that has now reached about 8.75 terawatt hours (TWh), the equivalent to around 20% of New Zealand's current electricity consumption.

Read the full article here.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