mint
ASSET MANAGEMENT

Quarterly Fund Report:
Mint New Zealand SRI Equity Fund

SINGLE SECTOR FUND

Mint New Zealand SRI Equity Fund

Investment Objective

The fund aims to provide investors with long-term capital growth by investing in New Zealand listed equities. The Fund has been designed to meet specific responsible investment criteria, with the aim of building a portfolio where the holdings in aggregate, generate a better ESG score in our systems than the benchmark. The objective is to outperform the S&P/NZX50 Gross Index after fees and expenses over the medium to long term.

Treading water

We are now over the halfway point for 2024, but the local market has yet to see much light at the end of the tunnel. The positive returns generated in the first quarter were short lived as a soft second quarter (down 3%) saw the S&P/NZX50 Index decline 0.5% since the start of the year. The dispersion between the winners and losers has been significant with the small cap universe down 12% for the quarter well below the larger end of town which held flat.

Despite the weak quarter, a few sectors did manage to net positive returns. Consumer staples (A2 Milk), Information technology (Vista and Gentrack) but also Healthcare all ended the quarter up. The more interest rate sensitive sectors including real estate and communication services (Spark) struggled over the quarter with negative returns, but none more so than the consumer discretionary sector down 25%.

The consumer in New Zealand remains under pressure. With the average mortgage rate at 6.3% we have seen household spending per capita fall nearly 2% over the past year. Additionally, household savings have also fallen in six of the past seven quarters and job ads continue to fall and are now down 35% year on year. The consumer softness is even visible from our office with the recently announced closure of department store Smith & Caughey and French beauty chain Sephora along Queen St in central Auckland. This negative sentiment will continue to weigh on GDP growth (or lack thereof) but does bring the RBNZ that much closer to enacting rate cuts.

With a May reporting season dominated by property and retirement companies, it was unsurprising to see lacklustre earnings outcomes. Many of the listed property names saw their earnings continuing to absorb the higher interest rates as well as the removal of the depreciation from commercial buildings. The sector's earnings per share (EPS) dropped ~7% whereas other sectors which reported saw EPS fall only 2%. We did see signs of maximum bearishness abate as earnings revisions from the reporting companies did lift for FY25 & FY26, although share price performance didn't follow suit.

By the end of June, the S&P/NZX50 index was trading at a market valuation median (PE) of 14.6x, which for context, is nearly two standard deviations below its 5-year average level, according to work undertaken by Forsyth Barr. When comparing with history, if you adjust for the S&P/NZX50 markets valuation for where the current 10-year NZ government bond rate is, this would imply an expected PE of 15.4x, indicating that the market looks cheap. The negative sentiment priced into the NZ market appears to be providing some solid opportunities and we are finding many names that offer significant upside.

Renewing the Renewables: A Tiwai Decision

After months (even years…) of waiting, we finally saw a new electricity contract signed for Rio's Aluminium smelter (NZAS) down at Tiwai point, Southland. This was a significant announcement for both the country (this is the single biggest electricity user) and the listed electricity sector. Having locked in the demand certainty it has provided a more conducive environment for the sector to commit capital for future generation projects throughout the country. The 20-year deal saw three of the listed names, Contact, Meridian and Mercury participate in providing generation commitments to the smelter, but also saw a substantial increase in contracted pricing from the lowly $35/MWh to what we believe is now $60+ varying between the individual generators. It's good to see the smelter supporting a higher value for those green electrons!

On the back of the major NZAS deal, Meridian took the opportunity to host an investor day down in Queenstown. This included a trip to showcase one of its key assets – the Manapōuri hydro power station, at 800MW it can supply enough power for ~650,000 homes, a monster feat of engineering and unlikely to be replicated in this country again.

The investor day focused on Meridian's views on the sector and more specifically its views on electricity wholesale prices out into the future with a significant lift in expectations. The driver being both a higher marginal cost to build new generation (with windfarms the marginal technology) but also from an increasing demand profile from EV adoption, data centres and industrial process heat as they transition to low carbon work. Meridian is the envy of sector with the best balance sheet, giving them plenty of scope for the near $10bn decades long development pipeline that was talked to at the investor day. Additionally, there is speculation around the chance of higher dividends (likely dependent on the investment noted above). News on this should come when it presents its full year result in late August. With its strong management team, outstanding renewable generation assets, and leading ESG credentials, Meridian continues to be a core holding for the fund.

Funding the future

After updating the market at the March investor day, Infratil announced a capital raise in early June for $1.15bn to fund investment growth into some key assets. This raise and associated market update focused largely on its fast-growing data centre company CDC with over half the raised funds looking to seed further developments in NZ and Australia.

With a potential 400MW contract approaching its final phases – CDC has decided to push ahead with a new mega site Marsden Park (720MW) as they continue to fill up there existing site and benefit from the cloud transition and AI thematic that goes from strength to strength. The size and scale of the expansions within the business now put CDC's enterprise value at a similar level to listed market player NextDC of around $13bn AUD, while valued at a lower earnings multiple. With CDC near the completion of 268MW of capacity, this when added to the 302MW of operational capacity, implies close to $1.2bn AUD of EBITDA based on the companies > $2m/MW EBITDA target. You can see how the scale of this business, while capital intensive, flows through to sizable earnings growth – and this is before the giant Marsden Park opportunity.

The opportunity with CDC is impressive and real. Factor in the additional growth assets like Long Road, Gurin (amongst others), it makes for a compelling story and is why we maintain a significant exposure to Infratil.

What's around the corner...?

As we begin the next quarter, we have already seen a more dovish tone from the RBNZ emerge as inflation has drifted back towards target levels. This is likely to be the biggest driver of overall market performance into the second half of the year as the S&P/NZX50 has a strong skew to yielding defensive names which traditionally perform well in a falling rate environment.

In August, we will have our next reporting season, which is likely to be a mixed bag. At one end we have the more stable gentailer sector whose largely pre-guided results should be somewhat predictable and supported by recent positive thematics in the Tiwai decision and elevated wholesale electricity prices. The focus within this sector will be on the development pipelines and dividend profiles.

Having seen many of the retirement sector names report in May, Summerset's result will be eagerly watched as housing sentiment and activity has remained subdued and we remain focused on the company's ability to maintain a healthy balance sheet and continue to grow.

Fletcher Building will again be in focus, with plenty of problems to solve for. While lacking a confirmed Chair and CEO and with assets up for sale (Tradelink), the weakness in the building and construction cycle appears to be getting worse in NZ and will weigh on any forecasts we are likely to see. Expectations have continued to disappoint and with the market expecting to see there 2025 earnings at or below last year, it remains a challenged story.

Portfolio Manager, David Fyfe

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David has over 15 years' experience in the financial industry. Previously he worked at BT Funds Management (NZ) as both a Quantitative and Equity Analyst undertaking sector research specialising in Transportation, Utilities and Technology in both New Zealand and Australian markets.

At Mint, David is the Portfolio Manager for the NZ SRI Equity Fund and the Australasian Property Fund and provides research across a number of sectors.

Signatory of: PRI Principles for Responsible Investment

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