



## BKI INVESTMENT COMPANY

ABN: 89 615 320 262

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BKI is managed by Contact Asset Management  
AFSL 494045

## QUARTERLY REPORT

### Quality Still Prevails – Reflections on February Reporting Season

Welcome to the 41<sup>st</sup> edition of the BKI Quarterly Report, prepared by Contact Asset Management (“Contact”).

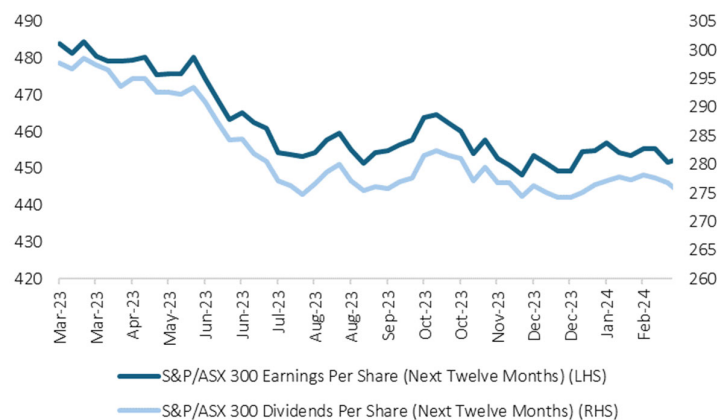
Investor expectations were low heading into Reporting Season and, in the main, results were better than feared. This time last year we noted that top line momentum (driven by price not volume) was a feature. Twelve months on, while top line momentum is sound, the overarching theme this year is an increased focus on costs. The good news is that the better quality companies have done well at protecting margins. In this note, we also highlight some interesting observations from Management Teams across different sectors.

In the face of widespread negativity over the past eighteen months, the Australian Equities market continues to grind higher. It is a reminder to long-term investors on the importance of staying the course. Australia’s economy is resilient, and our market has several structural tailwinds that are often underappreciated. There remain plenty of reasons for optimism.

### Reporting Season Review

Reporting season saw positive top line growth from most stocks held within our portfolios, exceeding expectations. However, profit conversion was increasingly difficult to come by as higher expenses and interest payments dragged on earnings. The better-quality companies are managing these headwinds, however those that were unable to do so found it difficult to raise or even maintain dividend payments. Negative dividend surprises were a feature of this reporting season with many companies taking a conservative approach to capital management with their first half FY2024 results.

**Dividend expectations for this year had been pared back and we saw evidence of reduced dividends in February**



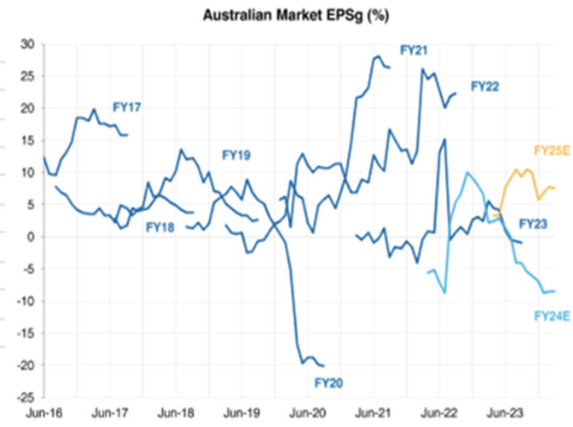
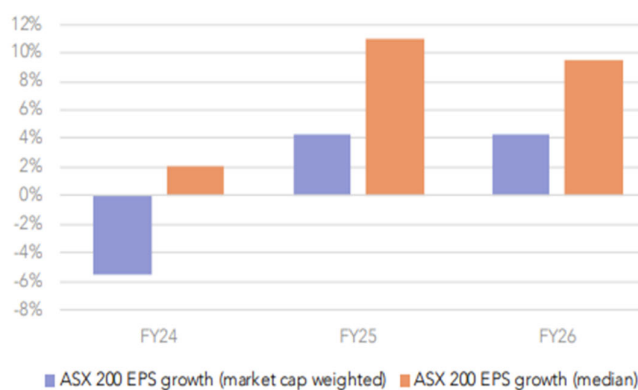
Source: Factset, Contact Asset Management

As we emerged from Reporting Season, earnings forecasts for FY24 were relatively unchanged (refer to EPS chart below from Macquarie). At a high level, the Reporting Season could be characterised by slowing revenue growth, but margins have been managed reasonably well. A lot of corporates highlighted a focus on cost-outs. The UBS Strategist wrote: “Cost management was the number one talking point this reporting season, with most companies still pointing to the elevated and sticky costs they face.”



Expectations were low going into reporting season (LHS) and Earnings expectations have not changed materially (RHS)

Figure 2: FY24 growth expectations were low going into reporting season



Source: Wilsons Research (LHS) and Macquarie Research (RHS)

## Commentary across certain sectors – what are Management teams saying?

**Banks – there are pockets of weakness and competition remains intense, yet a common theme was “resilience”**

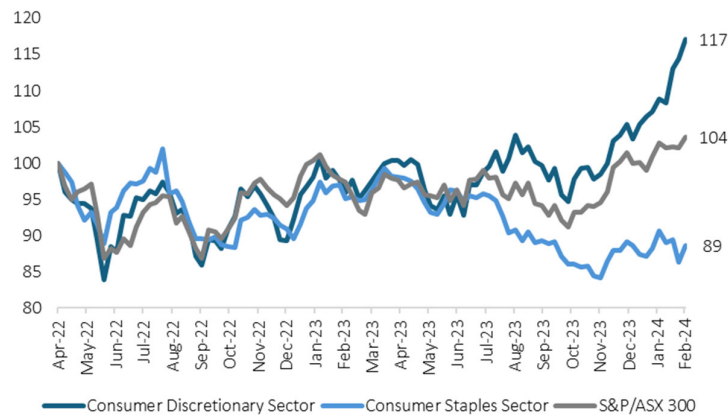
- Commonwealth Bank CFO Alan Docherty: *“It’s been a period of falling disposable incomes, an increasing cost of living pressure. On aggregate though, the economy continues to show resilience given both the impact on households and the fact that last year we had the largest net overseas migration to Australia since records began.”*
- Westpac’s Peter King: *“From a credit quality perspective, we saw a reduction in business stress” he said. “We expect the economy to remain resilient, supported by low unemployment and healthy corporate sector balance sheets”.*
- NAB CEO-elect Andrew Irvine: *“There are lots of companies out there that are looking to grow, employment levels are still exceptionally strong. And while interest rates have increased, most customers, both on the personal and on the business side have been able to work through that.”*

**Consumer – is looking for value and is being selective on where to spend the marginal dollar**

- Kmart was a standout for Wesfarmers and the value conscious shopper. CEO Rob Scott said: *“We’ve got a unique portfolio of businesses that are providing a good combination of resilience and growth. So we’ve got some high-quality businesses, and we’ve got teams that are executing very well and adapting to ever-changing needs of customers.”*
- Coles chief Leah Weckert says nearly all customers are taking active steps to budget their food bill *“Value is king”.*
- JB Hi-Fi’s Terry Smart says retailers are fighting for every consumer dollar. *“It’s absolutely a challenging economy and a challenging retail environment.”*
- Travel seems to be an area that is proving to be resilient. Flight Centre’s Graham Turner said, *“The level of recoveries strongly underlines the travel sector’s resilience. Travel, we believe, is non-discretionary. There is the emergence of the travelling class . . . with the means and propensity to travel.”* This was supported by comments from Qantas CFO Robert Marcolina, *“The group is seeing second half travel demand remaining strong across the portfolio with intake trends also remaining strong.”*



### Low expectations – the performance of the Consumer Discretionary sector since the first interest rate rise in May 2022 would have surprised a lot of market observers



Source: Factset, Contact Asset Management

### Resources – volume outlook remain buoyant

- BHP CEO Mike Henry: *"Longer term, we remain positively leveraged to the trends shaping the future of the planet. The world's population will continue to grow, continue to seek higher standards of living, and continue to urbanize. The global economy is expected to be 2.5 times larger by 2050, driving demand for the commodities we produce. The energy transition will further amplify that demand as the world will need more decarbonization infrastructure and more investment in defensive measures against the physical impacts of climate change."*
- SVW CEO Ryan Stokes speaking on demand and outlook - *"WesTrac is exposed to mining production through the volume of earth moved. The outlook for our key bulk commodity exposures like iron ore and coal remains robust."*
- Whitehaven Coal CEO Paul Flynn: *"In terms of supply-demand dynamics in the market. The Commodity Insights numbers are predicting growth in the thermal coal market over time out to 2040, some 28%. But there's also at the same time, a decline in the available supply just as we all know, it's difficult to bring new mines on, and that mines that are already on foot and producing do dwindle and exhaust their reserves over time. So a 23% decline in supply over the same period. That does point to a very solid backdrop from our perspective in terms of continued solid thermal coal pricing."*

### Finally, there were several comments on the prospect (hope!) of Interest Rate cuts

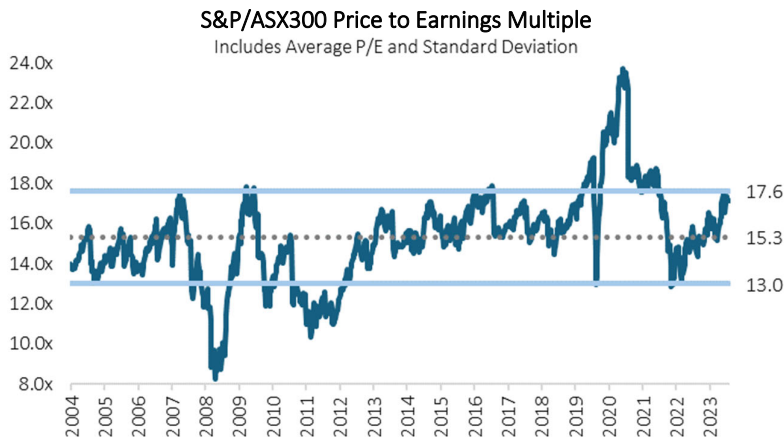
- James Hardie: *"We need to see consumer sentiment go up...We know this is going to come back. A big part of that is interest rates. You get an interest rate cut and then you start to see repair and remodelling accelerate"*.
- Westpac: *"To date, households have been squeezed by the high cost of living, a rising tax take and, for some, higher interest rates. But with inflation easing, tax cuts legislated to commence from 1 July, and the RBA likely to begin cutting rates later in the year, household spending power is likely to improve."*
- Beacon Lighting Group Ltd: *"I mean we would expect that if the consumer was maybe a bit more confident with their spending, then we will also receive the benefit of that. I don't think there's many retailers, pure retailers out there that are enjoying fantastic times in sales at the moment."*
- Charter Hall Group: *"Direct [property] funds had a quiet half as investors and advisors took advantage of higher interest rates to deploy equity into cash products. We expect these flows will return once expectations of rate cuts increase the appeal of property versus term deposits."*
- REA Group: *"The confidence that interest rates are at or very near the peak, should see the healthy market conditions we are enjoying today continue throughout 2024"*



### Quality Shines Through - Stay the Course

Each reporting season reinforces the importance of a Quality-first investing mindset. The companies that outperform are those with strong financials, pricing power and that boast agile and aligned management teams who know how to balance investing for growth with an unrelenting focus on costs.

Notwithstanding widespread negative investor sentiment over the past 12-18 months, the local share market has continued to edge higher. This has pushed the PE of the S&P/ASX300 higher to c.17x (FY2024e earnings). The dividend yield for the S&P/ASX300 is now c.3.5%.

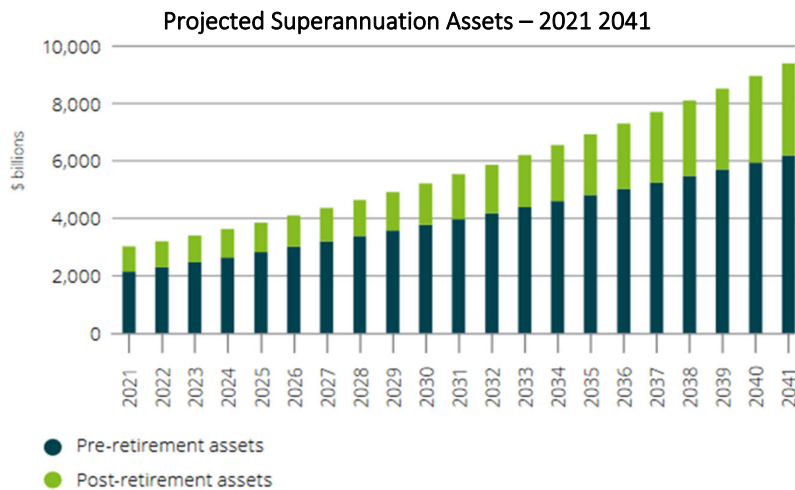


Source: Factset, Contact Asset Management

While the headline P/E multiples for the market appear elevated, there are still opportunities within sectors and certainly for stock pickers. Relative to global peers, we continue to believe that the Australian market looks attractive. We think it likely that Australian equities can keep delivering reasonable earnings growth throughout FY2024 on the back of:

- 1) low unemployment rate,
- 2) tight global commodity markets, and
- 3) strong migration.

The other often underappreciated fact is the huge tailwinds in the size of the Australian Superannuation pool, which is forecast to grow from c.\$3.8 trillion to \$9 trillion by 2040. With traditional asset allocation models investing 20-25% of capital into Australian Equities, this should provide strong foundations for ongoing market growth. With continued inflows into the asset class, one might argue whether a P/E multiple of 17x could become the new average for the Australian market?



Source: Challenger, Deloitte Actuaries & Consultants 2021

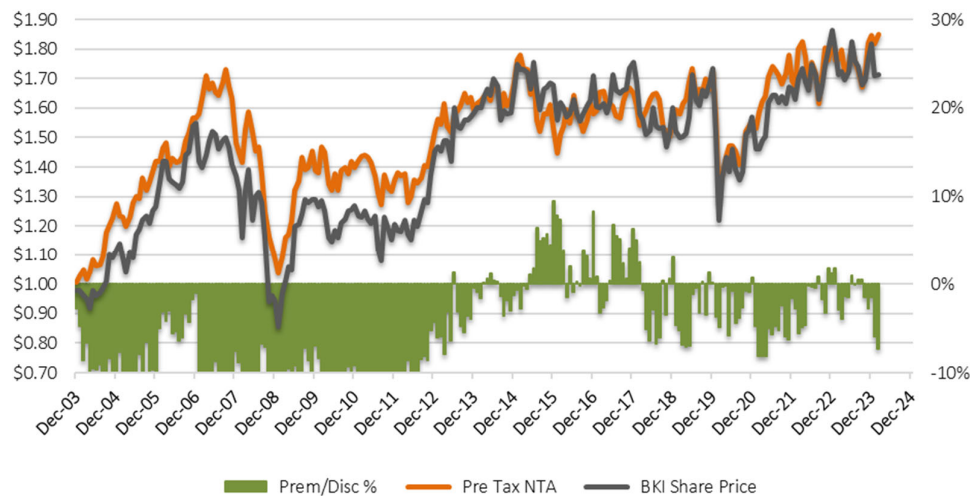




## Discount to Pre-Tax NTA

As discussed throughout this Quarterly Report, the higher-quality companies have done well at protecting margins and reporting solid results during February 2024. The Australian Equity market continues to grind higher and there are many reasons for investors to remain optimistic. However, this optimism hasn't transferred to BKI's share price post the payment of the 2024 fully franked interim dividend and we have seen a large discount to pre-tax Net Tangible Assets (NTA) appear.

BKI's consolidated unaudited weekly pre-tax NTA of BKI at Friday 8 March 2024 was \$1.85 per share. BKI shares closed on Friday 8 March at \$1.715, with a market capitalisation of \$1.38 billion - trading at a 7.3% discount to the pre-tax NTA. The chart below illustrates how the stock has traded relative to net tangible asset backing over the last 20 years. In particular, over the last 10 years the average discount to NTA that BKI has traded on is only 0.5%.



Source: Factset, Contact Asset Management

## Conclusion

We have been long term investors at BKI for over 20 years and each reporting season reinforces the importance of a Quality-first investing mindset. History shows that the companies that outperform are those with strong financials, pricing power and that boast agile and aligned management teams. Teams who know how to balance investing for growth with an unrelenting focus on costs.

Notwithstanding widespread negative investor sentiment and a concern leading into the reporting season, the local share market has continued to edge higher with those companies who have done well at protecting margins being rewarded. This reporting season has been another reminder to long-term investors of the importance of staying the course. Australia's economy is resilient, and our market has several structural tailwinds that are often underappreciated, giving us plenty of reasons to stay optimistic.

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