

How Perpetual's Aussie equities team identifies quality stocks

By Perpetual Asset Management

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Perpetual senior equities analyst LOUISE SANDBERG spends much of her time researching quality stocks for the Perpetual Equity Investment Company (ASX:PIC)

Here are two examples that illustrate Perpetual's longstanding investment process.

- *This is an edited version of a presentation by Perpetual's head of equities Vince Pezzullo at the [Perpetual Equity Investment Company \(ASX:PIC\)](#) AGM on Oct 19, 2023.*
- *You can find a summary of an accompanying presentation [from head of equities Vince Pezzullo here](#)*

PERPETUAL'S investment process sounds straightforward enough: searching for quality businesses with low debt, sound management and recurring earnings.

But how does it work in practice?

At the recent Perpetual Equity Investment Company investment update, senior equities analyst Louise Sandberg gave a glimpse into how the team thinks by discussing two contrasting holdings: Goodman Group (ASX: GMG) and A2 Milk (ASX: A2M).

Stock story: Goodman Group

Goodman Group is a developer, owner, and manager of logistics real estate around the world, with a presence in key growth cities globally.

It is the largest listed property fund manager in Australia with \$76 billion of external assets under management and a strong portfolio of assets near big cities.

Key to its attraction is leverage to long-term global trends like the growth of e-commerce, near-and on-shoring, and continued urbanisation.

"Early last year, concerns arose that interest rates were putting pressure on property companies' valuations, balance sheets, and also distributions," says Sandberg.

"We saw this as an attractive opportunity to build a position in Goodman and believe that the market was underestimating the strengths inherent to Goodman's model."

This was based on multiple factors — the macroeconomic strength of the logistics warehousing space and Goodman's development-driven growth model, strong balance sheet and excellent management team, she says.

"Our desire for next day or same day delivery pushes warehouses into the cities," says Sandberg.

"For a logistics company, your cost of delivering a product is much bigger than your rent. So, you can pay more rent to be closer to your end customers."

At the same time, warehouse automation has resulted in older warehouses being not fit for purpose — facilities need higher ceilings and bigger bays. This has pushed occupancy to record highs.

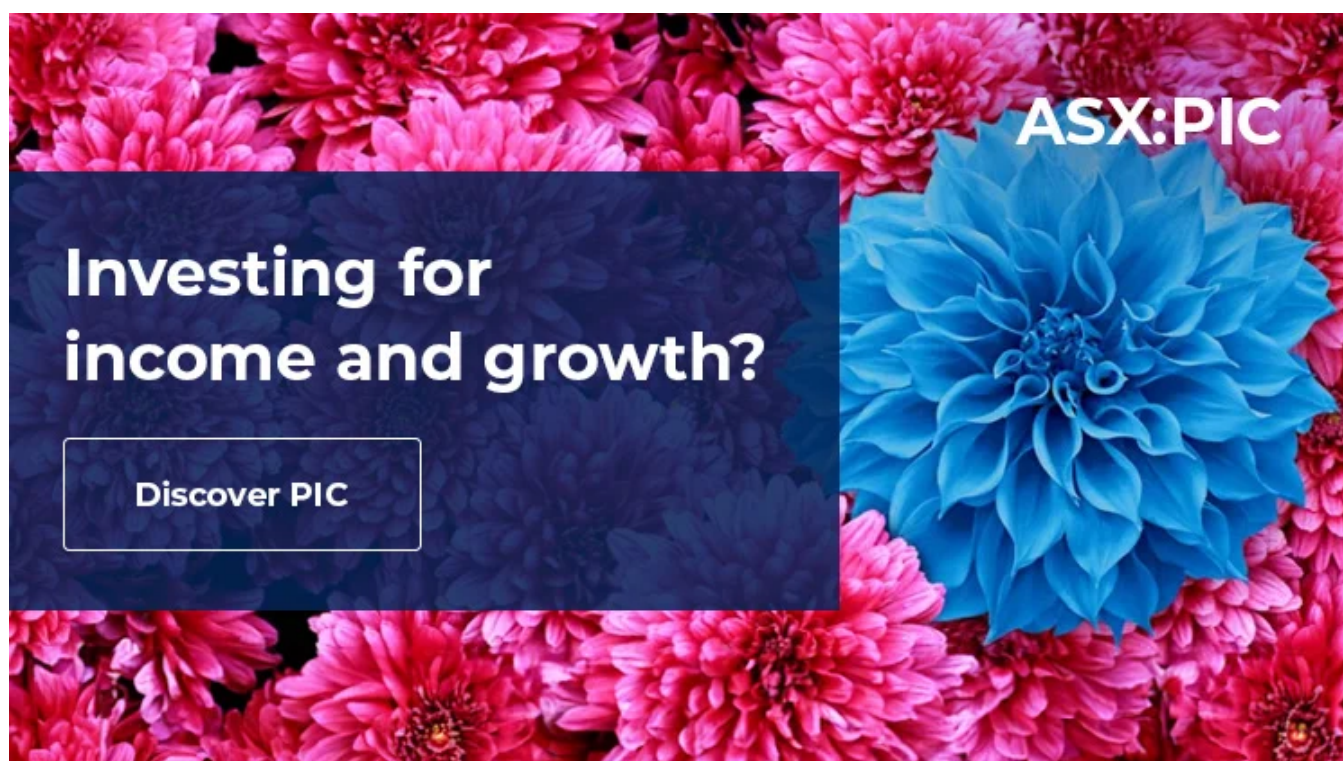
“Goodman’s portfolio is especially leveraged to these trends because management has consciously pruned and recycled its portfolio to placing its assets near big cities.

“Today, Goodman’s property portfolios are 99 per cent occupied and saw like-for-like net property income growth of 4.7 per cent in 2023.

“Find me an office manager that’s done that.”

More recently, Goodman has started repurposing logistics buildings as data centres, says Sandberg.

“Returns for data centres are even more attractive than traditional logistics.”



Stock story: A2 Milk

A2 Milk markets and sells premium-branded dairy nutritional products across Australia, New Zealand, China, and the US.

The A2 milk protein is marketed as easier to digest than other types of milk, which resonates particularly well with Chinese consumers.

Over time, infant formula sales to Chinese consumers have become a significant share of A2 Milk’s sales and profits.

“A2’s Chinese infant formula is available in close to 26,000 mother and baby stores in China,” says Sandberg.

That's a big turnaround from its pre-COVID model of selling infant formula in Australian stores to Chinese buyers who would then re-sell to family and friends back home.

"We see the growth of the Chinese label sold on the ground in China and the pivot to controlled sales of the Australian product on their own website as the creation of a much higher quality business model where A2 has control over its inventories, its marketing and also its price in China."

This has been demonstrated throughout this year as A2 gained market share in China while maintaining solid pricing and avoiding inventory build-ups in a very challenging overall market environment where a lot of the competitors cut price and saw inventories increase.

Sandberg says the weak Chinese birth rate remains a headwind for growth, but A2 has the potential to leverage its brand recognition by adding more products.

"A2 has over \$800 million in net cash at the end of fiscal year 2023 and an operating cash conversion of 114 per cent, meaning that every year they're building that cash pile further, so you have plenty of ability to invest in growth."

About Louise Sandberg and Perpetual Equity Investment Company (ASX:PIC)

Louise is a senior equities analyst with Perpetual Asset Management. She is responsible for covering large and small cap companies across property, discretionary consumer and consumer staples.

Perpetual Equity Investment Company Limited (ASX:PIC) is a listed investment company which provides a simple and transparent way to invest in a diversified portfolio of high quality Australian and global listed securities.

PIC is managed to provide investors with an income stream and long-term capital growth.

Perpetual is a pioneer in Australian quality and value investing, with a heritage dating back to 1886.

We have a track record of contributing value through "active ownership" and deep research.

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