PITCHER PARTNERS

Wealth Update

Winter 2021

pitcher.com.au

Winter 2021

Welcome to our latest Wealth Management Update.

This edition covers the following topics:

- Key Superannuation Changes from 1 July 2021
- Stock Spotlights:
  - Tesla Inc.
  - Alibaba

Key superannuation changes from 1 July

From 1 July 2021 a number of changes to superannuation caps, minimums and thresholds will come into effect.

In this article we look at three key changes to superannuation for the year ahead:

- Contribution caps
- Minimum pension income requirements
- Superannuation guarantee

Changes to contribution caps

Concessional

From 1 July this year, the concessional contribution cap increases from $25,000 p.a. to $27,500.

Concessional contributions are those that are made directly to your super fund before income tax, and are instead taxed at between 15% and 30%. This commonly includes Superannuation Guarantee, salary sacrifice and personal deductible contributions. This cap is indexed in line with average weekly ordinary time earnings in increments of $2,500.

Case study

- Rebecca's salary is $190,000 p.a. plus she earns an annual performance bonus of $20,000. In FY2022, we expect Rebecca's superannuation Guarantee to be $22,000 (10% x ($190,000 + $20,000)).
- From 1 July 2021 Rebecca can contribute a further $5,500 either as salary sacrifice or a personal deductible contribution, or a combination of both.
- Rebecca's total concessional contributions for the financial year would be $22,000 + $5,500 = $27,500.

Non-concessional

A non-concessional contribution is one that is made with after-tax money, typically from an individual's bank account. As this money has already been taxed, no further tax applies when it is contributed to superannuation.

The non-concessional contribution cap is four times the concessional contribution cap. This means the non-concessional contribution cap will be $110,000 from 1 July 2021. Additionally, the bring-forward provision will allow individuals to contribute up to $330,000.

Downsizer

The downsizer contribution cap may be available for those aged 65 and over who sell their primary place of residence and wish to use part of the sale proceeds to top-up their superannuation. The current cap of $300,000 is not indexed.

In the Federal Budget 2021-22 the government has proposed to reduce the downsizer eligibility age from 65 to 60. If this is legislated, it is expected it would come into effect from July 2022.

Small business capital gains tax cap

Small business owners who sell business assets may be eligible for tax concessions on capital gains and may be able to contribute an amount into superannuation to help fund their retirement.

When making a contribution under the 15-year exemption, the cap will increase from $1,565,000 to $1,615,000. However, when making a contribution under the retirement exemption, the cap is not indexed and therefore remains at $500,000.

Minimum pension income requirement

A minimum amount must be paid annually from superannuation pensions and annuities that commenced after 1 July 2007. The share market crash that began in February 2020 reduced retirement savings values for many retirees. Subsequently, the government reduced the minimum annual payment required to help retirees preserve their account values until markets recovered.

This standard minimum was reduced by 50% and initially applied in FY20 and FY21 only. On 29 May 2021, the Morrison Government announced an extension of the reduction for a further year. This means the standard minimum won't apply again until 1 July 2022.

The reduced minimum (applying until end of FY2022) and standard minimum (from FY2023 on) are shown below.

Age	Reduced minimum	Standard minimum
Under 65	2%	4%
65–74	2.50%	5%
75–79	3%	6%
80–84	3.50%	7%
85–89	4.50%	9%
90–94	5.50%	11%
95 or more	7%	14%

Case study

- Andrew's account-based superannuation income stream has a value of $1.6m on 1 July 2021, when he was aged 64. He elects to receive the reduced minimum of 2%, which means a minimum of $32,000 needs to be paid from his superannuation pension (2% x $1,600,000 = $32,000)
- Andrew is 65 on 1 July 2022 and his superannuation pension has grown to $1,696,000. Andrew continues to elect to take the minimum, which will now revert to the standard minimum of 5% (*note:* Andrew has fallen into the next age bracket, per the table above). Andrew's new minimum income for FY2022 is $84,800 (5% x $1,696,000).

Superannuation Guarantee

Superannuation Guarantee (SG) is a compulsory payment made by an employer directly to an employee's super fund. The SG amount is calculated as a percentage of the employee's ordinary time earnings (i.e. the amount you pay employees for their ordinary hours of work, including things like commissions and shift loadings).

The SG amount will increase to 10% from 1 July 2021 and continue to increase in 0.50% increments until reaching 12% in FY2026.

Financial year	General super guarantee
2021	9.50%
2022	10.00%
2023	10.50%
2024	11.00%
2025	11.50%
2026	12.00%

These payments need to be paid by your employer no later than 28 days after the end of each quarter. SG does not need to be paid where quarterly income is greater than $58,920 (FY2022) or less than $450 per month. Noting that the Government proposed to abolish the $450 minimum in this year's budget.

By Andrew Wilson,
Principal | Wealth Management
p. +61 2 9228 2455
e. a.wilson@pitcher.com.au

Stock spotlight: Tesla Inc (TSLA)

Overview

Tesla Inc. operates principally through two segments: automotive, and energy generation and storage. The automotive segment includes the design, development, manufacturing, sales and leasing of electric vehicles (EV's) as well as sales of automotive regulatory credits. The energy generation and storage segment includes the design, manufacture, installation, sales and leasing of solar energy generation and energy storage products, services related to its products, and sales of solar energy system incentives.

Investment Conundrum

Despite its phenomenal success, Tesla has always polarised investors due to its sky-high valuation. Yet its supporters have consistently pushed the share price significantly higher over the past decade. This has been notable in the past two years where the share price has risen from around $40 (this price accounts for a 5-for-1 stock split in 2020) in June 2019 to around $880 in 2021.

Tesla's first-mover advantage is significant in allowing the company to continue innovating to keep competitors at bay. An example of this is the company's intention to further reduce battery cells costs by 56%, further cementing a price advantage that sees it already paying 25% less for battery cells than its competitors. However, every stock should ultimately be judged against the valuation the market attaches to it. Tesla's valuation, like many others, has been inflated due to the historically low interest rate environment, as future cash flows are discounted by a lower rate than would otherwise be the case. Further, the "lower for longer" view has been reaffirmed by the Federal Reserve, who believes rates will be ultra-low for a long time.

Unlike most listed growth stocks that might trade on a multiple of between 25 and 35 times forecast earnings[2] (historically this has been between 20 and 30 times but unprecedented low interest rates have contributed to a significantly expanded earnings multiple). Tesla trades on a Price to Earnings (PE) ratio of 610 (based on a share price of $610.12 as at 10 June 2021 and an Earnings Per Share (EPS) of $1.00[3]). Granted, market consensus for the growth runway of Tesla is phenomenal. With strong earnings growth expected in FY21, the PE ratio is expected to fall to 134, before falling further to 98 in FY22, where EPS is projected to be around $6.23. These PE ratios also do not take into account further possible (and from past history, expected) share price appreciation over the next few years.

Investment Fundamentals

It may be seen from the table below that Tesla is currently trading on a multiple of 134 times expected FY21 earnings.

Share price 10/6/21: US$610.12	FY18	FY19	FY20	FY21 (E)	FY22 (E)
Revenue (US$bn)	21.5	24.6	31.5	49.1	65.7
Earnings Per Share (US$)	-1.14	-0.98	0.64	4.54	6.23
Price to Earnings (PE) ratio	N/A	N/A	953	134	98
Price to book value	12.74	12.54	32.36		
Revenue Growth	83%	15%	28%	56%	34%
EPS Growth	N/A	N/A	N/A	610%	37%

[1] B. Schmidt, *Tesla leads on EV battery costs*, despite soaring lithium prices, The Driven, Australia, 2021

[2] Nasdaq, *TSLA Earnings Date,* Nasdaq, Australia, 2021

[3] E. Yardeni, *Stock Market Briefings: Selected P/E Rations*, Yardeni Research, New York, 2021

As the market average multiple for the S&P500 is roughly 21.0 times earnings[4] and for growth stocks typically around 25 to 35 times earnings, it becomes clearer that Tesla's share price is elevated. On the assumption that a more normalised long run multiple for Tesla will eventually be closer to, say, 35 times earnings, Tesla earnings must grow significantly to justify the valuation that is currently being attached to its stock.

- **Current share price:** US$610
- **Minimum future EPS required to justify share price:** $17.43 (ie. $610/35)
- **EPS expected FY21:** US$4.54
- **EPS expected FY22:** US$6.23
- **EPS growth expected in FY22:** 37%

Assuming EPS grows by 37% (ie. the FY22 growth rate) in future years, we would have the following EPS figures over the next few years:

- **FY23:** US$8.72
- **FY24:** US$12.21
- **FY25:** US$17.10

Therefore, from this (admittedly) simplistic analysis of the future earnings potential of Tesla, it may be seen that FY25 earnings could indeed justify the present share price of Tesla.

A stock price is supposed to represent the present value of its expected future earnings. However, in reality, it is very difficult to predict such earnings and the accuracy of these estimates falls away the further one predicts into the future. In Tesla's case, if it is unlikely to grow its earnings by a compounded rate of 37% into the middle of the decade, then the current share price is not justified. If it can grow its earnings by more than this amount, or more, then the stock represents value at current levels.

Conclusion

Tesla may benefit from its first-mover advantage to be the dominant EV firm over the longer term. However, while Tesla has commanded a solid share of the EV market over the past few years, there are signs that competition is eroding this market share[5], with recent analysis showing Tesla's share of the global EV car market falling to 11% in April this year. This should surely raise alarm bells over whether the profit margins the company has benefitted from until now will come under pressure as competition increases and Tesla battles to recoup market share losses. The headache for Tesla is compounded as profit margins naturally contract as a result of EV vehicles becoming more affordable, which underscores the need for Tesla to significantly increase production in order to maintain its exceptionally strong earnings growth.

In summary, Tesla stock represents an investment with high uncertainty. If indeed the company can grow earnings at the rate it is expected to in the next few years, out to 2030 and beyond, the shares appear to offer value at current levels. However, any signs of a slowdown in growth, for whatever reason, will severely dent the share price.

By Dr. Riccardo Biondini,
Investment Analyst | Wealth Management
p. +61 2 8236 7856
e. riccardo.biondini@pitcher.com.au

[4] E. Yardeni, *S&P 500 Sectors & Industries Forward P/Es (monthly, weekly since 1997)*, Yardeni Research, New York, 2021

[5] G. Kay, Tesla's global market share fell to its lowest level in over 2 years as electric car competition heats up, Business Insider Australia, Australia, 2021

Stock spotlight: Alibaba Group

NYSE: BABA

Stock price 10 June: US$213.32

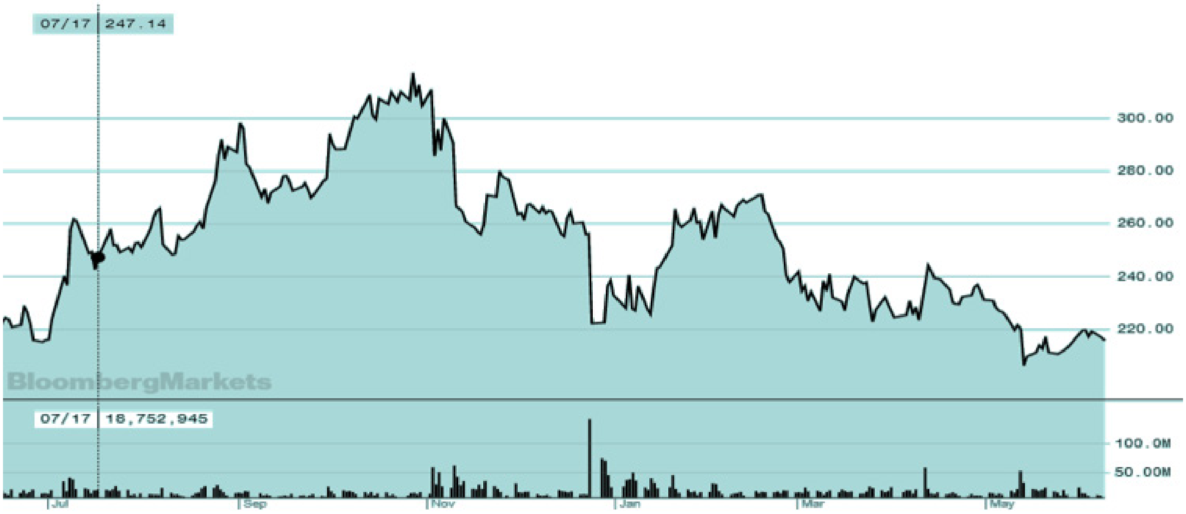
What does Alibaba do?

Alibaba is one of the world's leading companies founded by the entrepreneur, Jack Ma. Over the last 5 years earnings have grown at an annualised rate of 29% and sales at a stellar 46%.

Alibaba is the most popular destination for online shopping in China, accounting for over 50% of online sales through its related businesses. Its three core businesses are listed in the top 10 most popular retail sites globally. Alibaba.com is a business to business trading platform connecting manufacturers to wholesalers globally, Taobao has become China' largest shopping website, whereas Tmall.com offers branded products aimed towards the middle class. Unlike Amazon, Alibaba has created websites that facilitate the exchange of goods and services rather than holding physical inventory. Alibaba has also branched out into the high growth cloud computing arena as well as fintech solutions, via its highly successful Alipay payments platform.

Why has the share price disappointed in the last six months?

The share price has progressively drifted lower after the Chinese government decided to clamp down on emerging Fintechs on 3 November 2020 by suspending the much hyped, and highly anticipated Ant Group IPO, the fintech arm of Alibaba. This came shortly after the Alibaba founder accused Chinese banks of operating with a "pawnshop mentality". After these comments Jack Ma disappeared for several months, prompting further speculation about the Group's future, this was then compounded when Chinese regulators announced anti-monopoly rules targeted at online platforms like Alibaba. In March 2021, Ant Group executives were told to restructure the company's operations to turn it into a holding company and to comply with stricter financial regulations.



Source: Bloomberg

There is no doubt that these moves have eroded investor confidence as it is unclear where the government intervention will end. The company suffered a further blow in April when the national antitrust enforcement agency of China fined Alibaba 18.2 billion Chinese Yuan (approx. US$2.8bn). Alibaba will need to address its anti-competitive behaviour and is now required to submit compliance reports at the end of each year for three years and is encouraged to disclose the same to the public for supervision.

Recent Results

In May, Alibaba released it results for the 12 months ending 31 March 2021. Excluding the US$2.8bn fine, underlying revenue was up 32% to US$103bn and net income (non-GAAP) was up 30% to US$26bn. In Cloud computing, revenue grew by 50% to US$9bn. Revenue guidance of RMB 930bn was given for FY22, an increase of 30% on FY21.

Outlook

There is nothing like regulatory intervention to dampen investor confidence. Nevertheless, the recent fine reduces some of the uncertainty and the outlook for the group otherwise remains strong. There is no doubt that the group will have to make some changes to some of its businesses to comply with the anti-monopoly conditions. Inevitably these changes will reduce profitability. While consensus earnings estimates have been revised down for FY22 and FY23, they remain in the range of US$9.73 per share and $12.85 per share respectively. This would imply fair value of at least $US290 per share, implying significant near-term upside of 36%. Even if we apply a moderate discount for risk, value still appears compelling.

By Martin Fowler,
Partner | Wealth Management
p. +61 2 8236 7776
e. martin.fowler@pitcher.com.au

Making business *personal*

Authors

Charlie Viola
Partner and Service Line Leader | Wealth Management
p. +61 2 8236 7798
e. charlie.viola@pitcher.com.au

Jordan Kennedy
Partner | Wealth Management
p. +61 2 9228 2423
e. jordan.kennedy@pitcher.com.au

John Fisher
Lending Director | Wealth Management
p. +61 2 8236 7761
e. john.fisher@pitcher.com.au

Chris MacKenzie
Senior Insurance Advisor | Wealth Management
p. +61 2 8236 7819
e. chris.mackenzie@pitcher.com.au

Martin Fowler
Partner | Wealth Management
p. +61 2 8236 7776
e. martin.fowler@pitcher.com.au

Andrew Wilson
Principal | Wealth Management
p. +61 2 9228 2455
e. a.wilson@pitcher.com.au

Dr. Riccardo Biondini
Investment Analyst | Wealth Management
p. +61 2 8236 7856
e. riccardo.biondini@pitcher.com.au

Adelaide Brisbane Melbourne Newcastle Perth Sydney

pitcher.com.au