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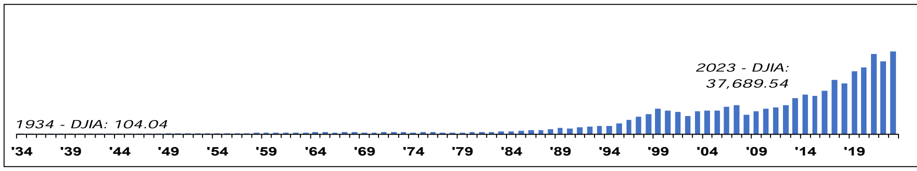
MARKET UPDATE



THURSDAY, OCTOBER 31, 2024

Good Afternoon. This is the Market Update for Thursday, October 31, 2024, with analysis of the financial markets and comments on **Annaly Capital Management Inc., Alphabet Inc., Booking Holdings Inc., IDEX Corp., Visa Inc., Weyerhaeuser Co., BP PLC and Sysco Corp.**

IN THIS ISSUE:

* Change in Rating: Annaly Capital Management Inc.: Upgrading to BUY on valuation (Kevin Heal)
* Growth Stock: Alphabet Inc.: Google Cloud drives 3Q as Waymo scales (Joseph Bonner)
* Growth Stock: Booking Holdings Inc.: Travel demand improves in the third quarter (John Staszak)
* Growth Stock: IDEX Corp.: Raising EPS estimates (John Eade)
* Growth Stock: Visa Inc.: Raising target to $330 after FYQ4 results (Stephen Biggar)
* Growth Stock: Weyerhaeuser Co.: Lower production, lower demand as housing market enters seasonal slowdown (Marie Ferguson)
* Value Stock: BP PLC: Waiting for a more favorable entry point (Bill Selesky)
* Value Stock: Sysco Corp.: Earnings miss on decline in restaurant traffic (John Staszak)

DAILY INSIGHT

ABBOTT LABORATORIES (NYSE: ABT) .... BUY

Abbott is a diversified MedTech company with solid portfolios in Diabetes Care and Cardiovascular medical devices. We believe that Abbott's growth drivers (including the FreeStyle Libre, electrophysiology products, leadless pacemakers, and cardiovascular devices) and ability to develop and launch new products will lead to continued growth in sales and earnings. We note that Abbott plans to expand the FreeStyle portfolio beyond the diabetic market and into the athletic market. We are encouraged by the recovery of market share in the U.S. Pediatric Nutrition business. Our target price is $145.

WEBINAR ANNOUNCEMENT:

Argus Research will host a webinar for clients at 11 a.m. ET on Wednesday, November 6, 2024. The webinar is titled Financial Services Sector Outlook. The webinar will be hosted by Argus Director of Research Jim Kelleher, CFA. Jim will be joined by Argus Director of Financial Services Research Stephen Biggar and Argus Fixed Income Strategist Kevin Heal.

During the call, we'll discuss the outlook for the fed funds rate and yield curve into 2025 and share forecasts for industry groups such as banks, brokers, insurers, exchanges, and financial data providers.

Listeners are encouraged to submit questions that we'll address in a Q&A session at the conclusion of formal remarks.

Please note that the CFP Board has accepted Argus' Monthly Webinar for one (1) hour of continuing education (CE) credit.

Please visit https://attendee.gotowebinar.com/register/4299896849254698078 to register. If you have any problems registering, please contact us at clientservices@argusresearch.com or by calling (212) 425-7500.

The webinar, as always, will be interactive with a question-and-answer period. We will be recording the webinar, and a rebroadcast will be available on the password-protected portion of our website. Slides related to the presentation will be posted on our website the day of the webinar and will be available via the webcast itself.

MARKET REVIEW:

The major indices are lower with the Nasdaq down more than 2%. The 10-year Treasury note is up 6 bps at 4.33%. Oil is up 1% at $69 per barrel. Inflation indicator PCE mostly came in line with expectations. Headline PCE edged a bit lower, rising at a pace of 2.1% for September, versus 2.2% in August. Core PCE held at 2.7% for September matching August.

ANNALY CAPITAL MANAGEMENT INC. (NYSE: NLY, $19.20) .... BUY

NLY: Upgrading to BUY on valuation

* On October 23, the company reported core 3Q24 EPS of $0.66, unchanged from a year earlier and a penny below consensus of $0.67. Book value increased to $19.54 per share at the end of 3Q24 from $19.25 at the end of 2Q24.
* NLY has historically traded near book value, which ended 3Q24 at $19.52 per share. On the recent earnings call, Management estimated that the book value has declined approximately 1% since the end of the quarter, placing it near the current stock price.
* The economic return, which combines the change in book value and the quarterly dividend payment, was 4.9% in 3Q.
* Although bond market volatility remains elevated we believe that NLY is positioned to take advantage of lower short-term rates, the current attractive spreads in the MBS sector and dividend yield of $13.6%. Based on these factors we believe that a BUY rating is now appropriate.

ANALYSIS

INVESTMENT THESIS

We are raising our rating to BUY from HOLD on Annaly Capital Management Inc. (NYSE: NLY) and setting a price target of $21. NLY has historically traded near book value, which ended 3Q24 at $19.52 per share. On the recent earnings call, management estimated that the book value has declined approximately 1% since the end of the quarter, placing it near the current stock price. We expect a series of rate cuts in the federal funds rate which would lower NLY's funding costs and increase the net investment spread. We also expect longer term rates to trade in the 4.0%-4.50% range keeping mortgage rates higher and MBS spreads attractive. We also like the low weighted average coupon of 3.12% in the MSR portfolio and successful non-agency securitizations.

NLY invests mainly in U.S. agency mortgage securities on a leveraged basis, funding the assets through repurchase agreements (repos). As of September 30, 2024, NLY's investment portfolio totaled $81.8 billion: $72.5 billion in agency MBS, $6.5 billion in nonagency securities and loans, and $2.8 billion in mortgage servicing rights (MSRs).

The company generates income from the interest earned on securities less hedging and borrowing costs, net realized gains and losses on its investment portfolio, and securitizations. The company's leverage was 6.9-times as of the end of 3Q, up from 7.1-times at the end of 2Q. This leverage enables the company to pay a high dividend, currently an annualized $2.60 per share.

The Federal Reserve's rate hikes and concerns about the health of regional banks caused mortgage spreads to widen in 2023 and 1H24, and they remain above historical norms. The Fed is also working to reduce its more than $2.35 trillion mortgage securities portfolio — which will put further pressure on MBS prices. Under its quantitative tightening program, the Fed will not reinvest MBS prepayments up to a maximum of $35 billion per month ($105 billion per quarter). We expect prepayments to continue to fall short of this goal (prepayments were approximately $45 billion in 3Q) and believe that the Fed will eventually have to take an active approach to reduce its holdings by selling MBS.

When it collapsed, SVB Financial Group had $91 billion of low-coupon MBS in the held-to-maturity portion of its investment portfolio. The portfolio sales were completed in 4Q23, removing an overhang from the MBS market. With the Fed no longer purchasing MBS and banks making smaller purchases, who will be the buyers? We expect hedge funds and asset managers to continue to purchase most of these lower-coupon MBS. Meanwhile, we look for mortgage REITs to buy new higher-coupon MBS, which carry rates of 6.0% or above. We note that mortgage securities rates remain at a higher-than-normal spread over 5-/10-year Treasuries (near 150 basis points compared with the historical average spread of 120-140 basis points).

Although bond market volatility remains elevated we believe that NLY is positioned to take advantage of lower short-term rates, the current attractive spreads in the MBS sector and dividend yield of $13.6%. Based on these factors we believe that a BUY rating is now appropriate.

RECENT DEVELOPMENTS

Year-to-date, NLY shares have risen 1%, compared with an increase of 22% for the S&P 500. Over the past year, the shares have risen 31%, versus a 41% advance for the index. We note that the main driver of the stock is the dividend yield, currently at 13.6%. NLY has a beta of 1.38. Approximately 19.4% of the shares are held in various ETFs; the stock accounts for 15.2% of the Mortgage Real Estate ETF REM.

On October 23, the company reported core 3Q24 EPS of $0.66, unchanged from a year earlier and a penny below consensus of $0.67. Book value increased to $19.54 per share at the end of 3Q24 from $19.25 at the end of 2Q24. The economic return, which combines the change in book value and the quarterly dividend payment, was 4.9% in 3Q.

On October 1, NLY announced that it has entered into a subservicing agreement with Rocket Mortgage. Rocket will handle servicing and recapture activities for a portion of Annaly's MSRs.

On the 3Q earnings call, management guided that they are comfortable with 4Q24 earnings available for distribution covering the quarterly dividend, which is currently $0.65 per share.

NLY reported a 3Q conditional prepayment rate (CPR) of 7.6%, down from 7.4% in 2Q24, primarily due to seasonal prepayments and lower rates. The CPR is the percentage of a mortgage security or pool that is expected to be prepaid in a year. We expect the CPR to trend slightly lower in 4Q24 as prepayments remain muted.

EARNINGS & GROWTH ANALYSIS

NLY invests mainly in agency MBS collateralized by residential mortgages. Its $81.8 billion investment portfolio includes $72.5 billion (88%) of agency securities, composed of specified pools, to be announced securities, and agency commercial MBS. NLY increased its agency portfolio by $6.4 billion, investing in higher-coupon securities. It also raised its hedge ratio to 101% from 98% in 2Q as lower rates moved hedges to shorter terms. The company generates income through the spread between the yield on its investments and the cost of borrowing and hedging activities.

Annaly continues to expand its platform for MSRs. MSRs are the rights to "service" an existing mortgage, including collecting payments and taxes. The originator of the loan pays a fee to the holder of the MSR. MSRs become more valuable in a steady- or rising-rate environment and act as a hedge against a decline in the value of the securities portfolio. The MSR book grew modestly to $2.85 billion in 3Q, with a weighted-average coupon of 3.12%. As of September 30, the MSR portfolio represented 21% of NLY's equity capital.

Annaly Residential Credit Group, with $6.4 billion in assets, invests in nonagency residential mortgage assets. The portfolio consists of $4.6 billion in securities and $1.8 billion in loans. Through 3Q24, the company priced 18 securitizations for a total of $9.4 billion. NLY is the largest nonbank issuer of nonagency securitizations.

In 3Q24, NLY took advantage of higher rates and wider mortgage spreads to add higher-coupon securities. The company funds its mortgage-backed securities via the repo market, allowing it to leverage its MBS portfolio in order to pay its dividend. NLY sees growth in times of economic stability, when U.S. interest rates and MBS rate spreads are steady, as it takes advantage of the spread between the yield of the acquired securities and its hedging costs. We note that NLY and other REITs are required to pay out 90% of their income to shareholders. Based on projected lower financing costs and ongoing MBS volatility, we are maintaining our 2024 EPS estimate of $2.66 and raising our 2025 EPS estimate to $2.81 from $2.72.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on NLY is Medium. The company scores average on our three main measures of financial strength: leverage based on debt/capitalization, profitability, and interest coverage.

In March 2023, the company reduced its quarterly dividend from $0.88 per share to $0.65, or $2.60 annually. The company maintained its quarterly dividend of $0.65 per share for a yield of 13%. Our dividend estimates are $2.60 for both 2024 and 2025.

Annaly has a stock buyback program. The current program runs through the end of 2024. The company did not repurchase any stock in 2Q24.

MANAGEMENT & RISKS

Founded in 1996 and based in New York, Annaly is managed by Annaly Management Company LLC. David Finkelstein became the company's CEO and chief investment officer in March 2020. Prior to joining Annaly in 2013, Mr. Finkelstein served as an officer in the markets group of the Federal Reserve Bank of New York. Serena Wolfe is the chief financial officer.

Investors in NLY shares face numerous risks. On a macro level, the company is dependent on a stable housing environment. Investments in agency MBSs are very interest rate sensitive, especially in a fast-rising rate environment. Liquidity risks are also significant, as NLY must be able to fund its securities through repurchase agreements. Federal Reserve actions in the repo market have diminished fears that the market could again seize up. The company also faces regulatory risks at both the national and state level.

COMPANY DESCRIPTION

Annaly Capital Management is a leading diversified capital manager. It is a publicly traded REIT that invests in and finances residential assets. The company has three different types of businesses: Agency, Mortgage Servicing Rights, and Residential Credit. The company's primary investment portfolio consists of agency MBS, managed on a leveraged basis. The company uses an actively managed portfolio and hedging strategies with the goal of preserving net asset value in different interest rate scenarios.

VALUATION

We think that NLY shares are attractive when compared to book value. On the fundamentals, the stock is trading below the September 30, 2024 tangible net book value of $19.52 and close to management's recent update on the current book value. The yield curve (10yr-2yr spread) has finally moved into positive territory and we expect future federal rate cuts to lower yields on the front end of the curve. We expect longer term rates to remain in the 4.00%-4.50% range and mortgage rates to remain higher, resulting in attractive investment opportunities for NLY.

If mortgage security spreads over Treasuries remain near 150 basis points in 4Q24 and into early 2025, we believe that NLY will continue to take advantage of this given its historically low leverage ratio. We look for mortgage spreads to potentially tighten in the first half of 2025 as banks reenter the market, which could boost NLY's book value. Our target price is $21.

On October 31 at midday, BUY-rated NLY traded at $19.20, down $0.14. (Kevin Heal, 10/31/24)

ALPHABET INC. (NGS: GOOGL, $174.13).. BUY

GOOGL: Google Cloud drives 3Q as Waymo scales

* Alphabet EPS rose 37% on 16% revenue growth in 3Q24.
* Alphabet continues to see generative AI as a key technology shift, warranting massive investment as it pushes its Gemini advanced AI model forward through a variety of enhancements and across its tech and product stacks.
* The company continues to face extreme regulatory pressure and risk from antitrust investigations, lawsuits, including a verdict in a U.S. case, a new U.S. trial, and new legislation in Europe.
* We are raising our 2024 GAAP EPS estimate to $8.02 from $7.61 and our 2025 forecast to $8.73 from $8.24.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Alphabet Inc. (NGS: GOOGL) to a target price of $200. It is perhaps ironic that Alphabet's spectacular success in internet search with often over 90% of search queries in many countries has led to a raft of antitrust allegations, investigations, and litigation. Although the outcomes of various litigation remain unknown, we think Alphabet is likely to operate in a more restrictive regulatory environment over time.

Alphabet remains an advertising juggernaut despite possible serious threats from competing generative AI platforms to its Search business and the antitrust litigation/regulatory pressure. YouTube and Google Cloud are also doing just fine as the company spikes investment in its own competitive AI applications as well as compute infrastructure as it races against Microsoft/Open AI and Meta to ensure its future relevance. Cost optimization remains a key priority for Alphabet in 2024 with the benefit observable in continued margin expansion.

We see Alphabet as one of the Tech industry's leaders, along with Meta Platforms, Apple, Amazon and Microsoft. These companies have come to dominate new developments in mobile, public cloud, and big data analytics, as well as emerging areas such as artificial intelligence, virtual/augmented reality, and even quantum computing. While Alphabet has often been criticized as a Johnny-one-note for its dependence on digital advertising, the rapid growth of Google Cloud has begun to diversify the company's revenue. Even the much maligned Waymo autonomous vehicle business has begun to expand commercial services, well ahead of competitors. Alphabet remains at a minimum competitive, if not a leader, in the development of generative AI, perhaps the new computing paradigm.

We remain positive on Alphabet's underlying businesses and believe that GOOGL shares are attractively valued.

RECENT DEVELOPMENTS

Alphabet reported 3Q24 results on October 29 after the market close. Alphabet beat the 3Q consensus estimates by $46 million on revenue and $0.27 on EPS. Alphabet provides no guidance, so large variances from consensus are typical. GOOGL shares rose about 3% on October 30.

Consolidated net revenue rose 16.4% from the prior year to $74.55 billion (less traffic acquisition costs). Google's 3Q24 advertising revenue, its primary revenue stream, rose 10.4% to $65.85 billion, reflecting 12% growth in both Search advertising and YouTube ads. This increase in advertising revenue was led by financial and the retail sectors. Google Cloud reported strong 35% revenue growth, accelerating from 29% in 2Q23 and 22.5% growth in 1Q24.

Google Subscriptions Platforms & Devices (renamed from "Google Other" and including YouTube subscriptions, Google Play, hardware, and other nonadvertising businesses) posted 28% revenue growth, driven by the launch of a new set of Pixel devices in September. In the small Other Bets segment, revenue rose 31% to $388 million.

Traffic acquisition costs (TAC) rose 8.5% from the prior year to $13.7 billion. The TAC margin as a percentage of revenue narrowed by 40 basis points to 21%.

The total cost of revenue rose 5% from the prior year. Other cost of revenue, excluding TAC, rose 10.5%, primarily driven by YouTube content and hardware costs. Third-quarter operating income rose 34% to $28.5 billion, and the operating margin expanded by 450 basis points to 32.3% as the company's cost optimization efforts continued to fuel robust margin expansion in the quarter. GAAP diluted EPS rose 37% from the prior year to $2.12. Share repurchases over the past year boosted EPS growth by three percentage points.

The much-maligned Other Bets segment, i.e., Google Fiber, Waymo and Verily Life Science (along with other smaller start-ups), reported a 3Q operating loss of $1.1 billion compared to losses of $2.3 billion in 2Q24 and $1.2 billion in 3Q23. The Google Cloud segment turned in an operating profit of $1.95 billion, accelerating from $1.2 billion in 2Q24 and just $266 million in 3Q23.

Waymo, Alphabet's autonomous driving business and the largest component of the Other Bets segment, continues to scale its commercial service, no doubt, also driving the continued segment losses. In September, Waymo expanded its partnership with ride-hailing service Uber Technologies to bring commercial autonomous ride-hailing to Austin, Texas and Atlanta, Georgia in 2025 whereby Uber will manage a Waymo fleet of vehicles. Waymo already operates its own autonomous vehicles in Phoenix, San Francisco, Los Angeles, and Austin, racking up one million fully autonomous miles per week and over 150,000 paid rides. While investors have regularly criticized Waymo as an expensive boondoggle over the last decade and a half, Waymo is far ahead of any AV competitor, namely Tesla. The company is also looking to apply its deep GenAI knowledge to improve on Waymo's reliability and lower costs as the business continues to scale.

Alphabet/Google remains beset by antitrust charges from all sides. The most important of these cases were filed by the U.S. Department of Justice. On August 5, a federal judge branded Google a monopolist in a ruling on the first antitrust case brought by the DOJ and joined by 37 U.S. states. The decision held that Google has monopoly power in the market for general search services and general search text advertising, that Google's distribution agreements are exclusive and have anticompetitive effects, and that Google exercised its monopoly power by charging above market prices for general search text ads allowing it to earn monopoly profits. The ruling really turned on the judge's view of the anticompetitive effect of Google's "exclusive" distribution agreements. According to the ruling, Google paid $26.3 billion in 2021 to secure its position as the preloaded default search engine on Apple's Safari browser, Mozilla's Firefox browser, all major Android device OEM's, Samsung, Motorola, and Sony, and the major U.S. wireless carriers, AT&T, Verizon, and T-Mobile. It was the exclusivity of the arrangements and the power gained from being the default search engine on almost all mobile devices sold in the U.S. that enabled Google to harness massive amounts of data to improve its search engine that gave Google its monopoly position even if other search engines could be installed on the devices. The judge did find for Google on a few issues including that Google lacks monopoly power in the market for search advertising, that there is no product market for general search advertising and that Google is not liable for actions involving its advertising platform. The judge also declined to sanction Google for its failure to preserve employees chat messages.

While Alphabet/Google will undoubtedly appeal the judge's ruling, the next steps in the case will be the judge's determination of sanctions and remedies for Google's behavior. While one of the sanctions sought by the DOJ is break up, most third party observers do not expect this but rather some type of decree prohibiting Google's monopolistic behavior, for example, prohibiting Google from entering into exclusive agreements with distributors. One unintended consequence of such a ruling is that Apple might need to forego a large part of the annual $20 billion that Google pays it in very high margin revenue for its distribution agreement with Google if the agreement is no longer exclusive.

A second federal antitrust trial brought by the DOJ and 17 states commenced in September. The government is alleging that Google has a monopoly in the market for software used to buy and sell ads placed on web pages also known as ad-tech. As is often the case, the wheels of justice turn excruciatingly slow, and Google has made the argument that it is already losing market share in ad-tech to competitors like TikTok and Amazon. This second trial is expected to be completed on November 25.

Meanwhile, Google continues to face regulatory issues in Europe. In September, the company lost an appeal of a 2017 decision that charged Google with giving preferential treatment to its own price-comparison shopping service versus competitors, which included a 2.4 billion euro fine. In a separate case, Google scored a partial win when the General Court of the European Union, the EU's second highest court, reversed a 1.49 billion euro fine, though upheld the European Commission's findings around Google's anticompetitive behavior in restrictive contracts related to advertising on third party websites. In an echo of the U.S. ad-tech case against Google, the U.K. Competition and Markets Authority made a provisional finding that Google has engaged in anti-competitive conduct around favoring its own ad-tech.

Google also continues to be sued for anti-competitive behavior in the private litigation space. In August, local business and social network website Yelp sued Google in federal court for preferencing its own local services over Yelp. In September, videogame maker Epic Games sued Google and Samsung, alleging that the two companies colluded to impose restrictions on third-party app stores, making it virtually impossible for users to load them and making the Google Play store the only real choice on Samsung mobile devices. Epic Games lost a similar suit against Apple but won an earlier case against Google. In something of a turnabout, Google filed a complaint against Microsoft in September with the European Commission alleging anti-competitive behavior in the enterprise software market by Microsoft's Azure cloud service.

EARNINGS & GROWTH ANALYSIS

We are raising our 2024 GAAP EPS estimate to $8.02 from $7.61 and our 2025 forecast to $8.73 from $8.24. Alphabet does not issue guidance. Our estimates imply 24% EPS growth on average over the next two years, above our long-term earnings growth rate forecast of 17%.

Search advertising, whether on Google sites or through its third-party Google Network (on desktop or mobile), remains the company's crucial revenue driver, even as its other businesses, such as YouTube, Google Play and Google Cloud have become multibillion-dollar businesses in their own right and in the case of Cloud has become a significant revenue growth driver. Management often notes that it manages for the long term and that quarterly results can be lumpy. Alphabet has been famously stingy with information on its business outside of advertising.

One of the key investor questions Alphabet has had to address is the perception that though the company did much of the basic research that led to generative AI that it has fallen behind Open AI's ChatGPT. Further, investors have been concerned about whether GenAI powered applications from ChatGPT/Microsoft, a well-funded giant along with a host of smaller GenAI start-ups, could pose an existential threat to Google's digital advertising business. Google's share of this business has been slowly eroding for years due to increased competition first from Amazon then TikTok and could drop below 50% in 2025 according to industry tracker eMarketer. Alphabet has responded to the threat by rolling out AI Overviews in Search first in the U.S. earlier this year and now into over 100 countries, reaching 1 billion users on a monthly basis. Google has also begun putting advertising around AI Overviews. Indeed, management has been laser-focused on infusing GenAI across its tech stack and product stack. GenAI applications to the Google Cloud Platform (GCP) are obvious though also will continue to entail significant capital expenditure. CFO Anat Ashkenazi noted that capex will increase in 2025. Capex was already up 80% in the first nine months of 2024 to $38.26 billion, again much of the increase due to GenAI infrastructure buildout. Even more to the point, GenAI is improving Google Search advertising and YouTube's content discovery engine. GenAI has also been incorporated into Android and the new Pixel hardware line.

With GCP, Google has provided a steady stream of improvements, as it does with most of its products, and is working to differentiate its services through AI. It has also moved to provide discounts, competing on price against Amazon, and has made investments and formed partnerships to secure long-term cloud computing deals with major clients. GCP has also tripled its sales force since 2019, essentially putting more feet on the street to compete with industry leaders Amazon and Microsoft. In addition, it has made strategic acquisitions in the space. CEO Sundar Pichai believes that GCP provides a number of differentiators relative to competitors, including AI-based real-time data and analytics, an open infrastructure that runs client workloads anywhere, and a superior level of cybersecurity.

Industry tracker Gartner places Google Cloud Platform a distant third in the market. Google is also partnering with multinational giants, as in its deals with SAP, Salesforce and Cisco, to integrate business software systems into GCP. Management clearly views GCP as critical to the company's future. Former Oracle executive Thomas Kurian heads GCP.

Google's YouTube is all about short-form video and as Netflix recently admitted, the most popular streaming-video service in the world. YouTube launched its Shorts service to compete with TikTok, and is currently working to monetize the new service. Management has introduced revenue-sharing with content creators, and YouTube content creation as well as advertising campaigns provide more prime opportunities for generative AI applications. YouTube also has a growing streaming television channel service, called "YouTubeTV." The service, technically a virtual multichannel video program distribution service (vMVPD), has become another formidable competitor in the over-the-top (OTT) streaming video market. This market already includes Hulu Live TV, Dish's Sling, as well as a host of other OTT services such as Netflix, Amazon Prime Video, and Disney+. We say "formidable" because YouTube users already spend over a billion hours a day watching its short-form content; it thus has a huge potential customer base. YouTube TV is available on both the Roku and Apple TV streaming devices. Google has also partnered with Verizon, the largest wireless provider in the U.S. and a growing player in the 5G-connected home market.

On April 24, President Biden signed into law a bill that would essentially force ByteDance, the Chinese owner of the popular social media site TikTok, to either sell TikTok or TikTok would be banned from distribution in the U.S. by January 19, 2025, subject to an additional three-month extension. TikTok has pledged to fight the new law in court. The passage of the law is an obvious positive for TikTok's competitor YouTube, Alphabet's Google division short form video business. An actual ban would be an even bigger positive for YouTube. We think the court case may turn on how the court views fundamental freedom of speech rights for TikTok and its users, versus the national security and user privacy concerns of the government. The simplest solution would be a sale to an American company or U.S. investor group, though it is unclear whether ByteDance could obtain Chinese government clearance for a sale. The Chinese government has already come out against a sale so it would have to reverse its position to now approve one. The situation is even muddier since many of the investors in ByteDance/TikTok are a who's who of Silicon Valley venture capital firms who may exert considerable political influence in the U.S. The outcome of the November U.S. presidential election could affect the outcome of the TikTok situation as former president Trump has expressed pro-TikTok sentiments after being anti-TikTok when he was previously in office.

With the start of the 2023 American football season, under an agreement with the NFL, YouTube began exclusively distributing NFL Sunday Ticket as an add-on to YouTube TV subscriptions, or on a standalone basis on YouTube Primetime Channels. Sunday Ticket broadcasts Sunday afternoon out-of-market regular season NFL football games produced by CBS and Fox. Direct broadcast satellite service DirecTV had previously held the rights to Sunday Ticket. According to the Wall Street, Journal Google pays about $2 billion a year for the residential rights to Sunday Ticket for a seven-year term, well above the $1.5 billion per year that DirecTV paid for both residential and commercial rights. While the return on investment for Sunday Ticket is unclear, given the high cost and Alphabet's usual stinginess with actual data, logic assumes it should be a subscriber draw at least during the NFL season.

Sources including a Wall Street Journal article on October 27, 2023, have reported that Google has agreed to invest $2 billion in generative AI startup Anthropic on top of a $300 million investment and partnership agreed in February 2023. Amazon made a $4 billion commitment to Anthropic in September. The WSJ also reported that Anthropic had signed a $3 billion multiyear deal with Google Cloud, which we expect is for cloud services to be used in training and exploiting generative AI models. The Google/Anthropic partnership illustrates how the Tech industry is starting to draw up sides in the competition for generative AI models after the much-heralded partnership of generative AI leader OpenAI and Microsoft. Google is also in partnership with key generative AI chip maker Nvidia.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Alphabet is High, our highest rating. The company's credit ratings are in the high As – high-quality investment grade – with stable outlooks.

Alphabet repurchased $45.3 billion of its stock in the first nine months of 2024, after buying back $61.5 billion of its stock in all of 2023. It repurchased $59 billion in 2022, $50 billion in 2021, $18.4 billion in 2020, and $31.1 billion in 2019. The share count has fallen 2% in the last 12 months.

Alphabet paid the first quarterly cash dividend in its history on June 17. The quarterly dividend is $0.20 or $0.80 on an annual basis with a forward yield of 0.5%. Our dividend estimates are $0.60 for 2024 (i.e. comprising the last three quarters of 2024) and $0.84 for 2025.

Management intends to provide both the new dividend and ongoing share repurchases as parts of its shareholder return program. With $111 billion in cash on the balance sheet and $56 billion in trailing 12-month free cash flow, Alphabet has the resources to cover the new dividend which we estimate to be about $10 billion a year and continue making large share repurchases.

MANAGEMENT & RISKS

Generative AI, exemplified by the success of OpenAI's ChatGPT model among a host of other competitors poses an existential threat to Alphabet's core revenue engine, internet search. In July, OpenAI launched its SearchGPT search engine in beta (test) mode. Google has begun to provide an AI overview in its search results which may be the beginning of useful commercial applications. The GenAI competitive threat to Google's internet search business bears close monitoring.

Like Microsoft and Intel before it, Alphabet has run into serious antitrust issues. The European Commission has issued adverse rulings and levied record-breaking fines, with perhaps more to come. The U.S. Department of Justice and many U.S. states have filed complaints against Alphabet's Google division. Much of this antitrust litigation targets Google's dominance in the search advertising and digital advertising markets. Google continues to face antitrust litigation from all sides.

In December 2023, Google lost an antitrust jury trial in a suit brought by videogame publisher Epic Games, the distributor of the iconic "Fortnite" videogame. Epic Games' lawsuit revolved around the Google Play app store, the 30% fee charged to app developers for customer purchases, and the rights of app developers to use their own distribution and billing methods while remaining on Google Play. Google is appealing the verdict. We note that Epic Games lost a similar antitrust suit against Apple and as Tech reporter Casey Newton points out, third-party app stores and billing systems will become a legal requirement in Europe in 2024.

In late 2022, the European Union passed new legislation, the Digital Services Act (DSA) and the Digital Markets Act (DMA), both aimed at strictly regulating large online businesses, i.e., Google and other large American tech companies. On April 25, 2023, Google Search, Google Play, Google Maps, and Google Shopping were designated as a "very large online platform" or a "very large online search engine" by the European Commission, making them subject to the DSA. The DSA is aimed at regulating Google's practices around content moderation/disinformation and user privacy, among other issues, and the company will be required to undergo outside audits of its practices and share algorithmic data with EU regulators.

The DSA took effect on August 25, 2023, and penalties for noncompliance are severe. The obvious risk to Alphabet is the imposition of a severe financial penalty for alleged noncompliance, though regulations could also have the perverse effect of locking in the existing competitive structure of an industry. Some critics claim that this occurred when the EU enacted its General Data Protection Regulation in 2018, as large companies with more resources are better able to comply with these laws than smaller competitors. EU regulators have tried to skirt this issue by making the new laws applicable only to services that aggregate very large numbers of users. While regulatory litigation and actions in the U.S. and Europe may take years to play out, we see them as a material risk to Alphabet which could one day be subject to onerous regulation and perhaps even to a forced breakup, as well as to additional large fines.

Alphabet's internet advertising-based businesses are highly competitive and subject to rapid and disruptive technological change. The rapid development of generative AI is a new and material risk to Google's dominance in internet search and to Alphabet as a whole. To remain relevant, Alphabet must keep up with, if not lead, such technological changes. Management recognizes that cultural norms around user privacy are evolving. Such norms could develop in a direction that limits Google's use of user data to make advertising more targeted, more relevant to the user, and thus more valuable to advertisers. The rapid adoption of mobile connectivity is a strong secular trend, and Google competitor Facebook has developed a mobile advertising platform to challenge Google's hegemony in digital advertising. Another deep-pocketed tech competitor, Amazon, has also moved into the advertising business, which threatens Alphabet/Google's industry position. Mobile search, particularly important to Alphabet/Google, remains a vibrant business, though it typically carries a lower rate. Alphabet must find ways to capitalize profitably on emerging platforms in order to sustain its growth.

Management does not provide forecasts and instead discusses the business only in general terms. This leads to large variances – positive or negative – between consensus estimates and actual results. In addition, while the first and fourth quarters are seasonally strong, the second and third quarters are seasonally slower, and the investment community may underestimate or overestimate these seasonal effects. Large negative variances to consensus may hurt GOOGL shares.

Finally, management may not be able to guide the company's rapid growth efficiently. Competitive pressures are also likely to increase as Alphabet's rivals – Apple, Facebook, Amazon, Yahoo and Microsoft – continue their attempts to capture market share in the online advertising space, enterprise cloud computing, streaming internet video, generative artificial intelligence and other competitive markets. While Alphabet's search engine, its core business, has essentially outpaced all its peers and its Android mobile operating system is the dominant global system, Alphabet competes at subscale in both cloud computing, well behind Amazon Web Services and Microsoft Azure, and in hardware, with a small fraction of competitor Apple's business. Alphabet has invested heavily to catch up in cloud computing and hardware, but although Alphabet's cloud computing business is obviously growing rapidly, it has yet to demonstrate that it can actually take market share while also expanding profitability.

Anat Ashkenazi became CFO on July 31, replacing Ruth Porat who was promoted to President and Chief Investment Officer. Ms. Ashkenazi had been CFO of pharma company Eli Lilly since 2021 and worked for Lilly in various financial executive positions since joining that company in 2001.

COMPANY DESCRIPTION

Alphabet, formerly called Google, maintains the largest online index of websites accessible through automated search technology. It generates revenue through online advertising, cloud services, and hardware. Google is now an operating segment of Alphabet. The company was founded in 1998 by Sergey Brin and Larry Page and went public in 2004.

Google's AdWords is an auction-based program that lets businesses display ads along with particular search results. Google's AdSense program enables websites in the company's network to serve targeted ads, based on search terms or web content, from AdWords advertisers. Most of the revenue generated through AdSense is shared with network partners. In addition, Alphabet owns YouTube.com, the web-based video site. It has also expanded into mobile telephony with its Android smartphone operating system and into public cloud services. About 52% of Alphabet's revenue is generated outside the U.S.

On April 3, 2014, Alphabet's new nonvoting class C shares began trading under the ticker GOOG. Alphabet's publicly held class A shares switched to the ticker GOOGL. The effect of the new class C share issuance was a non-economic 2-for-1 stock split.

On July 15, 2022, Alphabet executed a 20-for-1 stock split on its Class A, Class B and Class C stock. The stock split had no impact on the economic value of GOOGL shares.

VALUATION

Alphabet shares are up 22% year-to-date on a total return basis, compared to a 24% advance for the S&P 500, a 36% gain for the S&P 500 Information Technology Sector GICS Level 1 Index, and a 38% gain for the NYSE FANG+ Index according to Bloomberg. Alphabet's trailing EV/EBITDA of 17 is a below the peer median of 17.5 and near the five-year average. The forward EV/EBITDA of 13.3 is 2% below the peer average, compared to an historical discount of 5%. We are maintaining our BUY rating on GOOGL to a 12-month target price of $200.

On October 31 at midday, BUY-rated GOOGL traded at $174.13, down $0.33. (Joseph Bonner, CFA, 10/31/24)

BOOKING HOLDINGS INC. (NGS: BKNG, $4693.57) .... BUY

BKNG: Travel demand improves in the third quarter

* We have a favorable view of online travel companies, and of BKNG in particular, given its focus on Europe, where it generates most of its gross profit.
* We expect results to benefit as growing numbers of travelers book their flights, hotel reservations, and vacation rentals online.
* Reflecting solid bookings and higher room prices, we are raising our 2024 EPS estimate to $190 from $188 and our 2025 EPS estimate to $220 from $216.
* We are raising our target price to $5,500 from $5,045. This implies a potential return of 17% from current levels, including the recently initiated dividend.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY-rating on Institutional Model Selection Booking Holdings Inc. (NGS: BKNG) as the travel industry continues to recover. We have a favorable view of online travel companies, and particularly of BKNG, given its focus on Europe, where most of its gross product is generated. We expect the company to benefit from the strength of its Booking.com brand in Europe and from recovery in the U.S. BKNG is trading at 21.5-times our new 2025 EPS estimate, below the average for other online booking companies; however, we believe the company's strong earnings outlook merits a higher multiple. Our new target price of $5,500 implies a projected 2025 P/E of 25.0 and a potential return of 17% from current levels, including the recently initiated dividend.

RECENT DEVELOPMENTS

On October 30, 2024, Booking Holdings reported 3Q24 revenue of $8.0 billion, $355 million above the consensus estimate, and adjusted EPS of $83.89, up from $73.86 a year earlier. EPS topped the consensus estimate of $77.20. Bookings rose 9% to $43.4 billion, above the consensus of $41.54 billion. Room nights increased 8%, above the consensus estimate of 5.2% growth and management's guidance calling for 3%-5% growth. Interest expense rose to $305 million from $264 million a year earlier. Adjusted EBITDA rose to $3.7 billion from $3.3 billion in 3Q23 and topped the consensus forecast of $3.37 billion as well as management's guidance of $3.25-$3.35 billion. On a GAAP basis, EPS rose to $74.34 from $69.80 a year earlier.

The number of diluted shares fell year over year to 33.9 million from nearly 36.0 million, helped by share buybacks.

As discussed in a previous note, in 2023, revenue increased 25% to $21.4 billion, while adjusted EPS totaled $152.22, up from $100.75 in 2022.

EARNINGS & GROWTH ANALYSIS

Reflecting solid bookings, fewer shares, and higher room prices, we are increasing our 2024 EPS estimate to $190 from $188 and our 2025 EPS estimate to $220 from $216. Longer-term, we expect Booking Holdings to continue to benefit from growth in the online travel agent industry.

FINANCIAL STRENGTH

We rate the financial strength of Booking Holdings as Medium, the midpoint on our five-point scale. The company scores above average on key tests such as debt levels, cash balances, and profitability.

At the end of 3Q24, cash and cash equivalents were $15.8 billion, up from $12.1 billion at the end of 2023. Long-term debt totaled $13.8 billion, up from $12.2 billion. The third-quarter EBITDA margin was 45.8%, increasing from 44.7% a year earlier.

Booking Holdings initiated a quarterly dividend of $8.75 per share in 1Q24. Our 2024 and 2025 dividend estimates are $35.00 and $38.00, respectively.

MANAGEMENT & RISKS

Glenn D. Fogel has been the CEO of Booking Holdings Group since 2017. Ewout Steenbergen is executive vice president and CFO.

Booking Holdings earns most of its revenue in international markets, and is thus vulnerable to foreign exchange headwinds.

The online travel bookings market is growing rapidly, attracting such competitors as Google, Amazon, and Facebook. These large firms could take some of Booking Holdings' market share and squeeze industry pricing. The travel industry is cyclical and vulnerable to weak economic conditions. It also faces significant risks from outbreaks of disease, such as Covid-19.

COMPANY DESCRIPTION

Booking Holdings offers a variety of online booking services, including airline tickets, car rentals, cruises, hotel rooms, and vacations. Booking Holdings operates in Europe, North America, South America, the Asia-Pacific region, the Middle East, and Africa.

The company's brands, Booking.com, Agoda, KAYAK, OpenTable, and Priceline, enable customers to reserve hotel rooms anywhere in the world. More than 80% of bookings are international (primarily in Europe).

In July 2014, Booking Holdings acquired OpenTable, which provides restaurant reservations online in the U.S. and internationally. In May 2013, it acquired KAYAK Software Corp. KAYAK searches travel sites to obtain the lowest hotel room and airline ticket prices. In 2012, the company bought TravelJigsaw, now called Rentalcars.com, a provider of rental car services in Europe. In 2007, it acquired Agoda, an online travel company offering hotel bookings in Asia.

We think management's efforts to expand its services and diversify geographically have enabled the company to gain market share over the past five years. Although some of its competitors entered Europe before Booking Holdings, savvy acquisitions have, in our opinion, enabled the company to become a leader in the European market.

VALUATION

Reflecting a strong lodging industry, we believe that BKNG shares are undervalued at current prices. The shares are trading at 21.5-times our revised 2025 EPS estimate, below the average for other online booking companies. We believe the current valuation inadequately reflects prospects for stronger revenue and earnings in 2025. Consequently, we are maintaining our BUY rating. Our revised target price of $5,500 implies a potential return of approximately 17% from current levels, including the recently initiated dividend.

On October 31 at midday, BUY-rated BKNG traded at $4693.57, up $229.64. (John Staszak, CFA, 10/31/24)

IDEX CORP. (NYSE: IEX, $219.08).. HOLD

IEX: Raising EPS estimates

* IEX shares have underperformed the market over the past three months, gaining 6% while the S&P 500 has risen 7%.
* Business has turned south, with IDEX recently reporting 3Q adjusted EPS down 10% from the prior year.
* Orders in the problematic Healthcare segment are starting to improve, though.
* We may look to move this stock back to the BUY list if this positive trend in orders turn into better sales growth.

ANALYSIS

INVESTMENT THESIS

Our rating on IDEX Corp. (NYSE: IEX) is HOLD. This well-managed diversified industrial company has a long record of earnings and dividend growth. We think the company – which designs and manufactures fluidics systems and specialty engineered products for a range of industrial end markets, including healthcare, transportation, food, water and energy – is well positioned for the future. However, recent sales and order growth have slowed in two key segments – Fluid & Metering and Health and Science Technologies – due to industry slowdowns and project delays. The stock, from a technical perspective, is now in a bearish pattern of lower highs and lower lows. On a fundamental basis, the shares are trading at 26-times our 2025 EPS estimate, at the midpoint of the historical range of 20-33. Compared to the peer group (DHR, ECL, FTV, ROP, XYL, BMI), the shares are trading at discount multiples, which we think is appropriate given the growth trends. We may look to move this stock back to the BUY list if recent positive trends in orders turn into improved sales growth.

RECENT DEVELOPMENTS

IEX shares have underperformed the market over the past three months, gaining 6% while the S&P 500 has risen 7%. Over the past year, the shares have also underperformed, advancing 15% while the S&P 500 has risen 38%. The IEX shares have also underperformed the index and the industrial sector ETF IYJ over the past year and the past five years. The beta on IEX is 0.89.

IDEX recently reported 3Q adjusted EPS that fell 10% from the prior year but topped consensus forecasts. Adjusted diluted EPS came to $1.90, ahead of the consensus forecast of $1.88. Organic revenue rose 1% year-over-year to $798 million. The adjusted EBITDA margin narrowed by 150 basis points to 26.9%. For the first nine months, the company has earned $5.84 per share on an adjusted basis.

Along with the results, management raised the low end of its outlook for 2024. Management now expects adjusted EPS of $7.85-$7.90, compared to prior guidance of $7.80-$7.90. Management also forecasts a 1%-2% decline in organic revenue growth.

The company is continually refining its portfolio of assets. In 3Q, it acquired Mott Corporation, an engineering company that manufactures filters and fluid flow products. Mott will be integrated into IDEX's Health & Science Technologies group.

EARNINGS & GROWTH ANALYSIS

IDEX has a track record of delivering mid-to-high single digit growth, including 4% CAGR for sales, 5.5% for EBITDA and 8% for adjusted EPS.

IDEX has three operating segments: Fluid & Metering Technologies (FMT, 38% of 3Q24 sales); Health & Science Technologies (HSC, 38%); and Fire & Safety/Diversified Products (FSDP, 24%). Recent trends and outlooks in these businesses are summarized below.

Third-quarter organic sales rose 2% year-over-year for FMT. In FSDP, organic sales rose 4%. HST organic sales remained weak, declining 5%, but management noted that orders are starting to pick up.

On the expense side, the 3Q narrowed by 150 basis points to 26.9%. Margins narrowed in all three segments. Management recently lowered its segment EBITDA ratio target to 26.9%-27.2% from 28% for 2024.

Turning to our estimates, and based on expected sales and margin trends, as well as recent orders trends and management's guidance, we are raising our 2024 adjusted EPS estimate to $7.90 from $7.85. Our estimate is at the high end of management's revised guidance range, and implies an EPS decline of 4% year-over-year. We expect growth to return in 2025, as improved orders lead to better sales, and are raising our preliminary adjusted EPS estimate of $8.35 to $8.40. Our long-term EPS growth rate is 8%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on IDEX Corp. is Medium-High, the second-highest rank on our five-point scale. The company typically scores above average on our key financial strength criteria of debt levels, fixed-cost coverage, cash flow generation, and profitability.

IDEX ended its most recent fiscal year with cash of $534 million. Debt was $1.3 billion at quarter-end, and the debt/cap ratio was 27%. Operating income covered interest expense by a factor of 14 last year. The company had a healthy adjusted EBITDA margin of approximately 28% in its most recent year.

IDEX has paid 109 consecutive regular quarterly cash dividends. In May 2024, the board raised the payout by 5% to $0.69 per share, or $2.76 annually, for a yield of about 1.2%. We think the dividend is secure and likely to grow. Management has targeted a 30-35% dividend payout ratio. Our dividend estimates are $2.71 for 2024 and $2.88 for 2025.

MANAGEMENT & RISKS

Eric D. Ashleman is the company's CEO. He had served as COO and President. He succeeded Andrew K. Silvernail, who had been CEO for nine years. Abhi Khandelwal is the CFO. Katrina L. Helmkamp is the non-executive chairman.

The company's financial targets include consistent double-digit earnings growth, strong cash flow and superior return on invested capital.

The company has a history of growth through acquisitions. In 2Q23, IDEX completed its acquisition of Iridian Spectral Technologies, a global leader in designing and manufacturing thin-film, multi-layer optical filters, for CAN$150 million. Iridian has been integrated into the Health & Science Technology segment.

IEX investors face risks, including the risk that management will not be able to profitably integrate acquired companies. IEX investors also face risks related to the cyclicality of the company's businesses and end markets; intense competition; and economic, political and other risks associated with its foreign operations. In addition, we note that goodwill and intangibles represent a high proportion of total assets.

COMPANY DESCRIPTION

IDEX Corp. designs and manufactures fluidics systems and specialty engineered products for a range of industrial end markets, including healthcare, transportation, food, water, and energy. The shares are a component of the S&P 500. The company has approximately 8,800 employees.

VALUATION

We think that IEX shares are fairly valued at recent prices near $219, above the midpoint of the 52-week range of $183-$246. From a technical standpoint, the shares have been range-bound over the past 24 months.

On a fundamental basis, in terms of valuation, the shares are trading at 26-times our 2025 EPS estimate, near the midpoint of the historical range of 20-33. Compared to the peer group (DHR, ECL, FTV, ROP, XYL), the shares are trading at discount multiples, which we think is reasonable given the company's earnings trajectory.

On October 31 at midday, HOLD-rated IEX traded at $219.08, up $0.44. (John Eade, 10/31/24)

VISA INC. (NYSE: V, $291.35) .... BUY

V: Raising target to $330 after FYQ4 results

* On October 29, Visa reported adjusted EPS of $2.71 for fiscal 4Q24 (ended September 30), up from $2.33 a year earlier and above the $2.58 consensus.
* Payment volume (in constant dollars) rose 8% in 4Q, up from the 7% pace in 3Q, while cross-border volume rose 13% (versus 14% in 3Q) amid a continued rebound in international travel.
* Management issued initial FY25 guidance calling for revenue growth in the high-single to low-double-digits, and EPS growth at the high end of the low double-digits.
* In light of better spending volumes, we are raising our FY25 EPS estimate, and our target price to $330 (from $295) or a multiple of about 29-times our estimate.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Visa Inc. (NYSE: V) following the company's fiscal 4Q earnings. Payment volume accelerated sequentially from 7% in 3Q to 8% in 4Q, while cross-border volume continued at a healthy 13% pace. We continue to expect secular growth in payment volumes and believe that solid cost controls and strong buyback activity will boost EPS. Along with 4Q results, the company announced plans to host an Investor Day on February 20, 2025.

The company is focused on growing revenue from consumer payments (expanding credentials and acceptance points and driving user engagement), as well as from new flows (capturing new sources of payments and money movement between individuals, businesses, and governments) and value-added services (helping clients grow profits and deepen partnerships). It is also working to strengthen its brand and improve technology and security. Over the past two years, new flows and value-added services have grown significantly faster than consumer payments.

The company has noted the continuing large opportunity in consumer payments, estimating total global purchase personal consumption expenditure (excluding Russia and China) of $40 trillion, with an addressable market for Visa of $20 trillion. Components of this spend include: cash and check (about half of the addressable opportunity), including converting small-ticket cash transactions to Visa credentials; ACH and other electronic transactions, including extending Visa as a bill-pay method in categories such as rent, education and loan repayments; and cards that run primarily on domestic networks, where it has been focused on converting domestic-based cards to Visa credentials around the world.

Visa has been especially active on the acquisition front. In July 2019, Visa acquired Earthport, which provides cross-border payment services to banks, money-transfer service providers, and businesses. Other acquisitions announced in the second half of 2019 include the token services and ticketing businesses of Rambus; Verifi, which provides technology solutions to reduce charge-backs; and Payworks, a provider of payment gateway software for point-of-sale. In December 2021, Visa acquired Currencycloud, a global platform that enables banks and fintechs to provide foreign exchange solutions for cross-border payments, and in March 2022, it acquired Tink, an open banking platform that enables financial institutions, fintechs, and merchants to build financial products and services and move money. In January 2024, Visa acquired Pismo, an issuer processing platform with operations in Latin America, Asia Pacific, and Europe. In 1Q24, Visa acquired a majority interest in Prosa, a payments processor in Mexico.

We believe that tailwinds for Visa are both cyclical and structural in nature, and include generally favorable economic conditions, as well as the continued transition from cash to plastic for convenience, safety, and rewards program benefits. We also note that the market for payment processors is far from saturated given that more than 80% of the world's retail transactions are still done with cash and checks.

Our target price of $330 (raised from $295) implies a multiple of about 29-times our FY24 EPS estimate, at the high end of the historical range, but justified, in our view, by the company's near record operating margins in the mid- to upper-60s.

RECENT DEVELOPMENTS

Visa shares are up 16% over the past year, versus a 27% increase for the broad market.

On October 29, Visa reported adjusted EPS of $2.71 for fiscal 4Q24 (ended September 30), up from $2.33 a year earlier and above the $2.58 consensus.

Fourth-quarter net revenue totaled $9.6 billion, up 12% from the prior year, reflecting growth in payment volumes and international transaction revenue.

Payment volume in 4Q, on a constant-dollar basis, rose 8% year over year to $4.20 trillion, while the number of processed transactions rose 10% to 79.5 billion. Cross-border volume increased 13% as international travel rebounded.

Adjusted operating expenses rose 11%, and adjusted net income was up 13% to $5.4 billion. Earnings per share surged a greater 16% due to fewer shares outstanding.

For all of FY24, revenues were up 10% to $35.9 billion, while adjusted EPS rose to $10.05 from $8.77.

In September 2024, the U.S. Department of Justice filed a complaint against Visa alleging violations of the Sherman Act and that Visa monopolized the debit card market by, among other allegations, entering agreements with clients that discouraged the use of competing debit networks by imposing committed transaction volumes on merchants and their banks, thereby stifling competition. While the suit needs to be taken seriously and will remain a headline risk, we believe the process will take more than 18 months and a settlement is expected that only modestly alters Visa business. Interestingly, Visa is likely to use the Durbin amendment (legislation passed in 2010 that limits interchange fees) in its defense by arguing that it is these price caps that have deterred new entrants because the business of interchange fees is less profitable. We also think that competition in both the credit and debit markets is greater than at any point in recent memory, mostly from fintech players such as Square, ApplePay, and PayPal that have unique customer benefits.

In March 2024, Visa announced it agreed to a settlement with U.S. merchants that lowered credit interchange rates and capped those rates into 2030. The settlement would also provide updates to network rules giving merchants more choice in how they accept digital payments. However, in June, the settlement was rejected by a district court. Visa said it will continue to work towards another settlement.

EARNINGS & GROWTH ANALYSIS

On the fiscal 4Q earnings call, management provided initial guidance for fiscal 2025 calling for constant-dollar revenue growth in the high single-digit to low double-digit range, operating expense growth at a similar pace, and EPS growth at the high end of the low double digits.

The company's primary sources of revenue are services, derived mainly from payment volume on Visa-branded cards; data processing fees, from the number of transactions processed; and international transaction fees on cross-border transactions. Transaction volumes have generally benefited from both economic growth and the increased use of cards rather than cash. Inflation, to the extent that the average basket of goods costs more, is considered a tailwind for payments volume. Revenues grew 10% in FY24 and we expect a similar pace in FY25, in line with the company's guidance following fiscal fourth-quarter results.

Trends in client incentives (a revenue offset) are important to watch. These have historically been in the 22.5%-23.5% range of gross revenues, but recent renewals, including on some large deals, continue to increase that figure, which rose to 27% in FY23 and remained there in FY24. Based on a higher pace of renewals, the company expects growth in incentives to be significantly higher in FY25.

Based on continued favorable consumer spending patterns, we are raising our FY25 EPS estimate to $11.23 from $10.94, while initiating an FY26 forecast of $12.70.

FINANCIAL STRENGTH AND DIVIDEND

We rate Visa's financial strength as Medium-High, the second-highest rank on our five-point scale.

In August 2020, Visa issued fixed-rate senior notes in a principal amount of $3.25 billion with maturities ranging between 7 and 30 years, and interest rates from 0.75% to 2.0%. As of March 31, 2024, the company had long-term debt of $20.6 billion and a debt/equity ratio of 52%, but with high operating margins in the mid-60%.

The company has raised its dividend substantially over the last several years from a low base. In October 2024, it announced a 13% increase in the quarterly payout to $0.59, or $2.36 annually, for a current yield of about 0.7%. Our dividend estimates are $2.36 for FY25 (up from a prior $2.28) and $2.60 for FY26.

Visa repurchased 22 million class A shares in 4Q24 for $5.8 billion. In October 2023, it authorized a new $25 billion class A common stock repurchase program and had $13.1 billion remaining as of September 30. We look for a 3% decline in the average share count in FY25 and FY26.

MANAGEMENT & RISKS

Ryan McInerney was named CEO effective February 1, 2023, succeeding Alfred F. Kelly. Mr. McInerney had been the president of Visa since 2013. Chris Suh was named EVP and CFO, effective August 1, 2023.

In our view, management is transparent with investors, providing a range of financial projections for the business, including revenue growth, client incentives, operating margins, tax rate, and earnings growth.

Visa faces risks from regulation, including rules capping interchange reimbursement rates, as well as from economic variables that could impact service revenues, data processing fees, and cross-border transaction fees. Geopolitical factors, which could result in business disruption, are also a risk.

COMPANY DESCRIPTION

Visa Inc. operates the world's largest electronic payments network, providing processing services and payment product platforms, including credit, debit, prepaid, and commercial payments, under the brands Visa, Visa Electron, Interlink, and PLUS. Visa/PLUS is one of the world's largest ATM networks, offering cash access in local currency in more than 200 countries and territories.

VALUATION

Visa shares trade at about 26-times our FY25 EPS estimate, below the multiple of 30 for peer MasterCard. We think that Visa and MasterCard merit similar multiples. Visa has higher operating margins, while MasterCard's earnings are growing slightly faster. Visa is a large-cap name with consistent, and, we believe, enviable low- to mid-teens earnings growth prospects.

Our target price of $330 (up from $295) implies a multiple of about 29-times our FY25 EPS estimate, which we believe is warranted based on the company's historically high operating margins.

On October 31 at midday, BUY-rated V traded at $291.35, up $1.18. (Stephen Biggar, 10/31/24)

WEYERHAEUSER CO. (NYSE: WY, $31.62) .... HOLD

WY: Lower production, lower demand as housing market enters seasonal slowdown

* Over the past 52 weeks, the shares have underperformed peers with a decline of almost 8%, versus gains of 65% for the U.S. Home Construction ETF ITB and 36% for the Real Estate ETF IYR.
* WY reported 3Q24 non-GAAP net earnings of $35 million or $0.05 per share before special items. This compares with $239 million and $0.33 per share in 3Q23. The 85% decline is part of 10 consecutive quarters of negative year-over-year comparisons.
* Management reported lower domestic volumes, higher log inventories, and increasing competition from European exports cutting into WY's Japanese market.
* Weyerhaeuser pays base and supplemental dividends, but the special dividend paid in February was $0.14 per share compared with $0.90 in February 2023. The new base dividend of $0.80 per year provides a yield of about 2.5%, which is below the peer average.

ANALYSIS

INVESTMENT THESIS

We are maintaining our HOLD rating on Weyerhaeuser Co. (NYSE: WY). Weyerhaeuser is the largest domestic owner of forestland, with earnings driven by performance of the new housing market. The REIT reported banner results in 2021 as housing starts and lumber prices soared. However, the company has struggled since early 2022, as the economic environment and high borrowing costs have reduced demand from the construction industry. U.S. new home starts declined 9% in 2023 according to the U.S. Census Bureau, and while expected to grow from a low base in 2024, September housing starts remained below 2023 levels. With consumer confidence continuing to decrease, recovery is likely to have a longer lag time following the decline in mortgage rates than previously expected. A recent study from the Joint Center for Housing Studies at Harvard also projected that spending on home renovation, another key market for U.S. lumber and wood products, is expected to decrease 6% in 2024 compared with a year ago.

Lumber prices have also been depressed over the last year. Random-length lumber prices are currently trading around $547 per 1,000 board feet, far below the peak of close to $1,700 reached in 2021. The slow construction market has also led to oversupply and has maintained pressure on prices.

The company's earnings have been driven by its Wood Products segment, which has underperformed in the recent economy. For 2023, Wood Products accounted for 53% of adjusted EBITDA, down from 75% in 2022, while Timberlands accounted for 38%. Around 65% of Wood Products' EBITDA comes largely from new home construction, 15% from non-residential construction, and 20% from residential remodeling and repairs. Given the heavy reliance on new construction, Weyerhaeuser outlook is tied to the weak market for new housing, which has hurt lumber prices. We believe that these factors, combined with high mortgage rates, could replicate the perfect storm that resulted in record-low earnings for the company in 2019.

Weyerhaeuser pays base and supplemental dividends. However, the REIT substantially lowered its supplemental dividend year over year in 1Q24, and the new annual base dividend yield is just 2.5%, below the peer average. We would like to see lower mortgage rates and higher housing starts before considering an upgrade to our rating as initial earnings strength will be driven by favorable year-over-year comparisons. We also see the shares participating less in sector rotation as some peers interest rates drop.

RECENT DEVELOPMENTS

For the past three months, WY shares have gained 1%, compared with a 7% gain for the S&P 500, and a 6.7% gain for the Real Estate ETF (IYR). Over the past 52 weeks, the shares have fallen 8.3%, compared with a gain of 42% for the index, a gain of 65% for the U.S. Home Construction ETF (ITB), and a gain of 36% for the Real Estate ETF (IYR).

WY's earnings per share have had negative year over year comparisons every quarter since 2Q22. While the company had strong earnings growth in 2020-2021, results have continued to decline from a peak in 2021. Net income before special items in 3Q24 was $35 million, or $0.05 per share. This represents an 85% decline from $239 million, or $0.33 per share in 3Q23. WY excluded an after-tax special charge of $7 million in the third quarter and without the exclusion, net earnings would be $0.04 per share.

Adjusted EBITDA was $236 in 3Q24, down 54% from $509 million in 3Q23. For the year-to-date ending with 3Q24, adjusted EBITDA was $998 million, 38% from $1.4 billion for the same period a year ago.

WY's top line has continued to face challenges from lower demand from the housing market, low log prices, and over supply. While second-quarter net sales improved over 1Q24, sales declined in 3Q24 as compared with the prior two quarters. Net sales were $1.7 billion in 3Q24, down 17% from a year ago, and down 13% from 2Q24. The cost of sales in 3Q24 was $1.4 billion, down 6% from 3Q23. While 3Q24 selling expenses remained flat from a year ago, G&A costs rose 14% to $122 million versus $107 million a year ago.

Gross margin in 3Q24 was $250 million, compared with $502 million a year ago. For the year-to-date ending with 3Q24, gross margin was $1 billion, down 2% from $1.34 billion for the same period a year ago.

As for capital plans, management expects to invest $1 billion in its timberland portfolio through the end of 2025. A focus of the company's plans is to grow its Southern Timberland operations. In July, WY announced the acquisition of 84,300 timberland acres in Alabama for $244 million. The first part of the transaction closed during 2Q24 for $48 million, $82 million closed in the third quarter, with the remainder expected to close by year-end. The land is mature timberland to provide pine saw logs and fiber.

Management does not provide EPS guidance, although it did offer general 4Q24 projections for its three segments as compared with 3Q24. WY guided toward comparable earnings and adjusted EBITDA for its Timberlands segment with lower fee harvest volumes in the west, but higher fee harvest volumes in the south and north. The Real Estate/Natural Resources segment is expected to have lower earnings than in 3Q24 due to timing of real estate transactions. Wood Products is expected to see lower manufacturing costs, leading to slightly higher earnings and adjusted EBITDA, but only after excluding the impact of realizations for lumber and OSB.

EARNINGS & GROWTH ANALYSIS

Weyerhaeuser's business is heavily dependent on new residential construction. In the Wood Products segment, about two-thirds of EBITDA comes from new single-family homes, 15% from non-residential and commercial construction, and the remainder from residential remodeling and repairs. The company reports results for the following three segments.

Overall, management reported lower domestic sales realizations and weather conditions increasing costs in the Pacific Northwest. The company's Japanese sales continue to be hurt by the country's housing market with WY facing stronger competition from European exports to Japan. The Chinese market showed signs of an uptick, offset by elevated log inventories. In 3Q24, the company had lower sales volumes for lumber, OSB, and engineered wood products and higher manufacturing costs.

Third-quarter results by segments were as follows. For the Timberland segment, total sales in 3Q24 were $493 million, down from $555 in the prior month. Adjusted EBITDA was $122 million, compared with $147 million in 2Q24. While adjusted EBITDA increased 3% in the south to $72 million, it decreased 46% in the west to $54 million. Fee harvest volumes increased slightly in the north, compared with the prior month, volumes decreased 3.5% in the south and 7.3% in the west versus 2Q24.

The results in the Real Estate/Natural Resources segment largely reflect the timing of acreage transactions. In 3Q24, net sales dropped to $89 million, down from $109 million in the prior quarter. Adjusted EBITDA was $77 million in 3Q24 versus $102 million in 2Q24.

In the Wood Products segment, 3Q24 net sales dropped to $1.2 billion, down from $1.45 billion in 3Q24. Adjusted EBITDA decreased to $91 million, a dip of 60% from the prior quarter. Compared with 2Q24, third-quarter adjusted EBITDA dipped 68% for OSB to $39 million while adjusted EBITDA for engineered wood dropped 34% to $61 million. The OSB segment had 25% lower sales realizations versus the prior quarter while engineered wood had flat realization for joist products, but lower realizations for MDF and plywood.

WY is reliant on the housing market, and earnings have fallen sharply year over year for the past ten quarters. For the past several years, the company has faced lower demand, higher inventories, and a housing market that has remained depressed longer than anticipated. While many economists had thought interest rates would fall by this time, the higher-interest-rate environment has continued longer than expected. As a result, high borrowing rates have kept the housing market frozen longer than previously anticipated, and its thaw will likely require a longer lag time to correct supply and demand imbalances for construction supply, home sales, and housing starts. While lower rates should help strengthen the new home construction market by the end of 2025, WY earnings will likely lag the construction market into late 2025 or early 2026, with any earnings growth in 2025 driven by favorable comparisons.

After 2Q24 results, consensus estimates were lowered sharply. At that time, WY projected that upcoming earnings and adjusted EBITDA would be lower for all of the company's three reporting segments, and as a result, consensus estimates were lowered 45% at the end of 1H24. Management has admitted that the spring construction season was softer than previously expected as the industry faces a seasonal slow-down. The company considers the single-family market to have active construction with demand benefiting from a limited supply of existing homes on the market. Management also acknowledged that the repair and remodel demand has struggled as well as the multifamily segment, which has been more challenged with elevated supplies, higher borrowing rates, and higher construction costs.

The U.S. Census Bureau reports that compared with a year ago, September 2024 housing starts were less than 1% lower and building permits were 6% lower. Another key market for lumber and wood product suppliers is the home renovation market. However, as house price appreciation has slowed and home sales have tightened, so has there been a decrease in home improvement, repair, and renovation spending. A study of the effect by the Joint Center for Housing Studies at Harvard has projected that renovation spending is expected to decline from $486 billion to $457 billion in 2024 and to remain on a downward trajectory.

Borrowing rates are a leading indicator of the company's outlook. With the Federal Reserve (Fed) lowering interest rates more slowly than some expected, the housing market is remaining frozen longer than previously anticipated. Mortgage rates declined to their lowest level since February. As of the week ending October 24, 2024, Freddie Mac reports that the 30-year fixed-rate mortgage averaged 6.54%, up from September lows of 6.09%.

With rates remaining elevated longer than expected, consumer confidence remains hesitant. The U.S Consumer Sentiment index has decreased each month since March 2024 and has weighed on the demand for new homes. With Wood Products heavily reliant on the construction market, we expect the demand for lumber and OSB to lag recovery until consumers regain confidence. In addition, if rates do fall as the year continues, the winter months will also delay improvement in demand for new construction.

Although some segment sales are improving, the REIT continues to face high borrowing costs, tight margins, and oversupply resulting from lower demand for wood. We also expect high construction costs to continue to pressure home buyers even after mortgage rates ease as the construction sector responds to higher demand.

Given the importance of the Wood Products business in its overall mix, Weyerhaeuser is highly sensitive to changes in OSB and lumber prices. Management had previously estimated that for every $10 decline in the price of 1,000 board feet of lumber, total EBITDA is reduced by $50 million annually. Also, for every $10 change in the price of 1,000 square feet of OSB, $30 million is shaved from EBITDA annually.

According to Trading Economics, the price of random-length lumber on October 29, 2024 was $552.64. This compares with $572.50 at the end of December 2023 and $501.76 on July 31, 2024 and is well below the peak of $1,700 in 2Q21.

We are lowering our 2024 adjusted EPS estimate to reflect continued decreases in EBITDA and slower demand to $0.50, down from $0.60 per share. The REIT has struggled with lack of sales potential and while we project the company could return to positive earnings growth as 2025 progresses, it will be driven, in part, by favorable year-over-year comparisons. We expect the housing market to continue to remain sluggish and are lowering our 2025 estimate to $0.75, down from $1.00 per share.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Weyerhaeuser is Medium-High. Moody's rates the company's debt at Baa2.

At the end of 3Q24, WY had cash and equivalents of $877 million, compared with $1.2 billion at the end of 2023. Total long-term debt was $4.9 billion, down from $5.1 billion at the end of 2023. The debt/capitalization ratio was 33%, unchanged from the end of 2023 and below the Argus peer average of about 50%. At the end of 1Q24, the value of timberlands at cost, less depletion, was $11.5 billion, down slightly from year-end 2023.

In February, the REIT lowered its special dividend to $0.14 per share. The last special dividend was $0.90, paid in February 2023. The company raised its quarterly dividend to $0.20, up from $0.19 per share, when it announced its 1Q24 earnings. The new base annual dividend of $0.80 provides a yield of about 2.6%, which is below the peer average of 4.0%. Our 2024 blended dividend estimate is $0.94 and we are lowering our 2025 blended estimate to $0.90, from $0.98. We note that the company reported adjusted FAD in 3Q24 of $137 million. This compares with $316 million in 2Q24 and $424 million a year ago.

MANAGEMENT & RISKS

Devin W. Stockfish, the former senior vice president of the Timberlands segment, is the company's president and CEO and a member of the board. The CFO is David M. Wold. Former Plum Creek Timber Co. CEO Rick R. Holley is chairman.

Investors in Weyerhaeuser face a range of risks. Earnings are strongly tied to the outlook for new residential construction. In addition to industry-wide issues of competition, operational efficiency, environmental compliance, and potential litigation, wood prices can also be highly volatile.

The company also faces substantial threats from weather and wildfires, which could halt logging in parts of Canada. Weyerhaeuser's business may also be hurt by trade disputes with China.

COMPANY DESCRIPTION

Weyerhaeuser grows and harvests trees and manufactures forest products in North America. At year-end, the company owned about 10.5 million acres of timberlands in the U.S. and licensed just over 14 million acres in Canada. Its vast U.S. land ownership makes Weyerhaeuser the largest nongovernmental landowner in the U.S.

Weyerhaeuser is a REIT for tax purposes, though it is essentially a vertically integrated commodities company. WY also reports earnings as EPS rather than as FFO, which is the standard for REITs. The company has about 9,200 employees. The company reports results for three segments: Timberlands, which produces primarily saw logs; Wood Products, which includes engineered lumber, OSB, plywood, and medium-density fiberboard; and Real Estate/Natural Resources, which is comprised of acreage sales, solar/cell leases, and carbon capture revenues.

About three-fourths of employees are in the Wood Products segment. About 65% of demand for WY products comes from single-family home construction. The company's earnings have been driven by its Wood Products segment, which has underperformed in the recent economy. For 2023, Wood Products accounted for 53% of adjusted EBITDA, down from 75% in 2022. At the end of 1H24, Wood Product sales were about 73% of total revenues. The market cap is $23 billion.

VALUATION

Weyerhaeuser earnings have struggled since early 2022, driven by the frozen housing market. Disappointing inflation data and the later-than-anticipated Fed rate cuts have kept pressure on mortgage rates and decreased demand for new homes. Also increasing is the expectation of a longer lag time for recovery in the construction industry.

While REITs can benefit from positive sector rotation as income rates increase, we expect WY to have lower response to sector momentum that other REIT peers with stronger fundamentals. In fact, the shares have underperformed the Home Construction ETF ITB for the past 52 weeks. The shares also compare unfavorably in valuation to REIT peers. WY shares are trading around the midpoint of their 52-week range of $27-$36 and at 42-times our 2025 EPS estimate, versus WY's five-year historical average of 28.3.

The REIT has faced sequential quarters of year-over-year lower revenue and earnings growth. Although the company's results will likely improve when the housing market normalizes, we expect sales and margins to lag any uptick into late 2025 and 2026. In addition, the company's base dividend yield is below the peer average, and its supplemental dividend was recently cut substantially year over year, which may make the stock less attractive for income-oriented investors. In all, we believe that WY remains a HOLD rating, waiting a more favorable entry point.

On October 31 at midday, HOLD-rated WY traded at $31.62, down $0.09. (Marie Ferguson, 10/31/24)

BP PLC (NYSE: BP, $29.05) .... HOLD

BP: Waiting for a more favorable entry point

* On October 29, BP reported a 3Q24 underlying replacement cost profit of $2.267 billion, or $0.83 per diluted share, down from $3.293 billion or $1.15 per diluted share in the prior-year quarter. Earnings also benefited from a lower outstanding share count (down 5% year over year) due to share repurchases.
* Earnings reflected lower realized commodity prices (for crude oil, natural gas liquids (NGL's), and natural gas), lower refining margins, and a weak oil trading contribution.
* BP does not provide full year "forward-looking" detailed financial guidance, but the company continues to expect underlying crude oil production to be slightly higher when compared to 2023. BP also continues to expect a lower level of industry refining margins, with realized margins impacted by narrower North American heavy crude oil differentials.
* We are lowering our 2024 EPS estimate to $4.22 from $4.80 to reflect third-quarter performance, which missed our quarterly estimate by $0.58 per share. Looking ahead, our estimate generally assumes strong business operations, with continuing soft performance in the company's refining operations.

ANALYSIS

INVESTMENT THESIS

Our rating on the shares of BP plc (NYSE: BP) is HOLD. We principally base our rating on the company's high debt profile relative to its peer group. BP's total debt/capital ratio was 43% at the end of 3Q, meaningfully above the ratios of ExxonMobil (16%), Chevron (12%), and Shell (30%). In addition, management noted on the 3Q24 earnings call that its current strategy of focusing on cash flow and company returns and preserving its investment-grade credit rating are all major priorities moving into the future, implying that paying down debt is not as pressing a concern on management's list of concerns.

We view BP's high leverage as a distinct disadvantage during a period of significant crude oil price volatility and elevated global interest rates. We believe BP's less-leveraged peers are better able to manage sharp swings in energy prices and will be less affected by elevated interest expenses.

RECENT DEVELOPMENTS

On October 29, BP reported a 3Q24 underlying replacement cost profit of $2.267 billion, or $0.83 per diluted share, down from $3.293 billion, or $1.15 per diluted share, in the prior-year quarter. EPS missed our estimate of $1.41 but surpassed the consensus estimate of $0.78 per share. Earnings also benefited from a lower outstanding share count (down 5% year over year) due to share repurchases.

The lower third quarter 2024 earnings primarily reflected lower year over year realized commodity prices (for crude oil, natural gas liquids (NGL's), and natural gas), lower refining margins, and a weak oil trading contribution. Revenue for the third quarter of 2024 declined 11% to $47.254 billion, below the consensus forecast of $62.500 billion.

The company currently has three operating segments: Gas & Low Carbon Energy, Oil Production & Operations, and Customers & Products. Results for the third quarter of 2024 are summarized below.

In the Gas & Low Carbon Energy business, the segment reported a 3Q24 underlying replacement cost operating profit before interest and tax of $1.007 billion, compared to an operating profit of $2.275 billion in 3Q23. The lower year-over-year earnings performance largely reflected lower commodity price realizations and weaker trading (hedging) results. Total production was 890 thousand barrels of oil equivalent per day (mboe/d), down 6% from the prior year, mainly due to a base decline, particularly in Egypt.

In the Oil Production & Operations division, the 3Q24 replacement cost profit before interest and tax was $1.891 billion, down from $3.427 billion a year earlier. The year-over-year decline was primarily the result of increased depreciation charges, higher costs, and higher exploration write-offs. For the third quarter of 2024, production increased 8% from the prior year to 1,488 mboe/d, reflecting stronger base performance and the start-up of several major projects.

In the Customers & Products operating segment, the company reported a replacement cost profit before interest and tax of $23 million, down from a profit of $1.549 billion in the third quarter of 2023. The lower profit performance compared to the prior year period was mostly the result of lower refining margins, lower contributions from oil trading, costs associated with the impairment of the Gelsenkirchen refinery (Germany), and associated contract costs. BP-operated refining availability for the third quarter of 2024 was 95.6%, down from 96.3% a year earlier.

Average realized price (overall) for liquids was $70.68 per barrel, down 2% from the prior year, while the average price for crude oil was $46.81 per barrel, down 1%. The average realized natural gas price was $4.75 per mcf, down 3% from the prior-year quarter.

As discussed previously, BP announced in February 2022 that it would exit its 19.75% stake in Russian energy company Rosneft. Although it has written off this investment, taking a charge of $25.52 billion, some media reports continue to suggest that BP has still not sold all of its Rosneft shares.

The 2015 $18.7 billion settlement (for federal and state claims, as well as claims by local government entities) for the Deepwater Horizon will be paid over 18 years. As much as two-thirds of the settlement will be taken pre-tax, thus reducing the effective payout. The settlement covers most of BP's remaining liabilities from the accident and brings the company's total pretax spill-related charges to $66.691 billion. We view the settlement as a positive for BP, as it reduces uncertainty over the ultimate financial impact of the spill. BP expects Gulf of Mexico oil-spill payments for 2024 to be around $1.2 billion pre-tax, including $1.192 billion pre-tax paid during the third quarter of 2024.

EARNINGS & GROWTH ANALYSIS

BP does not provide full year "forward-looking" detailed financial guidance, but the company continues to expect underlying crude oil production to be slightly higher than in 2023. BP also continues to expect a lower level of industry refining margins, with realized margins impacted by narrower North American heavy crude oil differentials. Lastly, the company anticipates 2024 capital expenditures of about $16 billion, down slightly from $16.3 billion in 2023.

We are lowering our 2024 EPS estimate to $4.22 from $4.80 to reflect third-quarter performance, which missed our quarterly estimate by $0.58 per share. Looking ahead, our estimate generally assumes strong business operations, with continuing soft performance in the company's refining operations.

We are also reducing our 2025 EPS estimate to $4.91 from $5.78 per share to reflect our expectations for slightly lower commodity prices, weaker product (crude oil and natural gas) demand, and higher global inventory levels.

FINANCIAL STRENGTH & DIVIDEND

We rate BP's financial strength as Medium, the midpoint on our five-point scale. Standard & Poor's rating is A-/stable, while Moody's rating is A1/stable, and Fitch's rating is A+/stable. All are considered "investment-grade".

At the end of 3Q24, BP's total debt/capitalization ratio was 42.8%, up from 39.7% a year earlier and modestly higher than the company's peer group. Over the past five years, the average debt/cap ratio has been 44.5%.

Total outstanding debt was $64.1 billion at the end of 3Q24, up from $57.4 billion at the end of 3Q23. We believe that BP would easily be able to access the debt markets for additional liquidity if needed.

BP had cash and cash equivalents of $34.6 billion at the end of 3Q24, up from $29.9 billion a year earlier. Cash from operating activities (operating cash flow) in 3Q24 was $6.761 billion, down from $8.747 billion in 3Q23.

On July 30, 2024, BP announced a 10% increase in its quarterly dividend to $0.4798 per share, or $1.92 annually. The current yield is about 6.18%. Our dividend estimates are $1.83 for 2024 and $1.92 for 2025.

In 3Q24, BP repurchased $1.75 billion of its stock, completing 100% of its program to repurchase $1.75 billion by the end of the September 2024 quarter. Following third-quarter results, the company announced a new $1.75 billion buyback program, to be completed prior to fourth-quarter 2024 results. We expect BP to begin a similar program following 4Q24 financial results.

MANAGEMENT & RISKS

On January 17, 2024, BP announced that the company's board of directors had appointed Murray Auchincloss as chief executive officer with immediate effect.

In regards to risks, BP operates in some countries with a history of official corruption and in others that are prone to political upheavals. At the same time, its broad geographic presence reduces the impact of each individual risk. Like its peers, BP operates in a commodity business in which it has little control over the price of the products it sells.

COMPANY DESCRIPTION

Based in London, BP is one of the world's five super majors. Its operations are fully integrated, consisting of upstream, transportation, trading, refining, petrochemicals, marketing and renewable energy.

VALUATION

BP shares have traded between $29.00 and $40.40 over the past 52 weeks and are currently below the midpoint of this range. To value the stock on a fundamental basis, we use peer group and historical multiple comparisons, as well as a dividend discount model.

The shares are trading at 6.9-times our 2024 EPS estimate and at 5.9-times our 2025 forecast, compared to a 13-year annual-average range of 12-19. On other valuation metrics, the shares are trading at the midpoint level of their historical average range for price/book (1.3 versus 1.1-1.5) and at the midpoint of the range for price/sales (0.5 versus 0.4-0.6). They are trading below the low end of the range for price/cash flow (3.3 versus 4.2-7.0). The price/EBITDA multiple is 2.9, below the historical range of 4.2-7.5.

Despite relatively attractive valuation metrics, we believe that the above multiples reasonably reflect the company's current challenges, particularly its high leverage relative to peers. As a result, our rating remains HOLD.

On October 31 at midday, HOLD-rated BP traded at $29.05, up $0.02. (Bill Selesky, 10/31/24)

SYSCO CORP. (NYSE: SYY, $74.87) .... HOLD

SYY: Earnings miss on decline in restaurant traffic

* Sysco has wrestled with a decline in restaurant traffic and rising product costs for several quarters, driven by increases in the dairy, fresh food, and frozen food categories.
* We expect the company to face higher labor costs for drivers in the coming quarters.
* We are lowering our FY25 estimate to $4.56 from $4.60 and reducing our FY26 estimate to $4.95 from $5.00 per share.
* Given ongoing inflation and weakness in the restaurant industry, we believe that SYY shares are fairly valued at 16.7-times our revised FY25 EPS estimate.

ANALYSIS

INVESTMENT THESIS

We are maintaining our HOLD rating on Sysco Corp. (NYSE: SYY), reflecting our concerns about the company's high product costs. Sysco has wrestled with a decline in restaurant traffic and rising product costs for several quarters, driven by increases in the dairy, fresh food, and frozen food categories. We expect the company to face higher labor costs for drivers in the coming quarters. On the positive side, Sysco is seeing strong results in food distribution to grocery stores in the U.S., and in its international operations. While we have a favorable view of the company's diversified businesses, we expect costs to stay elevated in the near term, and believe that a HOLD rating remains appropriate.

RECENT DEVELOPMENTS

On October 29, Sysco reported fiscal 1Q25 sales of $20.5 billion, up 4.4% from the prior-year period, reflecting a 4.6% increase in U.S. Foodservice revenue and a 3.0% increase in International Foodservice revenue. The consensus estimate had called for revenue of $20.48 billion. Increased market share was offset by a decline in restaurant traffic. The adjusted gross margin decreased by 30 basis points to 18.3%, missing the consensus estimate by 20 basis points. The gross margin decline reflected less favorable product mix, fewer sales of Sysco's brands and lower than anticipated benefits from more careful sourcing. The company posted adjusted operating earnings of $8.73 million, up more than 2% from a year earlier. Interest expense rose to $160 million from $134 million. The adjusted operating margin was 4.3%, down 10 basis points in the prior-year period and 20 basis points below consensus. Adjusted operating expenses rose 3.1% to $2.9 billion. The diluted share count fell to 494 million from 507 million a year earlier.

The company reported fiscal 1Q GAAP EPS of $0.99, unchanged from a year earlier. Adjusted EPS rose to $1.09 from $1.07, below the consensus estimate of $1.13. GAAP net income fell to $490 million from $503 million.

As discussed in a previous note, in FY24, sales rose more than 3% to $78.8 billion, and adjusted EPS rose to $4.31 from $4.01 in FY23.

EARNINGS & GROWTH ANALYSIS

Sysco Corp. reports results for two business segments: U.S. Foodservice Operations and International Foodservice Operations. In the U.S. Foodservice segment, 1Q sales rose 4.6% from the prior year to $14.4 billion, gross profit increased 2.3%, to $27 billion, and the gross margin narrowed by 43 basis points to 19.1%. In the International Foodservice segment, sales rose 3.0% from the prior year to $3.8 billion, and gross profit increased 5.7% to $774 million. On an adjusted basis, the International Foodservice segment reported operating income of $130 million, up 12% from the prior-year period.

Based on high costs and fewer restaurant customers, we are lowering our FY25 estimate to $4.56 from $4.60 and reducing our FY26 estimate to $4.95 from $5.00 per share.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on SYY is Medium-Low, the second-lowest ranking on our five-point scale. The company had $733 million in cash and cash equivalents at the end of fiscal 1Q25 (up from $696 million at the end of FY24). We believe that it has sufficient liquidity to survive an extended period of restaurant industry weakness.

Long-term debt was $11.9 billion at the end of fiscal 1Q25, up from $11.5 billion at the end of FY24; the long-term debt/capital ratio rose to 84.4% from 83.7%.

In April 2024, the company raised its quarterly dividend by 2% to $0.51 per share, or $2.04 annually, for a yield of about 2.0%. Our dividend estimates are $2.40 for FY25 and $2.60 for FY26. Sysco has paid a quarterly dividend since its founding in 1970.

MANAGEMENT & RISKS

Kevin P. Hourican became the company's CEO in February 2020. Kenny Cheung is CFO and Greg Bertrand is COO.

Competition is fierce in the $279-billion U.S. food distribution industry. Sysco estimates its market share at approximately 16%. There are more than 15,000 foodservice distribution companies in the U.S., however, and Sysco must compete constantly on price, volume, and food quality.

COMPANY DESCRIPTION

Based in Houston, Sysco is the largest foodservice marketing and distribution company in North America. The company's major customers include restaurant chains as well as schools and colleges, hotels, hospitals, and other foodservice outlets. The company distributes more than 400,000 products, including approximately 40,000 Sysco-branded items.

VALUATION

SYY shares are trading at 16.3-times our revised FY25 EPS estimate, below the five-year average of 21. However, given stubbornly high operating expenses, we think that the current multiple is warranted and are maintaining our HOLD rating. If product costs and operating expenses moderate, we would consider returning the stock to our BUY list.

On October 31 at midday, HOLD-rated SYY traded at $74.87, up $0.62. (John Staszak, CFA, 10/31/24)