Sell James Hardie (JHX) and Buy Resmed Limited (RMD)

With equity markets having recorded strong gains in the last quarter of 2023, assessing the financial performance and outlook for companies continues to be at the forefront of portfolios.

This dynamic setting prompts us to carefully review portfolio exposures, ensuring they align with the aim of achieving strong returns while effectively managing risks.

For context, James Hardie Industries (JHX) is a globally renowned manufacturer of premium building products, at the forefront of fiber cement technology.

James Hardie plays a pivotal role in various markets such as new residential construction, manufactured housing, repair and remodeling, as well as diverse commercial and industrial applications.

Over the last year, James Hardie delivered a share price return of 93% (orange) vs the ASX 200 index of 0.8% (blue) as illustrated below. To put this into perspective, JHX had the third-highest return on the ASX200.

Today the share price trades at around ~$58 just 2% below its historical highest level in December 2021 and 98% higher from its 52-week low.

The price surge is supported by earnings releases and company guidance that surpassed market expectations. James Hardie delivered a robust performance in the second quarter, surpassing market expectations and the company's previous guidance for the third quarter.

This impressive outcome was fuelled by a positive volume outlook and anticipated higher margins. Following this announcement, JHX's stock price experienced a subsequent increase of 19%.

Importantly, JHX is closely tied to the US housing market, particularly residential remodel and repair. Despite robust economic growth, we note that US existing home sales were down 7.3% YoY in November 2023.

Housing demand is highly responsive to mortgage rate changes, and a recent slight uptick in rates, despite stabilisation in the mid-six percent range, continues to drive up housing prices due to high demand and limited inventory. Lower rates may improve affordability but may not be enough to significantly increase existing home inventory.

Furthermore, we note that JHX currently trades at NTM PE of ~22x, which is 7% above the 5-year average.

Considering current conditions, we believe there is a compelling case in selling at elevated levels.

In line with this, we recommend selling James Hardie (JHX) and capitalising on gains.

We recommend buying ResMed (ASX: RMD)

For context, ResMed (RMD) is a global producer of digital health and cloud-connected medical devices. More specifically, RMD's flagship offering is the manufacturing and distribution of Continuous Positive Airway Pressure (CPAP) machine for the management of respiratory disorders, primarily Obstructive Sleep Apnea (OSA) and Chronic Pulmonary Disease.

ResMed is solidifying its position as one of the top two players in the global obstructive sleep apnea (OSA) market by adopting a "smart devices" and big data approach. Through cloud-connected devices, physicians can now keep tabs on patient compliance, fostering continuous usage.

ResMed is leading the way in the OSA homecare device market, representing over an 80% estimated market share in over 140 countries it competes in. The market presents a substantial global growth opportunity, given that penetration in developed markets is only around one-fifth of the roughly 15% prevalence, and emerging markets remain largely untapped.

Recently RMD ventured into the acquisition game, snagging home healthcare software platforms to ride the wave of digital health and offer care in a more budget-friendly setting. With acquisitions like Brighttree in 2016 and MatrixCare in 2019, ResMed now boasts business management software catering to various home health providers.

We believe this strategic move aligns well with the prevailing industry trends, making it a smart play amidst the structural tailwinds in the sector.

In terms of pricing, ResMed encountered a 25% decline in its stock during Q3 2023, attributed to lacklustre results and apprehensions regarding GLP-1 drugs — a novel class of drugs for weight loss and type 2 diabetes.

Despite advancements in GLP-1 drugs, studies indicate a sustained demand for CPAP, suggesting that the impact on ResMed's market may be limited. Our perspective is that the perceived competitive risk from GLP-1 might not be substantial and could be inflated by prevailing market sentiment.

ResMed (RMD) has strong financial performance, with a 13% revenue and 23% earnings per share (EPS) compound annual growth rate (CAGR) over the past 5 years. The company maintains a 27% operating margin and a 25% return on equity (ROE).

Moreover, we favour RMD's conservative balance sheet, evident in an interest cover exceeding 20x and a Net Debt to EBITDA ratio of 1x.

Currently, RMD is trading at a 33% discount to its 5-year average Price to Earnings (P/E) ratio, making it an appealing option for medium-term earnings growth.

As such, we recommend buying ResMed (RMD).

If you have any queries or would like to speak with us regarding the above, please contact your Financial Adviser or Client Services on 1800 064 959.

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