

Week
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Stories To Read From FNArena

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Contents

Australia

- 1** [Demand For Appen Intelligence Escalates](#)
- 2** [Merger Dominates Outlook For AP Eagers](#)
- 3** [Capital Controls Another Knock To Banks](#)
- 4** [Incitec Pivot Mulls Fertiliser Strategy](#)

Commodities

- 5** [Material Matters: Nickel, Met Coal & Iron Ore](#)
- 6** [Material Matters: Nickel, Coal And Arctic LNG](#)

ESG Focus

- 7** [ESG Focus: Fresh Water Crisis Unfolding](#)
- FYI**
- 8** [Weekly Ratings, Targets, Forecast Changes - 02-08-19](#)
- 9** [Uranium Week: Doldrums Again](#)
- 10** [The Short Report - 5 Sep 2019](#)
- 11** [The Wrap: Auto Retail, Aged Care & Housing](#)

Small Caps

- 12** [Strong Prospects For Freedom Foods](#)
- 13** [Buoyant Outlook For People Infrastructure](#)

Treasure Chest

- 14** [Treasure Chest: a2 Milk Prioritises Diversity](#)
- 15** [Treasure Chest: Value Exposed In Incitec Pivot](#)

Weekly Analysis

- 16** [August 2019 Verdict: Strength From The Few](#)

Demand For Appen Intelligence Escalates

A period of investment is masking an encouraging growth trajectory at Appen, as demand for machine-learning applications escalates.

-Increase in speech & image data sales gathering momentum -Figure Eight disruption greater than expected -Main competitive advantage in long-standing relationships

By Eva Brocklehurst

Appen ((APX)), a global provider of language technology and services, has an encouraging growth trajectory as it capitalises on advances in the use of artificial intelligence.

The company should double 2018 revenue by 2023, UBS asserts, highlighting the fact the world is at an inflection point in artificial intelligence, fast approaching mass adoption. The broker also expects the company can achieve 20% operating earnings margins by 2023.

UBS ascertains machine learning applications are likely to continue requiring human training data sets for at least the next ten years. The company has modified 2019 guidance for operating earnings (EBITDA), expecting it will trend to the upper end of the \$85-90m range.

Citi suspects this range could prove conservative, anticipating some further FX benefit and strong broad-based growth in speech & image data and Relevance, which provides annotated data used in search technology. The increase in speech & image data sales is evidence that demand for these services is gathering momentum, the broker adds.

The market may have overlooked the implied growth outlook for the Relevance business, UBS suggests. On a like-for-like basis that business is expected to deliver around 80% growth in operating earnings, which implies the end-market dynamics are strong. Bell Potter calculates that, of the 60% growth in Appen's sales revenue in the half year, 53% was organic and the remainder from the Figure Eight acquisition.

Figure Eight

Appen has made a downgrade to 2019 expectations for Figure Eight, acquired early in 2019. Figure Eight allows the transformation of text, image, audio and video data into customised training data for a wide range of uses.

Given this business was only acquired recently, UBS acknowledges the downgrade requires close scrutiny. The business, naturally, requires some integration of software platforms and the migration of customers, which carries risk and may not always be smooth or timely.

Credit Suisse agrees, suspecting prudent cost management will feature more on the path to breaking even for Figure Eight than was previously anticipated. Management has retained its profit outlook as per guidance at the time of acquisition and synergies in 2019 are guided to be 25-35% of the pro forma financials.

Credit Suisse takes a more conservative estimate for synergies, partly because of concerns about the company's ability to hold costs down. Citi acknowledges a loss of momentum at Figure Eight in the June quarter but does not believe this is material to the growth trajectory.

The company appears to be undertaking a period of elevated R&D and this is masking a strong performance, UBS points out. At the time of acquisition Appen expected Figure Eight returns to grow 40-50% but the disruption has been greater than expected and, combined with a shift in customer focus and earn-out, has resulted in lower renewals and sales in the second quarter.

Nevertheless, UBS continues to envisage upside opportunity from Figure Eight while continued artificial intelligence requirements are a major tailwind, particularly in government business, where Figure Eight has worked previously.

The broker upgrades to Buy from Neutral, believing the valuation remains attractive relative to peers. Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, also upgrades to Buy from Hold, with a target of \$27.50.

The main competitive advantage is in long-standing relationships with many of the company's customers, the broker asserts. The majority of revenue is from repeat business from customers that regularly update and upgrade

products.

Credit Suisse is also upbeat when it comes to demand in the industry. Direct competitors to Appen are limited although, longer term, competition is likely to increase. Customers are highly concentrated, with the top five delivering 89% of 2018 revenue. Credit Suisse remains alert for any deterioration in the industry structure and considers the valuation full.

The main risk Citi is mindful of, as Appen adds scale with LeapForce (a website for independent contractors) and Figure Eight, stems from customers pushing harder to participate in the economies of scale. The FNArena database has two Buy and one Hold (Credit Suisse) rating. The consensus target is \$29, signalling 13.7% upside to the last share price.

See also, Appen Highlights Lift In Order Book on June 4, 2019.

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Merger Dominates Outlook For AP Eagers

AP Eagers has outperformed the broader market in the first half and will now consolidate the merger with Automotive Holdings, creating a substantial presence in car dealerships.

-AP Eagers makes no call on the outlook for vehicle sales, although notes improved trading conditions -Projected earnings from the merger important for the outlook for the next 12-18 months -Additional synergies with Automotive Holdings expected to provide the upside

By Eva Brocklehurst

The outlook and profile of automotive dealership AP Eagers ((APE)) has changed substantially as it prepares to absorb rival Automotive Holdings ((AHG)). Moreover, the company has demonstrated an ability to grow car sales through a cyclical downturn.

Brokers are encouraged by a suggested improvement in trading conditions towards the end of the first half, as the company continues to outperform the broader market in new car sales and also enjoys growth in used car sales.

First half net profit exceeded expectations, up 1.8%, driven by cost reductions and improved trading conditions late in the half. The increase compares to AGM guidance for a -7-10% decline. Management has ascribed the better result to conservative guidance, a better performance after the federal election than previously anticipated, cost savings and restructuring.

Truck earnings grew modestly in the first half while property and investment income declined. AP Eagers did not make a call on the outlook for vehicle sales but will reduce its inventory position in the second half.

Ord Minnett considers the company ideally positioned to participate in further consolidation, which should accelerate its market leadership and widen the competitive gap between scale networks and smaller operators. The acquisition environment may be favourable but Wilsons does not expect significant opportunities will emerge in the near term and the focus should remain on integrating Automotive Holdings.

Credit availability is constrained and excess inventory continues to hamper the market, although the broker points out the ban on flex commissioning will be cycled soon. Management has noted some challenges in delivering competitive rates to low credit quality customers but also has flagged highly successful outcomes in other areas. The target for 50% penetration in the finance & insurance division has been pushed out to FY20 but AP Eagers remains committed to the long-term target of 80%.

Merger

Projected merger synergies are expected to drive strong earnings growth over the next 12-18 months. The company has reiterated \$13.5m in synergies within a timeframe of six months and an additional \$16.5m to be realised within 12 months, for a combined synergy target of \$30m.

The synergy target is in line with Morgans' assessment, although the timeframe is shorter than envisaged. While synergies will come at a material cost and this is difficult to estimate, the broker calculates \$10-20m.

Credit Suisse assumes \$40m in synergy benefits over three years and now applies a 16.0x earnings multiple to 2020 earnings. Ord Minnett sets its target at a 20% premium to underlying valuation, because of the anticipated merger and the value attributed to synergies.

The company now has a relevant interest in Automotive Holdings of 71.9% and the offer closes on September 16. While the share price is factoring in the merger and base case synergies, additional synergies will provide the upside, in Morgan's view, along with any cyclical upturn in industry conditions.

The company is well-placed in any case, as it has a disciplined focus on cost. The combination of the two businesses is likely to create a strong earnings growth story and Morgans expects the company's influence on an underperforming Automotive Holdings and increased finance penetration will be welcomed.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, has a Hold rating and target of \$10.93. There are four Buy ratings on the database for AP Eagers. The consensus target is \$12.72, signalling 2.8% upside to the last share price.

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Capital Controls Another Knock To Banks

Brokers decide new prudential capital controls may limit growth for banks and curb dividends.

-ANZ, Westpac and NAB face \$500m capital add-ons -ANZ to be hardest hit by capital ratio changes to APS 222 -Big banks may be forced to cut dividends and reprice loans -Brokers mixed on outlook for big banks

By Nicki Bourlioufas

It's not over for the big banks in meeting potentially onerous capital requirements. The banking regulator APRA is requiring further changes to capital ratios and some of the big banks are better placed than others to meet them, according to analysts.

APRA has ordered Westpac ((WBC)), ANZ Bank ((ANZ)) and National Australia Bank ((NAB)) to put aside additional capital in response to the self-assessments of their risk management and governance.

The 'add-on' capital requirement will apply until the banks strengthen risk management and address flaws identified in their self-assessments, which follow the APRA-initiated Prudential Inquiry into the Commonwealth Bank of Australia ((CBA)). That has seen the CBA required to hold a \$1bn add-ons since April 2018.

According to UBS, these add-on requirements will lead to a 16 to 18 basis point drop in Common Equity Tier 1 (CET1) capital for the banks. As part of the Basel III reforms to the capital framework introduced in 2013, APRA requires ADIs (authorised deposit-taking institution) to hold a buffer of CET1 capital, over and above each ADI's minimum requirement.

Contagion risk control

On top of these 'add-on' capital controls, APRA recently released its revised version of Prudential Standard APS 222, Associations with Related Entities. The updated standard is designed to further reduce the risk that problems in one part of an authorised deposit-taking institution having a "detrimental impact" on the overall group.

APRA has confirmed that it will implement its previously announced proposal for ADIs to limit exposures to related entities (including offshore units) to 25% of Level 1 Tier 1 Capital, down from 50%.

The changes take effect from January 2021. By updating and strengthening the requirements of APS 222, APRA wants to ensure ADIs are better able to monitor and control contagion risk.

The practical implication of the revised APS 222 is that the big banks will now have caps on the amount of capital that can be injected into their NZ operations. ANZ Bank, with the largest NZ exposure, is the most impacted, according to brokers.

The bank has already disclosed that it is approaching the 25% cap on current metrics ahead of the Jan 2021 implementation.

ANZ on the radar

UBS believes ANZ Bank dividend payouts will come under pressure. "The vast majority of earnings for dividends would need to come from Australia and not NZ, placing pressure on group dividends."

JP Morgan is even more downbeat. Following changes to APS 222, the broker says it has downgraded its FY20 cash earnings per share (EPS) EPS forecasts for ANZ by -0.7% and FY21 cash EPS forecast by -2.7% and also stripped dividend growth from its forecasts.

ANZ's price target has been reduced -0.4% to \$27.70. JP Morgan expects no buybacks or discounts on dividend reinvestment plans (DRP) to ensure ANZ has enough capital to meet the RBNZ's forthcoming capital rules and to prevent it from breaching APS 222's 25% limit.

The banking research team at Macquarie says APRA's capital requirements are "penal" for ANZ. "We continue to believe that APRA will look to minimise the capital outflow, leaving the door open for future changes relating to NZ. Despite relative valuation attractiveness, we remain cautious on ANZ given uncertainty around NZ capital outcomes," the broker says.

Ord Minnett predicts ANZ is likely to try mitigate the impact of these changes by possibly making greater use of its NZ branches, writing more loans through the branch structure rather than the NZ subsidiary.

ANZ could also constrain growth capital allocated to the NZ unit. A potential sale of ANZ's NZ unit would need to be weighed up against the likely increase in funding costs for an independently listed NZ business against the cost of holding stranded group capital.

UBS says the banks are looking at a number of options to reduce the burden of the NZ capital proposals. "Writing loans out of the Australian branch rather than NZ business units is one option. However, it is only really effective for institutional business. Shrinking the balance sheet and repricing are also options which could be undertaken."

According to Citi, NZ capital proposals could lead to a CET1 shortfall of around -NZ\$21bn by FY23. "This could prevent or delay ANZ and CBA's buy-back agendas. WBC's capital position is expected to weaken, while NAB may need to continue to place a discount on its DRP to raise sufficient capital to meet the NZ requirements," says Citi.

For Westpac, UBS expects a dividend cut. With earnings under pressure from low interest rates, subdued revenue, remediation, and credit charges bouncing off lows, UBS predicts a dividend cut for WBC to \$0.84/share to be announced in the first half of 2020.

Citi says that "NZ subsidiaries will be required to build organic capital, likely through a combination of repricing and restriction of dividends paid back to the parent."

According to Credit Suisse, there is still the unknown effect of the RBNZ capital proposals and "all of these changes are making it more difficult for banks more generally to meet APRA's 10.5% 'unquestionably strong' benchmark which commences 1 January 2020."

Big banks split on capital holdings

UBS says there is a clear split in the capital ratios of the Australian banks once announced asset sales are taken into account.

"We estimate that ANZ and CBA are well capitalised, while a number of recent announcements once again put NAB and WBC's capital ratios under threat in our view."

UBS analysis shows that following asset sales, ANZ and CBA's CET1 ratios are materially stronger than NAB's or Westpac's.

General outlook is poor

Citi expects CBA and Westpac to join ANZ and NAB in cutting dividends should interest rates continue to fall. "Warning signals such as mortgage delinquencies and personal lending arrears continue to deteriorate. Even with a stabilisation in the housing market, many customers are likely to continue to come under stress as interest-only periods expire, implying credit impairment charges could rise," says Citi.

UBS says the banks' ability to generate a lending spread and return on equity is limited. "If the housing market does not bounce back quickly, this could put material pressure on the banks' earnings prospects over the medium term, implying that the dividend yields investors are relying upon come into question once again."

In addition to APS 222 and the add-on capital requirements for Westpac, ANZ and NAB, changes to Australian Accounting Standards Board (AASB) 16 from July 2019 further impact the banks' CET1 ratios.

UBS analysis suggests the introduction of AASB 16 Leasing, which capitalises operating leases on-balance sheet, has a negative impact on CET1 of around 8 to 11 basis points.

According to FNArena's database, the consensus target price for ANZ is \$27.69, suggesting 3.5% upside to the last share price. Targets range from \$25.80 (Morgan Stanley) to \$29.50 (Citi).

The consensus target price for CBA is \$72.44, suggesting -8.1% downside to the last share price. Targets range from \$66.00 (Morgan Stanley) to \$77.60 (Credit Suisse).

For NAB, the target price consensus is \$26.93, suggesting -1.2% downside to the last share price. Targets range from \$23.00 (UBS) to \$29.60 (Ord Minnett).

For Westpac, the consensus target price for is \$28.50, suggesting 1.4% upside. Targets range from \$24.50 (UBS) to \$33.00 (Morgans).

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Incitec Pivot Mulls Fertiliser Strategy

Ahead of an investor briefing, Incitec Pivot has downgraded guidance for FY19 and flagged a strategic review of its Australian fertiliser business.

-Majority of issues appear confined to FY19, although weather/pricing hold the key -Fertiliser distribution business expected to have the most appeal -Fertiliser divestment could reduce exposure to the Australian agricultural cycle

By Eva Brocklehurst

Incitec Pivot ((IPL)) has downgraded guidance, again (UBS counts 6 downgrades over FY19), amid ongoing drought in eastern Australia, extreme wet weather in the US and unplanned downtime at the Waggaman ammonia plant in Louisiana.

There are also higher gas costs flagged at Gibson Island. While the downgrade was not unexpected, the quantum was materially worse than Morgans envisaged although the issues are expected to eventually normalise.

Around half the downgrade relates to the impact of lower diammonium phosphate (DAP)/ammonia prices, partially offset by favourable FX and US gas prices. DAP and ammonia prices have been challenged by lower US crop demand. The remainder of the downgrade is driven by continued lower demand in NSW/Queensland for fertiliser.

As there was no reference to other parts of the business, by inference Macquarie expects production guidance will be met at both Phosphate Hill and Moranbah, while the Dyno Americas and Asia Pacific explosives divisions are in line with expectations.

The ammonia price may have bottomed, Morgans points out, and there are suspicions Chinese producers will cut DAP production, which should tighten the market and potentially lift prices.

A repeat of first half disruptions may be unlikely but Credit Suisse expects the dividend will be cut and discretionary capital expenditure reduced. However, Ord Minnett considers the potential for capital management attractive, although acknowledges volatility in fertiliser pricing and weather conditions remains a headwind.

Citi views the risk/reward turning favourable and upgrades to Buy from Neutral. The broker points out, while drought conditions have depressed near-term earnings, the leverage provided by a return to more normal conditions is significant.

Morgan Stanley believes the majority of the issues are largely confined to FY19 and the market has already looked past these. Management has guided to earnings of \$285-295m, representing around a -25% downgrade to consensus expectations.

Strategic Review

The company has announced a strategic review of the Australian fertiliser business and will consider divestment or de-merger as well as retention and reinvestment. While this is a logical review, Morgan Stanley is not convinced it will unlock additional value.

Ord Minnett assesses the fertiliser business has attractive distribution assets albeit low book-value plants at Gibson Island and Phosphate Hill. Given the fertiliser business resides presently at the bottom of the cycle, the broker finds it difficult to model a sale.

Ord Minnett is sceptical about elevated interest in the business, given the weather outlook, and suspects a spinning off of fertilisers might face similar risks to those encountered by Nufarm ((NUF)). Still, the stock is inexpensive and the broker errs towards being positive, noting the investor briefing is scheduled for September 4.

Citi notes, at the previous investor briefing, the company was intent on improving the performance of the fertilisers business, believing it was a natural owner at this point in the cycle. Having secured gas contracts to keep Gibson Island running and addressed the operating issues within Phosphate Hill, the broker suggests there is now increased certainty regarding the viability of the fertilisers business.

The distribution part of the business, with around 50% market share in eastern Australia would appeal most to potential buyers, in Citi's view. Morgans agrees there may be a number of potentially interested parties, as there

has been much speculation over recent years about merging Incitec Pivot's fertiliser business with the Wesfarmers ((WES)) fertiliser business.

Private equity has also shown interest in the past. Morgans was not surprised by the strategic review and suspects removing the more volatile fertiliser business would result in a re-rating.

Credit Suisse's valuation of the Australian fertiliser business is heavily dependent on Phosphate Hill and, to a lesser extent, east coast distribution. While the company has not committed to any course the broker suspects the strategic review will mean its fertiliser valuation is unrealised.

There is a large dependency in valuation numbers on assumed mid-cycle DAP prices of US\$400/t and an Australian dollar rate of US\$0.70. Credit Suisse attaches no value, currently, to manufacturing Gibson Island but accepts this could change over the three-near-term of the new gas supply contract.

The company's Australian fertiliser business is the largest domestic manufacturer and distributor by volume. Incitec Pivot services diverse markets including the agricultural, automotive, industrial and food & beverage sectors. The seasonal exposure in Australia is reduced through access to global markets such as Southeast Asia and South America.

Explosives

UBS believes a de-merger or divestment could reduce the company's exposure to the Australian agricultural cycle as well as the volatility in DAP prices in the US. This could allow the company to focus more on explosives manufacturing and technology through its Dyno Nobel brand.

The strategy for the explosives business appears centred on operating and capital efficiencies in the current manufacturing footprint, the broker notes, and there appears to be little justification in many of the company's markets for further capital expansion on a large scale.

Credit Suisse expects Incitec Pivot to generate \$400m in earnings and \$700m in operating earnings from North American and Australian explosives. Nevertheless, the broker hopes the manufacturing position at Moranbah and the Queensland nitrates JV receive some attention.

Process improvement should drive cost reductions and ammonia expansion appears to be a medium-term opportunity. The broker finds little justification for any significant expansion in Western Australia, with the company well-positioned as a buyer of bulk ammonium nitrate in an oversupplied market.

FNArena's database has four Buy ratings and three Hold. The consensus target is \$3.41, suggesting 12.1% upside to the last share price. This compares with \$3.58 ahead of the announcement.

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Material Matters: Nickel, Met Coal & Iron Ore

A glance through the latest expert views and predictions about commodities. Indonesia's nickel export ban; metallurgical coal; and iron ore.

-Severe market tightness may not eventuate despite Indonesia's nickel ore export ban -China may no longer be the marginal setter of seaborne coking coal prices -Iron ore likely to remain in deficit over 2019

By Eva Brocklehurst

Nickel

Indonesia will bring forward its export ban for nickel ore two years, to January 1, 2020 from 2022. This reflects a desire to build out domestic nickel smelting capacity more rapidly. Nickel ore export quotas for 2019 are around 260,000t or 12% of nickel supply.

The prospect of this ban being brought forward has caused the nickel price to rally by more than 50% over the past two months, Citi observes. The broker has raised its bull-case price forecasts to US\$17,500/t for 2020 and US\$17,000/t for 2021, from US\$14,000/t previously.

Prices need to remain high for some time to incentivise a supply response and Citi ascertains that current prices are enough to stop stocks becoming critically low in the medium term, although nickel ore and refined stocks will still draw down notably in the coming years.

UBS believes the ban could have a genuinely positive impact on the supply & demand dynamics for nickel over the next 1-2 years, supporting higher prices, but a squeeze is unlikely as there are a number of potential offsets. A buffer is likely to be provided by increased nickel supply from the Philippines and New Caledonia. Higher prices will also result in higher scrap recoveries as well as help offset nickel pig iron losses in China.

The Philippines lifted supply in 2015 after the last Indonesian ban, although UBS notes the exhaustion of some high-grade deposits and tighter environmental regulations may make this more difficult now. Chinese inventory at its ports stands at 115,000t of contained nickel and therefore a drawdown should allow Chinese nickel pig iron production to be sustained near current levels, the broker asserts.

While there are ample stocks to service projected deficits in refined nickel, project pay-back times have fallen sharply during the recent rally. Citi assesses nickel pig iron construction times are relatively short and the physical refined nickel market is not set to tighten until the second half of 2020.

Credit Suisse points out that when Indonesia banned exports for three years from 2014, tightness in the nickel market never eventuated, as the Chinese had large stockpiles and China stretched supplies in ways that remain unclear, although the Chinese economy slumped in 2015, reducing demand.

The broker suggests the world is probably better prepared for the export ban now, as there is so much more nickel pig iron production in Indonesia. The three largest producers, Tsingshan, Delong and Jinchuan together added 160,000t of nickel pig iron capacity in 2019.

While much of this is intended for coincident stainless steel plants, Credit Suisse also notes that this has proved problematic as many countries, including China, have blocked stainless imports. Hence, nickel pig iron exports may be the only option.

Credit Suisse believes in 2020 there could be a supply gap, as the market was not prepared for the ban to be brought forward to this extent. However, the global economy is in trouble and this may assist in reducing demand, as will the glut of stainless steel built up by China's producers.

On the demand side risks are skewed to the downside, Citi suggests, and the amount of supply required to fill the gap from Indonesian bans depends on the level of demand. The broker expects nickel demand to grow 4% in 2020 but, in terms of a mild recession scenario, nickel will be in surplus in 2020 and prices will average US\$14,000/t.

UBS points out Indonesia has a track record of reversing export restrictions so it is possible any ban will be partial and could be reversed. The broker questions whether all of the Indonesian smelters due to be financed in 2020/21 can get off the ground without the revenue from ore exports.

Metallurgical Coal

Morgan Stanley observes factors, other than the usual seasonality, have come into focus for metallurgical (coking) coal. A well-supplied market and weakness in steel production outside of China have driven a price correction in hard coking coal. There has also been muted demand from India during the monsoon while China has restricted imports by delaying customs clearance.

The broker suggests market fundamentals have changed and there is an emerging disparity between China's domestic prices and the seaborne price. China is a swing buyer of metallurgical coal but appears no longer to be the marginal setter of the seaborne price.

This is explained by the likelihood that China's import restrictions have pushed the seaborne market into surplus. Still, there has been a robust flow of seaborne material as imports in the first half of the year were up 19%.

Hence, Morgan Stanley suggests Chinese buyers may simply be unwilling to pay the same price for seaborne imports as for domestic coal. Beyond 2019, the broker believes China will maintain support for its domestic industry, possibly through import controls, and its metallurgical coal imports are likely to gradually decline, which means that seaborne production costs remain relevant.

The spot price has dropped back to levels close to the marginal cost of US\$146/t F.O.B. Australia. An extended period of low prices will eventually drive marginal production, mainly from the US and Mozambique, out of the market, the broker concludes.

Iron Ore

UBS suspects the iron ore price is oversold and, despite some positive signals, the market remains in deficit. There has been unprecedented volatility for iron ore over 2019 and the market is now looking at the stabilising of Chinese stocks at the ports.

Export data shows trade flows from the major producers have recovered, as the focus is now returning to restored output at the Brucutu mine in Brazil. Still, the major producers have not regained control of the market and UBS expects iron ore to remain in deficit in 2019, unless steel output slows dramatically.

UBS notes record Chinese steel output in the first half of 2019 kept prices at elevated levels but this could be topping out. Official output slowed in July and steel inventory at traders has lifted, while rebar and hot rolled coil prices have slipped. Sentiment has also been dampened by the trade conflict between China and the US. The broker expects any prospective Chinese stimulus will favour the bulk commodities over base metals.

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Material Matters: Nickel, Coal And Arctic LNG

A glance through the latest expert views and predictions about commodities. Nickel ban; coal price outlook; and Arctic LNG.

-Indonesian nickel ore ban expected to take -10% out of the global market -Coal demand likely to persist amid increasing supply-side constraints -Arctic LNG likely to be one of the more viable projects launched in 2019

By Eva Brocklehurst

Nickel

Macquarie upgrades nickel price forecasts to incorporate the early reinstatement of Indonesia's nickel ore ban, moved ahead two years to 2019. This is expected to take out -250,000tpa of supply, or around 10% of the global market.

Nevertheless, the broker anticipates a supply response from Indonesia before the ban takes effect and increased exports from the Philippines. Combined with softening global demand this should lessen the impact.

Macquarie calculates a 2020 deficit in nickel of -50,000t and -80,000t in 2021. This should translate to higher nickel prices and the broker upgrades 2019 and 2020 forecasts by 20% and 19% respectively. Forecasts for 2021 and 2022 rise 6% apiece.

Incorporating these upgrades transforms the earnings outlook for Independence Group ((IGO)), the broker suggests. FY20 earnings estimates are increased by 80% and FY21 by 19%. Western Areas' ((WSA)) strong leverage to nickel prices is demonstrated by upgrades to the broker's forecasts as well and it remains the preferred pure nickel stock.

The outlook for Panoramic Resources ((PAN)) has been affected by a number of adjustments to production and cost forecasts as well as an expected rights issue. As a result, Macquarie lowers FY20 production forecasts for Savannah by -20% for nickel, -21% for copper and -31% for cobalt. The broker maintains Outperform ratings for these three major ASX nickel producers.

UBS models a nickel deficit of -130,000t in 2019 and believes the market will remain in deficit for the foreseeable future, amid increasing consumption of nickel in battery technology.

The broker forecasts nickel prices peaking at US\$8.25/lb in the second and third quarters of 2021 and a long-term nickel price of US\$6/lb. Nickel prices reached five-year highs recently, at US\$8.17/lb after Indonesia announced the bans would be brought forward.

China continues to dominate, accounting for nearly 50% of global demand in 2018. Japan and Indonesia have the highest levels of demand following China, at 8% and 7%, respectively.

Coal

Coal prices have been affected by a slowing global economy and the uncertainty caused by the US/China trade conflict, as well as reduced margins for steel producers and port restrictions in China on coal coming from Australia.

On the supply side there has also been increases from China, Indonesia, Russia and Australia as well as the impact of substitute products such as gas. Regardless, Bell Potter expects demand growth will persist as there are increasing supply-side constraints, including infrastructure capacity, new project permits and financing of new developments.

The broker revises its coal prices lower across the board, with hard coking (metallurgical) coal forecasts for FY20 reduced to US\$165/t, and FY21 to US\$163/t. Thermal coal estimates for FY20-21 are now reduced to US\$70/t.

Bell Potter notes Whitehaven Coal's ((WHC)) production profile is supreme and its projects could add up to 15mtpa of managed coal production over the next eight years. The broker assesses the company can withstand the current weakness in thermal coal price and remains highly leveraged to any recovery. Nevertheless, estimates for earnings per share are reduced by -35% for FY20 and -28% for FY21.

Changes to currency assumptions now more than offset the changes to coal prices for NZ producer Bathurst Resources ((BRL)) across FY21-22, while estimates are reduced by -9% for FY20. The company has an export hard coking coal business supported by domestic thermal coal sales with stable utility-like margins, the broker notes. Earnings remain leveraged to a recovery in seaborne coking coal prices.

Meanwhile, Coronado Global Resources ((CRN)) has an opportunity to improve operations at Curragh amid wider index inclusion, all against a backdrop of weak coking coal prices and Bell Potter retains a Buy rating. The broker rates Stanmore Coal ((SMR)) as Hold, given the recent appreciation in the share price. In the absence of a significant run in coal prices, earnings are expected to fall markedly across FY20-21.

LNG

A project called Arctic LNG marks the fourth major LNG project to be launched in the last nine months and Citi believes this is one of the better ones. A perceived gap in the LNG market post 2022 is considered to be the catalyst.

Project shareholders include Novatek, Total, CNBC and CNOOC as well as Japan Arctic LNG. This follows a successful start-up, Yamal LNG, in December 2017. Arctic LNG obtains gas from the Salmanovskoye field on the Gydan peninsula, Siberia, to feed a 19.8mtpa LNG plant.

Citi estimates a US\$21bn cost with the capital intensity of US\$3.80/boe and considers the project screens well against competing global LNG projects. Citi models Arctic LNG requiring a US\$6/MMBtu landed gas price to break even. This is a blended average and reflects 60% sales to the Far East and 40% to Europe.

While the project carries higher transport costs versus other LNG assets this is more than offset by one of the lowest feedstock costs for the gas and makes it likely, in Citi's view, to be one of the more viable projects.

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ESG Focus: Fresh Water Crisis Unfolding

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Fresh Water Crisis Unfolding

By Richard (Rick) Mills Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

When planetary scientists search for life on other planets the first thing they look for is evidence of water.

"There are two main questions in the search for life: With so many places to look, how can we focus in on the places most likely to harbor life? What are the unmistakable signs of life -- even if it comes in a form we don't fully understand?

"Before we go looking for life, we're trying to figure out what kinds of planets could have a climate that's conducive to life," del Genio said.

Del Genio recognizes that life may well exist in forms and places so bizarre that it might be substantially different from Earth. But in this early phase of the search, "We have to go with the kind of life we know," he said.

Further, we should make sure we use the detailed knowledge of Earth. In particular, we should make sure of our discoveries on life in various environments on Earth, our knowledge of how our planet and its life have affected each other over Earth history, and our satellite observations of Earth's climate.

Above all else, that means liquid water. Every cell we know of -- even bacteria around deep-sea vents that exist without sunlight -- requires water." Our Living Planet Shapes the Search for Life Beyond Earth

Water - A non-renewable resource

Glaciers are normally perceived as rigid sheets of ice that advance or retreat at barely perceptible distances per year. New research however shows that, if a glacier's stability is compromised, it will lose ice faster and move further than if it was securely attached to the landmass or seabed.

A study funded by NASA found that instability within the Thwaites glacier in Antarctica would cause a tipping point, after which the huge ice mass flowing into the Antarctic Sea can no longer be slowed or stopped.

The eastern tongue of Thwaites glacier

The instability factor comes by way of another scientific study of Thwaites, which is part of the West Antarctic ice sheet. The study by the Proceedings of the National Academy of Sciences found that the glacier was likely to succumb to instability linked to the retreat of its grounding line on the seabed that would lead to it shedding ice faster than previously expected, as reported by The Guardian.

Other Antarctic glaciers are thought to be at similar risk of becoming "un-grounded" as they melt.

While largely unnoticed, this discovery has grave implications for civilization, as the effects of climate change become more pronounced - in record-shattering heat waves, a warming Arctic, melting permafrost exposing methane vents, powerful hurricanes, etc. It means the ice covering Antarctica could melt sooner than expected - within 150 years which, in earth science terms, is the blink of an eye.

If that were to happen, and the way warming is going, it could happen sooner, the effects on human populations living in coastal areas would be catastrophic. Most media reports concerning glacial melt focus on Greenland, but in fact Antarctica holds eight times as much ice, and 50x more than all mountain glaciers combined.

It's estimated that the melting of just the Thwaites glacier, resulting in billions of liters of fresh water flowing into the ocean, would trigger a 50-cm (19.6-inch) sea rise. Thwaites sits at the center of the West Antarctic Ice Sheet, if it breaks off into the sea, it would destabilize nearby glaciers raising sea levels by roughly 11 feet. If the entire West Antarctic ice sheet were to melt, the oceans would increase by five meters, or 16 feet, drowning many of the world's coastal cities, especially in Asia.

Another study published in July found the sea ice that floats around the desolate continent is disappearing rapidly. Antarctica has lost as much pack ice in four years than the Arctic has in the past 34, according to satellite data.

The loss of sea ice doesn't trigger sea level rise, the ice is already in the water - it's the loss of ice on land that increases sea levels but it is just another alarming indication of how a warming planet is affecting the poles. When sea ice melts, the bright surface for sun rays to reflect off also disappears. That triggers a feedback loop of warming, where the sun's rays become absorbed by areas of dark water formerly covered with ice, thus accelerating rising ocean temperatures.

The melting of Arctic sea ice and polar ice caps has other nasty implications for climate change, including an interruption of the polar vortex, causing cold Arctic air to escape to southern climes which experience winter storms; intense heat waves such as recently occurred in Europe; and the slowing/ potential stoppage of the oceans' current conveyor system that moderates climates and prevents ice ages.

For this article we are concerned with what is locked within billions of tonnes of, until now, rock-solid ice caps and glaciers: fresh water.

Fresh water facts

With the exception of a few weeks a year of water restrictions, most North Americans won't think twice about leaving a sprinkler on or taking an extra-long shower. Fresh water is seemingly abundant. Not so for many parts of the world that face constant water stress. There are somewhere between 780 million to one billion people without basic and reliable water supplies. More than 2 billion lack the water requirements for basic sanitation.

It's also slightly mind-blowing to remember that, while 70% of the earth's surface is covered by water, less than 1% is potable.

98% of the world's water is in the oceans - which makes it unfit for drinking or irrigation. Just 2% of the world's water is fresh, but the vast majority of our fresh water, 1.6%, is in a frozen state, locked up in the polar ice caps and glaciers. Our available fresh water (0.396% of total supply) is found underground in aquifers and wells (0.36%) and the rest of our readily available fresh water is in lakes and rivers.

Put another way, only 0.007% of the earth's water is available for drinking, feeding or fueling (through hydro-electric power or cooling towers needed to run industrial equipment) its 7.5 billion people. We are dancing much closer to the knife edge of water scarcity than we think.

National Geographic reminds us that, due to the water cycle, all the water around today was here in one form or another hundreds of millions of years ago. We've always had a relatively constant water supply throughout history, what has changed is our climate, the number of people in the world, and their expectancies.

For this article we are concerned with what is locked within billions of tonnes of, until now, rock-solid ice caps and glaciers: fresh water.

In high demand

If water was a tradable commodity, its price would be many multiples higher than it is currently. It isn't just fresh water's relative scarcity that makes it valuable, but the fact that demand for it is constantly increasing.

According to the UN, demand for water is expected to grow 55% by 2050, with most of the need (70%) driven by irrigation, to feed the expanding global population, expected to hit 10 billion by 2050. Water for energy use is forecast to rise by 20%.

But the supply won't be enough to satisfy everyone. By 2025, 1.8 billion people will live in areas where water is scarce, and two-thirds will be residents in water-stressed regions, reports National Geographic.

How we're losing fresh water

The water crisis has another dimension besides demand outstripping supply. The amount of water cities, towns and water boards are able to collect is diminishing, due to a number of factors.

Glacial melt

Most of the world's fresh water is contained within glaciers or hard-packed snow that falls in the mountains and becomes freshet [the flood of a river from heavy rain or melted snow] in the spring, filling creeks, rivers, lakes, rechargeable aquifers and reservoirs.

A clarification needs to be made between mountain glaciers, such as those found in Glacier National Park, and the glaciers at the poles. The latter slide and break off from polar ice caps and tumble into the sea, forever lost. Then

there's sea ice, which floats freely at the north pole, and at the south pole, moves around the Antarctic land mass.

Very little fresh water, apart from the amount needed to sustain local populations, is extracted from polar glaciers; mountain glaciers on the other hand sustain large numbers of people mostly in the northern hemisphere, who collect the annual freshet as the spring melt tumbles down from higher elevations and is funneled into creeks.

We know from several years of measurements, that mountain glaciers, like those at the poles, are in retreat.

Apparently when President Taft created Glacier National Park in 1910 it had an estimated 150 glaciers; the park is now down to fewer than 30. The snows of Kilimanjaro immortalized by Ernest Hemingway now have 80% less cover than in 1912. Himalayan glaciers in India could be gone by 2035.

The first State of the Mountains report, published in May 2018 by the Alpine Club of Canada, says outside of the ice sheets of Antarctica and Greenland Canada has more glacier cover than any other nation. Canada has 200,000 square kilometres of glaciers, one quarter is found in the west of the country and the remainder are in the Canadian Arctic archipelago. Up to 80 per cent of the mountain glaciers in Alberta and B.C. will disappear in the next 50 years.

As of April 8, 2019, all of the earth's glaciers combined have lost a hard-to-imagine 9 trillion tons of ice, reports Science Alert. The research team that came up with that figure focused on 19 glacial regions including Alaska, Greenland and the Andes. It works out to an annual loss of around three times the volume of all ice stored in the European Alps.

MarketWatch published a very interesting Associated Press article NASA scientists track Greenland's melting ice, and the findings are not good.

"Greenland contains enough ice to make world sea levels rise by 20 feet if it were all to melt. In a single day this month, it lost a record 13.7 billion tons by one estimate.

"It's a little scary," Willis said as looked down on an area filled with more water than ice. "We're definitely watching the ice sheet disappear in front of us."

Climate change is eating away at Greenland's glaciers in two ways. The most obvious way is from the warm air above, which has been brutal this summer, with a European heat wave in July working like a hair dryer on the ice. The other way is from warm, salty water, some of it from North America's Gulf Stream, nibbling at coastal glaciers from below.

When University of Georgia ice scientist Tom Mote, who isn't part of this project, started studying Greenland's glaciers in the early 1990s, researchers really didn't think the water was a big factor.

Willis' project — called Oceans Melting Greenland, or OMG — is showing that it is. Now the question is how much and how fast.

What Willis is measuring is the water 660 feet or more below the surface, which is warmer and saltier than the stuff that touches the air. It's this deep water that does the major damage."

A recent report from Chile showed that rising temperatures likely due to climate change, a nine-year drought, and conflicts with mining have put Chile's glaciers in peril. The majestic ice sheets are retreating at the decidedly non-glacial pace of a meter per year.

As home to 80% of South America's glaciers, and one of the world's largest repositories of fresh water, that's a problem. It's estimated by the World Resources Institute, that over 7 million people living around Santiago rely on the glaciers to supply them with fresh water in times of drought, Bloomberg said, noting an opposition bill that would protect them is currently before parliament.

Aquifer depletion

Fresh water aquifers are one of the most important natural resources in the world, but in recent decades the rate at which we're pumping them dry has more than doubled. The amount of water pumped has gone from 126 to 283 cubic kilometers per year. If water was pumped as rapidly from the Great Lakes they would be dry in roughly 80 years. These fast-shrinking underground reservoirs are essential to life on the planet. They sustain streams, wetlands, and ecosystems, and they resist land subsidence and saltwater intrusion into our freshwater supplies. Some of the largest cities in the developing world - Jakarta, Dhaka, Lima and Mexico City - depend on aquifers for almost all their water. Most rural areas pump groundwater from wells drilled into an aquifer.

According to the BBC, of the world's major aquifers, 21 out of 37 are receding.

In North America the major concern is over water levels in the Ogallala aquifer under the US Great Plains - the world's bread basket. The Ogallala is the world's largest known aquifer. With an approximate area of 450,600 square kilometers, it stretches from southern South Dakota through parts of Nebraska, Wyoming, Colorado, Kansas, Oklahoma, New Mexico and northern Texas. The Ogallala aquifer was formed roughly 10 million years ago when water flowed onto the plains from retreating glaciers and streams of the Rocky Mountains.

The Ogallala is no longer being recharged by the Rockies and precipitation in the region is only 30-60 cm per year. In three leading grain-producing states - Texas, Oklahoma and Kansas - the underground water table has dropped by more than 30 meters. A 2013 study of 40 aquifers across the United States by the US Geological Survey reported that the rate of groundwater depletion has increased dramatically since 2000, with almost 25 cubic kilometers of water per year being pumped from the ground. This compares to about 9.2 cubic kilometers average withdrawal per year from 1900 to 2008.

Much of the reason for declining groundwater is due to over-use. For example the Ogallala aquifer is being sucked dry at an annual volume equivalent to 18 Colorado Rivers.

A World Bank study indicates that China is over-pumping three river basins in the north: the Hai, the Yellow and the Huai. A 2017 study in Nature Journal found that in 10 years, China doubled its use of irreplaceable groundwater from underground reservoirs, and that they are draining faster than they are being replenished.

From 2000 to 2010, the study found that globally, the amount of water drawn from aquifers for the purpose of irrigation increased by a quarter. A third of earth's largest groundwater basins are being rapidly depleted says a 2015 study.

Streams, rivers and lakes are almost always closely connected with an aquifer. The depletion of aquifers doesn't allow these surface waters to be recharged. Lower water levels in aquifers are reflected in reduced amounts of water flowing at the surface. This is happening along the Atlantic Coastal Plain. Groundwater depletion is also responsible for the Yellow River in China not reaching the ocean for months at a time, the failure of the Colorado River in the US and the Indus River in Pakistan failing to reach the ocean every day.

Saltwater intrusion

If too much groundwater is pumped out from coastal aquifers, saltwater may flow into them, causing contamination of the aquifer. Many coastal aquifers - the Biscayne Aquifer near Miami and the New Jersey Coastal Plain aquifer for example - have problems with saltwater intrusion.

Saltwater intrusion is also caused by rising sea levels caused by melting ice. The warming of the earth's surface has caused a widespread retreat of the glaciers at both poles. According to NASA between 2002 and 2006 Greenland lost 60 cubic miles of ice; in Antarctica it was 36 cubic miles from 2002-05. All of this melting ice has caused sea levels to rise, from between seven and eight inches over the last 117 years, NASA states, with the most rise occurring since 1993. The expansion of ocean water as it warms also causes higher sea levels.

In Florida the ocean is already starting to seep into swamp land, which weakens the plants from their peat bedding. "When we start to lose the structure of the plants, essentially this peat, which is otherwise held together by roots, becomes a soupy pond," explains a University of Florida researcher in an NPR article. Millions of people in South Florida get their fresh water from the Biscayne aquifer in the Everglades.

The problem is also occurring in China, the Philippines and Australia. Salt water from the Bay of Bangladesh has penetrated over 100 kilometers inland, due to sea levels rising higher than elsewhere, thereby increasing the risk of water contamination and hypertension caused by drinking high-salinity water. High river and soil salinity in Bangladesh is also predicted to reduce rice crop yields, affect the productivity of fisheries, crack road surfaces, and increase poverty.

Warming & droughts

Global warming theory posits that higher temperatures are bringing more extreme weather and more frequent, high-intensity storms. Last summer in British Columbia, more of BC was burned by wildfires than any previous summer. Heat records were set in the United Kingdom, northern Siberia, the eastern two-thirds of the United States and southeastern Canada.

In 2014, California had its warmest year on record, and its warmest winter as well - the high in the Sierra Nevada's California's snowpack was at a 25-year low.

The hottest temperature ever measured, 51.3 degrees C, was in Ouargla, Algeria, in July 2018, shattering the previous record of 50.7C set in 1961 in Morocco.

This past June, a heat wave in Europe meant in France, Germany and Spain, the thermometer climbed to between 6 and 10 degrees higher than normal in the last few days of the month.

Global drought map

Records were blasted through in France (45C), Germany, Poland and the Czech Republic. Globally, the month was recorded as the hottest June in 140 years.

Meteorologists blamed the dangerously hot weather on a weakening of the jet stream, pushing super-heated air from Africa up to Europe.

Heat records were also smashed in July, the hottest month on earth since records began in 1880, CBC reported.

Emblematic of the warming Arctic, the Swedish hamlet of Markusvinsa was put on the map as the highest temperature ever measured north of the Arctic Circle.

Warming of course is linked to droughts, which are becoming more frequent and more intense as the planet heats up.

Recall Cape Town, South Africa in 2018. A combination of population growth, over-development and climate change conspired to bring about the worst drought on record, in the country's most popular tourist city. Officials in Cape Town warned that unless drastic conservation measures were taken, by summer the city's 4 million residents would be forced to cue up for drinking water surrounded by armed guards.

The BBC compiled a list of 11 cities with recurring water supply problems. They are: Sao Paulo, Bangalore, Beijing, Cairo, Jakarta, Moscow, Istanbul, Mexico City, London, Miami and Tokyo.

An estimated two-thirds of the world's population lives in drought conditions for at least one month every year.

A report from the UN Intergovernmental Panel on Climate Change notes developing countries like India are likely to be worst hit by climate change due to the frequency of droughts, which will lead to water shortages and problems with food production.

Between 2011 and 2016, California suffered its worst drought in 1,200 years. The effects on water included aquifers receding at a combined 16 million acre-feet per year, and 1,900 wells ran dry.

According to the EPA, four out of five state water managers expect water shortages in some part of their states over the next decade. (2014 report)

A Google search for Texas Heatwave returned the following headlines:

Heat wave fuels 'crazy heat, even for Mississippi' and power demand

USA TODAY-Aug. 13, 2019

A heat wave gripping much of the South and Midwest on Tuesday showed little sign of easing after fueling record demand for energy in Texas ...

Dangerous heat wave blazes across large parts of Plains, South NBCNews.com-Aug. 13, 2019

Parts of South and Midwest grapple with dangerous heat wave Associated Press-Aug. 12, 2019

'Prepare for the Worst': Dangerous Heat Wave Continues Across Parts CBN News-Aug. 13, 2019

'Ring of fire' pattern brings dangerous heat, severe storms, flooding Washington Post-Aug. 12, 2019

Heat Advisories in Place as Dangerous Temperatures Hit 13 States International-TIME-Aug. 12, 2019

All that energy use for air conditioning places huge demand on power generating stations.

Pollution

Water quality has always been of utmost importance to the health of human populations. Unsafe water sources and open sewers in the Middle Ages led to plagues that decimated villages and towns.

However despite the advances of science, many fresh water supplies are getting fouled. The Guardian reported that since the 1990s, pollution has worsened in almost every river in Africa, Asia and Latin America. The situation is expected to deteriorate due to runoffs of fertilizer and other agrochemicals that lead to the growth of pathogens

and algae blooms. About 80% of industrial and municipal wastewater is discharged without treatment, the newspaper states.

It might surprise Canadians to learn that in 2016, nearly 120 million cubic meters of untreated sewage and runoff entered Canadian waterways.

Over the last several years there has been a dramatic rise in the use of hydraulic fracturing - the technology used to extract shale oil and gas. As fracking has increased, worries are growing about fracking's effect on our fresh water supply.

Fracking just one well can use 2 to 8 million gallons of water with the major components being water (90%), sand or proppants (8 to 9.5%), and chemicals (0.5 to 2%). One 4-million-gallon fracturing operation uses from 80 to 330 tons of chemicals and each well will be fracked numerous times.

Methane concentrations are 17x higher in drinking-water wells near fracturing sites than in normal wells. Hydraulic fracturing increases the permeability of shale beds, creating new flow paths and enhancing natural flow paths for gas leakage into aquifers.

According to the industry's own numbers just 60 to 70% of the fracturing fluid is recovered. The remaining 30 to 40% stays in the ground and is not biodegradable.

The fracking fluid gets mixed with "produced water" (the water that is in the well naturally) and nearly all of it is injected into disposal wells - the safety of which has been called into question.

Conclusion

The depletion and fouling of already-scarce fresh water is bad enough, to the extent it becomes a looming threat to future generations. Imagine having to limit showers to, say, two minutes a day, or lining up for water. If we don't get smarter with how we consume and store fresh water, in a future that puts even more stress on it due to climate change, we are going to be in real trouble.

Unfortunately though, there are other knock-on effects. The most serious is how a lack of water could impact the global food supply.

A human-caused degradation of land, including unsustainable farming, overgrazing, clear-cutting, misuse of water and industrial activities, can all be intensified and accelerated by global warming.

According to Luc Gnacadja, executive secretary of the UN Convention to Combat Desertification (UNDD), "The top 20cm of soil is all that stands between us and extinction." What does that mean? It means that as we strip away the amount of available land for food production, we are literally depriving ourselves of the means to survive. Eventually this will lead to the destruction of human civilization - just as desertification contributed to the collapse of the world's earliest known empire, the Akkadians of Mesopotamia.

The highest rates of groundwater depletion are in some of the world's major agricultural centers: Northwest India, Northeastern China, Northeast Pakistan, California's central valley and Midwestern United States.

Iran is over-pumping its aquifers by an average of 5 billion tons of water per year. Saudi Arabia, relying heavily on subsidies, developed an extensive irrigated agriculture based on its deep fossil aquifer, and they sucked it dry. Some Saudi farmers are now pumping water from wells that are 4,000 feet deep. In 2015, the country announced that the 2016 wheat harvest would be its last. The research in Nature Journal found that depleted water reserves will limit the availability of food and raise food prices.

Pakistan uses the most irreplaceable groundwater to grow and export its food, closely followed by the US, then India. The crops that contribute most to trade in food grown using groundwater are rice, wheat, cotton, maize and soybeans. Climate change is exacerbating over-use of groundwater stored in aquifers.

China's wheat crop is mostly grown in the semi-arid northern part of the country and is particularly vulnerable to water shortages. Irrigated land accounts for four-fifths of the grain harvest in China. In India the water situation is even more serious - the 21 million wells drilled are lowering water tables in most of the country.

In a feature article, National Geographic writes that aquifer depletion exacerbated by climate change will make farming days hotter and longer, and cause more frequent droughts. Hotter temperatures in feedlots in southwest Kansas mean that beef cattle drink more water than they did in cooler years. The combination of depleted aquifers and lower snowpacks due to warmer winters and hotter summers is causing some of the world's major lakes and rivers to dry up. Among the most extreme are Lake Poopo in Bolivia, the Colorado River, the Aral Sea, Lake Badwater, Lake Chad, Owens Lake, Lake Powell and Lake Mead.

Our warming planet has not only caused droughts and exacerbated groundwater depletion, which leads to land subsidence, and saltwater intrusion in aquifers near coastal areas.

“Time is running out for Jakarta.

One of the fastest-sinking cities on earth, environmental experts warn that one third of it could be submerged by 2050 if current rates continue.

Decades of uncontrolled and excessive depletion of groundwater reserves, rising sea-levels, and increasingly volatile weather patterns mean swathes of it have already started to disappear.

Existing environmental measures have had little impact, so authorities are taking drastic action: the nation will have a new capital.

Its location could be announced imminently, according to local reports.

“The capital of our country will move to the island of Borneo,” Indonesian leader Joko Widodo said on Twitter.” Sinking city: Indonesia’s capital on brink of disaster

Droughts are also responsible for denuding the landscape of vegetation, which has dire implications for crops and food supply. Desertification is what happens when fertile land is degraded, due to it becoming too arid, or as a result of deforestation or improper agriculture. The process usually results in a loss of vegetation, water bodies and wildlife.

River run-off and water availability is expected to decrease in dry regions as global temperatures increase and rainfall is reduced - further adding to desertification. According to the United Nations Convention to Combat Desertification (UNCDD), by 2020, 60 million people could be forced from desertified areas of sub-Saharan Africa towards North Africa and Europe. These “climate” refugees would add to the political refugees already pouring into Europe. By 2050, some 2.4 billion may be living in areas subject to periods of intense water scarcity, with up to 700 million being forced to move elsewhere.

Eventually populations will become so water-stressed that conflicts break out, even wars. Water shortages inevitably have a greater impact on the poor, who can least afford to pay extra for higher-priced water or have connections to unofficial sources.

In a feature article on water scarcity, the BBC notes the current civil war in Syria can be traced back to a 2007-10 drought, one of the worst in the country’s history. Rural communities were decimated, and drove hundreds of thousands of people off their lands and into cities where they became marginalized. One source in the article notes that a lack of resources, degraded land and lack of water drastically reduces opportunities for young people, making them vulnerable to radicalization and recruitment into militant Islamic groups like Boko Haram and Al-Shabaab in Africa.

Is fresh water depletion, and all its causes and effects, on your radar screen? It is definitely on mine.

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Richard is the owner of Aheadoftheherd.com and invests in the junior resource/bio-tech sectors. His articles have been published on over 400 websites, including:

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FNArena is proud about its track record and past achievements: Ten Years On

Weekly Ratings, Targets, Forecast Changes - 02-08-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of seven major Australian and international stock brokers: Citi, Credit Suisse, Macquarie, Morgan Stanley, Morgans, Ord Minnett and UBS.

For the purpose of broker rating correlation, Outperform and Overweight ratings are grouped as Buy, Neutral is grouped with Hold and Underperform and Underweight are grouped as Sell to provide a Buy/Hold/Sell (B/H/S) ratio.

Ratings, consensus target price and forecast earnings tables are published at the bottom of this report.

Summary

Period: Monday August 26 to Friday August 30, 2019 Total Upgrades: 17 Total Downgrades: 28 Net Ratings Breakdown: Buy 36.73%; Hold 46.39%; Sell 16.89%

The final week of the August reporting season ending on Friday, 30th August, proved an extremely busy one. FNArena registered no less than 17 upgrades and 28 downgrades for individual ASX-listed stocks. Ten out of the 17 upgrades moved to Buy, so there is a silver lining.

Surprisingly, maybe to some, among the stocks receiving a fresh Buy rating we find Appen, Macquarie and NextDC. Sandfire Resources welcomed two new Buys. Boral equally received two upgrades, but one didn't move higher up the rankings than Neutral/Hold.

Plenty to see on the opposing side of the ledger where -another silver lining- only four downgrades sunk as low as Sell. Virgin Australia, Ebos Group, Independence Group, and Whitehaven Coal are responsible for all four. Caltex Australia received multiple changes on both sides of the ledger. G8 Education copped three downgrades to Neutral/Hold. Midway kept it to two.

Given the tsunami in changes to stockbroker recommendations, the week's table for positive amendments to valuations and price targets looks quite tame. Only the two leaders enjoyed increases in double digit percentages; IDP Education and Appen, followed at length by Santos, Woolworths, Wesfarmers, and Qantas.

The negative numbers look decisively larger with Virgin Australia's price target suffering most for the week, followed by Boral, Ingham's Group, Costa Group, and Viva Energy Group.

Not completely unexpected, the two tables for changes made to earnings forecasts show large numbers on both sides. This year's August reporting season had mostly small and mid cap companies featuring in the final week.

On the positive side, the largest gainers were Pilbara Minerals, Freedom Foods, Northern Star, Mayne Pharma, Webjet, Fortescue Metals, and Village Roadshow. On the negative side, the news was (very) bad for NextDC, Ardent Leisure, Orocobre, Nearmap, South32, and Viva Energy Group.

Upgrade

APPEN LIMITED ((APX)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/1/0

First half results were strong, although UBS notes 2019 guidance was not upgraded. The broker believes upside risks remain and considers the valuation attractive relative to peers.

Rating is upgraded to Buy from Neutral and the target raised to \$30.00 from \$26.20.

UBS continues to envisage upside opportunity from Figure Eight, and artificial intelligence requirements remain a major tailwind, especially in government, where Figure Eight has operated previously.

AUTOSPORTS GROUP LIMITED ((ASG)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

A weak new auto market impacted vehicle supply in the first half but improved execution by Autosports in the second half, including better inventory and cost management, led to improved trends in the second half, Macquarie notes.

After 16 months of downtrend, worse than the GFC, there are now signs of stabilisation in the car market.

Autosports is strongly positioned to capitalise on a turnaround and while the broker acknowledges illiquidity remains an issue, a deep discount to peers appears excessive. Upgrade to Outperform from Neutral, target rises to \$1.76 from \$1.15.

BORAL LIMITED ((BLD)) Upgrade to Buy from Neutral by UBS and Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 3/2/0

FY20 guidance is in line with expectations and UBS forecasts Boral Australia's operating earnings (EBITDA) to decline -6% and property to increase to \$40m. Zero operating earnings growth is forecast in North America.

The company is articulating a clear a strategy in managing costs and positioning for the lower demand in Australia, while the fly ash business is reporting positive price and volume growth, the broker observes.

UBS upgrades to Buy from Neutral and reduces the target to \$5.20 from \$5.40. Boral has also finally reached an agreement with Knauf over the USG Boral JV. The JV will expand by acquiring Knauf's plasterboard assets in Asia for US\$533m.

FY19 results were broadly in line. Credit Suisse observes the North American business, combined with Headwaters, has underperformed market growth by around -25% since Boral made the acquisition.

The broker suggests this could prompt questions of a write-down to the US\$3.2bn carrying value. In Australia, FY20 concrete volume forecasts are better than the declines envisaged in NSW by peers.

Credit Suisse upgrades to Neutral from Underperform and does not anticipate a re-rating until the North American earnings issue is resolved and the volume outlook for Australia improves. Target is reduced to \$4.10 from \$4.40.

See also BLD downgrade.

CALTEX AUSTRALIA LIMITED ((CTX)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/4/0

First half net profit was ahead of Ord Minnett's forecasts. The broker considers the interim result an inflection point and is pleased with the increased focus on return on capital.

Rating is upgraded to Accumulate from Hold. The company has announced a \$100m cost savings program by 2020 and the divestment of 50 alternative-use retail sites. Target is raised to \$27 from \$25.

See also CTX downgrade.

FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED ((FPH)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/1/3

In the wake of Fisher & Paykal Healthcare's AGM Macquarie has upgraded earnings forecasts to reflect modest growth in the Hospital business combined with a weaker NZD. Commentary around new applications revenue, which the broker notes is a key growth driver, is positive.

There remains a risk from further deterioration in mask growth but the company suggests this has stabilised, despite, as the broker notes, the recent update from ResMed ((RMD)) suggesting market share gains.

Macquarie nevertheless upgrades to Neutral from Underperform. Target rises to NZ\$16.61 from NZ\$14.78.

HUB24 LIMITED ((HUB)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/3/1

On Citi's calculations, the company has made a robust start into the fresh financial year and risks are seen as to the upside, with net flows expected to grow by 18% in FY20. Estimates go up on lower cost growth as well as lower share based payments.

Given the improved outlook for net flows, Citi has upgraded to Neutral from Sell, despite still seeing risk to platform pricing and potentially higher cost growth. Price target improves to \$12.45 from \$12.05.

Citi believes another RBA rate cut will have a negative impact, while margins remain under pressure, also because there is increased focus on fees from advisors.

IOOF HOLDINGS LIMITED ((IFL)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/4/1

IOOF posted a big miss on profit, reflecting remediation provisions, but net of those it was still a miss of UBS' forecast, with the benefit of stronger markets in the period offset by declining revenue margins.

The broker has cut its earnings forecasts, suggesting significant operating headwinds remain in FY20, and dropped its target to \$4.85 from \$5.15. But as the stock has already traded down to this price, UBS upgrades to Neutral from Sell.

INGHAMS GROUP LIMITED ((ING)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/5/1

As reported yesterday, the FY19 report missed consensus forecasts, and it was accompanied by guidance for a decline in profits for FY20. Following on from the share price shellacking that ensued post the release, Citi has upgraded to Neutral from Sell.

Forecasts have been slashed by -18%-19%. Price target reduces to \$3.40 from \$3.85. The two challenges for management are rising costs and slowing price increases, which creates a double whammy, the analysts explain.

The company is organising a Strategy Day on 22 October 2019. Longer term, the analysts highlight this company is operating inside a concentrated industry structure, where scale benefits are important.

JAPARA HEALTHCARE LIMITED ((JHC)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/4/0

FY19 net profit was in line with estimates. Macquarie notes difficult operating conditions and inflated net debt provide for a tough investment case. This is likely to persist as the industry awaits the Royal Commission interim report in October.

As the share price has reached the target the broker upgrades to Neutral from Underperform. Estimates for earnings per share are cut by -40% and -18% for FY20 and FY21 respectively. Target is reduced to \$1.05 from \$1.10.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Upgrade to Buy from Neutral by Citi .B/H/S: 6/1/0

The release of FY19 financials did not remove all threats and uncertainties (that would be unrealistic) but according to Citi's assessment it did bring home the message to investors that the share price is simply too low.

Even after yesterday's firm rally, Citi has upgraded to Buy from Neutral with an increased price target of \$6.20. EPS forecasts went down -8% for FY20 and up +1% for FY21.

The risk of major cost overruns seems more contained, suggest the analysts. Lots of amendments have been made to forecasts, including new leasing standards, the share buyback and a significant rise in depreciation and amortisation. In particular the Woodford issue in the UK is seen as an ongoing overhang.

See also LNK downgrade.

MACQUARIE GROUP LIMITED ((MQG)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/2/0

Macquarie Group has launched a capital raising to fund new investments in green energy, technology and infrastructure. The company has also provided an update on the first half, currently expecting net profit to be around 10% above the prior corresponding half.

The primary driver of this performance is strength in the commodities business, which is expected to fade over the remainder of the year. Ord Minnett observes the growth outlook is supported by the depreciation in the Australian dollar and falling bond yields.

Rating is upgraded to Accumulate from Hold and the target reduced to \$133 from \$134.

MOTORCYCLE HOLDINGS LIMITED ((MTO)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

FY19 results were ahead of guidance and above forecasts. This came despite a tough year for motorcycle dealerships. Morgans upgrades forecasts by more than 20%.

The broker believes FY20 will post fewer headwinds for the company and the industry. Rating is upgraded to Add from Hold. Target is raised to \$2.27 from \$1.32.

NEXTDC LIMITED ((NXT)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 5/1/0

NextDC's revenue and earnings largely met Macquarie's forecast, with revenues impacted by some site-specific issues that have now been sorted. FY20 guidance is in line with the broker albeit below consensus.

The broker believes consensus numbers were too bullish regarding Generation 2 ramp-ups.

Macquarie also believes the bearish issues are not sufficient to justify the large short position in the stock. Upgrade to Outperform from Neutral, target rises to \$7.75 from \$6.75.

OZ MINERALS LIMITED ((OZL)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 4/3/0

First half net profit was ahead of Credit Suisse estimates. The underlying result includes various non-cash adjustments, as usual, the broker notes. Cash flow remain strong.

2019 guidance is unchanged although costs are now at the lower end of expectations. Credit Suisse upgrades to Neutral from Underperform on valuation. Target of \$9.50 maintained.

SANDFIRE RESOURCES NL ((SFR)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/3/0

The Credit Suisse mining sector analysts love providing a flood of hard numbers and little in the way of commentary. Suffice to say Sandfire's profit was \$106m to the broker's \$116m forecast and the dividend of 65.2c missed a 72.6c assumption.

An earnings miss is apparently due to lower inventory credit than expected.

Credit Suisse upgrades to Outperform from Neutral and retains the \$6.75 target..

FY19 results were in line with estimates. The company expects to update the market on the timing and scope of the T3 project in the second quarter along with the completion of the acquisition of MOD Resources.

Macquarie envisages value at current levels and upgrades to Outperform from Neutral. The company has not changed FY20 guidance and, therefore, the broker has not updated estimates. Target is steady at \$6.70.

Downgrade**ATLAS ARTERIA ((ALX)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/5/0**

Atlas Arteria reported APRR earnings ahead of forecast despite declining traffic due to lower snow clearing costs. Greenway earnings were in line.

Macquarie notes an opportunity is to simplify the structure with the MEIF2 transaction but Greenway is at risk of any weak economic environment or major weather event locking up distribution for another three years. Yield growth otherwise re-accelerates in 2021-22 with French tax cuts and Greenway dividend.

On a full valuation the broker downgrades to Neutral from Outperform. Target unchanged at \$8.12.

AVEO GROUP ((AOG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/3/0

FY19 underlying profit was in line with recent guidance. Ord Minnett downgrades to Hold from Accumulate as the stock is trading close to the \$2.15 offer price from Brookfield.

The broker considers the prospects of a higher offer are low, despite being at a material discount to what is deemed fair value. Target is set at \$2.15.

AUSTRALIAN VINTAGE PTY LTD ((AVG)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

FY19 results were ahead of forecasts. Commentary for FY20 appears cautious, amid cost pressures from a prolonged drought and continuing uncertainty with Brexit.

Morgans observes the company has made considerable progress on its growth strategy and its core brands are performing strongly in a highly competitive industry.

The broker is also pleased with the increased disclosure. Valuation remains undemanding but the rating is downgraded to Hold from Add because of the challenging near-term operating environment. Target is reduced to \$0.52 from \$0.61.

BORAL LIMITED ((BLD)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 3/2/0

FY19 results were weaker than expected. Guidance is for net profit to be down -5-15%, which implies meaningful downgrades to Morgan Stanley's forecasts. The company has signalled a weaker outlook in Australia and minimal growth in the US.

The broker is quite alarmed by the decline in Australian guidance, as it comes despite Boral remaining relatively upbeat on materials pricing. Infrastructure is not expected to offset the weakness in residential construction.

As the balance sheet is likely to come under scrutiny, Morgan Stanley finds no reason to own the stock at this stage and downgrades to Equal-weight from Overweight. Target is reduced to \$4.50 from \$6.50. Industry view is Cautious.

See also BLD upgrade.

CAPITOL HEALTH LIMITED ((CAJ)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 1/1/0

FY19 operating earnings (EBITDA) were slightly ahead of Ord Minnett's forecasts. The company will focus on appropriately managing costs and staffing requirements while ensuring patient and referrer needs.

Additional capital investment will be undertaken as management intends to capture the benefits of the transition to higher-value modalities. In the meantime, Ord Minnett notes industry growth in Victoria is lacklustre.

Given the uncertainty that comes with company transformations, the broker downgrades to Hold from Buy. Target is reduced to \$0.24 from \$0.27.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Downgrade to Hold from Add by Morgans .B/H/S: 3/2/0

First half results were weaker than expected. The company has downgraded 2019 guidance and flagged further downside risk.

Morgans recognises the company has a range of growth projects which should support any earnings recovery over 2020-21, particularly when combined with a normal season.

Given the near-term uncertainty the broker downgrades to Hold from Add. Target is reduced to \$3.48 from \$4.77.

CALTEX AUSTRALIA LIMITED ((CTX)) Downgrade to Neutral from Outperform by Macquarie and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/0

Caltex Australia's result fell short of Macquarie as weak industry trends persist. Retail fuel margins are under pressure as competitors look to defend market share by cutting prices, while refiner margins are also soft.

As a result of the retail trend the company will close 50 of its 790 convenience sites which the broker estimates would raise \$256m.

Caltex is responding by reducing costs and lowering capex guidance but given the headwinds facing the retail business Macquarie downgrades to Neutral from Outperform. Target falls to \$24.78 from \$26.50.

The take-out from Caltex result was not the numbers themselves -- they were within the guidance range and unsurprising as far as Credit Suisse was concerned -- but the omission of earlier guidance to a profit uplift for the Convenience business. But given the broker never included such an uplift in its forecasts, announced cost-cuts mean there is "no significant void" left by a lack of Convenience profit growth.

Rather, Credit Suisse looks to lower assumptions for refinery production and margins in lowering its FY expectations. This leads to a target cut to \$26.85 from \$32.22 and a downgrade to Neutral from Outperform.

See also CTX upgrade.

EBOS GROUP LIMITED ((EBO)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/3/1

FY19 underlying earnings were ahead of expectations. The business continues to make steady progress despite the pressures, Credit Suisse observes.

The company has distinguished itself as a high-quality operator in wholesale pharmaceutical supply but a number of factors constrain the broker's valuation, including limited wholesale remuneration growth and competitive pressures.

Rating is downgraded to Underperform from Neutral. Target is raised to NZ\$21.75 from NZ\$21.00.

ERM POWER LIMITED ((EPW)) Downgrade to Hold from Add by Morgans .B/H/S: 0/3/0

Shell has launched an unconditional cash takeover offer at \$2.465 per share. The board has unanimously recommended the offer. The offer will be reduced to reflect any cash paid as dividends.

Morgans believes the deal is likely to proceed and suggests the risk of missing out on the offer premium is low.

Morgans found the FY19 result solid, despite some misses on retail sales volumes. The outlook for FY20 is stronger and the energy solutions division is expected to break even.

Morgans downgrades to Hold from Add and raises the target to \$2.47 from \$2.05.

G8 EDUCATION LIMITED ((GEM)) Downgrade to Hold from Buy by Ord Minnett and Downgrade to Equal-weight from Overweight by Morgan Stanley and Downgrade to Neutral from Buy by UBS .B/H/S: 0/5/0

First half earnings (EBIT) were slightly below forecasts. Growth in costs and the reduced outlook for greenfield assets disappointed Ord Minnett.

The broker materially reduces its forecasts, lowering the target to \$2.40 from \$3.40. Rating is downgraded to Hold from Buy.

Morgan Stanley notes occupancy rates became harder to increase in the second quarter and the company must now cycle an improvement in the prior corresponding second half.

The broker envisages little upside to management's view of a 1.5% occupancy uplift. When combined with the cost pressures of labour and rents there is less scope for operating leverage as a result.

Estimates are reduced by -12% for 2019 and -20% for 2020. Rating is downgraded to Equal-weight from Overweight. Target is lowered to \$2.50 from \$4.00. In-Line industry view maintained.

G8 Education's earnings came in ahead of UBS and a number of metrics, particularly organic centre performance and increased occupancy, but there the good news ends.

Acquisitions and greenfield projects materially underperformed expectation and management's FY20 earnings guidance falls well below prior consensus.

UBS continues to believe in the long term story and notes the stock appears cheap at the level, but consistent headwinds cannot be ignored and the broker admits having been too optimistic on earnings growth.

Downgrade to Neutral from Buy and target slashed to \$2.25 from \$3.80.

GOODMAN GROUP ((GMG)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/2/1

FY19 results were largely in line with expectations. Credit Suisse expects FY20 will be another strong year and the business is well-positioned to deliver development margins and growth in funds under management.

While earnings growth is strong, the broker considers this is reflected in the price and downgrades to Neutral from Outperform. Target is raised to \$14.43 from \$14.04.

Credit Suisse notes the conundrum of whether to view the stock as an expensive A-REIT or a fund manager. At a time when many A-REITs lack earnings catalysts the broker suspects the stock will retain investor support.

INTEGRAL DIAGNOSTICS LIMITED ((IDX)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 2/1/0

Operating earnings were slightly below forecasts in FY19. The implied market share gains demonstrate the value of a strong regional focus and geographical diversification, in Ord Minnett's view.

This was bolstered by the acquisition of Imaging Queensland, a large practice with a strong regional presence. The broker believes the acquisition is a good one and should yield strong benefits in FY21.

Ord Minnett raises the target to \$3.41 from \$3.31. Rating is downgraded to Accumulate from Buy on valuation.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/3/2

Citi found the released FY19 financials in line with the June quarter update, but it considers the share price too rich. Hence the downgrade to Sell from Neutral with an unchanged price target of \$5.

The analysts consider there is potential upside from a higher nickel price or from the \$66m exploration budget, while management is actively on the look out for M&A. Citi has reduced average copper price projections.

Management also indicated there are no more franking credits left, for the time being. It might decide to buy back shares instead in case of returns to shareholders, suggest Citi analysts, or pay dividends without franking.

LINDSAY AUSTRALIA LIMITED ((LAU)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

Lindsay Australia's FY19 result met guidance thanks to a one-off fuel tax credit, but otherwise the result was well below Morgans' forecasts.

The company reports weak trading across all divisions, thanks to fuel-price volatility, the North Queensland floods and weather-inspired falls in produce freight volumes. Operating cash flow proved a beat, the company posting 107% conversion thanks to strong working capital management.

No FY20 guidance was provided for the rail expansion and the company will exit Connect this September quarter citing barriers to entry into China.

Morgans cuts profit forecasts and the target price falls to 39c from 50c. Rating downgraded to Hold from Add, the broker appreciating the company's good management and undemanding valuation, but noting the lack of catalysts.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 6/1/0

FY19 results were in line with expectations. Guidance for operating earnings (EBITDA) in FY20 to be "broadly in line" is open to interpretation, Credit Suisse asserts.

An on-market share buyback sends a positive message and the broker estimates the company has room to buy back around 6-7% of share capital.

Rating is downgraded to Neutral from Outperform, post the recent recovery in the share price. Target is reduced to \$5.75 from \$5.85.

See also LNK upgrade.

MIDWAY LIMITED ((MWY)) Downgrade to Hold from Buy by Ord Minnett and Downgrade to Hold from Add by Morgans .B/H/S: 0/2/0

FY19 results were worse than expected. Ord Minnett notes pricing is also looking a little shaky for 2020. The company has indicated that pulp prices have declined materially because of a combination of higher Brazilian production at the same time as Chinese demand has slowed.

While this is expected to normalise in coming months Ord Minnett suspects the company is concerned that 2020 prices may be negatively affected. The broker downgrades estimates for earnings per share by -24% for FY20 and -28% for FY21.

Rating has been downgraded to Hold from Buy as the results have created significant market uncertainty. Target is reduced to \$3.31 from \$4.37.

FY19 results were in line with expectations. Morgans finds the outlook for FY20 more challenging, suspecting the company is not immune to weaker wood fibre conditions.

No formal guidance was provided although modest growth is targeted. Morgans reduces FY20 and FY21 operating earnings (EBITDA) forecast by -16.2% and -14.3%, respectively.

Pulp prices have dropped significantly in recent months largely because of over-production and high levels of inventory at Brazilian pulp mills. A resumption in buying activity is expected to support better prices but the timing is unknown.

Morgans downgrades to Hold from Add given the short-term uncertainty. Target is reduced to \$3.16 from \$3.90.

NATIONAL STORAGE REIT ((NSR)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/2/1

FY19 net profit was in line with guidance. Guidance for FY20 growth is unchanged. Ord Minnett suggests self-storage centres have, effectively, flat organic income growth prospects over the next 12-18 months because of lower housing market turnover.

The broker believes the stock is trading at fair value albeit not at a premium. Rating is downgraded to Hold from Accumulate.

The broker forecasts 2-3% growth in earnings per share for the next five years based on a stabilising occupancy rate of 85%. Target is reduced to \$1.85 from \$2.00.

OROCOBRE LIMITED ((ORE)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/3/0

Macquarie suggests Orocobre's result was slightly softer than expected on a profit -15% below forecast. While FY20 production is forecast to exceed FY19, lithium pricing headwinds remain the issue.

A debt facility has been finalised to finance Olaroz stage 2 but on lithium pricing pressure the broker downgrades to Neutral from Outperform. Target falls to \$2.50 from \$3.30.

PERSEUS MINING LIMITED ((PRU)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/3/0

The share price has been on a tremendous run, which underpins Citi's decision to downgrade to Neutral/High Risk from Buy/High Risk. The analysts acknowledge if gold rallies higher, this would translate positively for Perseus Mining.

Coming to the FY19 performance, it missed expectations by quite a large margin, underlying. At the operational level (EBITDA), however, it turns out market consensus has been beaten by 5%. Lower exploration expenses and higher D&A made the difference.

Citi's bull case valuation is \$1.20 while the bear case puts valuation at \$0.40. Price target rises 5c to \$0.90. Earnings estimates fall as Citi incorporates updated FX assumptions (AU\$/US\$0.72 instead of 0.68 for 2020).

REECE AUSTRALIA LIMITED ((REH)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/1/0

Reece Australia's FY19 numbers revealed significantly slower growth in Australia & New Zealand in H2, as well as the fact that Morsco's contribution only makes up for 26% of the group's total. Both elements combined have triggered a downgrade to Neutral from Buy from Citi.

Core EPS estimates have been scaled back by -15%-16%, exaggerated by the inclusion of an incremental -\$33m in amortisation, the analysts explain. Price target loses -11% to \$11.21.

The FY19 performance slightly missed Citi's forecasts at face value but the analysts acknowledge there were a number of non-core elements such as FX and amortisation that had to be taken out, before concluding the result was broadly in-line.

SG FLEET GROUP LIMITED ((SGF)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/3/0

SG Fleet's profit was ahead of Macquarie on a reduction in operating expenses and success in increasing additional products & services in a competitive environment.

The company has quantified previously flagged strategic initiatives which, to cut a long story short, mean accounting changes that impact materially on earnings per share calculation but only lead the broker to drop its target to \$2.92 from \$2.95 given the earnings change is transitional.

However given the time it will take to build earnings from the strategic shift, the broker downgrades to Neutral from Outperform.

VIRGIN AUSTRALIA HOLDINGS LIMITED ((VAH)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/0/2

FY19 results were weaker than expected. Credit Suisse notes the aggressive initiatives to cut costs amid reviews of fleet capacity and network.

While the initiatives are likely to deliver a sustainable improvement, the broker suggests this may take 2-3 years.

Credit Suisse believes the new CEO is taking the right action and downgrades to Underperform from Neutral on valuation grounds. Target is reduced to \$0.10 from \$0.18.

VIVA ENERGY GROUP LIMITED ((VEA)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/2/0

Interim results were below expectations. Macquarie finds the retail outlook negative, with margins to remain under pressure from competition. Refining is not expected to show an improvement until the fourth quarter of 2019 at the earliest.

Macquarie reduces 2019 and 2020 estimates for earnings per share by -58% and -42%, respectively, to reflect lower fuel volumes, lower retail margins, a higher corporate cost base and the lower ramp-up of the Geelong refinery.

Target is lowered to \$2.06 from \$3.10 and the rating is downgraded to Neutral from Outperform.

WHITEHAVEN COAL LIMITED ((WHC)) Downgrade to Lighten from Accumulate by Ord Minnett .B/H/S: 6/0/0

Ord Minnett notes the second half was broadly positive, with earnings and cash flow beating expectations. However guidance for FY20 is lacklustre.

Critically, the company has kept its word and returned surplus cash to shareholders, delivering a \$0.30 second half dividend. The broker transfers coverage to another analyst and incorporates a new model, resulting in substantial changes.

Rating is downgraded to Lighten from Accumulate and the target reduced to \$3.00 from \$4.80. Relative to its peers the stock appears expensive on key valuation metrics and the broker notes coal prices are also under pressure.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 APPEN LIMITED Buy Neutral UBS 2 AUTOSPORTS GROUP LIMITED Buy Neutral Macquarie 3 BORAL LIMITED Buy Neutral UBS 4 BORAL LIMITED Neutral Sell Credit Suisse 5 CALTEX AUSTRALIA LIMITED Buy Neutral Ord Minnett 6 FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED Neutral Sell Macquarie 7 HUB24 LIMITED Neutral Sell Citi 8 INGHAMS GROUP LIMITED Neutral Sell Citi 9 IOOF HOLDINGS LIMITED Neutral Sell UBS 10 JAPARA HEALTHCARE LIMITED Neutral Sell Macquarie 11 LINK ADMINISTRATION HOLDINGS LIMITED Buy Neutral Citi 12 MACQUARIE GROUP LIMITED Buy Neutral Ord Minnett 13 MOTORCYCLE HOLDINGS LIMITED Buy Neutral Morgans 14 NEXTDC LIMITED Buy Neutral Macquarie 15 OZ MINERALS LIMITED Neutral Sell Credit Suisse 16 SANDFIRE RESOURCES NL Buy Neutral Macquarie 17 SANDFIRE RESOURCES NL Buy Neutral Credit Suisse Downgrade 18 ATLAS ARTERIA Neutral Buy Macquarie 19 AUSTRALIAN VINTAGE PTY LTD Neutral Buy Morgans 20 AVEO GROUP Neutral Buy Ord Minnett 21 BORAL LIMITED Neutral Buy Morgan Stanley 22 CALTEX AUSTRALIA LIMITED Neutral Buy Macquarie 23 CALTEX AUSTRALIA LIMITED Neutral Buy Credit Suisse 24 CAPITOL HEALTH LIMITED Neutral Buy Ord Minnett 25 COSTA GROUP HOLDINGS LIMITED Neutral Buy Morgans 26 EBOS GROUP LIMITED Sell Neutral Credit Suisse 27 ERM POWER LIMITED Neutral Buy Morgans 28 G8 EDUCATION LIMITED Neutral Buy UBS 29 G8 EDUCATION LIMITED Neutral Buy Morgan Stanley 30 G8 EDUCATION LIMITED Neutral Buy Ord Minnett 31 GOODMAN GROUP Neutral Buy Credit Suisse 32 INDEPENDENCE GROUP NL Sell Neutral Citi 33 INTEGRAL DIAGNOSTICS LIMITED Buy Buy Ord Minnett 34 LINDSAY AUSTRALIA LIMITED Neutral Buy Morgans 35 LINK ADMINISTRATION HOLDINGS LIMITED Neutral Buy Credit Suisse 36 MIDWAY LIMITED Neutral Buy Morgans 37 MIDWAY LIMITED Neutral Buy Ord Minnett 38 NATIONAL STORAGE REIT Neutral Buy Ord Minnett 39 OROCOBRE LIMITED Neutral Buy Macquarie 40 PERSEUS MINING LIMITED Neutral Buy Citi 41 REECE AUSTRALIA LIMITED Neutral Buy Citi 42 SG FLEET GROUP LIMITED Neutral Buy Macquarie 43 VIRGIN AUSTRALIA HOLDINGS LIMITED Sell Neutral Credit Suisse 44 VIVA ENERGY GROUP LIMITED Neutral Buy Macquarie 45 WHITEHAVEN COAL LIMITED Sell Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 APX APPEN LIMITED 67.0% 33.0% 34.0% 3 2 SFR SANDFIRE RESOURCES NL 50.0% 21.0% 29.0% 7 3 S32 SOUTH32 LIMITED 83.0% 57.0% 26.0% 6 4 FPH FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED -75.0% -100.0% 25.0% 4 5 IFL IOOF HOLDINGS LIMITED -20.0% -40.0% 20.0% 5 6 DOW DOWNER EDI LIMITED 50.0% 30.0% 20.0% 5 7 NXT NEXTDC LIMITED 75.0% 58.0% 17.0% 6 8 ALG ARDENT LEISURE GROUP 33.0% 17.0% 16.0% 3 9 ING INGHAMS GROUP LIMITED -17.0% -33.0% 16.0% 6 10 QAN QANTAS AIRWAYS LIMITED 33.0% 17.0% 16.0% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 EBO EBOS GROUP LIMITED -25.0% 25.0% -50.0% 4 2 VAH VIRGIN AUSTRALIA HOLDINGS LIMITED -83.0% -50.0% -33.0% 3 3 CTX CALTEX AUSTRALIA LIMITED 25.0% 50.0% -25.0% 6 4 VEA VIVA ENERGY GROUP LIMITED 50.0% 70.0% -20.0% 5 5 GMG GOODMAN GROUP 20.0% 40.0% -20.0% 5 6 IDX INTEGRAL DIAGNOSTICS LIMITED 50.0% 67.0% -17.0% 3 7 CGC COSTA GROUP HOLDINGS LIMITED 42.0% 58.0% -16.0% 6 8 NSR NATIONAL STORAGE REIT -33.0% -17.0% -16.0% 3 9 SGM SIMS METAL MANAGEMENT LIMITED 17.0% 33.0% -16.0% 6 10 ORE OROCOBRE LIMITED 57.0% 71.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 IEL IDP EDUCATION LIMITED 18.396 16.670 10.35% 5 2 APX APPEN LIMITED 28.997 26.330 10.13% 3 3 STO SANTOS LIMITED 7.623 7.094 7.46% 7 4 WOW WOOLWORTHS LIMITED 32.078 30.228 6.12% 5 5 WES WESFARMERS LIMITED 35.081 33.108 5.96% 7 6 QAN QANTAS AIRWAYS LIMITED 6.108 5.825 4.86% 6 7 MPL MEDIBANK PRIVATE LIMITED 3.119 2.980 4.66% 7 8 EBO EBOS GROUP LIMITED 24.035 23.035 4.34% 4 9 GMG GOODMAN GROUP 15.442 14.904 3.61% 5 10 DOW DOWNER EDI LIMITED 7.970 7.730 3.10% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 VAH VIRGIN AUSTRALIA HOLDINGS LIMITED 0.143 0.177 -19.21% 3 2 BLD BORAL LIMITED 4.760 5.683 -16.24% 5 3 ING INGHAMS GROUP LIMITED 3.375 4.000 -15.63% 6 4 CGC COSTA GROUP HOLDINGS LIMITED 4.228 4.660 -9.27% 6 5 VEA VIVA ENERGY GROUP LIMITED 2.274 2.494 -8.82% 5 6 IFL IOOF HOLDINGS LIMITED 5.010 5.380 -6.88% 5 7 ALG ARDENT LEISURE GROUP 1.327 1.423 -6.75% 3 8 WHC WHITEHAVEN COAL LIMITED 4.164 4.421 -5.81% 7 9 ORE OROCOBRE LIMITED 3.829 4.057 -5.62% 7 10 NSR NATIONAL STORAGE REIT 1.663 1.733 -4.04% 3 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PLS PILBARA MINERALS LIMITED 0.895 -1.023 187.49% 3 2 FNP FREEDOM FOODS GROUP LIMITED 15.500 7.933 95.39% 3 3 NST NORTHERN STAR RESOURCES LTD 55.883 31.795 75.76% 6 4 MYX MAYNE PHARMA GROUP LIMITED 2.110 1.288 63.82% 4 5 WEB WEBJET LIMITED 78.204 58.172 34.44% 5 6 FMG FORTESCUE METALS GROUP LTD 172.874 133.235 29.75% 7 7 VRL VILLAGE ROADSHOW LIMITED 14.400 11.133 29.35% 3 8 IEL IDP EDUCATION LIMITED 33.340 26.260 26.96% 5 9 SKI SPARK INFRASTRUCTURE GROUP 8.467 6.704 26.30% 6 10 VAH VIRGIN AUSTRALIA HOLDINGS LIMITED -0.460 -0.567 18.87% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NXT NEXTDC LIMITED -2.650 -0.117 -2164.96% 6 2 ALG ARDENT LEISURE GROUP -0.300 0.150 -300.00% 3 3 ORE OROCOBRE LIMITED 2.923 10.312 -71.65% 7 4 NEA NEARMAP LTD -3.767 -2.800 -34.54% 3 5 S32 SOUTH32 LIMITED 22.004 29.030 -24.20% 6 6 VEA VIVA ENERGY GROUP LIMITED 8.900 11.300 -21.24% 5 7 REG REGIS HEALTHCARE LIMITED 12.900 15.975 -19.25% 4 8 IFL IOOF HOLDINGS LIMITED 44.580 54.820 -18.68% 5 9 LNK LINK ADMINISTRATION HOLDINGS LIMITED 31.446 37.153 -15.36% 7 10 ING INGHAMS GROUP LIMITED 24.300 28.693 -15.31% 6 Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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Uranium Week: Doldrums Again

The uranium market went quiet again last week as participants prepared for the World Nuclear Association's 2019 Symposium in London this week.

-Brief burst in activity in uranium market proved short-lived -Industry consultant TradeTech has lowered its term price indicators -Nuclear generation continues to grow around the globe, most rapidly in Asia

By Greg Peel

The brief burst of activity seen in the uranium spot market the week before, after swing producer Kazakhstan announced intentions to extend its -20% production reduction through 2021, gave way to another quiet week as participants prepared for the World Nuclear Association's 2019 Symposium in London this week.

The market is also awaiting the recommendations of Trump's Nuclear Fuel Working Group due on October 10. Notwithstanding the last week of the northern summer vacation period typically sees activity grind to a halt.

Indeed all of August is a quiet period. Industry consultant TradeTech reports only three transactions were completed in the spot market last week, totalling 870,000lbs U3O8 equivalent. No transactions were reported in term markets.

TradeTech's weekly spot price indicator closed the week unchanged from the week before at US\$25.30/lb, up US5c from end-July.

TradeTech's term price indicators have fallen to US\$28.00/lb (mid) from US\$28.50/lb, and US\$30.00/lb (long) from US\$31.00/lb.

Attention at the Symposium will be specifically focused on utilities with "uncovered needs" in 2020, meaning uranium they'll need to buy. Participants do expect activity to increase post-Symposium as we move into the northern autumn. That said, they've been expecting increased utility interest for some time now, in vain.

Attention will also be on the purchasing intentions of major Canadian producer Cameco, which continues to buy in the spot market to satisfy delivery contracts, having curtailed production due to low prices.

A New Generation

While industry participants await signs of new demand in the uranium market, the longer-term view of nuclear power continues to strengthen globally. Nuclear generation is growing most rapidly in Asia, which recorded a 12% increase in generation last year, which is more than one-fifth of global generation, according to the World Nuclear Performance Report 2019 published last week.

In addition, new build projects in the European Union are expected to introduce 4.1 GWe in new nuclear generation capacity in the near term, and have the potential to add more than 6 GWe of capacity to the region over the next 25 years.

In the UK, nuclear power has played an important role in the transition to a low-carbon economy. The nation continues to work toward a new generation of nuclear power plants to replace an existing fleet of reactors, as all but one plant will be out of service by 2031. Recently Britain went a whole week without having to draw upon coal-fired power.

Over in the Dark Ages, Australians are awaiting the results of a new parliamentary inquiry into the use of nuclear power, which are due at year end. Ziggy Switkowski, who led the 2006 review for the Howard government, said the technology had no chance of being introduced unless Australia had a coherent energy policy.

Which it hasn't had in decades, and there appears no hope on the horizon.

In the US, the fate of the country's uncompetitive nuclear power industry will no doubt hang on the findings of the aforementioned Working Group.

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The Short Report - 5 Sep 2019

Guide:

The Short Report draws upon data provided by the Australian Securities & Investment Commission (ASIC) to highlight significant weekly moves in short positions registered on stocks listed on the Australian Securities Exchange (ASX). Short positions in exchange-traded funds (ETF) and non-ordinary shares are not included. Short positions below 5% are not included in the table below but may be noted in the accompanying text if deemed significant.

Please take note of the Important Information provided at the end of this report. Percentage amounts in this report refer to percentage of ordinary shares on issue.

Stock codes highlighted in green have seen their short positions reduce in the week by an amount sufficient to move them into a lower percentage bracket. Stocks highlighted in red have seen their short positions increase in the week by an amount sufficient to move them into a higher percentage bracket. Moves in excess of one percentage point or more are discussed in the Movers & Shakers report below.

Summary:

Week ending August 29, 2019

Last week saw the ASX200 recovering ground along with Wall Street before a last day of August flurry.

This from last week's Report:

"Wow. Get a load of the sea of green below. One would be forgiven for thinking there was an earnings season on.

"Indeed, last week was the biggest by stock count in the earnings season, so that may explain the aforementioned sea, but we also had the macro overlay of extreme global market volatility, which in itself may explain short-covering. Or a combination of both. I just sincerely hope the ASIC data is accurate, and we don't see everything go back the other way next week (wouldn't be the first time), or my assessment would make me look a fool (again)."

I stand before you a fool.

Ignore all the red below as 99% of the moves are a reversal of the sea of green last week that had me suspicious, and unfortunately not suspicious enough. Better to simply focus on the nominal levels of shorts, which are little changed from two weeks ago.

As for how earnings season impacted on short positions we'll never know, because the ASIC data have proven to be a sham. It may not be ASIC's fault, given short-position declarations are an honour system, not a computerised process.

Weekly short positions as a percentage of market cap:

10%+ NUF 18.7 ING 17.3 GXY 16.7 ORE 16.3 BAL 15.9 SYR 14.7 NXT 14.0 JBH 13.8 HUB 11.7 BWX 11.5 GWA 10.7 PLS 10.7 BGA 10.6 DMP 10.3

In: BWX, HUB, PLS, BGA, GWA

9.0-9.9

BOQ, BIN, MTS, RWC, IFL, HVN, SGM, CGC

In: RWC, HVN, IFL, BIN, SGM, CGC Out: PLS, BWX 8.0-8.9%

BKL, IVC, PPT, DCN, SUL, SDA

In: DCN Out: BGA, BKL, HUB, HVN, IFL, CGC, KGN

7.0-7.9%

CGF, CLH, AMP, MYR, OML, WSA

In: AMP, OML Out: SGM, BIN, DCN

6.0-6.9%

NCZ, A2M, CSR, KGN, PGH, NWL, SFR, COE, NEC, WEB, CTD, GEM

In: NCZ, NWL, SFR, COE, NEC, WEB, CTD, GEM, KGN

Out: RWC, GWA, IVC

5.0-5.9%

NEA, CLQ, LNG, GMA, CUV, ELD, MSB, SXY, SEK

In: ELD, SXY SEK

Out: SDA, CGC, AMP, GEM, BKL, NCZ, CTD, NWL, EHL, ECX Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.8 0.6 RIO 4.2 4.6 ANZ 0.6 0.7 S32 1.0 1.1 BHP 3.4 3.4 SCP 0.9 0.9 BXB 0.0 0.1 SUN 0.8 0.7 CBA 1.1 1.2 TCL 0.4 0.5 COL 0.7 0.9 TLS 0.3 0.3 CSL 0.2 0.2 WBC 1.0 1.0 IAG 0.6 0.6 WES 1.0 1.1 MQG 0.7 0.8 WOW 1.4 1.6 NAB 0.4 0.5 WPL 0.9 0.9 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

The above information is sourced from daily reports published by the Australian Investment & Securities Commission (ASIC) and is provided by FNArena unqualified as a service to subscribers. FNArena would like to make it very clear that immediate assumptions cannot be drawn from the numbers alone.

It is wrong to assume that short percentages published by ASIC simply imply negative market positions held by fund managers or others looking to profit from a fall in respective share prices. While all or part of certain short percentages may indeed imply such, there are also a myriad of other reasons why a short position might be held which does not render that position "naked" given offsetting positions held elsewhere. Whatever balance of percentages truly is a "short" position would suggest there are negative views on a stock held by some in the market and also would suggest that were the news flow on that stock to turn suddenly positive, "short covering" may spark a short, sharp rally in that share price. However short positions held as an offset against another position may prove merely benign.

Often large short positions can be attributable to a listed hybrid security on the same stock where traders look to "strip out" the option value of the hybrid with offsetting listed option and stock positions. Short positions may form part of a short stock portfolio offsetting a long share price index (SPI) futures portfolio - a popular trade which seeks to exploit windows of opportunity when the SPI price trades at an overextended discount to fair value. Short positions may be held as a hedge by a broking house providing dividend reinvestment plan (DRP) underwriting services or other similar services. Short positions will occasionally need to be adopted by market makers in listed equity exchange traded fund products (EFT). All of the above are just some of the reasons why a short position may be held in a stock but can be considered benign in share price direction terms due to offsets.

Market makers in stock and stock index options will also hedge their portfolios using short positions where necessary. These delta hedges often form the other side of a client's long stock-long put option protection trade, or perhaps long stock-short call option ("buy-write") position. In a clear example of how published short percentages can be misleading, an options market maker may hold a short position below the implied delta hedge level and that actually implies a "long" position in that stock.

Another popular trading strategy is that of "pairs trading" in which one stock is held short against a long position in another stock. Such positions look to exploit perceived imbalances in the valuations of two stocks and imply a "net neutral" market position.

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

Finally, a simple fact is that the Australian Securities Exchange also keeps its own register of short positions. The figures provided by ASIC and by the ASX at any point do not necessarily correlate.

FNArena has offered this qualified explanation of the vagaries of short stock positions as a warning to subscribers not to jump to any conclusions or to make investment decisions based solely on these unqualified numbers. FNArena strongly suggests investors seek advice from their stock broker or financial adviser before acting upon any of the information provided herein.

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The Wrap: Auto Retail, Aged Care & Housing

Weekly Broker Wrap: automotive retailers; aged care; housing; and listed property.

-Slump in new vehicle sales augur poorly for dealerships -As Royal Commission rolls on, M&A a source of opportunity in aged care -House prices surge in Sydney & Melbourne as residential building approvals fall to 6-year lows -David Jones to be more "aggressive" in its strategy to downsize

By Eva Brocklehurst

Automotive Retailers

New vehicle sales data for August from the Federal Chamber of Automotive Industries showed a fall of -10.1%. Rolling annual sales were down -8.1%. However, JPMorgan notes that August was cycling a tough comparable and from September easier comparables will be cycled.

Nevertheless, this was a reversion to a double-digit decline. On a year to date basis, passenger vehicle sales were down -15.9%, sports utility vehicles (SUV) down -3.8% and light commercial vehicles down -4.1%. SUVs remain the most popular segment, making up 45% of new vehicle sales.

When adjusting new car sales by dealerships in operation over the 12 months in each state, UBS calculates that new car sales volumes in the month were down -5.0% for Autosports Group ((ASG)) and -8.8% for Automotive Holdings ((AHG)).

There were mixed results for the Autosports brands, as Audi turned around in NSW, recording a 27% lift in August after a -45% drop in July. BMW was strong in Victoria, Mercedes-Benz and Honda recorded declines nationally and Volvo was flat.

The broker notes the largest decline in private car sales since April 2017 occurred in Western Australia, down -14.6%. New car sales in Western Australia comprised more than 30% of Automotive Holdings' volumes.

Aged Care

JPMorgan observes residential aged care providers are hoping the Royal Commission recommendations will inspire the federal government to introduce reforms that support sustainability. The broker suspects investors will steer clear of the sector as the Royal Commission rolls on.

Sector consolidation and M&A remain a source of opportunity, as the weaker groups struggle to survive, potentially offering the prospect of buying facilities that are below the cost of development. All listed residential aged care providers expect a material reduction in reported profit in FY20. Generally, the providers anticipate a -5-15% drop in reported operating earnings (EBITDA).

The interim report of the Royal Commission is due in October but this is not expected to provide a likely direction for the final recommendations, as it will focus on the state of the industry rather than required reforms.

Housing

UBS observes house prices appear to have returned to boom times. CoreLogic data shows a surge of 0.8% in August, the largest monthly gain since April 2017. The year-on-year fall has reduced to -5.2% from -6.4%.

Units rebounded more than houses and the recovery is being led by Sydney & Melbourne. Nevertheless, the broker points out the number of home sales are still down to a 23-year low, down -19% year-on-year.

Residential building approvals, which have fallen to a six-year low, are a negative lead for consumption, while renovation activity remains resilient.

Morgan Stanley believes a seasonal pick up in turnover will be the key test for the near-term, regardless of the acceleration in house prices. The broker is also watching the construction cycle for any spill-over into employment and economic activity. Auction clearance rates averaged 70% nationally in August, which Morgan Stanley believes indicates a tight housing market and near-term upward pressure on prices.

Morgan Stanley assesses there will be a potential undersupply of housing into 2021. The broker's proprietary data is still not pointing to a rebound for housing in the medium term, as key components such as credit supply, rental

conditions and the supply/demand balance are weak.

UBS expects the Reserve Bank of Australia to cut official rates by -25 basis points in October and in February 2020, given the ongoing per-capita recession and global weakness. Moreover, if house prices continue to rise at this pace, regulators could resort to reinstating macro prudential tightening.

Listed Property

South Africa's Woolworths Holdings has taken out an onerous lease provision worth \$22.4m against upmarket retailer David Jones and aims to reduce the floor space for David Jones by -20% by 2026. The company's Country Road network is also looking to rationalise its footprint.

David Jones was originally intending to reduce its footprint upon the expiry of its flagship Market Street, Sydney, lease but will now be "more aggressive". The stated intention is to have fewer stores and less space in lower demographic areas, exiting any marginal or undesirable leases.

As smaller stores are a key component of the new strategy of David Jones, Macquarie expects a handing back of floor space to occur, as well as store closures. With similar programs from Myer ((MYR)) and Big W ((WOW)), which are downsizing by -20% and -16%, respectively, backfill appears difficult.

Lower-quality centres are more likely to have limited backfill options. Macquarie considers this a negative item of news for the listed property sector. More favourable rental terms for retailers are also a headwind.

The broker retains Underperform ratings on Scentre Group ((SCG)). Scentre Group is exposed to 17 David Jones stores while Vicinity Centres ((VCX)) has five, Stockland Group ((SGP)) has one and GPT ((GPT)) has four. GPT remains the broker's preferred large cap retail property exposure.

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Strong Prospects For Freedom Foods

Freedom Foods offers strong prospects for growth from its dairy and nutritional products but are expectations too optimistic?

-Specialist dairy products to underpin margins in FY20 -Strategy to avoid daigou channel appears vindicated -Has peak capex occurred, or is more growth expenditure likely?

By Eva Brocklehurst

It's all happening for Freedom Foods ((FNP)), with strong growth across existing and new products, an expanded distribution profile and upgraded facilities. The company's portfolio has significant leverage to healthy eating and drinking trends.

New product streams from nutritionals, such as lactoferrin, are expected to make a material contribution in FY20 and growth is expected to come from the scaling up of new facilities and production of higher-margin dairy products. The company has prospects from the organic opportunities derived from its dairy, plant-based and allergen-free foods.

Unlike past practice, Freedom Foods has not provided formal sales guidance, although expects revenue and operating profits to increase. FY19 sales were slightly below guidance, albeit up 35%.

Morgans was encouraged by the performance of dairy and plant-based beverages, which appear to be scaling up. Strong demand is expected to continue across Australia, Asia and the Middle East. However, the broker also suspects consensus expectations in the outer years are too optimistic and lactoferrin prices will remain high despite significant new capacity coming on line.

Margins, in particular, in FY19 were disappointing for Morgans as overheads rose 66%. Capital expenditure was 45% higher than expected, largely because of items brought forward from FY20. UBS expects a combination of operating efficiencies and the contribution from lactoferrin & cream should underpin margin expansion into FY20.

Exports to China and Southeast Asia are the drivers of growth, with around 80% of new volume to be exported. Citi highlights the company is in the last stages of transforming into a branded food manufacturer and high-value dairy ingredient producer from a low-margin contract manufacturer. Higher returns are expected going forward as a result.

Freedom Foods has, historically, resisted the temptation to leverage the high-margin daigou (local purchase of goods for China) channel in order to sell into China, with a focus instead on alternative channels supported by its office in China and local partnerships. Citi believes this strategy has been vindicated, given the adverse impact that China's new e-commerce laws have had on Bellamy's Australia ((BAL)) and Blackmores ((BKL)) in their sales to China.

Milk Supply

The company has emphasised that price and volumes for FY20 milk supply are contracted and has managed to contract around 400m litres in milk supply for FY20. Freedom Foods has a direct sourcing model which locks farmers into long-term, fixed-price contracts, but will have to pay higher prices for new suppliers commencing in the second half of FY19.

Citi considers the company well-positioned in a higher price environment for milk, although points out competition remains fierce. There have been reports of some processors offering higher prices to attract farmers in Victoria and others have been offering advance payments.

Capital Expenditure

Citi calculates a three-year rolling return on invested capital of 8% in FY19, in line with the cost of capital. This suggests the benefits from the company's expenditure are beginning to materialise.

Freedom Foods has largely completed the expenditure program to take UHT processing capacity at Shepparton to over 500m litres and yoghurt processing capabilities were completed at Ingleburn in the first half.

The production outlook has been helped by wetter conditions during winter in Victoria and southern NSW, with these areas now out of severe drought. These are the regions where the company currently sources the majority of

its milk.

Yet this remains a capital-intensive business. While investors will be relieved that Freedom Foods is now through its peak capital expenditure cycle, Morgans suspects another growth opportunity may loom and require additional capital, a situation that has occurred previously.

Specific guidance may not have ensued but UBS notes the company's option packages show a target of \$160m in aggregate operating earnings (EBITDA) over FY19-20. This implies that operating earnings of \$105m are required in FY20 to hit this target. The broker forecasts \$98m. Cash flow may have been weak in FY19 but UBS expects a marked improvement in FY20, given materially lower expenditure is likely.

There is no room for disappointment in the stock, Morgans suggests, given forecasts have been missed for a number of years. The broker assesses the extent of trade receivables that are past due rose to 22%.

While an improvement on the prior year, the magnitude is still considered too high. The broker suspects the receivables relate to Chinese and Southeast Asian customers and there is a risk these could continue to build as the company pursues growth in these markets.

FNArena's database shows two Buy and one Hold (Morgans) rating. The consensus target is \$6.05, suggesting 13.4% upside to the last share price.

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Buoyant Outlook For People Infrastructure

Brokers are excited as more than 70% of People Infrastructure's operating earnings are now derived from healthcare and IT, segments with the highest rates of expected employment growth over the next five years.

-Scope for further acquisitions -Significant beneficiary from NDIS -Multiple avenues for earnings growth

By Eva Brocklehurst

The outlook for workforce management company, People Infrastructure ((PPE)), is particularly buoyant as it has achieved strong earnings growth despite integrating six acquisitions over the past 12 months.

Returns are continuing to rise as the business focus shifts to high-margin areas and corporate overheads are amortised over increasing revenues. The company's profit in FY20 will be heavily skewed to healthcare & social services, 49%, and information technology, 20% - defensive and fast-growing industries.

Moelis considers the business is under-appreciated in this regard, as more than 70% of operating earnings are now derived from these high-growth and defensive verticals, which have the highest rates of expected national employment growth over the next five years.

The valuation is compelling, the broker suggests, with over 40% of earnings growth priced in at just a 14.5x price/earnings (PE) ratio. Moelis has a Buy rating with a target of \$4.06.

Morgans, too, likes the earnings growth profile, given the scope for further acquisitions and a supportive macro backdrop. The company expects continued organic growth across the business and reported strong revenue growth of 27% in FY19. Operating earnings (EBITDA), at \$17.8m, were up 42.8%.

The company will also be a significant beneficiary from the roll-out of the National Disability Insurance Scheme (NDIS). Morgans has an Add rating and \$3.83 target, valuing the stock using a blended PE multiple and discounted cash flow.

FY19 results met Ord Minnett's forecasts and the broker believes the upcoming year provides an opportunity for the business to leverage its expertise across health care. There are multiple structural tailwinds including enhanced disability funding, an ageing population and an undersupply of nurses.

On the IT front the company's capability is similarly favoured, as new technologies continually emerge and updates are a recurring theme. Technologies are often complex and rely on a high level of expertise to integrate.

Ord Minnett maintains a Buy rating and \$3.74 target. The company has delivered consistent earnings growth since its initial public offer. Each new acquisition has also opened up other geographies or verticals, and revenue synergies by cross-selling staff and/or expertise.

This is a key quality of the stock, in the broker's view, as there are now multiple avenues for growth in the next 12 months. The main driver of earnings is the staffing business, providing nurses and allied health professionals, but specialist services in payrolls, facilities maintenance and contract planting have also contributed.

See also People Infra Raises Profile In Healthcare on July 3 2019.

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Treasure Chest: a2 Milk Prioritises Diversity

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Changes to China's e-commerce laws have meant a2 Milk has revamped its strategy and margins are likely to suffer as a result.

-Direct distribution in China likely to require material investment in brand -Step down in margins could be permanent -Valuation remains highly dependent on success in China

By Eva Brocklehurst

As a result of changes to doing business in China, a2 Milk ((AZM)) has revamped its strategy, targeting a more diverse product, channel and geographical footprint going forward. Marketing costs and further investment in capability meant the recent FY19 result fell short of many expectations and the channel shift to direct sales in China was an emerging issue in the second half.

This change in mix is likely to accelerate in FY20, Bell Potter suggests, as shipments from Australia and New Zealand continue to demonstrate. Serving as a proxy for offline growth, there was 115% growth in Chinese-labelled product in FY19. There has also been a slowdown in daigou demand - purchases made in Australia for sale in China - following changes to Chinese e-commerce rules which came into effect in the second half of FY19.

Several companies have reported softer trading following the implementation of these new laws, although a2 Milk asserted there was minimal impact albeit, Credit Suisse highlights, on the interpretation that sales were pulled forward in the third quarter of FY19. Moreover, the broker points out that volatility in inventory levels makes it difficult to use export data to estimate top-line growth.

UBS observes the company is looking to corporatise - increasing channel capability and backing a US and Asian expansion. This is considered an expensive strategy and the future will be about tracking the return on investment, and whether it delivers more market share or just meets expectations. UBS expects a2 Milk's decision to "future-proof" growth should yield dividends in the long term.

Margin

The general view is that the transition to direct sales in China will result in an elevated gross margin that will counter the impact of rising marketing expenditure. Yet Bell Potter considers it more likely that marketing as a proportion of revenue will continue to rise while the change in margin is structural rather than a one-off.

Citi agrees that a step down in margins is likely to be permanent and expects further contraction over the medium term. Entities selling infant milk formula with a exposure of more than 90% offline have a material higher level of investment in brand than that of a2 Milk. Hence, as the offline presence of a2 Milk rises, a step change is envisaged.

Moreover those that service the channel have a materially larger personnel base compared with a2 Milk. The company's professional service fees were up significantly in FY19, as it leveraged external capabilities to drive growth ahead of investing in its cost base. Macquarie surmises there could still be cost savings as the company internalises some of the functions, given the high consultant margins.

a2 Milk has guided to flat gross margins and a -350 basis points compression in operating earnings (EBITDA) margins. The second half earnings margin of 28.2% compared with 35.2% in the first half. Credit Suisse is disappointed that operating earnings margin guidance for FY20 remains broadly consistent with the second half and agrees with the implication that non-marketing operating expenses will step up substantially.

Macquarie suggests the market will have to weigh up just how much the lower margin reflects more expensive revenue growth, as the company moves away from daigou, against the larger and better-understood market opportunity being sought through investment. Flat gross margins are an improvement on previous commentary regarding a decline, the broker adds, and to an acquirer this provides a more attractive business proposition given potential cost synergies.

Outlook

As China infant formula and US fresh dairy sales become important revenue growth drivers, Bell Potter expects the margin transition will be unfavourable and, while this may be necessary, it implies a structural change in the earnings profile that is not reflected in the current premium rating of the stock.

The broker points out that it would be very unusual if a company that is growing at 30% per annum, with an incremental contribution margin of around 40%, experienced a contraction in operating earnings margins, even if investing in capability, and questions whether consensus should have upgraded revenue growth assumptions for FY20.

Credit Suisse, too, is cautious about just when operating leverage will re-emerge for the company, and finds it difficult to assess the required investment in capabilities amid increased complexity related to a multi-channel approach.

Direct growth in China is largely being driven through "mother baby stores" and cross-border e-commerce channels. The broker suspects these direct sales are more resilient in nature versus the less-formal daigou trade but are also a higher cost-to-serve channel.

Meanwhile, the company is undertaking an extension of its portfolio in the US while deciding to exit the UK liquid milk market, given the insufficient opportunity to achieve scale. The latter will be wound down over the first half, although Macquarie notes this does not preclude the business pursuing UK or European markets at some stage in the future.

The broker also points out the company has stepped away from providing a break-even date for the US business, prioritising the market opportunity over near-term profitability. A structural gross margin issue is not envisaged in this market. Citi expects the US business to be an increasingly important driver of growth going forward, yet valuation is still highly dependent on the company's continued success in China.

Bell Potter, not one of the seven brokers monitored daily on the FNArena database, retains a Sell rating and target of \$12.25. The database has two Buy, three Hold and two Sell ratings. The consensus target is \$14.18, signalling 3.7% upside to the last share price.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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Treasure Chest: Value Exposed In Incitec Pivot

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Brokers welcome Incitec Pivot's new focus on its explosives business, which will be supported by technology and expansion of the Moranbah plant.

-Opportunity to re-rate the stock on a single explosives focus -Manufacturing excellence expected to provide additional \$40-50m in earnings -Value likely to come through higher explosives volumes and increased market share

By Eva Brocklehurst

Incitec Pivot ((IPL)) will focus on the earnings upside in its explosives business, which is expected to grow at higher rates than the market over the next 3-5 years. The company's confidence is supported by its technology and expansion of the Moranbah plant, where output will increase by a further 15% by FY22.

The company has also announced a geographic expansion into Chile. Large-scale capital expenditure is off the agenda and a US bond has been refinanced, which has removed some short-term risk.

At the investor briefing, brokers noted interest was also centred on the decision to review the fertiliser business. The review reflects a different priority being pursued for capital investment, as the company finds little aside from ammonia manufacturing that connects its fertiliser and explosives business.

Various options are being considered and the process is expected to take most of FY20. As fertiliser markets are at cyclical lows, there is a question about whether the timing is ideal. Still, Incitec Pivot is confident strategic buyers will be attracted to the business, although emphasised that, should a reasonable valuation not be obtained, a sale will not be pursued.

Credit Suisse believes the opportunity is straightforward: divest the volatile and structurally-weaker Australian fertiliser business and put capital into the explosives business. The broker considers the opportunity for re-rating the stock based on a single explosives focus is significant.

Manufacturing

The company will concentrate on improving the reliability of its manufacturing and de-bottlenecking the Moranbah plant to create incremental capacity. Credit Suisse believes the 15% increase in output at Moranbah from de-bottlenecking should be a high-returning opportunity.

Assuming fertiliser prices hold, Citi expects earnings (EBIT) to strongly rebound in FY20 to \$560m. Manufacturing excellence is expected to drive an additional \$40-50m in earnings and, with a 15% expansion of Moranbah and organic growth project returns of 10-15%, the broker assesses normalised earnings could reach \$630-650m.

All up, Macquarie calculates an effective opportunity to increase earnings by \$100m, although notes, so far, the performance over FY19 appears disappointing. While the production performance needs to improve, the broker acknowledges there is a clear plan for the next few years.

Incitec Pivot is confident the Waggaman plant in Louisiana has strong profit potential, despite the operating issues encountered in FY19. The main competitive advantage is the plentiful low-cost US natural gas, the primary feedstock for ammonia production, of which the US is a net importer.

The company expects above-market growth in quarry & construction and improved share in base and precious metals. Thermal coal production is expected to experience a slowdown in the rate of decline over the next five years.

Technology

Technology, including the company's Delta E emulsion and the EZshot electronic detonator, is expected to provide a significant reduction in emissions, lowering mining costs and increasing safety.

UBS assesses shifting customer demands in both farming and mining are now dependent on technology and data and that carries unique considerations for capital deployment.

The company's blasting technology is based on developing products that are compatible with current mine plans. Hence, UBS believes Incitec Pivot can realise value through increased volumes, growth in market share and

productivity-sharing arrangements with customers.

Macquarie points out this has been validated by the \$25m technology alliance agreement between Dyno Nobel Asia-Pacific and BHP Group ((BHP)) in an effort to catch up with Orica's ((ORI)) lead in explosives technology.

While acknowledging the positive potential in explosives as mining demand normalises, UBS still believes market dynamics and re-pricing are likely to weigh on earnings growth and operating leverage. The stock is at 3-year lows and Citi reiterates a Buy rating, assessing the risk/reward has now turned favourable, given a probable upturn in seasonal fertiliser demand.

FNArena's database has four Buy ratings and three Hold. The consensus target is \$3.41, suggesting 11.0% upside to the last share price.

See also Incitec Pivot Mulls Fertiliser Strategy on September 3 2019.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

FNArena is proud about its track record and past achievements: Ten Years On

August 2019 Verdict: Strength From The Few

Dear time-poor reader: Some stats and reflections on a corporate reporting season that might have been the worst in a long time.

In this week's Weekly Insights:

-August 2019 Verdict: Strength From The Few -Rudi Talks -Rudi On Tour

August 2019 Verdict: Strength From The Few

By Rudi Filapek-Vandyck, Editor FNArena

On the micro-level, a failed or splendid financial performance release can have a noticeable impact on a company's share price up to three months down the track.

On the macro-level, recent observations suggest beats and misses can set new trends for sectors and broad themes, or keep the momentum going for longer.

With the August reporting season revealing more weakness, and most performance disappointments, from laggards and cheaply priced companies, the obvious conclusion might be it remains way too early to predict the downfall of highly priced, rapidly growing performers.

Patient investors in lagging building materials companies, retail landlords, listed professional value investors and small cap financials might have to be patient for longer.

If I restrict my memory to the past two years, investors turned cautious and sceptical ahead of the February reporting season in 2018, but were subsequently blown away by results released by Appen, Altium, WiseTech Global, CSL, ResMed and most other highly popular, High PE growth stocks which then re-launched the momentum for Growth in the share market until the following August, when the scenario pretty much repeated itself.

We recall that CSL shares rallied no less than 15% after updating its financials that month, which only broadly met expectations at the time.

Then followed a nasty and volatile downturn. By February this year, the previously virtually untouchables, including ResMed, CSL, etc, started releasing financial reports that either missed expectations or proved merely OK. This then, of course, begged the question: has the time finally arrived for cheaper priced "value" stocks to have their moment under the sun?

It turns out, that swing in momentum hardly made it into August. Even miners and energy companies merely showed their weaknesses throughout last month, disappointing on multiple levels except when larger dividends and share buybacks had been announced, which in itself poses a few questions regarding operational performances against cost controls and boards inclined to offer compensation.

General weakness in commodity prices exacerbated the weakness in share prices. Right at the cut-off of reporting season, nickel popped up as the against-the-general-trend exception, alongside gold.

As things turned out, corporate Australia is in a vulnerable state with plenty of sectors battling multiple headwinds. Against this background, good old bricks and mortar retailers delivered the stand-out, positive surprise in August. Their performance was matched by the High Quality names of CSL, ResMed, REA Group, Altium, WiseTech Global, Goodman Group, Charter Hall, and numerous others.

But nothing can mask the cold hard impartial observation that August 2019 marks the weakest reporting season since August 2013, when FNArena started keeping detailed records and stats. We didn't know it at that time, but August 2013 was a pretty weak reporting season. August this year has, for the very first time since we keep records, generated more "misses" than "beats" in the corporate results releases.

If we combine the recent reports with the fact that both preceding reporting seasons in 2019 (February and March-July) only saw total "beats" equalling "misses" on each occasion, one can only conclude things are incredibly tough and challenging for large parts of the Australian economy. Judging by the latest update, the broad trend is not improving either.

We can all but wonder what exactly the impact could have been on the local share market if the general background was not made up of central banks loosening policies, including the RBA, and a global investment community thirsty for yield. A weakening Aussie dollar will be keeping hopes alive that more of the benefits will start showing up in the six months ahead.

August Report Card

Few will criticise or deny, some of the strongest performances in August were released by CSL ((CSL)), WiseTech Global ((WTC)), AP Eagers ((APE)), Infomedia ((IFM)), IPH Ltd ((IPH)), James Hardie ((JHX)), Magellan Financial ((MFG)), Medibank Private ((MPL)), Pro Medicus ((PME)), and ResMed ((RMD)).

Special Note: none of these companies fall into the category of cheaply valued stocks.

Strong performing retailers include Accent Group ((AX1)), JB Hi-Fi ((JBH)), Baby Bunting ((BBN)), and Shaver Shop ((SSG)) while all companies in car leasing and salary packaging came out solidly too with Smartgroup ((SIQ)) and McMillan Shakespeare ((MMS)) taking sector honours.

Companies that proved the doubters wrong include Bapcor ((BAP)), Treasury Wine Estates ((TWE)) and Lendlease ((LLC)).

Companies that in particular disappointed include Boral ((BLD)), Brambles ((BXB)), Bellamy's ((BAL)), Blackmores ((BLK)), Cimic ((CIM)), Citadel Group ((CGL)), Cleanaway Waste Management ((CWY)), Costa Group ((CGC)), CYBG ((CYB)), G8 Education ((GEM)), Ingham's Group ((ING)), Insurance Australia Group ((IAG)), Orora ((ORA)), Pact Group ((PGH)), and Virtus Health ((VRT)).

But nothing compared to the Big Question Mark that is now attached to Pioneer Credit ((PNC)), Smiles Inclusive ((SIL)) and Speedcast International ((SDA)). Serious questions also persist for Corporate Travel Management ((CTD)), Collection House ((CLH)), and Virgin Australia ((VAH)), while patience must be running out for shareholders in value-investors on the wrong side of history, including Platinum Asset Management ((PTM)) and Perpetual ((PPT)).

Miners and Energy producers largely failed to impress, delivering rather mixed performances with positive stand-outs delivered by Santos ((STO)) and Origin Energy ((ORG)), as well as some of the coal producers, but the sector offered plenty of disappointment including from Iluka Resources ((ILU)) and BlueScope Steel ((BSL)).

Among High Growth, High PE names a2 Milk ((A2M)) surprised against the trend negatively, on the need for increased investment, and Domino's Pizza (DMP)) has ceased providing guidance, having now missed it three reporting seasons in a row. IDP Education ((IEL)) got punished severely, which also happened to Nearmap ((NEA)) shares. Jumbo Interactive ((JIN)) experienced similar, but that lasted but a brief moment.

Plenty of potential turnaround stories delivered yet more evidence any turning around might require a lot more time, and maybe a good chunk of luck too - see also last week's Weekly Insights. Financials in particular stood out with plenty of weak results.

Investors should be aware market speculation has it Westpac ((WBC)) is considering raising additional capital in order to prevent having to cut its dividend while recent regulatory tightening by APRA has singled out ANZ Bank ((ANZ)) as possibly most at risk from forthcoming regulatory tightening in New Zealand. This is why shares in Commbank ((CBA)) and National Australia Bank ((NAB)) have been the better performers in the sector recently.

See also "Capital Controls Another Knock To Banks" published on Tuesday:

<https://www.fnarena.com/index.php/2019/09/03/capital-controls-another-knock-to-banks/>

(Most) Trends Are Negative In Australia

In terms of underlying trends, the momentum in earnings forecasts is negative, was negative prior to and during August and is expected to remain negative in the lead-up to the February reporting season next year. According to AMP's chief economist Shane Oliver earnings downgrades during August have dominated by more than two to one versus upgrades.

Earnings downgrades have been greatest among energy stocks, financials, telcos and industrials. Ultimately, the dial stopped at 1.5% growth in earnings per share for FY19, but without resources it was negative: -2%. Forecasts for FY20 have now fallen to an average of 6.3%, but it shouldn't surprise to see this halve, or worse, by this time next year.

Oliver also reports only 58% of companies have seen earnings rise from a year ago compared to 77% this time a year ago. In addition, only 49% of companies raised their dividends, well below the norm of 62%, while 28% of companies cut their dividends, the most in the last seven years.

FNArena counted 65 upgrades in stock-specific recommendations in relationship to released profit reports, while 71 downgrades were issued. The average consensus price target rose by 2.49% throughout the month. As stated earlier, never before did we witness a local reporting season wherein more companies missed expectations than managed to beat them. The final percentages stand at 24.4% (77 companies) "beats" versus 25.3% (80) "misses".

Historically, the near 2.5% increase in targets doesn't look too bad (but it hides the sharp bifurcation behind the average) while total misses are on the high side. The percentage in "beats" is the lowest recorded for any reporting season since 2013.

CommSec & UBS

Some additional insights are worth highlighting from analyses published by CommSec and UBS to wrap up the August reporting season. CommSec limits its research to constituents of the ASX200 of which 138 released full year numbers in August and 31 others published interim reports. UBS stays within the boundaries of those stocks that are actively covered by its own analysts.

A high number of 92% of companies reported statutory profits, on CommSec numbers, which is above the long term average of 88%, but only 52.2% of those companies managed to grow their profits. More companies -88.4% versus the average of 86% elected to pay a dividend to shareholders.

CommSec reports the 52.2% is better than the February reporting season earlier in the year when only 48.6% managed to grow profits from a year earlier. February marked the second lowest percentage on this measure since 2010, only beaten to the downside by August 2011.

In aggregate, revenues lifted by 6% but expenses (costs) rose by 6.8%. And while dividends increased by 4.9%, CommSec numbers reveal aggregate cash generated fell by -0.1%. Also, dividends in total only grew because companies including Rio Tinto, ASX, Coles and Medibank Private paid out special dividends. Excluding these, aggregate dividend payments fell by -0.6%.

Of those companies paying out a dividend, 21.3% cut the dividend and 23.8% kept dividends unchanged. The 54.9% that chose to pay out a higher dividend represents the smallest proportion in around six years on CommSec data. All in all, these numbers suggest it has been a tough six months, if not twelve months for corporate Australia, which is also the view of CommSec.

Analysts at UBS are decisively more blunt about it, calling August "a reporting season to forget". The weakest in six years, on UBS's assessment, and the timeline only stops there because that's when the current team starting gathering stats and records. Incidentally, CommSec suggests it may well have been the weakest season on record for the past decade.

Maybe we should simply call it possibly the worst performance we all have witnessed in Australia post GFC?

FY19 achievements were generally weak, highlights UBS, but on top came generally soft forward guidance. The upgrade-to-downgrade ratio for August stopped at 0.6; the lowest in five years. A minority managed to trigger noticeable upgrades to forecasts. Most results were followed-up with reductions.

UBS still thinks FY20 forecasts remain too high, in particular for Financials, but the analysts also concede ultra-low interest rates do offer compensation.

UBS was mostly pleased by the fact that 36% of large cap companies beat expectations on dividends, while only 15% missed. Playing the Devil's Advocate here, is this not merely a sign these boards felt they had to put in an extra effort to compensate for disappointment elsewhere?

The trend in earnings revisions remains decisively negative and UBS highlights once again Resources remain the offset while Industrials ex-Financials are currently trending well below average. For Financials, current negative EPS revisions are the worst since the GFC on UBS's numbers.

Post revisions, market consensus now expects 6.3% market EPS growth in FY20, with strongest outlook for Resources (+9.2%), then Industrials ex-Financials (+8.4%), with Financials (+3.7%) the weakest.

UBS thinks the more realistic outcome will be for 3% EPS growth, supported by Resources, implying Industrials, but more so the banks and other Financials are likely to remain subjected to downward trending forecasts.

Share Market Valuation

The August reporting season is unlikely to stop the public debate about whether share prices are too richly priced, or not. On FNArena's observation, index weakness in August and in early September means only a minority of the circa 400 active ASX-listed stocks in our database are trading above consensus target.

While this includes regular and obvious offenders such as WiseTech Global, Cochlear and Altium, it also applies to portfolio staples such as Woolworths ((WOW)) and Wesfarmers ((WES)). In broad terms, most ASX-listed stocks that are on most investors' radar are trading below consensus target.

The obvious comment to make here is that none of these targets incorporate the prospect of an economic recession, here in Australia or elsewhere. Given ongoing risks globally, this is something investors should bear in mind. Ditto for prospective earnings growth potential and dividends.

If we look at where the Big Four banks are at, we notice CommBank shares are trading solidly above target, while National Australia Bank is above and Westpac close but below its target. ANZ Bank is the current laggard in the sector leaving a gap of a little less than -4%.

Assuming the Big Four can still be used to assess investor sentiment in general, I'd be inclined to suggest overall sentiment remains elevated, but not extremely so. Given risks have definitely risen for local banks, also see above, there is but a fair argument to be made share prices should be lower, not higher in the short term. Whether this also applies to the share market in a broad sense is likely to be determined by macro factors and uncertainties.

Craig James and Ryan Felsman, economists at CommSec, agree with my assessment that Australian shares may not be as bloated on valuations as it may seem at first sight, also considering central bankers in support and exceptionally low bond yields. CommSec expects the All Ordinaries to range between 6700-7000 by year-end, while the ASX200 is expected to range between 6600-6900.

UBS analysts note High PE Growth companies have been among the better performers in August, both on results and in share prices, which means the Top End of the Australian share market is now trading on an average Price-Earnings (PE) ratio of 25x, a new cycle high.

All-Weather Portfolio Performance

In line with all of the above, the FNArena/Vested Equities All-Weather Model Portfolio significantly outperformed the broader share market in August with several portfolio constituents posting sizable rallies upon releasing financial results. Only a small number genuinely disappointed.

Whereas the ASX200 Accumulation Index dived deep in the red, and recovered somewhat during the final days of the month, to post a -2.36% loss following a positive performance of 2.94% in July, the All-Weather Portfolio posted gains of 2.95% in July and 0.47% in August.

The combined performance for the All-Weather Portfolio over the first two months of the new financial year is thus 3.43% compared with 0.52% for the ASX200 Accumulation Index.

As reported last week, we made several changes to the Portfolio to reduce the cash balance, while increasing exposure to yield/income, but not to the share market. More about this next week.

All-Weather Performers - Have Your Say

Several subscribers have approached FNArena in recent days with specific questions about stocks included in my selection of All-Weather Performers.

If you like me to address specific All-Weather Performers, or other companies included in the dedicated selection on the website, you can send in a request via the website (preferred) or via email (info@fnarena.com).

I'll do my best to include requests in my writings in the coming weeks.

Addendum

FNArena updates daily on August Corporate Results via a dedicated section on the website:

https://www.fnarena.com/index.php/reporting_season/

See also:

-The Quality Of Quality Continues To Show

<https://www.fnarena.com/index.php/2019/08/28/the-quality-of-quality-continues-to-show/>

-August Reporting Season: Early Signals

<https://www.fnarena.com/index.php/2019/08/22/august-reporting-season-early-signals/>

-August Reporting Season: Early Progress Report

<https://www.fnarena.com/index.php/2019/08/15/august-reporting-season-early-progress-report/>

-August Preview: Lower Rates & Lower Growth

<https://www.fnarena.com/index.php/2019/08/08/august-preview-lower-rates-lower-growth/>

Rudi Talks

Audio interview from last week:

<https://www.youtube.com/watch?v=F7gKYUtt50A>

Rudi On Tour In 2019

-AIA and ASA, Perth, WA, October 1

In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday and Tuesday 2 & 3 September 2019. It was published on the Tuesday in the form of an email to paying subscribers, and again on Thursday as a story on the website. There will be no Part Two this week).

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In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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