WEEK 43

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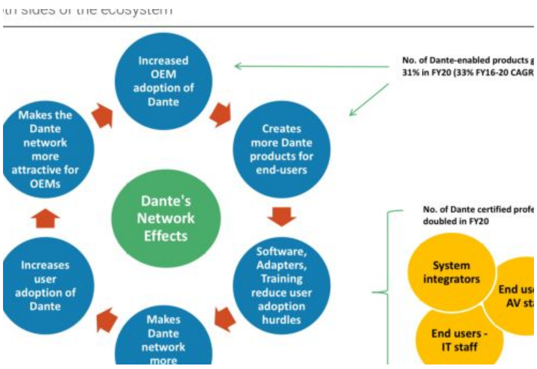
Friday, 23 October 2020



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AUSTRALIA

Audinate Forging The Future

As investors increasingly focus on technology companies, it is timely to review the investment thesis for Audinate.

-Audinate is the global standard in digital audio networking
-Network effects are becoming more relevant
-Target prices increase after company update

By Mark Woodruff

Technology has become a key focus for investors in recent years, despite remaining a small portion of the broader Australian share universe.

This interest culminated in the formation of the ASX All Technology Index back in February this year, just prior to the pandemic-induced meltdown.

Despite this hiccup, the value of the index has climbed to 2,650 points from approximately 1,800 points upon listing. Over the last three months the index has added $33 billion in value. Appearing in the top ten by market capitalisation are names including Afterpay ((APT)), Altium ((ALU)) and Appen ((APX)).

Stockbroker Shaw and Partners believe Audinate Group ((AD8)) should be included amongst this august group of A's when thinking of impressive Australian technology companies. While significantly smaller in size, the company is already included in the All Technology Index of 58 companies. However, the broker warns some semblance of caution is required until clarity around earnings transpires.

The company's product, named Dante, has attained the position as the global standard in digital audio networking and has a significant addressable market with limited competition.

Audinate - A Users Guide

When the following definitions and examples are used in conjunction with the diagram in Figure1 (below), it should help to clarify Audinate's products and business niche. Ultimately this will assist in illuminating the overall investment thesis.

Audinate has three business segments audio, video and software. The company is leveraging its audio dominance into synergistic verticals with a combined total addressable market (TAM) of over one billion dollars.

Dante replaces point-to-point audio and video connections with easy-to-use, scalable, flexible networking. Networked AV (audio visual) technology is a relatively new concept. It uses the power of the network to distribute content wherever it is needed.

Dante has been adopted by hundreds of original equipment manufacturers (OEM) in thousands of professional products. When any audio or visual system is installed for commercial use it is referred to as Pro-AV. The company's clients are the largest global OEM's including Bose, Yamaha, Shure and Sony, who sell Pro-AV products (speakers, amplifiers and mixers) to system integrators. As an illustration, end users include universities, corporates, convention centres, theatres, stadiums, zoos, theme parks, recording studios and houses of worship.

Finally, the term AVoIP or (AV over IP) stands for "Audio-Visual over Internet Protocol". Essentially, it is the transmission of audio-visual data over a network such as a LAN, WAN, or the internet.

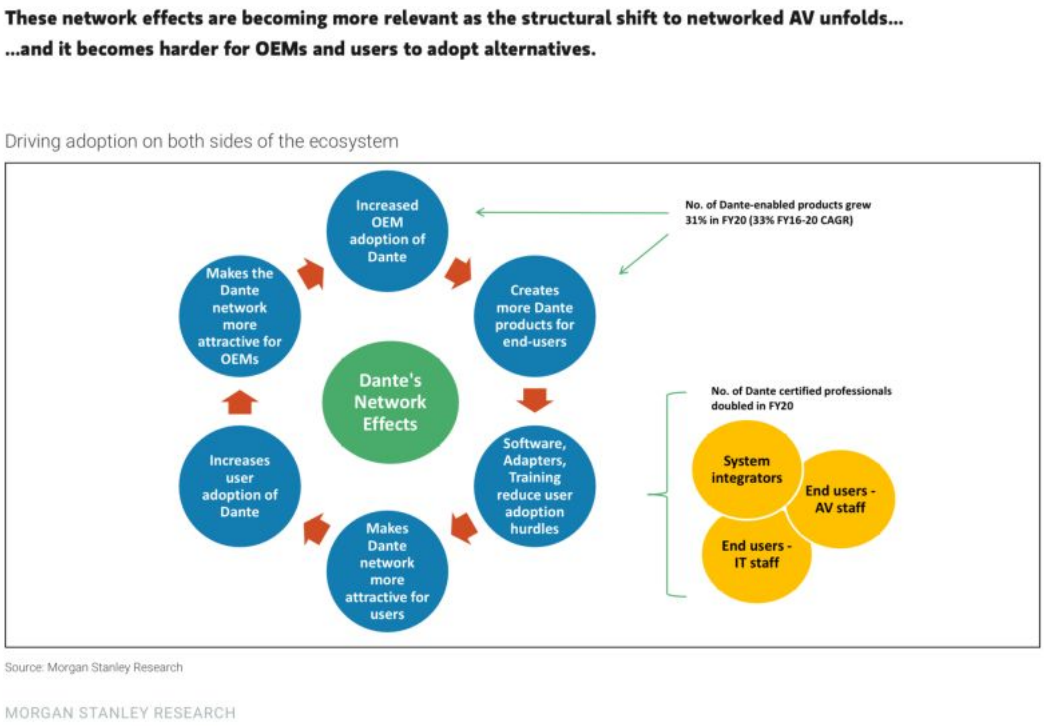
With traditional audio visual setups, wires and cords only add complexity to the presentation. As an example, presenters sharing the same stage must share plugs and cords. This creates delays and potential technical difficulties.

Wireless presentation technology enables a new approach to meeting collaboration by allowing attendees to plug in to the meeting wirelessly and participate in ways that had previously only been imagined. The cables are not based on circuits but packets. With this technology, you do not have to place receivers at every device.

Network Effects

Network effects are becoming more relevant for the company as the structural shift to networked AV unfolds and it becomes harder for OEMs and users to adopt alternatives, according to Morgan Stanley.

Networks are one of the most powerful competitive advantages a business can possess. Strong network effects make it difficult for businesses to be replicated, enabling long-term pricing power.



Outlook and Focus on Growth

Back in July when the company raised $40m of capital, UBS felt the right strategic steps to emerge stronger had been taken.

And now, with growth opportunities ahead across all three segments, Morgan Stanley thinks Audinate will be running the business for growth, not profitability, in the coming years.

The broker suggests the competitive position is improving, but transitory headwinds have masked underlying earnings power. It's considered top-line re-acceleration will occur from FY22 and this is being underestimated by consensus views. Also, the structural growth story remains intact and risk-reward is compelling at these levels, according to the analysts.

UBS also believes the focus should be on growth metrics and the company has an opportunity during covid-19 to step up cost reinvestment to further entrench its competitive moat. This could put pressure on short term earnings. However, the broker's Buy rating is predicated on a greater than twelve month view.

The robust balance sheet at financial year end and stronger-than-expected operating cash flow for FY20 appealed to Shaw and Partners when releasing a late September update. The broker made special mention of the first indications for merger and acquisition activity potential, either in software, platforms or video.

First Part Of The Investment Thesis - Networked AV adoption

Morgan Stanley believed Audinate's growth trajectory has been rebased materially lower by the market, prior to a recent first quarter update.. However, recent industry feedback and decision-making clearly showed the broker the networked AV growth trend should continue. Over the past two to three years, there has been over 20% growth.

Having seen structural shifts evolve in other categories like VoIP and cloud computing, the broker has conviction in the longevity of the networked AV migration.

According to a September survey published by commercialintegrator.com, readiness to fully embrace AVoIP has significantly increased in 2020 from 2019. And this readiness has been and will continue to be reflected in more networked AV installations, asserts Morgan Stanley.

The broker believes covid-19 has further accentuated the benefit of networked AV versus incumbent solutions, and the industry is not going back. Customers are increasingly looking for quality, flexibility, and scalability in their AV infrastructure to address whatever the "new normal" looks like.

The analysts explain there is a natural transition that will take place to continue adoption. It's considered once Dante has been integrated in one product, incremental integrations get easier and become part of an OEM's future product roadmap.

Audinate is also assisting in the acceleration of adoption by making new Dante implementations available (such as software). This will make it even easier and more cost-effective for OEMs to integrate, explains Morgan Stanley.

<u>Second Part of The Investment Thesis – Competitive Positioning</u>

A lower forecast revenue trajectory by the market implies little conviction that Audinate's competitive position is getting better, explains Morgan Stanley. Additionally, there is little belief the company will continue to take market share when conditions normalise post-pandemic.

However, the competitive position is fully intact and the company's ecosystem (see network effects diagram above) is clearly strengthening, according to the broker. Dante-enabled product registered 31% growth in FY20 and the company's interoperable product ecosystem is now eight times that of the nearest competitor (Cobranet). Additionally, Dante certifications doubled in FY20 after also doubling in FY19.

Canaccord Genuity agrees and says despite the number of projects system integrators could bid on falling away, OEM partners are advancing the number of networked products released to the market. As a result the company reported the largest six month increase of networked products in the second half of FY20.

Continued ecosystem growth should enable the company to continue taking market share. The analysts at Morgan Stanley have forecast compound annual growth rate (CAGR) for Dante units at 25% for FY20-23.

Networked AV still makes up small percentages of total OEM product portfolios. This implies to the broker plenty of ecosystem growth.

Also, Dante training is delivered live via on-demand videos. Training is important to for competitive positioning, highlights the broker, as it keeps users in the Dante ecosystem and creates lifetime value.

UBS agrees the company can strengthen its competitive position through industry Dante/digital AV training and further entrenching the Dante network (2,804 products as at June 30). Additionally, the broker highlights the video and software opportunity, with "encouraging" progress of early licensees.

<u>Final Part of The Investment Thesis - Revenue Upside</u>

While Audinate is not immune if the entire industry is not spending, once that returns Morgan Stanley expects the company to capture a much larger share with expanded adoption. The broker's projection of 23% revenue CAGR for FY20-23 is materially is backed by adoption growth and still below medium-term guidance of 26-31%. However, if recent industry volume estimates are to be believed, there is potentially another 20% upside to the FY23 revenue forecast.

Morgan Stanley thinks the market has not appreciated the link between Audinate's growth in underlying monetisation potential (which is independent of cycles) and future earnings power.
Instead, up until the first quarter results the market had extrapolated forward estimates from transitory near-term headwinds and what FY21 growth looked like.

Market share growth is a main driver of the broker's conviction. However, it's considered additional upside will result from continued progress in video and software. These will likely also contribute to revenues in FY23.

The broker does temper FY21 estimates slightly, but factors in normalisation in FY22. This is driven by an industry rebound, but more significantly, by Audinate continuing to compound OEM/user adoption, driving those market share gains.

To counter the above positivity, Shaw and Partners focus on the covid-19 impact. Due to the slowdown in economic activity, many infrastructure facilities which were formerly likely to use Dante are now shut.

However, the broker points out the various operating expense levers the company has the ability to 'flex'. This includes employees, marketing, travel, administration, corporate, discretionary and other costs. Previously, R&D/engineering expenses were forecast to double over the next two years. The analyst suggests this is an easy cost to curtail until conditions improve.

First quarter update (on 15/10/2020)

The first quarter update shows transitory headwinds are abating, says Morgan Stanley, resisting the 'I told you so' urge. The broker previously had the highest target price and recently reiterated an Overweight rating based on underappreciated industry adoption and competitive position. It was considered consensus had underestimated the sharpness of a potential rebound. Morgan Stanley retains a price target of $7.50.

Sales are back to pre-covid levels, which in UBS' view de-risks FY21 revenue forecasts. The result was considered particularly strong given the challenging macro conditions and the revenue for the highest value product (Brooklyn) was significantly down year-on-year (impacted by live events). Additionally, with new project activity returned, the company will re-commence the previously planned reinvestment into the cost base. However, the broker cautions it is unclear whether the first quarter result may have been driven by a short-term boost from education and corporate outfitting (adapting to the new covid-19 "Zoom" environment). An alternative interpretation is audio fit-out projects are coming back and digital is taking market share, explains the analyst.

Whatever the case, UBS believes the long-term opportunity remains intact and lifts the target price to $8.00 from $7.35.

In upgrading Audinate's target price to $8.00 from $5.30, Credit Suisse now has an increasingly upbeat view of corporate/education growth to offset live events challenges. Selected products such as Adapters, Ultimo, Broadway and Retail Software are experiencing "strong growth" versus FY20.

Corporate (not live events) is the biggest end market for Pro AV and the broker believes corporate penetration is likely to see structural acceleration post covid. Flexible/remote working and reduced business travel are considered to be accelerating structural growth in corporate audio/video requirements (particularly unified communications). As a result, the analyst can still see an ample penetration opportunity, from which Dante is well placed to benefit.

Monthly sales have been steadily improving sequentially, with the worst of the covid-19 impact appearing to have passed, thinks Credit Suisse. Dante increasingly appears to the broker as the de-facto networked audio standard which drives penetration in audio. In addition, further opportunities are expected to exist across video and services.

Canaccord Genuity had not updated it's stance at the time of writing to incorporate Audinate's first quarter update. However, the broker believed the e current share price weakness presented an opportunity to incoming investors who can take a long-term view given the company's deep tech expertise (which is limited on the ASX), market leadership position and incremental growth at elevated earnings (EBIT) margins.

While acknowledging the better-than-expected first quarter sales figures, Shaw and Partners would be be more positive in buying the stock under $6.00.

In a slightly scathing assessment, the broker would like to see the company improve its earnings transparency to the market, with more quantifiable measures and detailed key metrics that can be tracked and compared.

However, the analyst believes it is 'a ripper of a story' with compelling attractions and a clear earnings runaway. Shaw lifts its 12 month target price to $7.25 from $5.75.

FNArena's database has two Buy ratings and one Hold (Credit Suisse) for Audinate. The consensus target is $7.83, suggesting 17.6% upside to the last share price.

Both Canaccord Genuity (Buy/Target $5.70- pre first quarter update) and Shaw and Partners (Hold/Target $7.25) are not part of the group of seven brokers monitored daily on the FNArena database, but appear in the wider FNArena universe in The Australian Broker Call *Extra* Edition. This additional news report is updated "regularly" depending on availability of suitable quality content.

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

AUSTRALIA

Delays, Missteps Jolt Confidence In Rio Tinto

Delays stemming from the pandemic amid ebbing demand conditions confront Rio Tinto, while there is also work to do to improve perceptions about its cultural sensitivity.

-Easing demand conditions suggest commodity inventory may build
-Risk mounts at Oyu Tolgoi
-Is the market underestimating potential changes to WA Heritage Act?

By Eva Brocklehurst

Rio Tinto ((RIO)) has called out an expansion of lockdowns stemming from the second wave of coronavirus that may threaten a global recovery. The company has indicated most economies are starting to slow as pent-up demand eases back.

While anticipating a strong performance in the fourth quarter from major seaborne iron ore producers, easing demand conditions are likely to mean inventory builds. Shaw and Partners asserts, if stock is building at Chinese ports, then the situation needs to be closely monitored.

Consumer demand remains the biggest risk for the December quarter, UBS believes, and Europe and the US could pay the price for "summer mobility" during which several countries lost control of coronavirus case numbers.

This is key to the outlook, Morgans agrees, as the potential for further global macro economic weakness stemming from the pandemic may impinge on demand for commodities.

Rio Tinto has also flagged weakening demand for iron ore as China's consumption eases back from record highs and scrap consumption increases . Pilbara shipments fell -5% in the quarter, to 82.1mt, largely because of port maintenance.

Mined copper production was down -2%, stemming from lower grade at Kennecott (US). Refined copper was -57% lower, primarily because of delays in restarting the Kennecott smelter. Titanium dioxide production was down -9% because of pandemic restrictions in Quebec and South Africa, and lower demand.

Attention is riveted on Mongolia, Morgans observes, as its government has rejected an updated feasibility study for the Oyu Tolgoi copper/gold mine without a reason, and there is material political risk for this important copper asset.

Goldman Sachs also envisages technical issues at Oyu Tolgoi, noting partner, Canadian-listed Turquoise Hill Resources, has provided a recent update that was negative compared with its estimates.

There are potential delays to first production from Winu (WA) copper because of discussions with traditional owners that have only just resumed since the pandemic halted travel. The company has re-started talks with the Guinean government to look at infrastructure sharing at Simandou, while the Zulti South (South Africa) mineral sands project extension is on hold.

Meanwhile, Morgans notes demand conditions are better for aluminium, which is encouraging, and the price environment for alumina/aluminium has improved. Still, Rio Tinto's Pacific Aluminium operations remain uncertain, experiencing sustained losses. The company has indicated if it cannot secure affordable energy sources it will have to take further steps to mitigate the impact.

Iron Ore

Buoyant iron ore prices are the main driver of the stock, Macquarie asserts. Free cash flow yields increase to more than 15% in the spot price scenario for 2021/22. Iron ore shipments are expected to be 324-334mt for 2020.

Rio Tinto has indicated all four Pilbara replacement mines are on schedule. Pilbara's production increased 4% in the September quarter with higher volumes from Yandi and Hope Downs. Cost guidance is US$14-$15/t and unchanged, although Macquarie notes there is some risk because of a stronger Australian dollar.

Ord Minnett believes the stock is trading on an attractive price and points to the dividend yield but acknowledges the **short-term challenges in navigating cultural heritage that could have consequences in terms of production, capital expenditure and reserves**. Nevertheless, the broker believes the likely impact will be small relative to the size of the company.

Cultural Sensitivities

There are likely to be ramifications for Rio Tinto from the reform of the Aboriginal Heritage Act in Western Australia and the company is changing the way it approaches such heritage sites.

Shaw assesses it will require time to reinvigorate shareholder confidence. While Rio Tinto was a pre-eminent global miner for decades it has, since 2000, sustained several missteps which have, both culturally and in terms of dubious acquisitions, tarnished its reputation.

Rio Tinto is consulting on the range of options and supports an appeal to give greater voice to traditional owners in the decision-making relating to mining on their land. Several brokers believe the market is underestimating the potential effect on production and costs from this reform.

Goldman Sachs envisages elevated risk for the company in this area, with possible impact on future approvals in the Pilbara as well as production and capital expenditure. Citi points out an update on any potential impact is unlikely until late January 2021.

Shaw and Partners, not one of the seven stockbrokers monitored daily on the FNArena database, has a Hold rating and $99.99 target while Goldman Sachs, also not one of the seven, has a Neutral rating and $97.10 target.

There are three Buy ratings and four Hold on the database. The consensus target is $107.14, signalling 11.5% upside to the last share price. Targets range from $95 (Credit Suisse) to $121 (Ord Minnett). The consensus dividend yield on present FX values for 2020 and 2021 is 6.4% and 7.4%, respectively.

AUSTRALIA

Divestment Of SAEC Critical For South32

South32 has reinstated its buyback program, having built up cash reserves after a solid performance in the September quarter, while kicking off 2021 unencumbered by South Africa Energy Coal is considered critical to the outlook.

-Buyback could be extended
-FY21 production guidance maintained
-Dependent on recovery in key commodities

By Eva Brocklehurst

Metals and coal producer, South32 ((S32)), sustained a strong performance in the September quarter but the main news in its report was the reinstatement of the buyback as a result of the build up in net cash to US$368m.

The buyback could be extended in February, Credit Suisse suggests, anticipating the company could complete the remaining US$121m of the current program by December. UBS also anticipates the buyback will be completed at the end of the year and a top-up possible at the interim results in February.

The Hermosa (Arizona) pre-feasibility study has now slipped to the June half and Credit Suisse assesses timing of first production will also move out, albeit with a greater understanding of both the Taylor and Clark deposits and the prospect of greater scale as these are developed in parallel.

Morgans is reluctant to make assumptions about Hermosa, ahead of the pre-feasibility study, given the few details available, but believes an up-scaled project will be worth waiting for.

A decision on the Eagle Downs (Queensland) metallurgical coal project is on track for the December quarter, but UBS does not expect the company will progress the opportunity, given the attractiveness of its existing resource base. Shaw and Partners also suspects South32 will choose not to proceed, and concludes this would be the most “favourable” outcome.

Plans are afoot at Illawarra Coal to extend the Dendrobium coking coal mine, with a final decision in the second half of FY21. Shaw considers this a positive development as it will extend returns from existing invested capital, although the projected returns are not stellar.

SAEC

FY21 production guidance is maintained, with the exception of South Africa Energy Coal (SAEC) where the company is now expecting the lower end of 10.5-12.5mt production in the first half. South32 expects a resolution on the future of SAEC by the end of the year.

UBS suspects the company is attempting to push regulators to a final decision on outstanding conditions and will, if this is not forthcoming, consider closure. Morgans, however, expects the competition tribunal will approve the deal, although acknowledges a positive outcome from public utility Eskom is harder to ascertain.

Divestment of SAEC remains a critical factor behind the broker's investment thesis, as a **successful offloading of what has been a difficult asset will boost earnings quality and shrink the overall workforce meaningfully**. There is potential for a re-negotiation of the sale to Seriti Resources before closure, a common occurrence in South Africa, Macquarie points out.

Goldman Sachs calculates the sale should deliver a $0.11 per share uplift in value. The broker remains positive about metallurgical coal, manganese and alumina prices in 2021, noting these commodities represent over 50% of the company's operating earnings (EBITDA). The cost reduction program could also result in further upside in FY21.

The September quarter was favourable across most of the company's commodities, manganese was up 19% with the South African unit at full production. The Worsley (Western Australia) alumina refinery is also nearing nameplate, expected in FY21.

Macquarie notes guidance for Hillside (aluminium, South Africa), where discussions around the new power agreement with Eskom are ongoing, and Mozal (aluminium, Mozambique) does not assume any impact from load-shedding.

In manganese, the company intends to divest TEMCO (Tasmania), with approval subject to the Foreign Investment Review Board. Metalloys (South Africa) remains on care and maintenance.

Over the next 12 months Morgans expects South32 will close its price discount as manganese, nickel and aluminium continue to recover. In contrast, Macquarie believes there is downside risk to earnings at spot prices, calculating earnings decreasing -17% in FY21 and -7% in FY22.

Of the seven stockbrokers not monitored daily on the FNArena database Shaw and Partners has a Buy rating with a $3.00 target while Goldman Sachs retains a Buy rating and $2.90 target.

FNArena's database has six Buy ratings and one Sell (Macquarie). The consensus target is $2.66, signalling 22.4% upside to the last share price. Targets range from $3.00 (Credit Suisse, Ord Minnett) to $1.90 (Macquarie).

AUSTRALIA

Cochlear On The Mend But Recovery Unclear

Implant volumes in Cochlear's major markets appear to be on the mend, which is supportive of revenue, but concerns are emerging regarding another bout of elective surgery restrictions.

-First quarter rebound largely stemming from a backlog
-New candidate pipeline filling but is it enough?
-Little clarity on timing of recovery in emerging markets

By Eva Brocklehurst

Growth in developed markets has returned for Cochlear ((COH)) in the first quarter of FY21, amid both rescheduled and new surgeries. Implant volumes are stemming from the major market recovery as activity in emerging markets is at a standstill.

While health systems across the globe are preoccupied with the pandemic, non-paediatric surgery has to give way to more pressing procedures. Moreover, several brokers note the resurgent coronavirus cases, particularly Europe, could result in another downturn in elective surgery.

Despite implant volumes falling -14% in the September quarter the company reported just a -6% drop in revenue, reflecting the strong growth in higher-price developed markets, specifically the US, Germany and Korea.

Macquarie is positive about the stock, given this shift in mix towards more expensive markets. While surgery in China is growing, other emerging countries are substantially down on volumes. The broker's investment view is based on the scope for above-industry unit sales and market share gains as a surgical procedures resume.

Credit Suisse now assumes implant unit sales decline -10% in the first half while services & acoustics revenue is on a positive trajectory and should return to pre-pandemic levels by the first half of FY22.

Pace Of Recovery

There is little clarity regarding the expected pace of recovery in emerging markets, where volumes declined -40% in the quarter, UBS points out. Despite robust operating assumptions going forward, including sustained implant sales growth of 7% and processor upgrade penetration reaching 60%, the broker continues to derive a price target well below the share price, at $175.

The new candidate pipeline is filling and Goldman Sachs is encouraged but with the company not in a position to provide guidance and the recovery appearing to lag many other stocks in the sector, considers this a less-assured road to recovery.

The broker's concerns stem from the **disproportionate reliance on the adult/senior cohort** and a larger negative correlation to further outbreaks of coronavirus and/or restrictions on surgery.

Furthermore, a backlog was built up through March to May and this has been largely delivered. Hence, a lack of late-stage pipeline candidates now exposes Cochlear to risk centred entirely on new demand. Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, has a Sell rating and $165 target.

Ord Minnett suggests fears the early uplift in implant numbers would purely reflect catch-up have not been realised, as the company has reported most recent surgery in key markets came from newly-identified patients and lead generation remains solid.

The broker lifts forecast to reflect a more rapid recovery in revenue, with a significant increase in expected earnings in FY21, but with the stock trading close to its historical high maintains a Lighten rating.

Yet Wilsons, also not one of the seven, assesses the glass is half empty when it comes to implant numbers, observing the increase in the first quarter volumes was more about clearing the backlog.

The broker finds no evidence organic demand has recovered, particularly within the adult/seniors cohort in the developed world, and a primary determinant of earnings and valuation over the next year or so is the propensity of these cohorts to seek treatment.

Wilsons maintains a Market Weight rating with a target of $228.95 and believes **the next major processor launch, Nucleus 8, could be the catalyst to become more positive about the stock, valuation permitting.**

Credit Suisse remains cautious about the rate of recovery particularly because of the rise in coronavirus infections in the northern hemisphere and the likelihood further restrictions will be reimposed in coming weeks. The broker considers it unlikely a strong rebound in sales will occur in FY21 and it will take time for the market to clear the backlog in demand.

Meanwhile, the company will reinvest any additional benefits from the government's R&D tax incentive into growing its business in FY21. The main areas of investment will be the pipeline of products & services, referral channels in developed markets, direct-to-consumer marketing and expansion in emerging markets.

FNArena's database has two Buy ratings, two Hold and three Sell. The consensus target is $206.05, signalling -7.3% downside to the last share price. Targets range from $175 (UBS) to $241 (Macquarie).

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AUSTRALIA

Strength From Diversity Underpins BHP Group

A softer performance is likely over the December quarter for BHP Group but brokers remain confident the company can meet FY21 guidance, underpinned by key commodities.

-Activity in Dec quarter likely affected by maintenance, weather
-Robust fundamentals underpin the stock
-Olympic Dam expansion shelved

By Eva Brocklehurst

BHP Group ((BHP)) beat broker estimates on copper, iron ore and petroleum in the first quarter but has flagged a subsequently softer performance in all three. Coal, on the other hand, lagged expectations.

Brokers believe the company can meet FY21 guidance, which is unchanged. Expenditure on Jansen (Canada) potash has increased to US$3bn and an investment decision is slated for mid 2021.

Shaw and Partners believes the scorecard in the September quarter has provided enough cover for what could be some shortfall in the December quarter stemming from maintenance and weather.

Earnings upgrade momentum remains strong, in Macquarie's view, as the stock is trading on 13% free cash flow yields at spot prices, while Goldman Sachs has a positive view on growth options across oil, copper and metallurgical (coking) coal.

The broker also believes BHP will "win in the Pilbara" in terms of capital expenditure, margin and free cash flow compared with rivals Rio Tinto ((RIO)) and Fortescue Metals ((FMG)), after the ramp up of South Flank (Western Australia).

Ord Minnett also retains a slight preference for BHP based on a steady operating performance and attractive valuation, while Morgans highlights a strong combination of robust fundamentals (earnings, yield & gearing) and solid top-down market exposures (currently iron ore, copper and a recovery in coal, energy).

Softness Ahead?

The company has indicated the iron ore volumes in the December quarter will be affected by activities tying in South Flank with the Mining Area C rail spur as well as maintenance at the port. FY21 guidance for shipments is unchanged 276-286mt.

Credit Suisse notes **sentiment around iron ore has eased in the past month as port inventory has slowly risen,** while steel margins remain low and finished steel inventory elevated. Iron ore continues to perform well for the company but pricing is likely to drive sentiment over the short term, the broker adds, retaining a slight preference over Rio Tinto because of greater commodity diversity.

Petroleum volumes in the Gulf of Mexico could be softer as the company has flagged potential for a more intense hurricane season, while tie-ins for the Ruby project will affect Trinidad and Tobago. The additional acquisition of a 28% interest in Shenzi, taking BHP's stake to 72%, is expected to be finalised by the end of the year.

FY21 guidance unchanged 95-102mmboe which does not reflect the acquisition. Goldman Sachs expects Trinidad and Tobago will provide a large share of future petroleum growth for the company.

Copper weakness will stem from fewer workers at Escondida (Chile) which is likely to continue at current levels for the December quarter, with production expected in a range of 1.48-1.65mt.

Metallurgical coal guidance for FY21 is 40-44mt and the company has previously announced it will look at exiting metallurgical assets at the BMC joint venture as well as its NSW and Cerrejon (Colombia) thermal assets.

Macquarie believes the exit process could take up to two years with de-merger a possibility. The first quarter was affected by plant shutdowns at Queensland coal wash plants and ongoing industrial action at Cerrejon means coal volumes are under review. BHPis also monitoring the potential impact of China's import restrictions on coal.

Olympic Dam

The expansion of Olympic Dam (South Australia) has been shelved, with BHP citing complexity in the orebody, where grades are highly variable, and higher capital constraints.

The company will move away from the BFX expansion project and focus on de-bottlenecking, plant upgrades and infrastructure modernisation. However, resource definition drilling at the nearby Oak Dam copper prospect will commence in the first half of 2021.

Credit Suisse was not surprised at the company's decision on Olympic Dam, given there was minimal commentary recently around growth opportunities at the site. Production hit a five-year record in the September quarter but there is no change to guidance given the refinery crane work being planned for the March quarter.

Morgans worries Olympic Dam will drag on earnings quality and valuation, with the company appearing committed to a large-scale, low-return copper mine, which creates confusion given the strategy of "value over volume".

The broker suspects that the site sits outside the company's capital allocation framework because it offers scale in a preferred commodity (copper) and copper assets are hard to come by.

Among those stockbrokers not monitored daily on the FNArena database Goldman Sachs retains a Buy rating with a $41.50 target while Shaw and Partners has a Buy rating and $40.00 target.

The database has six Buy ratings and one Hold (Citi). The consensus target is $40.81, signalling 13.2% upside to the last share price. The dividend yield at present FX values on FY21 and FY22 forecasts is 6.1% and 5.8%, respectively.

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Orora Surprises With Growth In North America

Orora has strengthened its packaging business in North America in the first quarter, with earnings growth that surprised to the upside, while Australasia remains flat.

-Earnings recovery gaining momentum
-Re-rating to come from sustained improvement in North America
-Australian beverage division affected by poor wine vintage

By Eva Brocklehurst

Orora ((ORA)) has combatted the restrictions created by the pandemic by strengthening its business through enhancing and expanding products & services, achieving earnings growth in North America in the first quarter which surprised several brokers.

In contrast, Australasian beverages were in line with the prior corresponding quarter while there remains scope to invest in new capacity and expand offshore. No formal earnings guidance was provided at the AGM.

Orora Packaging Solutions has stabilised, brokers note, and future growth is expected to be underpinned by the digital transformation. Meanwhile, Orora Visual continues to build its value proposition.

Taking advantage of the economic disruption, the company bought raw materials in the June quarter to use rebates and improve subsequent margins while also cutting 100 personnel. Orora has increased its sales of personal protective equipment and the SAP system is no longer impacting on productivity.

Credit Suisse now expects modest growth in FY21 and upgrades estimates by 10% across the forecast period, also upgrading the valuation of the packaging distribution business, which it describes as a rare asset that could surprise in terms of transaction value.

Goldman Sachs assesses the earnings recovery has gained more momentum, although considers this largely captured in the share price, retaining a Neutral rating and target of $2.69.

The broker, not one of the seven stockbrokers monitored daily on the FNArena database, believes the share price adequately balances a stronger short-term outlook with concerns surrounding execution risk in North America.

Morgan Stanley agrees Orora is well-positioned, although acknowledges the poor wine vintage in Australia will affect the second half. With defensive earnings, a strong yield, capital management and upside for North America, the broker asserts the current multiple presents attractive value.

North America

Orora remains committed to improving its North American business, which accounts for 37% of Macquarie's FY21 earnings (EBIT) estimates, rather than selling it. While the recent quarter showed positive momentum, the broker wants evidence this is being sustained.

With management clearly signalling intentions to pursue growth, the broker believes this must come from organic initiatives as M&A is limited.

UBS suspects the recent restructuring in the US will help offset the challenging market conditions from the pandemic and the pending presidential election, and expects North America will deliver EBIT of $85m, up 10%.

Any re-rating, therefore, will need to be derived from a sustained improvement in North America where the broker suspects investor confidence is low following several periods of underperformance.

Australasia

UBS is attracted to the Australian beverage division as the business holds a dominant position in a defensive duopoly and there are significant barriers to entry. In Australian beverages Macquarie forecasts flat segment earnings in FY21.

The outlook for wine-related glass is tough, as the grape vintage is reduced and exports subdued. Greater clarity on the wine sector outlook is required as China's tariff uncertainty continues. Orora is also open to adjacent growth opportunities in Australasia and the broker notes potential for further domestic expansion in cans and offshore.

FNArena's database has six Hold ratings and one Buy (Morgan Stanley). The consensus target is $2.73, suggesting 0.4% upside to the last share price. The dividend yield on FY21 and FY22 forecasts is 4.2% and 4.6%, respectively.

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COMMODITIES

Material Matters: Industrial Metals On The Rise

A glance through the latest expert views and predictions about commodities. Commodity hierarchy; batteries; platinum group; and coal.

-Demand for industrial metals growing strongly
-Nickel likely the biggest beneficiary of battery demand
-Silver highly leveraged to a global recovery
-Platinum surplus expected to continue
-Talk of coal "ban" creates volatility

By Eva Brocklehurst

Commodity Hierarchy

A weak US dollar, better views on global growth and stimulus fuelling Chinese demand are all playing an important role in broadening the recovery for commodities. Hence Morgans is encouraged for the resources industry beyond just **precious metals** and **iron ore**.

Most **base metals** are now performing and some **energy** resources are showing signs of recovery. The broker prefers **copper** as prices have quickly rebounded to pre-pandemic levels. The second choice is **oil** as the supply response has now reached a point where the market is back in balance and should recover to a more typical trading range of US$50-70/bbl. In third place is **gold**, which is retaining its position as a safe haven purchase, aided by low bond yields and a weaker US dollar.

In terms of stocks, Morgans retains **BHP Group** ((BHP)) as a top choice, given its favourable mix of commodity exposures. The broker, noting **South32** ((S32)) appears undervalued, continues to believe patience is required. Morgans has an Add rating for all three large oil & gas producers with **Santos** ((STO)) the top pick.

ANZ Bank strategists expect **industrial metals** will continue to perform as fiscal stimulus is fuelling investor appetite and the market is tightening. Moreover, increased focus on renewable investments is boosting sentiment for metals as a shift towards a low-carbon world is more metals intensive.

Disruptions to mine supply have played a role in offsetting the weakness in demand resulting from subdued economic activity. The strategists note iron ore prices are once again reflecting changes in underlying industrial demand, which has rebounded strongly throughout the second half of 2020. This is providing a strong signal for the direction of the Australian dollar.

The strategists point out, for the first time since 2018, the commodity complex (a composite of iron ore, oil, gold and copper) is approaching the top of the Australian dollar correlation structure.

Chinese **steel** production has risen during the pandemic, filling a hole left by other countries. Hence, demand for raw materials is showing up in Australia's trade numbers which signals that total iron ore exports are expanding.

Moreover, manufacturing, rather than services, has been at the centre of the recovery, as goods trade and construction have rebounded much faster than household-facing industries. Hence industrial commodities have rallied strongly compared with their "soft" counterparts.

Battery Metals

Morgan Stanley lifts forecast for electric vehicle sales, expecting penetration rates of 13.2% globally by 2025 and 31% by 2030. This takes into account EU proposals for a -50% reduction in average fleet emissions of carbon dioxide by 2030, China's target of a 25% penetration rate for new electric vehicles by 2025 and California's ban on internal combustion engine sales by 2035.

This is bullish for battery commodities but the mix of technology has broadened and, hence, Morgan Stanley finds it less certain which cathode types will dominate the market by the end of the decade. **Cobalt** will continue to be thrifted from **nickel/cadmium/manganese** batteries in favour of higher nickel use.

Lithium/iron/phosphate batteries are gaining share at the lower cost end of the market, particularly in China, and their quality, safety and energy density are improving. **Lithium/nickel oxide** batteries are also being developed while Tesla's new **lithium/manganese/nickel oxide** technology has been unveiled and could be commercialised as early as 2022/23.

Morgan Stanley expects nickel will be the biggest beneficiary of battery demand while strong supply growth means the lithium market will be well supplied. Electric vehicles already account for 41% of global demand for lithium.

Infrastructure requirements are expected to further boost copper demand in the sector as well. Lastly, manganese, often overlooked, could grow significantly with development of the Tesla technology.

Despite the higher demand, Morgan Stanley still expects major lithium providers will not outperform without a meaningful improvement in prices. A price recovery will eventually materialise, but it is likely to be limited. Lithium is an abundant material and several experienced operators are already investing in capacity expansion and reducing costs.

Platinum Group

Silver remains highly leveraged to a global recovery and Citi forecasts prices will rise another 70% to US$40/oz over the next 12 months. Sustained investor demand and a recovery in industrial consumption during 2021 should underpin silver.

If there is significant easing of policy and a relatively rapid global recovery amid sharply declining US real rates than the broker considers silver may rise to US$50/oz by mid 2021. Conversely, if growth remains weak and there is a lack of policy easing, prices are likely to decline to around US$20/oz.

While expecting silver will outperform gold over the medium term, Citi remains bullish on gold tactically over the short term and structurally over the medium term. Silver is more leveraged to any overshooting of inflation along with rebounding manufacturing activity.

Meanwhile, **rhodium** is expected to lead **palladium** prices higher amid tight supply. Citi is bullish for palladium prices for the next 6-12 months, expecting the market will move back into deficit. The broker notes, on the back of the recent rally in gold, rhodium and palladium, South African miners have enjoyed historically higher margins and have ramped up operating capacity.

Citi assumes an 11% recovery in global automotive demand in 2021 with a sharp rebound in US and European sales. Stricter emissions standards are also set to drive growth in autocatalyst demand.

Yet accelerated growth in pure battery electric vehicle sales poses a threat to demand over the longer term, particularly for palladium. As a result, strong growth in battery vehicles may contribute to autocatalyst demand peaking over the next 3-5 years.

Platinum is expected to stay in surplus until 2023, when substitution of palladium into platinum in gasoline vehicles becomes significant. Citi assumes 10% substitution by 2023. Despite the large surplus, the broker expects investment demand will remain buoyant and tighten the market, supporting platinum prices reaching US$1100/oz by the end of 2021.

Coal

Talk of a potential "ban" on Australian **coal** to China spooked the market, Macquarie notes, as it came just ahead of the winter buying surge and at a time of rising Chinese prices. China's raw coal production has scarcely grown recently because of the clampdown on illegal capacity in Inner Mongolia.

Despite no official notice from authorities, Macquarie's feedback suggests restrictions on Australian coal are being enforced with various end-users confirming Chinese customers have cancelled cargoes.

Macquarie believes it worth noting a similar policy was implicitly enforced in 2019, with volumes of both metallurgical (coking) and thermal coal exports from Australia falling to almost zero in the fourth quarter. This rebounded with new quotas in 2020.

The broker highlights the fact that Australian hard coking coal is hard to replace and if China were to ban imports from Australia it would come at a significant cost to its steel industry. In the case of Australian high-ash thermal coal, this can be easily replaced with both Chinese and seaborne material.

ESG FOCUS

ESG Focus: Covid, The Aftermath - Part 2

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:
https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

In Part 1 of this series, FNArena examined the massive post-covid stimulus - the division between clean aid and dirty aid - and the broad directions of funds. In this article we examine the rise of the S in ESG, stakeholder capitalism and the acceleration of Modern Monetary Theory onto the global economic stage and its links to ESG.

ESG Focus: Covid, the aftermath - Part 2

-MMT to fund social and environmental investment - behold the rise of the State and stakeholder capitalism
-How to balance the issuance of covid stimulus against inflation, moral hazard and corruption
-Big institutional investors expect covid will accelerate ESG investing

By Sarah Mills

The new normal

Covid-19 is forcing a recalibration of the world's investment markets.

The production of a safe vaccine is the only scenario under which the world is likely to return to any kind of normal, but even then the shock to the economy and the chain of events set in train will, combined with broader global policies, set the world on a new trajectory.

Covid-19 will strengthen forces already in play, accelerating changes in trade, technology, finance and economic policy.

Much of this article focuses on the rise of the "S" in ESG, the role of post-covid Modern Monetary Theory (MMT), and how ESG fits into this big picture. It's a long read but it's a broad subject. In our next article, Part 3, we will focus on the broader investment impact of these trends on the E, the S (Social) and the G, as well as the likely winners and losers.

Recession and lay-offs sharpen focus on inequality

One of the most interesting effects of covid-19 has been to propel issues of inequality and wealth distribution to the top of the political agenda as the recession and high unemployment pressure governments around the world to attend to the "S" in ESG.

Covid is expected to increase social inequality (a key ESG theme) with developing economies proving particularly vulnerable given pandemic concerns are likely to accelerate another ESG-related trend of corporate on-shoring and continue to hamper international tourism.

These economies were also more vulnerable under an ESG roll-out given the push to remove slavery from supply chains.

There are multiple reasons for the sudden focus on social issues.

Even prior to covid-19, many speculated that a massive recession was imminent. Marx's capitalism-threatening surpluses bloomed as China industrialised.

Then there is the impending fourth industrial revolution, which is expected to further increase surpluses (of all kinds) while destroying old industries; not to mention the potential for new technologies to replace jobs (possibly before new jobs are created).

Then there is the potential for big data, extended networks and economies of scale to concentrate more power in the hands of fewer organisations (which reduces competition and employment - and hence consumption, which is necessary to mop up the surpluses).

On top of this, serious environmental concerns and the shift to a circular economy represent a further threat to business-as-usual consumer spending and the value of capital in some industries.

But it is global demographics that are proving the biggest bugbear. Ageing populations typically exhibit reduced consumption.

The combination of all of the above is resulting in a state of affairs known as secular stagnation, a situation of rising inequality and falling global growth – a recipe that could upend the status quo.

Grappling with this problem is a key preoccupation for policymakers. One of the solutions has been to propel social concerns to the top of the policy agenda.

The State is expected to take a more central role (as we have seen post-covid); universal basic income has been mooted; and more immediately evident is a dramatic transformation of monetary policy to fund new ESG-related infrastructure such as a circular economy, renewables and recycling.

New age of stakeholder capitalism

Given the ideology of the day favours a private over a public approach to solving social problems, much of the post-covid stimulus is likely to be channelled to corporations that address key gaps in social services by way of grants and loans, rather than to governments as service providers.

This is likely to result in a sharp increase in "social" corporations, or social enterprise, which we discuss in Part III of this series.

Of particular interest is that recipient corporations of government and ESG fund investment (both green and social) will be answerable to more than just shareholders, as will other non-recipients as legislation and regulation tightens in response to social concerns.

The Economist's Schumpeter and CBNC suggest the post-covid focus on social inequality may have serious implications for investors.

In particular, they point to the sudden rise of the "growing stakeholder" approach.

This trend has been dubbed **stakeholder capitalism** and *The Economist's* Schumpeter is scathing of the concept, arguing that it is not efficient to serve so many masters.

CNBC also notes the trend's growing influence post-covid.

"All this goes under increased number of stakeholders," says CNBC.

"As a function of government intervention, or just moral persuasion, shareholder value in the form of share buybacks, and dividend payments may be less prioritised …

"Some companies have already cut dividends as some of the hardest-hit struggle to stay afloat, and buybacks are also expected to slow this year. Longer term, the 'shareholder first' attitude may prove a thing of the past."

"Or, as JPMorgan sums up: 'Covid-19 is accelerating the trend of stakeholder capitalism and challenger shareholder primacy'."

Sceptics doubt that it will eventuate. Then again, they also doubted the oil price would plunge to US$20 a barrel. It is a new world in which nothing is certain.

But for the cautious, the early ESG catchcry of "who cares wins" is holding sway.

Grand ambitions require grand funding – enter Modern Monetary Theory

From whence will this massive social funding come? From where it has always come – the printing presses.

Covid-19 has accelerated the adoption of Modern Monetary Theory, with printing presses whirring around the world to crank out enough money to fund the new social and environmental enterprises.

"A profound shift is now taking place in economics as a result, of the sort that happens only once in a generation," reports *The Economist* in one of many articles discussing the subject.

"Much as in the 1970s when clubby Keynesianism gave way to Milton Friedman's austere monetarism, and in the 1990s when the central banks were given their independence, so the pandemic marks the start of a new era.

"Its overriding preoccupation will be exploiting the opportunities and containing the enormous risks that stem from a supersized level of state intervention in the economy and financial markets."

The role of the State

A key policy difference between pre and post-Covid MMT will be the elevation of the State given the increasing impotence of interest rates to re-fire the economy and the moral hazards associated with free money.

Because rate rises often cause indiscriminate unemployment, supporters advocate placing more power in the hands of regulators to break up monopolies to stimulate productivity and loosen supply constraints, or to assiduously use taxes to control demand and debt obligations.

Increasing fossil fuel taxes has been mooted as just one option (noting that the global fossil fuel industry attracts global subsidies of US$400bn a year). Investors will need to keep a close eye peeled to the tax environment.

Yes, the State may be being asked to take a more central role but its intervention is likely to be more as a financial intermediary and regulator rather than as a service provider to reduce the risk of political corruption, which many observe distorts markets and hampers growth.

"Today the task for policymakers is to create a framework that allows the business cycle to be managed and financial crises to be fought without a politicised takeover of the economy," notes *The Economist*.

Some use the analogy of the old Wool Floor Price Scheme to help visualise the manner of government intervention. Under the scheme, the government stabilised farmers incomes, protecting them against volatility. They are also likely to use taxation as an inflation lever and, of course, print money.

Supporters of MMT advocate mechanisms such as job guarantees, by which the government creates jobs for the unemployed, and seed funding for social projects (using models recently developed that only extend further funding if the service is widely adopted) and support for circular-economy oriented manufacturing and adoption.

Mental health and health innovation (think biotechs) are two social examples. A healthier population is a more productive population.

MMT in a nutshell

In a nutshell, the idea is that if the government prints and borrows in its own currency, it has the power to recoup that money by printing more money to pay its creditors and fund spending.

It can also use its tax base, as always, to repay debt, particularly if the money is used internally in domestic employment, (think on-shoring or industries that primarily serve the domestic market such as recycling). Another option is issuing fixed-rate bonds at low interest rates.

The story goes that by printing money and creating jobs, the government increases consumer spending, which then absorbs some of those pesky capital surpluses.

"The main constraint on government spending is not the mood of the bond market, but the availability of underused resources, like jobless workers," notes *The Economist*.

And taxes are likely to be the go-to tool, along with interest rates, to manage inflation.

"*Spending is the accelerator, taxation the brakes.*"

The theory is that, so long as supply exceeds demand, inflation can be kept in check.

Given 4IR, an ageing population, the shift to a circular economy, corporate onshoring, and the covid-triggered demand collapse, this does not appear to be an imminent problem.

The risks are high – grand experiment

Critics deride MMT as a reckless experiment, describing it as "voodoo economics".

Some of the world's greatest minds, including Nobel prize-winners note the mathematics supporting the theory are weak and claim the theory is ideologically driven – an extension of Milton Friedman's monetarism.

They also cite modern macroeconomists' tendency to dismiss facts to support their theories, a case in point being that unemployment during recessions is said to be caused by choice, rather than overwhelming evidence that most are fired.

On the other hand, many monetarist theories have proved correct, such as the power of interest rates to affect inflation.

Inflation, moral hazard and corruption

The key risks are inflation, moral hazard and corruption.

Starting with inflation, printing money is not, in and of itself, the issue, nor is it new.

Modern Monetary Theory appears to be an extension of new Keynesian ideas.

Ever since the abandonment of the gold standard as a monetary system in 1971, and even before, it has been recognised that a country's wealth is largely a function of the productivity of its people (which can be affected by technology and the availability and distribution of resources, etc).

An economy is, essentially, a function of human existence, driven by human dynamics, and printing money has often been used to regulate economies with some success.

But on very notable occasions, such as in post-WWI Weimar Republic, Zimbabwe, Brazil, Argentina, Venezuela and Chile, printing money has triggered hyperinflation, raising nightmarish visions of wheelbarrows full of money being exchanged for a loaf of bread, the collapse of society and values, and in some instances, war.

MMTers, however, note that the massive quantitative easing in recent decades (in both Japan and the West) has not resulted in an increase in inflation.

Rather, inflation has fallen as the deflationary effects of ageing populations outweigh the effects of quantitative easing, triggering a state of secular stagnation.

This is a situation wherein demand is below capacity even when the economy appears to be booming, and new technologies are boosting efficiency.

This partly explains *The Conversation's* observation that: "It is a major paradox that labour productivity, the most important source of long-run economic growth is actually rising much slower today than for decades, even though technological progress has seemingly accelerated."

MMTers also point to key differences between functioning modern economies and those that have suffered hyperinflation such as the WWI-damaged Weimar Republic, and those that lend money offshore, and countries that don't print their own currency. In the above cases, demand exceeded supply.

As noted above, MMTers argue that printing money is acceptable so long as supply exceeds demand.

Not everyone agrees – too many moving parts

MMTers argue that covid will trigger a long-term slump in demand (although detractors argue that demand could bounce with a vengeance, particularly given the size of the stimulus provided).

Detractors also point out the main differences between previous successful money-printing ventures in the past 70 years and quantitative-easing have been the relatively low debt levels of the past and the fact that the baby boomer generation was in its natural phase of rising productivity.

Analysts note that human productivity peaks at about age 47 and declines thereafter. The baby boomers, who triggered the biggest spending wave relative to GDP in history, are now in the thereafter.

Immigration (of persons aged roughly 18-30) is one way to increase productivity but very few developed countries have an appetite for increased immigration given the global economic malaise (except perhaps Australia and New Zealand), covid persistent infection concerns and the recent flood of immigrants into Europe from Syria.

Many MMT and ESG proponents point to the fourth industrial revolution as a key input in their favour.

Industrial revolutions typically seed long periods of economic growth, but the transition can be ugly.

But MMTers theorise that extending finance during the "ugly period" is affordable because the productivity gains to come will finance the endeavour.

ESG proponents argue that combining 4IR with a circular economy with improved sustainability will further productivity during this period, and provide greater resilience to potential environmental crises.

Both sides of the argument generally concede that growing social inequality and monopolies also hamper growth, as funds are monopolised by a few.

Hence we come full circle to the "S" in ESG, as a potential demand lever – a policy shift that heralds new risks and opportunities for investors.

Debt, debt, D-d-d-debt and moral hazard

Let's first return to the second risk of moral hazard, and detractors' arguments that printing money is a recipe for disaster given the proliferation of debt in the past two decades.

Quantitative easing and massive post-covid stimulus has raised concerns about debt dynamics and creditworthiness.

In the US, Britain, the Eurozone and Japan, central banks have created new reserves of money worth roughly 4trn in 2020, much of which has been used to buy government debt, and corporate debt, raising concern about debt dynamics and creditworthiness.

At the end of 2019, world debt reached US$253trn, equivalent to 322% of global GDP (a ratio exacerbated by the lockdown-induced recession).

By the first quarter of 2020 it was US$258trn (331% of GDP). It increased another US$12.5trn in the second quarter, well above the quarterly average of US$5.5trn, notes the Institute of International Finance.

The International Monetary Fund (IMF) forecasts that rich countries will borrow 17% of their combined GDP this year to fund US$4.2trn in spending and tax cuts designed to keep the economy going. More is likely to come.

The IMF predicts the gross public-debt-to-GDP ratio of advanced economies will rise from 10% in 2019 to 132% by 2021.

Central banks have become the market makers of last resort and deficits and money printing may well become the standard tools of policymaking for decades if inflation stays low.

The US Federal Reserve has been buying securities in exchange-traded bond funds to keep corporate interest rates low, but concerns are abound about the quality of the credit.

The Fed can buy bonds of investment grade credit rating, and more than 92% of government debt is investment grade, although it is worth noting this can be as low as one notch above junk.

Meanwhile, cash is also pouring in from all corners into the junk bond market, and the covid-induced oil-price crash has hit the high-yield bond market hard, a topic we will discuss in an article on fossil fuels to come.

Commentators everywhere are warning of the moral hazard.

As risk is removed from the equation, a surge in corporate borrowing generally accompanies a steady deterioration in the quality of the credit and corporate stability.

If money is free, why not keep failing companies afloat, bail out investors, and protect obsolete industries and jobs – all sure-fire ways to hamper growth and demand, creating a downward spiral.

The answer, say some, lies in increased regulation, greater market intervention and the checks and balances provided by ESG.

Rise of the zombies

To date, detractors have reason to be cynical. Where are these checks and balances?

Detractors are particularly concerned about the growing rise of “zombie” companies, which are kept alive because interest rates are (essentially) "free" - as in: without a tangible cost.

The Bank for International Settlements reports the share of listed firms in advanced economies with low market capitalisations-to-book value, and whose profits were insufficient to cover their interest payments, rose from roughly 4% in the mid-1980s to 15% in 2017.

It is estimated the proportion of zombie companies is now approaching 20% - although how many of those bounce back after covid lockdowns are lifted is yet to be seen.

Morgan Stanley estimates zombie banks and zombie firms comprise 16% of all publicly traded companies in the US, and more than 10% in Europe.

The problem with zombie firms is not just the threat of collapse (which is a direct issue for investors in individual shares) but their drag on economies (which is an issue for the broader market, economy and society).

Investors that do their homework have a chance of avoiding the zombies, but they cannot so easily sidestep a recession and a broad-based long-term loss of capital.

The Organisation for Economic Development and Co-operation (OECD) estimates Italian and Spanish productivity levels would be more than 1% higher were it not for the growth of zombie firms, which are alleged to have crowded out more productive, competitive rivals.

The global outstanding stock of non-financial corporate bonds in advanced economies amounted to US$13.5trn; twice the level of December 2008 in real terms.

To be or not to be – who decides which zombies live?

Since the pandemic, governments have intervened in the economy on an enormous scale in order to keep firms alive, including zombie firms.

But intervention is taking other forms.

A Delaware judge recently approved Hertz’s plan to raise up to US$1bn while in bankruptcy, despite the New York Stock Exchange planning to delist the company.

This precedent may herald a trend for non-market arbitrators to more directly determine the fate of companies – another key issue for investors to be abreast of.

The Economist says greater market intervention may be needed to ensure that firms can fail quickly and efficiently so that they can either be recapitalised and assets and staff redeployed.

“Bankruptcy courts must be able to revive firms with reasonable prospects, or liquidate assets that can find new productive uses in other hands,” says *The Economist*.

“Making the process faster and clearer will reduce the incentive of creditors to seek scorched-earth liquidations, especially for small businesses.”

This raises the thorny question of who survives such bankruptcies and why? The prospect of cronyism raises its ugly head, taking us to the third risk: corruption.

Corruption – the stuff of fairytales?

Even if inflation stays low, the new monetary machinery remains vulnerable to capture by corporate lobbyists and cronies – another path to stagnation, argue detractors

MMT is all very well in theory, but not everyone is honourable. Critics also point out the real danger free money and corruption poses to hyperinflation, and to values.

They argue evidence suggests the breakdown in simple value relationships such as money to the price of goods leaks to other value systems related to social cohesion.

And, as noted above, where are these so-called checks on government corruption? Morningstar notes sovereign ESG credit ratings are not yet being enforced.

And one only has to look at the cosy relationship between the Australian governments and shadow government and the resources industry to see that democracy and individual votes are hardly likely to hold elected representatives accountable.

Debt, corruption and coercion are also familiar bedfellows.

One only has to think of the self-interested war recovery loans, or the debilitating loans to South Africa after Apartheid fell. Debt has been used as a tool throughout modern history to rape and shackle countries (and individuals), and impede their progress.

In other instances, it has provided great leverage.

We suspect the proof will be in the MMTer's "magic pudding". Norman Lindsay's 1918 children's fairy tale of the same name may well be instructive.

The existence of a magic pudding didn't progress as well as one might have hoped – the book proving an indictment of human greed, corruption and avarice: a running testimony to the nature of the beast. But it did have a modestly happy ending for a few.

Managing the MMT risks: The great balancing act

As noted above, inflation is a key risk of MMT given the proliferation in debt. If inflation gets away, it's all over red rover.

The task is to balance stimulus with inflation.

Post-covid, the Federal Reserve has changed policy direction and raised its inflation target to an average 2%: an acknowledgment the economy may need room to reheat. It's a tightrope.

Also noted above, one tactic to manage inflation and limit government corruption appears to be to channel stimulus largely to corporations and individuals through government rather than to government, as in previous eras when stimulus was in vogue.

This is one of main difference between Modern Monetary Theory and previous concepts and in this sense appears to be an ideological experiment.

It is yet to be seen as to whether the mobilisation of social capital through the private sector will be more efficient than through governments.

The general agreement would be that the proven power and benefit of government distribution is less risky than the untried model.

Monetarists point to the threat of government cronyism and say corporations are by nature efficient mobilisers and distributors of capital (until they are not, as in the case of monopolies and corporate capitalism – enter the G in governance).

Considerable scepticism abounds as to the suitability of corporations as social guardians given the conflict of interest posed by the profit motive.

Certainly in most areas in which corporations have been given unfettered reach in the social sector, the outcomes have been poor.

The United States health system, for example, is considered by most as a failure from an affordability, accessibility and outcomes perspective, the country ranking poorly in most studies of western medical systems.

Others argue that stimulus is acceptable, depending on the direction of funds.

Even MMT critics favour increased government spending, arguing it might be prudent – especially if the money is spent on infrastructure, education and research and development.

ESG proponents argue reducing risks to the environment and improving biodiversity, and investing in the infrastructure for a circular economy, is a good start.

But how is this judicious allocation of funding and prospective risk managed? As noted in the Hertz precedent, greater market intervention and regulation is one option.

And then there's ESG.

Enter ESG and greater regulation

Enter the UN Sustainability Goals, ESG, disclosure and regulation.

Readers of previous columns will be well aware of the growing disclosure net facing corporations through tighter reporting standards.

This is a trend being aided by big data – another post-covid ESG winner for investors.

The argument is that greater transparency and regulation will stave off the worst abuses of corporate social capitalism.

This is a sustainability and risk issue for investors; and the ESG investing fraternity is on board.

Analysts note that, from an investment perspective, one of the major effects of covid is a "refocusing" of decision-making on the sustainability of investment opportunities and on building more resilient portfolios to guard against future crises.

JPMorgan analysts expect that in the long run, and in hindsight, **covid may prove to be a major turning point for ESG investing** and for the application of ESG metrics alongside traditional financial metrics.

“As action and awareness of long-term sustainability risks are likely to increase in the longer run in the aftermath of the covid crisis, this should be a positive catalyst for ESG,” say the analysts.

Institutional investors agree

JP Morgan polled 50 global institutions managing US$12.9trn in funds and found this view is shared by a majority of investors.

About 70% of respondents said it was “rather likely, likely or very likely" that covid (a low probability risk) would increase awareness and actions globally to address high impact/high probability risks.

A majority (55%) expected covid to be a positive catalyst in the next three years; 27% expected a negative impact; while 18% believed it would be neutral.

The most immediate problem with ESG as a moderating influence on corporate excess is that stimulus has accelerated post-covid, but the ESG policing infrastructure is not yet fully operational.

ESG disclosure nets are not fully in place, nor are governments yet being subjected to ESG sovereign ratings. Big data and its applications in this space are nascent.

ESG ratings are only just beginning to make their presence felt in corporate equity and bond markets.

Meanwhile, ESG disclosure demands and regulations are expected to translate to increased costs for companies, hence the fear of lower dividends and shareholder returns.

However, it is worth considering that, as long as interest rates remain low, the corporations and banks in question are receiving free money from the taxpayer.

In Part 3 of this series, we examine covid's impact on the broader investment market and on the individual environment, social and governance arenas, and examine the winners and losers.

Part 1 of this series can be accessed via: https://www.fnarena.com/index.php/2020/10/01/esg-focus-covid-the-aftermath-part-1/

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:
https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 16-10-20

By Mark Woodruff

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 October 12 to Friday October 16, 2020
Total Upgrades: 14
Total Downgrades: 5
Net Ratings Breakdown: Buy 51.29%; Hold 38.36%; Sell 10.34%

Another positive week (ending Friday October 16) for ASX-listed stocks, resulted in fourteen upgrades and five downgrades by FNArena database stockbroking analysts.

Bank of Queensland received two upgrades and one downgrade to ratings. This may be explained in terms of two brokers having the same positive outlook and one being diametrically opposed. On most occasions, when a stock is simultaneously upgraded and downgraded it is explained by the relative starting position of the target prices in relation to the current share price.

On this occasion all three broker's started with identical target prices or estimated valuations in 12 months time. On the one hand the bank was described as conservatively provisioned with limited downside, while on the other hand it was overvalued with a price earnings (PE) premium 25% above its five-year average relative to peers. It's sometimes all in the eye of the beholder and happily this creates a marketplace of buyers and sellers.

In a similar vein Link Administration received one upgrade and one downgrade in rating. However, the waters are more muddied in this case due to an approach by a consortium to acquire 100% of the company's shares. The upgrade was on the basis of the strategic interest in the company, while the downgrade was prompted by a strong uplift in the share price following interest from the consortium.

There were immaterial percentage decreases in target prices for companies in the database during the week and thus no commentary is necessary.

In the table for the highest percentage uplift in target price for the week, Bank of Queensland and Link Administration came second and fourth on the table, respectively. This change for both companies may be explained by the narrative for ratings upgrades above. Eagers Automotive topped the table and received a downgrade in rating during the week. Sales were up strongly in a quarterly update and the company's margins are benefiting from an ongoing cost-out program. Ord Minnett downgraded the company's rating on the basis of recent share price gains, but like three other brokers in the FNArena database raised the target price.

Given the above, it was no surprise Eagers Automotive had the second largest percentage increase in earnings upgrades by brokers in the FNArena database.

The largest percentage increase in earnings was reserved for NextDC, after a renegotiation of debt facilities. According to some brokers, this not only significantly reduces interest costs but also de-risks the company's data centre roll-out strategy. Next in order of percentage increase in earnings was ARB Corp after reporting strong sales figures. The company is benefiting from multiple drivers including higher consumer spending and domestic tourism. Bluescope Steel also received a significant boost to earnings forecasts from US steel spreads, which have effectively doubled since their July lows. There is an expectation that the company's free cash flow yield will improve materially in coming years.

As highlighted last week, Transurban Group also suffered a large percentage decline in earnings forecasts after a first quarter traffic update. In addition, there was a rating downgrade by one broker last week, that noted covid-19 continues to ravage Citylink traffic volume by -59% and declines of between -30% to 50% for the US.

Opinions varied for six brokers casting an eye over the third quarter operational performance of Whitehaven Coal. On balance, strong production and sales were overwhelmed by weaker pricing for coking and thermal coal. As a result, the company received a large percentage downgrade to earnings estimates for the week.

Despite favourable target price moves for Audinate, EPS estimates moderated for the company. Not far behind in the percentage earnings downgrades table were both Galaxy Resources and Viva Energy Group. Lower production and weakness in the lithium market amid elevated inventory and mothballed capacity is not a happy recipe for Galaxy Resources. Neither is lower than expected retail and commercial volumes and a worse than anticipated loss in refining for Viva Energy Group.

Brokers were generally disappointed with Iluka Resources' production and sales of zircon and rutile in the September quarter. The immediate issue/catalyst for the stock is the demerger of Deterra, which (assuming shareholder approval) will be listed on October 23.

Total Neutral/Hold recommendations take up 51.29% of the total, versus 38.36% on Neutral/Hold, while Sell ratings account for the remaining 10.34%.

Upgrade

ANSELL LIMITED ((ANN)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/3/1

Ansell is a clear beneficiary of the coronavirus pandemic to date, observes Ord Minnett. The broker also thinks this will continue given the increased demand for hygiene and personal protective equipment (PPE) products is likely to endure well into the future.

The broker highlights higher input costs have been fully passed on to customers, unlike in the past. Earnings estimates have been raised and the broker now thinks Ansell is undervalued.

Recommendation upgraded to Accumulate from Hold with the target price increasing to $44.00 from $36.20.

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 7/0/0

Ord Minnett's stance on the major banks has turned somewhat positive. While the fundamental revenue outlook has not improved, the broker notes the stocks are cheap and trading below book values (except Commonwealth Bank).

House prices are holding up better than feared, points out Ord Minnett, and housing finance approvals continue to improve. This is further bolstered by the federal budget aiding the households and small- to medium-sized enterprises (SME).

The broker expects a rally in value stocks into year-end and also believes all the major banks will pay dividends this year.

Reflecting its incrementally more positive view on the sector, Ord Minnett upgrades its recommendation on ANZ Banking Group to Accumulate from Hold. The target price rises to $20 from $19.50.

BANK OF QUEENSLAND LIMITED ((BOQ)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Add from Hold by Morgans.B/H/S: 3/3/1

Following the FY20 result Credit Suisse upgrades cash earnings estimates by 3-4% for FY21 and FY22.

The broker now envisages the downside is limited, amid a conservatively set provision for the pandemic and good execution of the bank's strategy, which is delivering underlying profit growth.

Nevertheless, the broker acknowledges Bank of Queensland is still likely to struggle to achieve double-digit returns on equity in the near term. Target increases to $7.60 from $5.50 and given the limited downside risk the rating is upgraded to Outperform from Neutral.

Bank of Queensland has reported FY20 cash earnings of $225m, which is 4% better than Morgans expected. The beat is largely the result of net interest income being stronger than the broker expected.

The bank will pay a 12cps fully franked dividend.

Despite Morgans forecasts being above consensus, they are starting to look conservative in light of this new data, explains the broker.

Morgans adjusts EPS forecasts up by 3.5% for FY21 and reduces FY22 by -1.25%.

The rating is increased to Add from Hold and the target price is increased to $7.20 from $5.50.

See also BOQ downgrade.

G.U.D. HOLDINGS LIMITED ((GUD)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/4/0

Citi upgrades GUD Holdings to Buy from Neutral with the target price rising to $14.30 from $12.75.

GUD Holdings' medium term outlook appears better placed than previously expected due to changes in consumer mobility behaviour.

The company is trading at a -21% discount to Bapcor ((BAP)), considered excessive by Citi given the strong demand for aftermarket auto parts is likely to offset a risk of customers pursuing private label strategies.

Earnings estimates upgrade for FY21-22 due to better than expected first-quarter sales in Auto and Davey.

HUB24 LIMITED ((HUB)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/2/1

Flows continue to meet or beat Macquarie's expectations. Platform margins are likely to remain under pressure, nevertheless, although a large step change is unlikely.

Trading volumes were elevated in the second half of FY20, because of heightened market volatility. The broker is now forecasting a normalisation of trading volumes.

The recent performance suggests the valuation is stretched but sustained flow momentum is expected to support the share price for the remainder of FY21.

Macquarie upgrades to Neutral from Underperform. Target is raised to $22.50 from $9.60, because of the compounding impact of upgrades to earnings per share in outer years, a higher terminal growth rate and lower discount rate.

JANUS HENDERSON GROUP PLC. ((JHG)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 3/1/0

Credit Suisse upgrades to Neutral from Underperform, following further analysis on the potential initiatives activist investor Trion could employ to enhance shareholder value.

Initiatives could include improving the operating margin by streamlining product and reducing the real estate footprint as well as leveraging the balance sheet and repurchasing stock. The broker raises the target to $26 from $16.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 1/3/0

Link Administration Holdings received a conditional proposal from a consortium of Pacific Equity Partners and Carlyle to acquire 100% of Link's shares for an indicative cash price of $5.20 per share.

The offer puts Link Administration at circa 30% premium to the last closing price. Perpetual holds about 9.65% of Link and is in favour of the offer.

Apart from the offer, the broker notes the company is also in the process of acquiring the PES loan management business.

Given the strategic interest in Link Administration, Morgan Stanley upgrades its rating to Equal-weight from Underweight. Target is increased to $5.20 from $3.40. Industry view: In-Line.

See also LNK downgrade.

MEDIBANK PRIVATE LIMITED ((MPL)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 2/5/0

Medibank Private's policy-holders grew 0.6% in FY20 amid the pandemic. Morgan Stanley considers this a good performance and believes the insurer's target for 1% growth in FY21 is achievable.

FY21 guidance expects claims to be broadly in line with FY20's circa 2.9% growth. Morgan Stanley lowers its claims growth forecast by -0.5-2.4% leading to upgrades in earning growth forecasts in FY21-22.

Morgan Stanley upgrades its rating to Overweight from Equal-weight with the target price increasing to $3.10 from $2.70. Industry view: In-line.

NEWCREST MINING LIMITED ((NCM)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/2/0

Newcrest Mining will move to the second stage at the Cadia expansion project. This -US$175m expansion should be completed in late FY22.

The miner will also spend -US$65m at Lihir to pick up more gold. Citi believes consensus expectations at Lihir have been reset and earnings momentum is now positive.

Newcrest Mining will also list on the Toronto Stock Exchange this week but, as there is no equity issue with this secondary listing, liquidity could be challenging, Citi asserts, noting the TSX is "crowded with gold stocks".

Citi upgrades to Buy from Neutral and maintains a $37 target.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 1/4/0

Ord Minnett now assesses the merger with Saracen Mineral Holdings makes for a compelling gold option for large domestic and global investors.

The portfolio offers a rare combination of well-run mines, production growth, cash flow and lower sovereign risk exposure. As a result the broker upgrades Northern Star to Hold from Lighten and raises the target to $13.90 from $11.50.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/2/1

Morgan Stanley believes green shoots in Sydney Airport's routes over the next 12 months should support a re-rating back towards (but not exceeding) historical valuations.

The broker considers the company could also benefit from proposed concessional corporate tax arrangements in FY21 and FY22 (100% capex write-offs), pushing out cash tax payments further in time.

Modest distributions may resume in late 2021, according to the broker.

The rating is upgraded to Overweight from Equal-weight and the target price is increased to $6.67 from $6.39. Industry View: cautious.

TREASURY WINE ESTATES LIMITED ((TWE)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/5/0

Ord Minnett reduces estimates for earnings per share by -2.5% in FY21 and -9.6% in FY22 because of lower expectations for EMEA, Asia and corporate earnings.

Treasury Wine has had a turbulent year, with challenges from bushfires in the Americas and Australasia and the anti-dumping investigation in China. The broker notes the share price has been volatile and is underperforming the ASX100 index.

Based on valuation, the rating is upgraded to Hold from Lighten. Target is unchanged at $10. The broker envisages the uncertainty around China's plans for tariffs is now better reflected in the target.

Also, the analysts do not think management will proceed with its demerger plans, citing "unsound economics".

WOOLWORTHS LIMITED ((WOW)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/3/0

Morgan Stanley continues to consider the Australian supermarkets well-placed over the medium term on account of covid-19 tailwinds, better industry structure outlook with Kaufland no longer entering and Aldi slowing its space roll out and an attractive sector valuation in a low yield world.

While Coles ((COL)) has been the broker's preferred major supermarkets exposure since April, Morgan Stanley has switched its preference to Woolworths given its share price underperformance and better operational momentum.

Woolworths' share price has outperformed the ASX200 by circa 1% and underperformed Coles' by circa -22% since February. The broker points out Woolworths started the year with better food momentum than Coles and appears to be growing ahead of Coles in the online and liquor segments.

Moreover, Woolworths is believed to have better leverage to a post-covid reopening via its hotels business. The broker expects earnings growth of 14% in FY21.

Rating has been upgraded to Overweight from Equal-weight with the target rising to $43.50 from $42. Industry view: Cautious.

Downgrade

AUCKLAND INTERNATIONAL AIRPORT LTD ((AIA)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/3/1

The Auckland Airport share price has rallied 77% from its March 2020 trough. Morgan Stanley thinks the company's leading domestic pax recovery and favourable leverage to the trans-tasman bubble are well appreciated by investors.

As a result of a survey of Chinese outbound travel intentions, Morgan Stanley tempers enthusiasm somewhat (noting Asia-NZ flights are longer haul). However, the broker hasn't changed its view on a long list of positives for the company including earnings diversity from the Mangere land bank and lack of competition.

Morgan Stanley downgrades the rating to Equal-weight from Overweight with the target price increasing to NZ$7.47 from NZ$7.07. Industry view: Cautious.

EAGERS AUTOMOTIVE LIMITED ((APE)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 3/3/0

Eagers Automotive's third-quarter trading update was strong, notes Ord Minnett, with the company delivering a profit of $56.3m versus $40.3m in the first half.

Ord Minnett is positive on the medium-term prospects for Eagers, especially considering the strong order bank and the government’s recent decision on responsible lending that could further help the new vehicle sales market.

Looking at the recent uplift in the share price, Ord Minnett downgrades its rating to Hold from Accumulate. The target price rises to $12 from $9.50.

BANK OF QUEENSLAND LIMITED ((BOQ)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 3/3/1

Bank of Queensland delivered an "adequate" result, Macquarie suggests, thanks to positive margin trends, although volume growth required to meet guidance appears unlikely to be achieved. Revenue growth will remain subdued given the ongoing impact of low interest rates.

The bank's recent re-rating, including yesterday, has taken its PE premium to 25% above its five-year average relative to peers. Target rises to $6.00 from $5.50 but the broker downgrades to Underperform from Neutral on valuation.

See also BOQ upgrade.

FLIGHT CENTRE LIMITED ((FLT)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/0

As coronavirus cases increase in the northern hemisphere, Credit Suisse extends the rate of recovery assumed for travel bookings by six months. The broker no longer expects a meaningful recovery in travel in the second half of FY21 but notes the company has ample liquidity for 2021.

As a result of the diminished potential for a recovery in the short term, the rating is downgraded to Neutral from Outperform. The target is raised to $15.31 from $14.01 because of changes to modelling of the corporate segment.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/3/0

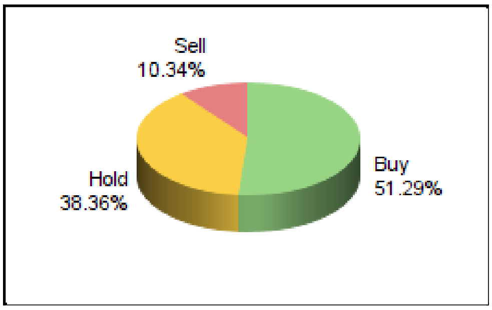
Link Administration has received a conditional proposal from a consortium at $5.20 a share. In Ord Minnett's view a higher rival bid is less than likely.

The offer would be by way of a scheme of arrangement at $5.20 a share, or some scrip alternative.

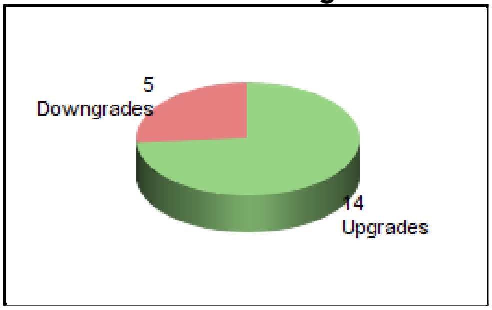
Ord Minnett downgrades to Hold from Accumulate because of the strong uplift in the share price following the announcement. Target is raised to $5.00 from $4.60.

See also LNK upgrade.

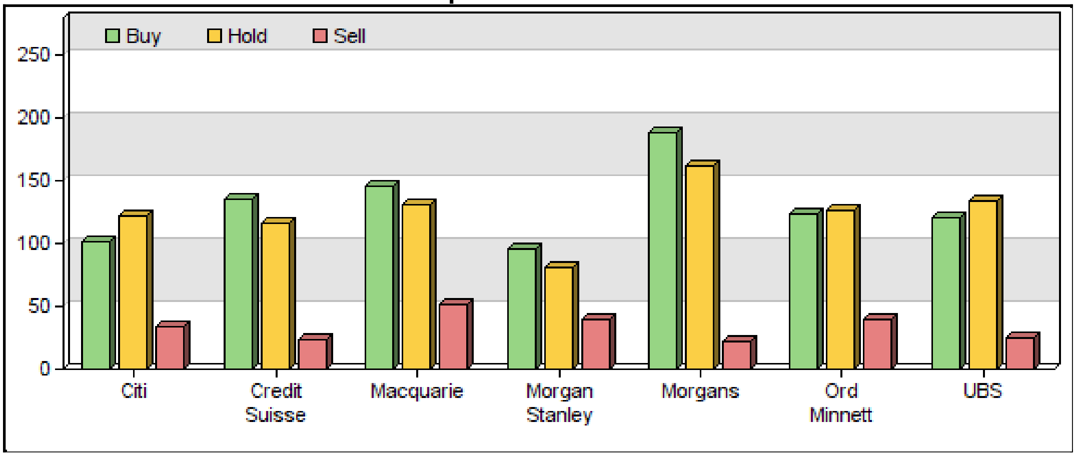
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ANSELL LIMITED	Buy	Neutral	Ord Minnett
2	AUSTRALIA & NEW ZEALAND BANKING GROUP	Buy	Neutral	Ord Minnett
3	BANK OF QUEENSLAND LIMITED	Buy	Neutral	Credit Suisse
4	BANK OF QUEENSLAND LIMITED	Buy	Neutral	Morgans
5	G.U.D. HOLDINGS LIMITED	Buy	Neutral	Citi
6	HUB24 LIMITED	Neutral	Sell	Macquarie
7	JANUS HENDERSON GROUP PLC.	Neutral	Sell	Credit Suisse
8	LINK ADMINISTRATION HOLDINGS LIMITED	Neutral	Sell	Morgan Stanley
9	MEDIBANK PRIVATE LIMITED	Buy	Neutral	Morgan Stanley
10	NEWCREST MINING LIMITED	Buy	Neutral	Citi
11	NORTHERN STAR RESOURCES LTD	Neutral	Sell	Ord Minnett
12	SYDNEY AIRPORT HOLDINGS LIMITED	Buy	Neutral	Morgan Stanley
13	TREASURY WINE ESTATES LIMITED	Neutral	Sell	Ord Minnett
14	WOOLWORTHS LIMITED	Buy	Neutral	Morgan Stanley
Downgrade				
15	AUCKLAND INTERNATIONAL AIRPORT LTD	Neutral	Buy	Morgan Stanley
16	BANK OF QUEENSLAND LIMITED	Sell	Neutral	Macquarie
17	EAGERS AUTOMOTIVE LIMITED	Neutral	Buy	Ord Minnett
18	FLIGHT CENTRE LIMITED	Neutral	Buy	Credit Suisse
19	LINK ADMINISTRATION HOLDINGS LIMITED	Neutral	Buy	Ord Minnett

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs

1	JHG	JANUS HENDERSON GROUP PLC.	75.0%	50.0%	25.0%	4
2	WOW	WOOLWORTHS LIMITED	50.0%	33.0%	17.0%	6
3	NWL	NETWEALTH GROUP LIMITED	-17.0%	-33.0%	16.0%	6
4	BOQ	BANK OF QUEENSLAND LIMITED	29.0%	14.0%	15.0%	7
5	MPL	MEDIBANK PRIVATE LIMITED	29.0%	14.0%	15.0%	7
6	NCM	NEWCREST MINING LIMITED	64.0%	50.0%	14.0%	7
7	SYD	SYDNEY AIRPORT HOLDINGS LIMITED	43.0%	29.0%	14.0%	7
8	COE	COOPER ENERGY LIMITED	50.0%	38.0%	12.0%	4
9	NST	NORTHERN STAR RESOURCES LTD	20.0%	10.0%	10.0%	5
10	TWE	TREASURY WINE ESTATES LIMITED	29.0%	21.0%	8.0%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	25.0%	42.0%	-17.0%	4
2	FLT	FLIGHT CENTRE LIMITED	21.0%	36.0%	-15.0%	7
3	TCL	TRANSURBAN GROUP	-7.0%	7.0%	-14.0%	7
4	APE	EAGERS AUTOMOTIVE LIMITED	50.0%	58.0%	-8.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	APE	EAGERS AUTOMOTIVE LIMITED	11.798	9.315	26.66%	6
2	BOQ	BANK OF QUEENSLAND LIMITED	6.850	5.886	16.38%	7
3	NWL	NETWEALTH GROUP LIMITED	12.665	10.957	15.59%	6
4	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	5.125	4.535	13.01%	4
5	JHG	JANUS HENDERSON GROUP PLC.	36.675	33.375	9.89%	4
6	SXY	SENEX ENERGY LIMITED	0.412	0.397	3.78%	6
7	NST	NORTHERN STAR RESOURCES LTD	14.870	14.390	3.34%	5
8	ANN	ANSELL LIMITED	39.766	38.651	2.88%	7
9	MPL	MEDIBANK PRIVATE LIMITED	2.839	2.781	2.09%	7
10	S32	SOUTH32 LIMITED	2.694	2.651	1.62%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	ORG	ORIGIN ENERGY LIMITED	6.274	6.380	-1.66%	7
2	BPT	BEACH ENERGY LIMITED	1.880	1.893	-0.69%	6
3	NCM	NEWCREST MINING LIMITED	36.086	36.314	-0.63%	7
4	COE	COOPER ENERGY LIMITED	0.433	0.435	-0.46%	4
5	STO	SANTOS LIMITED	6.503	6.531	-0.43%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	NXT	NEXTDC LIMITED	-0.626	-0.930	32.69%	7
2	APE	EAGERS AUTOMOTIVE LIMITED	36.642	28.092	30.44%	6
3	ARB	ARB CORPORATION LIMITED	97.025	86.175	12.59%	4
4	BSL	BLUESCOPE STEEL LIMITED	59.540	53.157	12.01%	6
5	BAP	BAPCOR LIMITED	33.457	30.635	9.21%	6
6	SHL	SONIC HEALTHCARE LIMITED	173.157	159.157	8.80%	7
7	BOQ	BANK OF QUEENSLAND LIMITED	50.414	47.100	7.04%	7
8	SYD	SYDNEY AIRPORT HOLDINGS LIMITED	-8.848	-9.465	6.52%	7
9	SXY	SENEX ENERGY LIMITED	1.223	1.165	4.98%	6
10	CGF	CHALLENGER LIMITED	38.829	37.071	4.74%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	TCL	TRANSURBAN GROUP	6.390	13.361	-52.17%	7
2	WHC	WHITEHAVEN COAL LIMITED	-7.740	-5.834	-32.67%	7

3	AD8	AUDINATE GROUP LIMITED	-4.797	-3.717	-29.06%	3
4	GXY	GALAXY RESOURCES LIMITED	-26.216	-21.707	-20.77%	6
5	VEA	VIVA ENERGY GROUP LIMITED	-1.902	-1.580	-20.38%	5
6	ILU	ILUKA RESOURCES LIMITED	40.376	47.792	-15.52%	5
7	FLT	FLIGHT CENTRE LIMITED	-105.929	-95.386	-11.05%	7
8	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	19.702	21.700	-9.21%	4
9	PLS	PILBARA MINERALS LIMITED	-1.005	-0.930	-8.06%	4
10	Z1P	ZIP CO LIMITED	-11.860	-11.260	-5.33%	5

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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WEEKLY REPORTS

Uranium Week: Restart For Tsunami-Hit Reactor

As the tsunami-hit Onagawa nuclear reactor gets the OK for a restart, the weekly uranium price continues its downward trend.

-Japanese nuclear reactor to restart
-IEA's World Energy Outlook 2020
-The weekly spot price falls marginally

By Mark Woodruff

A nuclear reactor in north-eastern Japan damaged by the 2011 earthquake-tsunami disaster is all but certain to resume operations, according to the JapanToday website. The governor of the prefecture hosting the facility has decided to give consent, local officials said Wednesday.

For the No. 2 unit of the Onagawa nuclear plant in Miyagi Prefecture to restart, winning consent from local government leaders is the last remaining step needed. This is after the plant cleared a national safety screening in February.

Miyagi Governor Yoshihiro Murai will formally announce his consent by the end of the year, according to the officials, who spoke on condition of anonymity, reports JapanToday.

By doing so, he would be the first governor of a disaster-hit prefecture to give the green light to the restart of a nuclear reactor.

Other News

When announcing its World Energy Outlook 2020, the International Energy Agency (IEA) recognised the role of nuclear power in a clean energy transition.

A surge in well-designed energy policies is considered needed to place the world on track for a resilient energy system that can meet climate goals, amid the disruption and uncertainty caused by covid-19.

Industry consultant TradeTech explains the IEA's flagship annual report focuses on the next decade and considers different pathways out of the crisis caused by covid-19.

Reacting to the report, World Nuclear Association Director General Agneta Rising commented, "We welcome the IEA's recognition of the potential for nuclear energy to play an important role in the transition to a clean energy system and we strongly endorse the IEA's call for investment in clean energy, including nuclear energy, to rise from the current one-third of total energy investment to around two-thirds by 2030."

Company News

Energy Resources of Australia's ((ERA)) Ranger uranium operation continued to process existing stockpiles during the third quarter. Rio Tinto ((RIO)) has recorded third quarter production of 735,000lbs which was up marginally compared to the previous quarter.

Rio Tinto"s ((RIO)) share of production was 26% higher than the third quarter of 2019, primarily due to a change in shareholding following completion of Energy Resources of Australia's entitlement offer in February 2020.

Rio's production is derived solely from its now 86.3% share in the company, which operates the Ranger Uranium Mine in the Northern Territory of Australia.

Uranium Pricing

TradeTech's Weekly Uranium Spot Price Indicator fell -US$0.10 to US$29.70/lb last week.

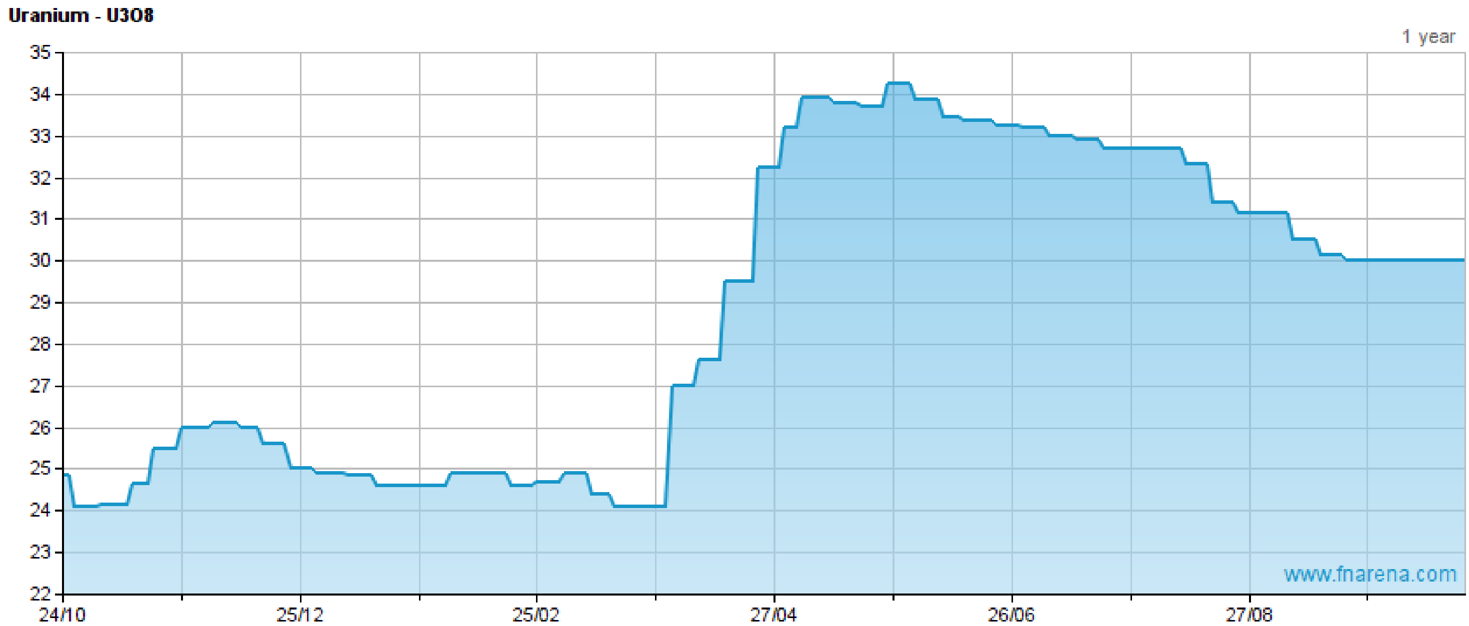
On the surface, the spot uranium market was quiet for most of the week, reports TradeTech. However, a number of parties were busy picking up material "off-market" over the course of the week. Utilities participated as buyers, along with traders and producers, in deals closed this week.

A total of 11 transactions involving 1.2 mlbs U3O8 were concluded this week in the spot uranium market.

The Weekly Spot Price Indicator has declined steadily over the last five months, falling over -13% since early May. The indicator currently sits 19% above its value from a year ago and has increased almost 20% since the beginning of the year. The weekly spot price has averaged a 0.5% weekly increase in 2020.

The average Weekly U3O8 Spot Price Indicator for 2020 is US$29.69/lb, US$3.85/lb above the 2019 average.

TradeTech's term price indicators are unchanged at US$34.00/lb (mid) and US$37.00/lb (long).



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WEEKLY REPORTS

The Short Report - 22 Oct 2020

See **Guide** further below (for readers with full access).

Summary:

Week ending October 15, 2020.

Last week saw the ASX200 kick on from the prior budget-driven week to post further gains as Victorian restrictions began to be eased. The prospect of further easing is looking a little dicey today.

I noted last week that the budget rally had appeared to prompt somewhat of a short-covering scramble, given the number of stocks seeing positions reduced. But I wanted to wait until this week for confirmation it wasn't one of ASIC's occasional data blips.

Well, it wasn't. Thus what we're left with is a not a lot of changes in positions last week.

Only one stock saw a position change of one percentage point or more. Flight Centre ((FLT)) shorts rose to 8.1% from 6.8%. The shorters are no doubt looking to the second wave crisis in Europe/UK and assuming international borders will not be reopened anytime soon.

On that basis, Credit Suisse downgraded to Neutral from Outperform last week.

The only other point of note from last week is that shorters appear to be moving in on biotechs.

Mesoblast ((MSB)) is sitting there at 9.1% shorted having failed to receive FDA approval for its remestemcel-L drug, which prompted a -37% share price plunge on the news earlier in the month.

Ticking up to 6.4% last week was PolyNovo ((PNV)), while making a debut appearance at 5.1% was Pro Medicus ((PME)).

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+
WEB 14.7
IVC 10.0

No changes

9.0-9.9

MYR, MSB

Out: GXY

8.0-8.9%

GXY, ING, FLT

In: GXY, FLT

7.0-7.9%

CUV, BOQ

No changes

6.0-6.9%

FNP, A2M, MTS, PNV, AVH, WHC

In: PNV, WHC Out: FLT, ORE

5.0-5.9%

LOV, TGR, Z1P, ORE, PLS, COE, NEA, EML, EOS, HUB, BIN, SEK, SUL, PME, GWA, URW

In: ORE, HUB, PME, URW Out: PNV, WHC, BEN, SGM

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	3.1	3.2	MQG	0.4	0.4
ANZ	0.9	1.0	NAB	1.2	1.3
BHP	4.1	4.1	NCM	0.1	0.1
BXB	0.3	0.2	RIO	1.1	1.0
CBA	0.6	0.7	TCL	0.5	0.4
COL	0.5	0.3	TLS	0.3	0.3
CSL	0.3	0.3	WBC	1.0	0.9
FMG	1.0	0.9	WES	0.4	0.4
GMG	0.2	0.2	WOW	0.1	0.2
IAG	1.3	1.1	WPL	1.4	1.3

To see the full Short Report, please go to this link

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.

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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WEEKLY REPORTS

The Wrap: Housing, Office REITs & Banking

Morgan Stanley's housing indicator fell in the September quarter; office property stocks may be in for downgrades; the shift towards digital banking continues.

-Softer demand outlook for housing
-Downside risk to Melbourne-exposed REITs
-The shift to digital banking continues
-Housing loans and responsible lending

By Angelique Thakur

Housing credit supply expected to improve

Regarding the housing market, Morgan Stanley is of the view the upcoming period will see a demand-driven cycle as opposed to the credit-driven cycle we witnessed in 2017-19.

This view has been corroborated by the findings of Morgan Stanley's proprietary housing indicator – MSHAUS.

MSHAUS, a leading indicator for housing prices and building approvals, fell in the September quarter to -0.7 points. Morgan Stanley believes this suggests a softer housing market for the rest of 2020.

The indicator is made up of various components including demand-supply balance, rental conditions, mortgage serviceability, housing accessibility, credit supply and house price expectations.

The fall this quarter was primarily due to an increase in the net supply which in turn reflects the sharp decline in net migration – and consequently housing demand – due to the pandemic.

Morgan Stanley analysts expect the situation to persist while border restrictions are in place. The impact of declining migration was also seen on rental conditions, impacted by higher vacancies in Sydney and Melbourne.

Balancing the index are two of the other components - mortgage serviceability and credit supply.

Helped by a combination of income stimulus, payment holidays and rate cuts, mortgage serviceability is at its strongest since 2002, finds Morgan Stanley.

The other factor, credit supply, has been one of the key drivers of weakness over the last few years. While still soft, credit supply is expected to turn positive due to changes to responsible lending laws and a demand rebound seen from owner-occupier home loan customers.

Going ahead, the outlook for pricing is more balanced, suggests Morgan Stanley, with recent auctions even hinting some modest near-term upside to prices and a stable 2021.

Melbourne-exposed REITs

According to Morgan Stanley, the market may be too bullish on Melbourne-exposed property stocks. The broker highlights earnings expectations haven't moved since August even though the Melbourne lockdown has gone on for a longer time than anticipated.

Vicinity Centres' ((VCX)) exposure to Melbourne is 50% and the broker feels the REIT will earn only 55% of its contracted rent in the first half, down from 65%. For the second half of FY21, the rent expected to be collected dropped to 75% from 85%.

Melbourne exposure for GPT Group ((GPT)) is 36% and Morgan Stanley expects rent collections for the group will be 60% of the total rent in the first half of FY21, rising to 80% in the second half.

While Waypoint REIT ((WPR)) and Arena REIT ((ARF)) have material exposure to the city, the triple net nature of their leases makes Morgan Stanley comfortable enough to leave its forecasts intact.

For the residential side of the market, Morgan Stanley is not worried at the moment. The HomeBuilder stimulus looks to have offset the lockdown impact with home sales in the September quarter about 19% higher than in the June quarter.

Unsurprisingly, Morgan Stanley chooses to maintain its Underweight rating on GPT Group and Vicinity Centres.

Branch numbers continue to reduce across banks

Branch numbers across banks are on a decline, according to APRA's points of presence data numbers. To June 30, the total number of branches across the banking system fell by -141. This implies a -2% reduction and implies a continuation of the decline seen in recent years.

Strangely, the onset of covid-19 seems to have slowed down the pace of the decline. JP Morgan analysts think another possible explanation could be the lease on some of the bank branches are long-dated.

All major banks saw a -2% reduction in branches with the exception of the Westpac Bank ((WBC)) although JP Morgan suspects this may be due to a re-classification related quirk.

JP Morgan analysts suggest falling branch numbers will help keep operating expenses flat for retail divisions. With more than 100 branches spread across Australia, JP Morgan believes both Westpac Bank and Commonwealth Bank ((CBA)) have the maximum scope to reduce their branches.

Some tailwinds aiding the shift towards smaller branch footprints are a rapid increase in digital banking and declining foot traffic in branches. A case in point is the total transactions (by value) that are being done digitally have gone up to 66% for the Commonwealth Bank, up from 52% in 2016.

The impact of repealing responsible lending

Repealing responsible lending laws may not stimulate housing credit as much as expected, concludes a study conducted by UBS to look into the impact the repealing of responsibility laws will have on the economy. The study was conducted post the government's announcement seeking to repeal responsible lending laws.

The broker comes up with some interesting insights. According to UBS, the tightening of loan verification procedure may have slowed the lending process but the broker does not find any evidence to suggest credit was not available. The survey shows borrowers were able to access credit despite stricter verification.

Data from ABS shows owner-occupied housing lending rose by 29% in August to a record high of $16.2bn. Even after catering for some post lockdown catchup, UBS believes this figure points towards strong underlying housing lending.

Since there is little evidence of responsible lending constraining housing lending, UBS thinks its repeal will not lead to any material uptake in credit. The repeal may however speed up the approval process, adds the broker.

More importantly, the repeal will encourage banks to lend by reducing the risk of litigation.

There are pitfalls to repealing responsible lending, cautions UBS, which include an increase in the financial stability risk over the medium term especially since Australian households are already highly leveraged.

Supermarkets: strong online sales growth

The supermarket space is currently dominated by two themes, according to Macquarie analysts. One is the growth in online sales which has continued into the first half of FY21. Macquarie believes this will aid Woolworths ((WOW)) more than Coles ((COL)) owing to the latter’s investment with Ocado capping its online sales growth.

The other is the "shopping local" theme. Melbourne has seen the shop local trend continue under the lockdown. Macquarie notes the main beneficiary of this preference for local shopping is Metcash ((MTS)).

Heading into the final quarter of 2020, Macquarie expects stronger volumes growth to continue within supermarkets. The broker expects a record Christmas as gatherings resume in Victoria.

Analysing app and Google Trends for the supermarkets for the September quarter, Macquarie finds Coles has been losing traction online since August while Woolworths saw an uptick in October. Retail liquor continues to trend strongly with Dan Murphy the clear leader.

Macquarie retains its Outperform rating on Woolworths and expects strong performance across all divisions. The retailer had a strong start to the first quarter of the financial year due to its online sales growth and a successful Ooshies campaign (while Coles’ Little Treehouse Books campaign was not as popular).

Metcash is expected to benefit from strong sales in the hardware segment due to increased renovation activity and more time at home. Gains in the foods segment are expected to remain sticky in FY21. Macquarie rates Metcash as Outperform.

With its Little Treehouse promotion not resonating with customers and online sales lagging Woolworths, Coles has been downgraded to Neutral.

Consumer trends

According to data by Illion/AlphaBeta, home improvement spending remained elevated in Australia with spending during the week ending October 11 up 34% from 28% the week before that. The furniture and office segment saw sales up 33% from 28% on a weekly basis with Macquarie expecting growth in this segment to settle within the 20-30% range.

Analysing online search activity and Google Trends for the September quarter, Macquarie finds Wesfarmers is seeing strong momentum driven by Bunnings and Catch. Bunnings in particular stood out on Google Trends, notes Macquarie, in the home improvement segment.

Zip data shows garden and hardware segment was up 37% from 34% the prior week while spending on electronics rose 11%, down from 15%. Macquarie feels the electronics segment will be supported by a strong product pipeline during the Christmas period. With gatherings resuming in Melbourne, this segment is expected to get a further boost.

Macquarie finds spending in cafes, up 19% was flat versus the week ending October 4 but at its highest levels since July. Food Delivery remained strong with growth of 364%.

Macquarie retains its Outperform rating for JB Hi-Fi ((JBH)), Wesfarmers ((WES)), Woolworths ((WOW)), and Harvey Norman Holdings ((HVN)) and Coles.

Subdued construction outlook

Amid the ongoing covid-19 related uncertainty, the ANZ Bank research team expects private sector non-residential engineering construction to deteriorate over 2020-21 with businesses either deferring or cancelling investment commitments. This will lead to a slowdown in the development of new projects.

While the June quarter saw engineering construction work increasing across both private and public sectors, September quarter was a different story. Private sector non-residential work done fell -1.6% but the public sector non-residential building work done recorded a fall of -3.4%, the largest quarterly dip since 2016.

However, the pandemic alone is not to be blamed, says ANZ, since private investment was already falling, not only in Australia but across other developed economies. It looks like the pandemic merely accelerated the pace of the slowdown.

Adding to the woes, non-mining firms are planning to reduce their total capital expenditure by almost -20% in 2020-21. The mining sector has essentially shelved plans to increase mining capex throughout the sector with firms expecting flat growth.

Amid such bleak conditions, ANZ is pleased to see the federal budget 2020-21 focus has been on encouraging business investment. However, they admit the approach of trying to get the private sector to invest more rather than directly lift public spending is a risky move and could fizzle out if the private sector does not meet expectations.

Ultimately, it all comes down to the public sector to help fill the hole, concludes the team.

The government has announced a number of new and fast-tracked projects to help lift spending with capital spending revised up by $33.4bn for 2020-21 through to 2022-23. This puts the total spend as a percentage of GDP at 2.9% (just below the point reached post-GFC).

While the budget announced a slew of infrastructure investments, the analysts admit there are limitations to using infrastructure investment as short-term economic stimulus since these typically have long lag times. Instead, they consider spending on small-scale projects or maintenance works to be more realistic alternatives.

An example is the JobMaker Plan which was allocated $2bn over 2020-22 for small-scale road safety projects and upgrades. Another example is the Local Roads and Community Infrastructure Program that has been extended out to 2021-22 to the tune of $1bn.

With Western Australia the only state to have released its 2020-21 budget, ANZ expects to see more funding committed and even larger projects put forward.

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SMALL CAPS

Bank Deal Adds Scale For Tyro Payments

Tyro Payments has brokered an alliance with Bendigo and Adelaide Bank to provide merchant acquiring services thereby lifting its profile, particularly in Victoria.

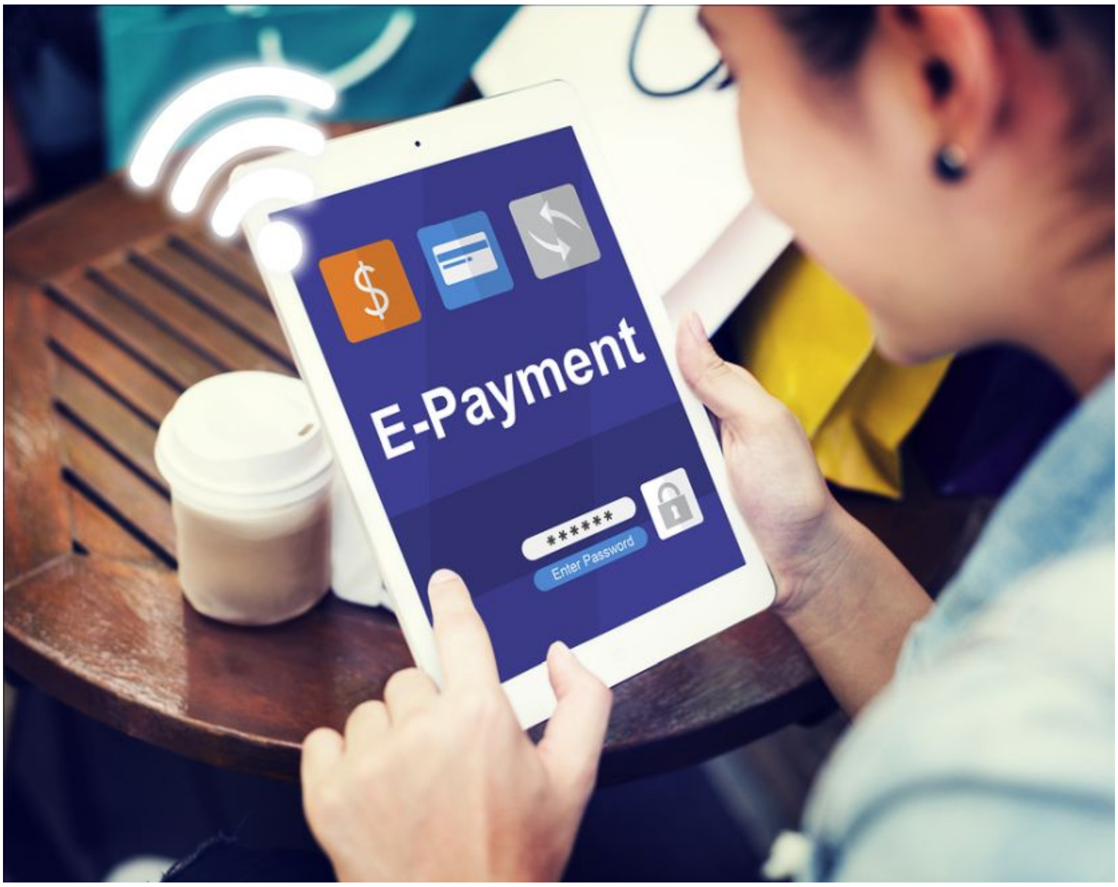
-Deal demonstrates operating leverage from higher payment volumes
-Higher market share for Tyro Payments in Victoria
-Suncorp the most obvious candidate for similar arrangements

By Eva Brocklehurst

An alliance with Bendigo and Adelaide Bank ((BEN)) is expected to set Tyro Payments ((TYR)) on a growth trajectory that will allow the payments provider to narrow the gap to peers in terms of scale.

The company has entered an exclusive alliance with the bank to provide merchant acquiring services to current and referred customers. To Goldman Sachs the transaction demonstrates the operating leverage that can occur from higher payment volumes, given relatively modest incremental costs.

Bendigo and Adelaide has been losing market share in this segment, with a probable inability to provide bespoke solutions for its merchant network as it relies on multiple third-party software solutions. Hence, Goldman Sachs believes the alliance will be mutually beneficial.



The transaction should be materially accretive to earnings in FY22, on Ord Minnett's estimates. The 10-year alliance has five-year options. Under the deal Bendigo and Adelaide will experience a full separation of its existing merchant acquiring services.

Tyro will pay $9m up front, with $20m one-off costs, with an ongoing gross profit share from existing and newly referred bank business customers that use the merchant acquiring services. The company expects to roll out 26,000 terminals and generate $5bn of annual transaction value, with gross profit of $19m and additional ongoing costs of $6.7m per annum.

Morgan Stanley is positive about the development, believing the $5bn in transaction value at scale should lift total transaction value in FY22 by around 20%. **The main issue is what will happen to top-line growth after the pandemic fades**. Will this return to 20-30% or remain lower? Morgan Stanley suspects it will return to its former strength and this deal should help.

Increases Victorian Presence

Tyro will also obtain a significant market share in Victoria. Goldman Sachs notes the higher exposure of Bendigo and Adelaide to Victoria means it has a much higher rate of currently inactive merchants because of the pandemic.

Ord Minnett agrees Tyro will be positioned to benefit from the re-opening of Victoria as well as the broader economy over FY21. The ability to partner rather than acquire the book is also favourable, given a minimal capital outlay that will add scale to the business.

The deal makes sense to Macquarie, too, and the cost is modest. The transaction should add 13-25c of value per share. The main issue for this broker is the duration of the contract and whether or not the deal is extended indefinitely.

Macquarie recognises the strategic appeal in the alliance but believes the recent re-rating of the stock has already begun to factor in the upside from the re-opening of Victoria. Moreover, the broker is cautious about the risk of elevated churn over coming months.

Similar Deals?

Goldman Sachs suspects **similar arrangements could occur with other financial institutions that are losing share in the payments market** as the arrangement protects the banking service relationship for the bank but allows customers to benefit from a specialist payment solution. The broker does not explicitly include any further arrangements for Tyro Payments in its estimates.

Macquarie suggests Suncorp's ((SUN)) bank is the most obvious candidate, with 23,000 terminals. Bank of Queensland ((BOQ)) has previously left the merchant-acquiring segment so it is a less obvious option.

A partnership with a major bank would be a significant development but the broker considers this a much less likely outcome, as the majors would not want to relinquish their customer relationships and the profit share could be far less lucrative for Tyro.

Tyro is the fifth largest merchant acquirer in Australia by number of terminals, and amongst licensed financial institutions the only one that has been growing market share according to Goldman Sachs data.

The broker notes Australian Deposit-taking Institutions (ADIs) have experienced a declining trend, while outsiders such as Tyro Payments have their increased market penetration. Major ADIs have experienced a net reduction in terminals in the market.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, makes no changes to the Neutral rating and raises the target to $3.65. The database has two Buy ratings and one Sell (Macquarie). The consensus target is $4.20, signalling -0.7% downside to the last share price.

SMALL CAPS

Nickel Mines An Emerging Force

Nickel Mines has taken a stake in another nickel pig iron development in Indonesia, set to catapult the company to the world stage as the largest pure nickel exposure.

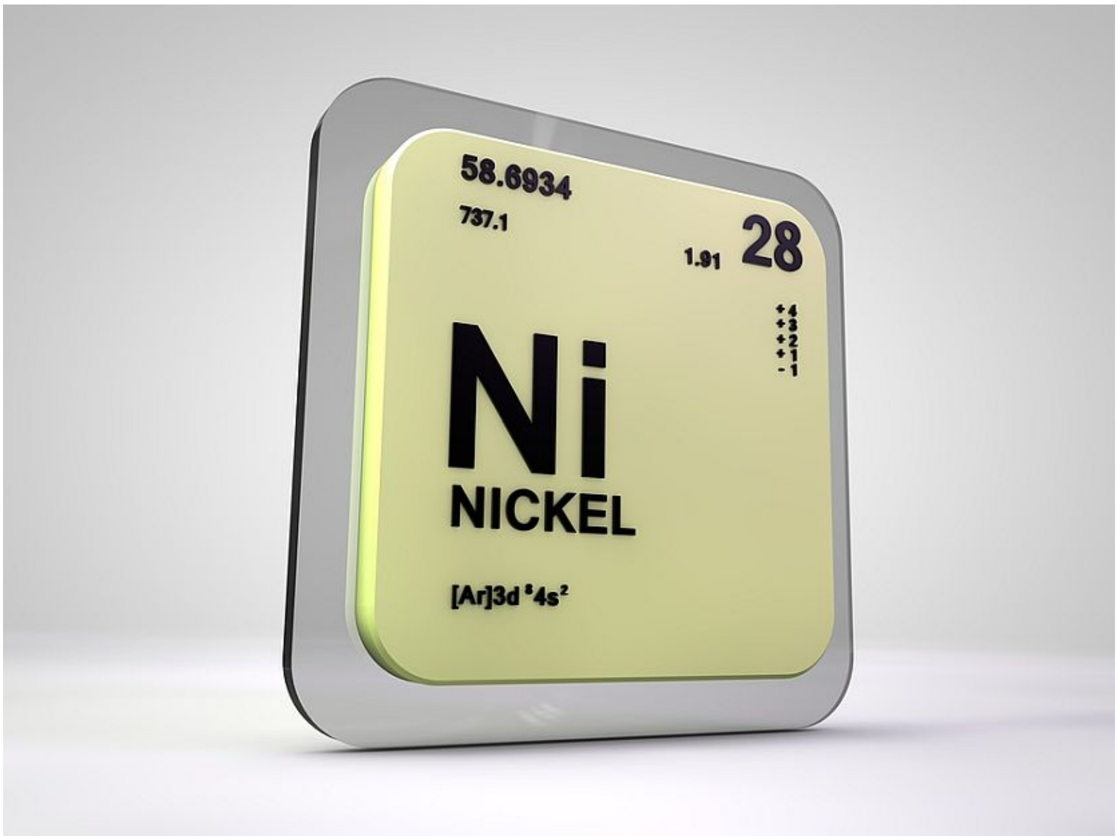
-Highly attractive option with a rapid payback period
-Launching Nickel Mines as the No 6 nickel producer globally
-Hengjaya, Ranger running 20-30% above nameplate

By Eva Brocklehurst

Nickel Mines ((NIC)) is entrenching its position as a major force in nickel globally, with a deal with Tsingshan to develop another facility in Indonesia. The Memorandum of Understanding is with Shanghai Decent Investment (SDI), a subsidiary of Tsingshan, to build, own and operate four new rotary kiln electric furnace (RKEF) lines at the Weda Bay industrial park.

This MOU outlines terms in which Nickel Mines can acquire a 70% interest in PT Angel Nickel Industry for US$490m, a new nickel development with a nameplate capacity of 36,000tpa of contained nickel from nickel pig iron that will also build a 380MW coal-fired power station.

This would imply exposure to an additional 25,200tpa for the company and double its nickel production to 58,000tpa by 2025. The new lines are scheduled to be commissioned in the September quarter of 2022.



Nickel Mines will then be the largest pure nickel exposure and the sixth nickel producer globally, according to Canaccord Genuity's assessment. It already has an 80% interest in two RKEF lines (Hengjaya and Ranger) at Morowali industrial park, 20% owned by Tsingshan.

Bell Potter considers Weda Bay a highly attractive option with the potential for aggressive earnings growth and a rapid payback period, estimated to be under three years. **The company will also obtain lower operating costs from the ownership of the power station**.

Bell Potter, with a Buy rating and $1.52 target, believes this deal is highly value accretive as it allows for efficient growth for Nickel Mines in a market where peers are facing either stable or declining production.

Incorporating the transaction means a 50-70% upgrade to Macquarie's estimates for earnings per share while the dilution, assuming a 50:50 debt:equity funding split, means a -19% and -24% reduction to 2021 and 2022. Nevertheless, buoyant nickel prices drive upside risk to forecasts.

However, Shaw and Partners does not believe Nickel Mines will need to raise equity for the acquisition, assessing existing cash flow forecasts means this can be funded from reserves, future cash flow and US$250m in debt.

The broker has a Buy rating and a $1.33 target and incorporates earnings from Weda Bay in its financial modelling from the second half of 2023. Meanwhile, 2020 forecasts are also upgraded to allow for a stronger nickel price in the second half.

Shanghai Decent will construct and operate the four RKEF lines at Weda Bay along with the power station, and has contractually committed to a maximum cost of US$700m. By way of comparison the existing Morowali ramp-up took 1-2 quarters.

Weda Bay is not directly comparable to Morowali, Macquarie asserts, because it also includes a coal-fired power station while Canaccord expects the company will be granted the same tax concessions.

Canaccord applies a 60% risk consideration in its valuation to account for funding requirements and execution risk, calculating a $1.60 target with a Buy rating.

At Morowali, the Hengjaya mine re-started supply early in 2019 and Ranger in mid 2019 and both now have a steady state production of 22,000tpa of nickel a piece, running at 20-30% above nameplate. Shaw notes Morowali has a cheap source of both nickel ore and power which means costs are highly competitive at around US$7750/t.

Macquarie points out **the Weda Bay transaction does not incorporate any nickel ore supply agreement** and there is some risk, therefore, that it could cost more compared with Hengjaya and Ranger. The broker has an Outperform rating and $1.20 target.

Background

Tsingshan is a major shareholder in Nickel Mines, with 18.6%, and is also the world's largest stainless steel producer. The relationship between Tsingshan and Nickel Mines has meant the latter went from a raw material supplier from the Hengjaya mine to being a partner in building the RKEF capacity at Morowali.

Hence, as Shaw points out, it has become a high-value industrial processor of nickel pig iron. For Tsingshan the benefit was having an Australian-listed entity in which could make a strategic investment.

The Weda Bay complex has already been established with four commissioned RKEF lines and a further eight under construction is part of a strategy by Tsingshan to shift its nickel pig iron production to lower cost operations near the source of raw materials in Indonesia.

See also, Nickel Mines Poised For Price Recovery on July 10, 2020.

RUDI'S VIEWS

Rudi's View: Quality & Growth, Confidence & Execution

In this week's Weekly Analysis:

-Quality & Growth: Confidence & Execution
-Value Versus Growth - The Chart That Confirms
-That Dreadful ASX Website (Continued)
-Rudi Talks
-Conviction Calls

Quality & Growth: Confidence & Execution

By Rudi Filapek-Vandyck, Editor

On Wednesday last week, one local newsletter published a list of thirteen stocks that had all closed at a new all-time high on that day.

It didn't take long for me to realise five of the companies mentioned are included in the **FNArena/Vested Equities All-Weather Model Portfolio**.

One scroll through the full list of companies owned in the Portfolio instantaneously revealed the large majority of stocks in the Portfolio are either in the vicinity of their all-time high, or they peaked earlier in 2020 and have retreated somewhat since.

Most importantly, only a minority has been added during the course of 2020, indicating most stocks in the Portfolio have been trending upwards for a long while pre-covid, plus, of course, the pandemic hasn't destroyed their business model or corporate greatness.

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The philosophy behind the All-Weather Model Portfolio was born out of the GFC in 2008 when the likes of CSL ((CSL)) showed not every stock is equal when it comes to hunkering down for the bad times.

My research and experience since have proven stocks are almost never equal. Add to this the macro-observation that cycles are much shorter these days, and inflation subdued (at best), while disruption is all-around, targeting low-quality, low-growth laggards and the ideal starting point has been created to look for structural growth and high quality with a moat.

Despite the general view such companies represent higher risk, because of trading on higher valuations, the past five years in Australia have proved otherwise.

A share price that temporarily rises too high is easily fixed with ongoing strong growth, while a cheap looking valuation burdened by profit warnings, dividend cuts and other forms of disappointment literally translates into "lower for longer".

However, the (many) critics of this year's swift share market recovery do have a point when they argue not every fast-grower in 2020 is automatically a long-term shareholder champion.

As a matter of fact, if we stay true to statistics and observations from the past, we have to conclude most winners today are likely not of exceptional quality or destined for eternal greatness; they just happen to be in the right sector under the right circumstances at the right time.

And so it is much easier to look back and conclude if only I'd participated in the CSL float back in 1994, and held onto my shares since, instead of trying to figure out which of today's freshly emerging rapid-growers will remain successful beyond the coming weeks/months/years/decades.

I regard a successful track record an important piece of the puzzle. So does the market. CSL shares would never have consistently enjoyed today's valuation premium in the nineties or the noughties. Back then, it still had to prove itself and ultimate success was far from guaranteed.

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This is not to say that companies such as Fineos Corp ((FCL)), Readytech Holdings ((RDY)), Whispir ((WSP)), Pro Medicus ((PME)) and Audinate ((AD8)) cannot develop into long-term wealth creators; they all look interesting and successful (thus far), but we cannot possibly know what the future will bring.

So how do we know which ones to choose for the longer-term investment horizon? The honest answer is: we don't.

All the answers we are looking for will be provided through management's execution, either positive or negative, which will dominate the direction of share prices and determine whether market sentiment will improve, stick around or deteriorate.

This is not something we can find on a company's balance sheet or in the next set of stockbroker forecasts. Execution is all about providing evidence and building confidence.

It's easily forgotten today, but once upon a time CSL was operating in a market burdened by too much supply, while both Cochlear ((COH)) and ResMed ((RMD)) have had their product recalls, and subsequent share price shellacking.

A company of exceptional quality is not immune to day-to-day vagaries and challenges out there in the real world, but none of the headwinds and set-backs destroys them. In most cases, they arise in better shape and with renewed positive momentum.

This is why those share prices today are not far off from all-time record high price levels, and why I remain confident those record highs from the year past will, at some point, be replaced by new record highs.

Just like this has turned out this year's scenario for stocks including Carsales ((CAR)), NextDC ((NXT)), REA Group ((REA)), Xero ((XRO)) and Bapcor ((BAP)); all mentioned in last week's newsletter list, and all held in the All-Weather Model Portfolio.

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Most newsletters and investors are obsessed with valuation -cheap or expensive- but I'd argue the performance of the All-Weather Model Portfolio strongly suggests a strategy built on identifying quality businesses that reliably deliver combined with emerging new businesses on a sustainable, structural growth path has numerous benefits.

A few obvious observations to make:

-the number of negative profit warnings and/or dividend cuts suffered inside the Portfolio since inception nearly six years ago has been very low;

-bad news and misfortune don't stick around for too long (good things happen to great companies);

-periods of doubt and temporary stasis for the companies owned are usually followed by positive surprise(s);

-share prices in the Portfolio do not always hold up during the toughest of times, but they surely bounce and recover first;

-most retreats in share prices have been nothing but a temporary pause in a long-term uptrend.

All in all, I find, if I can remain confident the underlying trajectory for most companies owned remains up, I don't have to worry as much about what is likely to happen to the share price in the short term.

One look at the long-term price graph of AMP, for example, immediately reveals how important the timing of entry and exit points is. Look at the same graph for Xero and timing almost looks irrelevant.

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The most important feature about investing in the share market remains, without the slightest doubt, **the ability to respond to changes in general context and circumstances**.

We can all admire the tenacity of the early shareholders in CSL, but what about the many more who are still holding AMP shares today -two decades after they peaked- or shares in Telstra -more than two decades after they peaked?

Identifying great companies brings many virtues, but some greats do lose their mojo eventually. GE and Boeing spring to mind internationally. Locally, companies including Monadelphous, InvoCare and the banks could literally do no wrong for a long while, but their fortunes eventually changed, and quite in a dramatic manner.

Agility and flexibility remain every investor's best friend.

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Apart from combining quality and structural growth companies, the All-Weather Model Portfolio has always leaned on a third pillar; that of reliable and sustainable dividend growers.

But when the pandemic hit earlier in the year, that part needed to be re-assessed and replaced with a different set of trustworthy, dependable sources of income.

The only dividend stock we kept, and which still is held in the Portfolio, is Waypoint REIT ((WPR)) for a reliable 5.6% yield this year (on current share price of $2.68) and 5.9% next year, on market consensus projections.

Waypoint shares have since been joined by Aventus Group ((AVN)) and two of the other three names mentioned on my list of Australian dividend champions (see website, section All-Weather Stocks).

When it comes to this particular segment of the Portfolio, my view is certainty, low risk and reliability should be the highest priorities.

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The FNArena/Vested Equities All-Weather Model Portfolio continues to significantly outperform the broader market in Australia, despite repeated attempts by market participants to rotate into cyclicals and value laggards.

Portfolio performance for three months up to October 18th is a positive 4.76%, of which 0.55% was derived through dividends, versus the ASX200 Accumulation index posting a slightly negative performance of -0.44% over the same period.

The All-Weather Portfolio is migrating away from the Praemium platform, towards, we believe, much better service and lower costs. This will be a win-win-win for everyone involved.

More news about this in a few weeks from today.

Paying subscribers have 24/7 access to my research and commentary on All-Weather stocks and the Model Portfolio via a dedicated section on the website.

<u>Value Versus Growth - The Chart That Confirms</u>

One chart a thousand words?

I sat in long and boring presentations, have read a copious number of research reports and witnessed how teams of value investors presented their findings in an attempt to prove there was no fundamental justification as to why popular tech stocks are trading on elevated multiples, while their beloved 'value' companies where largely being ignored.

If ever investors wondered how biased the human mind can be, and how this is reflected in research and analysis done, there are quite a number of such regrettable examples around.

At times, it's not about what I can see that you cannot. It can also be a case of I can only see what I want (and I'll make damn certain I will find plenty of reasons to support it too!)

And then comes along the chart that explains it all. Thanks to Forager's Steve Johnson who kindly submitted the Goldman Sachs chart below to his Twitter followers on Monday.

The interesting factor on display is the fact Goldman Sachs has not taken into account forward looking estimates, but concentrated on actual achieved growth numbers instead.

I think the evidence speaks for itself: no growth for most parts of global companies, except when they are part of the fast-growing technology disrupters and hearts-and-minds conquerors.

It is exactly that gap that has been reflected in price action over the past five years, in Australia, and longer than that in the USA.

I have no doubt the value-biased investors who have been trying to disprove the thesis that has been dominating equity markets will accuse their peers at Goldman Sachs of somehow massaging the data to serve their personal views and conviction.

Having done a lot of research and analysis myself to find Goldman Sachs's observation is most accurate, one only has to question: who's fooling who?

That Dreadful ASX Website (Continued)

A lot of anger and disappointment has been spewed over social media, and elsewhere, following the launch of the new ASX ((ASX)) website.

Apart from the fact that change always unsettles and we humans like to stick with old habits and tricks, a lot of the bad feelings towards the ASX are expected to subside as investors find their way around the updated website.

On Monday, for example, the ASX reinstated company announcements going back as far as 1998, which has been a major achievement by activist investors who had been jumping high and low since the ASX -apparently- had initially decided it's better to stick to younger-dated announcements only.

Given the ASX has been preparing six long years for the newly launched website, and given the new website seems extremely keen to promote the ASX's role as seller of data and market insights, surely, I am not the only one around who is suspicious about the true strategy/motives behind many missing parts and a seemingly user-unfriendly design of the new website?

The fact the ASX has decided to make the new website advertisement free equally suggests the top has decided there is more money to be made from selling data and announcements than accommodating hordes of free-loading retail investors.

But hey, in a time of free-roaming conspiracy theories, I am simply doing my bit on this occasion.

Rudi Talks

Among the popular podcasters in Australia when it comes to investing and finance is the duo of Bryce and Alex at Equity Mates who have a knack of getting lots of experts in front of their microphone.

Last week it was my turn to see my hour-long conversation with the two going live on social media and on the Equity Mates website.

Check it out here: https://equitymates.com/podcast/rudi-filapek-vandyck/

Conviction Calls

Portfolio managers at stockbroker Morgans have used Macquarie Group ((MQG)) as the funding source to expand their exposure to Australian banks post the Australian government's budget announcements and a more benign environment for bad debts than initially assumed.

In addition, share market laggard Aurizon Holdings ((AZJ)) has seen its weight increasing in the stockbroker's Balanced Model Portfolio as at the end of September.

Morgans' Growth Model Portfolio is participating in the retail entitlement offer at Corporate Travel Management ((CTD)).

Coincidentally, Sze Chuah, Senior Investment Analyst at Ord Minnett, is equally of the view share prices for Australian banks have seen the bottom earlier in the year.

(This story was written on Monday 19th October, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's - see disclaimer on the website.

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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RUDI'S VIEWS

Rudi Interviews Harry Dent

A whirlwind interview with Harry Dent, former uber-bull on Wall Street who nowadays predicts the crash of all crashes, while at the same time offering investors post-crash optimism

-Harry Dent predicts biggest crash in history about to unfold
-Central banks' money-printing experiment (soon) to prove unsustainable
-Australia among few countries poised to dominate post-event

By Rudi Filapek-Vandyck, Editor FNArena

He's known as the modern day perma-bear, so when I was offered the opportunity to interview Harry Dent I thought: let's do this. Let's see what you've got, Harry!

What we got is a high-energy, full-velocity whirlwind history of financial bubbles, from the 1600s until today, with a rare pause in between. This guy has no "off" button!

He thumbs the table, gesticulates wildly, imitates a morose drug addict, then stares into the camera with all-fired up beaming laser eyes, raising his voice, declaring solemnly: if my predictions don't come out in the next three years, I am quitting my career!

His prediction, by the way, is nothing to be sniffed at: the biggest crash humanity has ever seen. More savage than the 1930s or the GFC. There will be very few places to hide for investors.

Dent's premise is based upon the fact that demographic trends usurp everything else and all cycles move through four stages, and right now we have entered "winter".

The sole reason this is not being reflected in asset prices, most prominently US equities, is because of massive money printing by the Federal Reserve and other central banks.

This policy, enacted "by accident" following the collapse of Lehman Bros in late 2008, won't prove sustainable and is only postponing the inevitable, Dent believes.

Though, when prodded with the right questions, he's willing to concede a second scenario outcome is possible, but Dent suspects not many are going to like that outcome either.

Dent is not universally uber-bearish, offering once this 11-year old financial asset bubble starts deflating, opportunities will be plenty, and he's sharing his strategy for the onslaught ahead – meanwhile marketing his new Dent Sector Fund.

Deflation, not inflation remains the dominating theme, he explains, while referencing Alan Greenspan, Ray Dalio, Peter Schiff and Mark Bouris.

Quote of the day: Facebook is the new Darth Vader.

Dent's promise: once the dust settles, Australia will be among five countries to stand-out in the post-crash recovery bull market.

Final tune: The future is uncertain; the end is always near. Thanks Jim Morrison and the Doors, and to you, Harry Dent.

To view the full interview (60 minutes): https://www.fnarena.com/index.php/fnarena-talks/2020/10/23/one-hour-with-harry-dent/

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions.)

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P.S. II - *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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