WEEK 47

FNArena
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FNArena
Financial News, Data & Analysis

GPO Box 3145 - Sydney NSW 2001
info@fnarena.com

Your editor:
Rudi Filapek-Vandyck

Your dedicated team of journo's:
Greg Peel & Eva Brocklehurst

AUSTRALIA

Coca-Cola Amatil Confident Of Growth In 2020

Coca-Cola Amatil expects a return to growth in 2020 with both channel and product mix providing positive impetus to revenue.

-Improving revenue trends in Coca-Cola trademarked product
-Indonesia still challenging although Coca-Cola Amatil well-positioned
-Value-added dairy and energy drinks the two opportunities in NZ

By Eva Brocklehurst

Coca-Cola Amatil ((CCL)) anticipates a return to growth in 2020, emerging from a transition period and renewing its focus on the top line. As cost savings diminish, revenue growth will become more important. Low single-digit growth in Australian beverages has eluded the company for several years but this should change from 2020. Growth in sparkling categories is expected to return, led by Coke.

There are improving revenue trends being seen for the Coca-Cola trademark, while merchandising and promotions in Australia have been revamped. The company is taking back control of merchandising in Australian supermarkets and this is expected to be critical for in-store execution.

Citi assesses the company's targets require low single-digit earnings growth in Australia and double-digit growth in Indonesia, PNG, coffee and alcohol while both channel and product mix should be positive for revenue per case and earnings.

UBS has become less negative about the stock in the wake of the update but retains a Sell rating on valuation grounds. The broker increases estimates for earnings per share by 1% to reflect higher Australian beverages volume growth in 2020 and a **large skew in profit to the second half**. Ord Minnett is more confident, finding the valuation more attractive versus the large Australian consumer staple peers.

<u>Lower Costs</u>

The main driver of the better outlook is lower costs, which Citi calculates could add 4-5% to growth in earnings per share in 2020. Costs are expected to fall -5% in Australia and -6% in Indonesia. The main costs include sugar, aluminium and PET resin which are inherently volatile, although only represent 20% of the cost of goods sold. Yet reduced costs should provide at least a $25m tailwind, in the broker's estimates.

Citi remains concerned that revenue growth will still be sluggish in key markets, forecasting growth in earnings per share of 3% in 2021 and just 1% in 2022. The broker also calculates, as the stock has recovered over the past year and now trades at 19x 2020 PE (price/earnings) estimates, a 16x PE is more appropriate given the benefit from lower commodity costs is a one-off.

UBS estimates the company has spent more than $120m over the last three years reinvesting in its Australian beverages business. Although top-line trends have started to improve the broker suspects further investment will be required. To become more positive UBS would need to witness a sustained pay-back of this investment in terms of volume growth and stable margins.

As cost reduction programs are largely complete, Macquarie upgrades to Neutral from Underperform. While Australia has returned to growth and New Zealand is outperforming, the broker notes Indonesia remains challenging.

Indonesia

Citi points out Coca-Cola Amatil has begun repatriating cash from both Indonesia and PNG, totalling around $243m of the almost $900m that is stranded in these countries. **The broker suspects the put option on the Indonesian stake from The Coca-Cola Company will not be exercised in 2023** as Indonesia will not meet its target. Returns on invested capital (ROIC) will be well below the weighted average cost of capital (WACC).

Ord Minnett notes, while a slowdown is occurring at the consumer level in Indonesia the beverages industry is still performing well and Coca-Cola Amatil is positioned for both revenue and earnings growth. The company has indicated it may be logical down the track to add other markets to its Indonesian franchise such as the Philippines, Singapore, Malaysia and Laos.

The Australian container deposit scheme is now embedded in base estimates which should help comparable sales, Macquarie points out. New Zealand is less reliant on the Coke brand or water and value-added dairy & energy drinks remain two key opportunities the broker envisages could provide growth in the region. The main risk ahead is the implementation of an NZ container deposit scheme in 2022.

FNArena's database has one Buy (Ord Minnett), two Hold and three Sell. Targets range from $9.10 (UBS) to $11.50 (Ord Minnett). The consensus target is $10.14, suggesting -7.0% downside to the last share price. This compares with $9.54 ahead of the company's update and with several brokers yet to comment on the briefing. The dividend yield on 2019 and 2020 forecasts is 4.5% and 4.4% respectively.

AUSTRALIA

How Important Is Home Ownership?

Home ownership has long been considered critical to building wealth in Australia. So, does it matter if young people are taking longer to get into the mortgage belt?

-Home ownership decline mostly attributable to affordability
-Yet other aspects of life have also been delayed
-Indefinite deferral of home purchase does have consequences

By Eva Brocklehurst

Home ownership has an impact on financial and personal well-being over the course of a person's life. This is a given. However, does it matter if young people are taking longer to get into the mortgage belt? Home ownership is a significant part of the retirement income system in Australia, in addition to the age pension and mandatory and voluntary superannuation.

Here are the statistics: just over half of Australian household wealth is stored in housing, distributed across 10.3m residential dwellings which are amongst the most expensive in the world.

Yet, home ownership is in decline. Across measures modelled by the ARC Centre of Excellence in Population Ageing Research (CEPAR) , home ownership is down -3-4 percentage points over the last two decades, led by young households of all incomes and middle-aged households with low incomes.

The median age of first home buyers decreased in the 1960s and 1970s as home ownership became widespread. Subsequently, from 1981, it has increased by nine years to a median age of 33


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Much of this decline has been attributed to affordability and there are both cyclical and structural factors supporting this. The Senate committee on housing affordability in 2008 found it to be at a record low. In the past 20 years house prices grew faster than household incomes.

A greater allocation of credit has become available to investors, supported by tax breaks, and a lag of about 10 years has opened up between the peak increase in demand and peak increase in the supply of housing. Several parliamentary investigations into such factors have suggested state governments should boost supply to fix the latter, while banking oversight was deemed preferable to tax changes to control excessive investor activity.

Yet, there are misleading features in some of the explanations being offered, with the researchers finding increases in migration are likely to overstate the percentage decline in home ownership, as migrants tend to rent apartments (around 75% of long-term temporary arrivals rent). Also, exempting the family home from the pension means test has been found to only inhibit downsizing to a small degree.

The research does point out declines in home ownership should be viewed in a wider demographic context and it's not just the price tag that is the obstacle. The biggest impetus associated with buying a home is marriage, which implies some potential to catch up over the life cycle.

Importantly, home ownership is just one of several life events that are being delayed, or put off. These include finishing education, the first job, having a child, getting married and... dying. **Even deferring their first home purchase by nine years would probably mean younger generations still enjoy home ownership longer than their parents**.

However, when it comes down to the indefinite deferral of home purchases there are consequences. Without your own home in old age, security of both tenure and finances can be compromised.

Banks may be reluctant to lend past a certain age and a greater share of home owners may retire with debt. The modelling suggests there is no imminent "wave of bequests" about to occur (as baby boomers retire) and the recipients of bequests are getting older.

Property made up 70% of assets of those dying aged 65-84 and research confirms that bequests are being delayed as life expectancy increases. Pensioners tend to hold onto assets rather than liquidate, to maximise pension income.

Meanwhile, one significant conclusion from the research is that **the retirement income system is failing those who rent.** When taking account of housing, older Australian renters have among the highest relative poverty rates in the OECD.

Moreover, financial hardship in old age is more likely for single older women with low education who rent. Hardship expectancy for women with similar characteristics, but who owned their home, was half that of those who rent.

CEPAR suggests the retirement income system review by the federal government, due to report next year, is an opportunity to take housing into account, with the aim of narrowing the financial gap between those who rent and those who own.

AUSTRALIA

Upgrades Happening Again At Appen

Appen has upgraded guidance for 2019, underpinned by its core Relevance revenue and largely from existing customers. Figure Eight provides the extra potential in 2020.

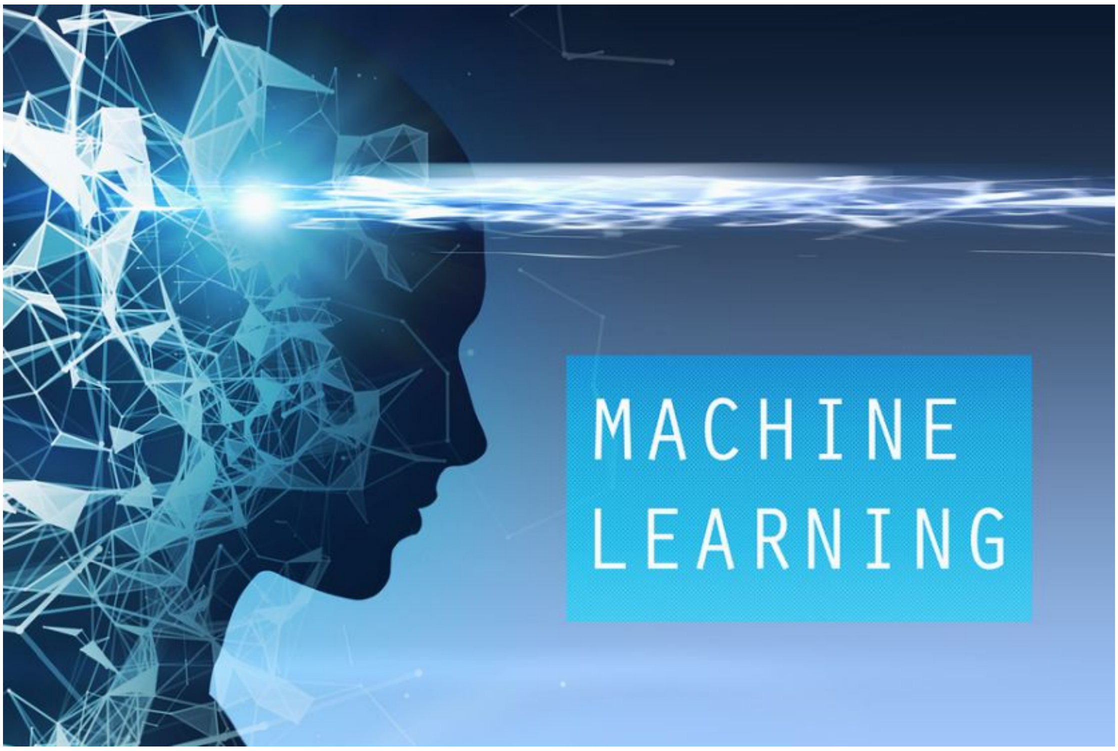
-Figure Eight revenue guidance confirmed
-Appen likely to be net cash by 2021
-Revenue model remains unpredictable

By Eva Brocklehurst

For the third time in 2019, language technology data provider Appen ((APX)) has upgraded guidance for operating earnings, to $97-100.5m from $85-90m, implying an increase of around 7% at the mid point.

The increase was driven by Relevance revenue and margins, largely from existing projects and customers. The company has also reiterated its conviction in the Figure Eight artificial intelligence acquisition and confirmed the annual recurring revenue (ARR) expectations in 2019 of $30-35m.

This suggests to Credit Suisse Figure Eight business has stabilised, after ARR expectations were revised down at the first half result because of the distraction in bedding down the transaction.



UBS had upgraded its investment opinion based on the strength of the core Relevance business, which should become clearer at the 2019 results and support a re-rating on multiples.

Bell Potter now forecasts operating earnings of $100.7m, slightly above the top end of guidance. Strong underlying growth is also expected in 2020 and 2021, at 19% and 21% respectively. Positive underlying operating earnings are expected from 2021 as losses from Figure Eight diminish.

The broker assesses there is potential upside to distribution forecasts as these assume a pay-out ratio of just 20%, and the company should be net cash even after the payment in 2020 of the deferred consideration for Figure Eight.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, reduces the weighted average cost of capital applied in its valuation to 9.7% from 10.1%, because of a reduction in the risk-free rate.

The net result is an increase in the target to $28.00 from $27.50 although, as the total expected return at this level is 6% and below the required 15% threshold for a Buy rating, the recommendation is reduced to Hold.

Credit Suisse suggests the next catalyst is likely to be 2020 guidance at the February result and retains some concerns about the earnings bridge, such as the isolated earnings improvement from Figure Eight and capture of the synergy benefits.

Still, the broker remains upbeat about demand and envisages Figure Eight as a tool to broaden the customer base. Bell Potter notes the acquisition requires integration of software platforms and the migration of customers, carries some risk.

Moreover, the company's revenue model is unpredictable, as most is generated from purchase orders rather than recurring subscription fees. This means there can be a lack of visibility or certainty beyond the short term.

Appen, established in 1996, has a track record of revenue growth and strong margins. The two divisions include Relevance and Speech & Image. The former provides annotated data used in search technology while the latter provides data used in speech & image recognition, machine translation and speech synthesisers.

FNArena's database has two Buy ratings (Citi is one and yet to comment on the update) and one Hold (Credit Suisse). The consensus target is $29.66, suggesting 11.1% upside to the last share price.

See also, Demand For Appen Intelligence Escalates on August 6, 2019.

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

AUSTRALIA

Are Market Fears For Suncorp Overdone?

In his first presentation to investors as CEO of Suncorp, Steve Johnston opted to exclude all reference to profit margins and returns, implying potential for another earnings re-set.

-Banking focus back towards the Queensland market
-Stable margin outlook in banking for the first half
-Some signs of improvement in home and motor insurance

By Eva Brocklehurst

Suncorp ((SUN)) has renewed the focus on its home banking market in Queensland, as the first investor briefing from the new CEO, Steve Johnston, avoided referencing past targets. Mr Johnston opted to exclude all references to profit margins and returns, Credit Suisse points out, implying management is not yet comfortable with putting in place any medium-term targets.

This signals to the broker another earnings re-set and a gradual rebuilding of investor confidence. Credit Suisse also suspects a renewed focus on the Queensland market may worry some investors.

A tough lending environment continues to shape the business as total lending contracted -0.6% over the first quarter. The housing book declined -0.6% amid a competitive mortgage market, although volumes appear to have improved since July. Business loans contracted -0.4%, affected by a reduction in agribusiness.

Net interest margins in the first half are expected to be consistent at around 1.9% amid solid deposit growth and improved wholesale funding costs. **There are some signs of recovery in the property market but the competition for owner occupier and investor business is expected to continue.** Moreover, Suncorp has pointed to ongoing drought in Queensland and NSW contributing to a decrease in funding demand from farmers who are focused on paying down debt.

Some slippage may have occurred in the bank loan book but UBS assesses the margin outlook for the first half is stable and benign bad debt should provide support. Citi agrees market fears of a more significant downgrade to bank estimates were not realised. Also, the simplification of reporting lines appears to have potential to alleviate some of the recent difficulties with growth.

Macquarie is not so certain, finding the FY20 performance difficult to benchmark and noting, along with a new CEO, there are only acting chief financial officers, and a vacant CEO position for the bank division.

Impairment levels in the first quarter appear unsustainable and the broker envisages heightened risk for expectations being re-based in FY20, particularly given the drought, and adds 3.5 basis points of impairments to FY20 forecasts.

General Insurance

In the larger general insurance business there appears to be some signs of improvement across both home and motor insurance, and Citi understands momentum is strong in motor insurance. Suncorp has reversed its previous decision to shut down call centres.

Pricing is mostly in line with, or ahead of, inflation, which should ease concerns about the necessity to pull on the price lever. Commercial insurance is enjoying price increases, although there is greater competition outside of Queensland in CTP (green slip) insurance. Macquarie points out there remain ongoing market share losses for Suncorp in home and motor products.

Surplus Capital

Suncorp has still not indicated what it will do with the proceeds from the sale of Capital SMART. The after-tax profit has been upgraded to $285-295m while cash consideration for ACM Parts is unchanged at $20m. Bell Potter assesses these transactions will generate around $300m in excess CET1 capital. **Suncorp is expected to update the market on these initiatives at the FY20 result in August 2020**.

Given strong organic capital generation, and assuming natural hazards do not exceed the $820m allowance for the full year, Bell Potter forecasts another $0.08 special dividend and a further return of capital in the second half of FY20.

The broker, not one of the seven brokers monitored daily on the FNArena database, has a Buy rating and $14.80 target, based on Suncorp's yield and growth story. Citi agrees the dividend yield is attractive and a PE (price/earnings) multiple below 16x indicates some value exists. In contrast, Credit Suisse considers the earnings risk elevated and still not reflected in the share price.

FNArena's database has three Buy ratings, one Hold (Ord Minnett) and three Sell. The consensus target is $13.38, suggesting 0.7% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 5.4% and 5.3% respectively. Targets range from $12.10 (Morgan Stanley, yet to comment on the update) to $14.50 (Citi).

See also More Returns as Suncorp Sells Chop Shops? On October 2, 2019.

AUSTRALIA

Growth And Challenges Ahead For a2 Milk

A2 Milk envisages strong growth in the year ahead despite the challenges in the Chinese infant formula market. The main issue for brokers is whether the necessary investment will deliver the expected returns.

-Marketing, investment and costs likely weighted to the second half
-Strong growth expected despite challenging trading conditions
-Re-negotiated supply contract with Synlait Milk highlights improved pricing

By Eva Brocklehurst

Broker opinions differ widely on the near-term outlook for a2 Milk ((A2M)) as the company negotiates complex changes in the Chinese infant formula market and advances its marketing of liquid milk in the US.

Ord Minnett assesses the step-up in investment that is required to access the significant opportunity in the Chinese infant formula and US liquid milk market is now more likely to occur from 2020 onwards.

There are also ongoing challenges in the channel mix and rising competition in the Chinese market for infant formula. Breaking even in the US liquid milk category is also expected to be long-dated. As the stock offers limited valuation support, the broker retains a Lighten rating.

The company recognises further growth in the Chinese market requires success in cross-border e-commerce and mother & baby stores, along with other bricks & mortar channels. Yet Ord Minnett points out the abandonment of the US break-even target to better pursue the opportunity has resulted in margin compression being deferred to 2020, rather than being avoided.

Morgans agrees the margin will still decline relative to FY19 as the company moves into an investment phase. **Revenue growth will now come at a much higher cost than in the past given a2 Milk is not as reliant on daigou** (product purchased outside China for sale in China).

Still, the broker considers the forecast for strong growth a credible outcome, in the light of peer results that highlight the challenging trading conditions, increased competition and regulatory changes. Declining birth rates in China are also cited as a limiting factor going forward, although the company argues that increased household penetration still contributes to the attractive category growth prospects.

Margins

FY20 margin guidance has been upgraded to 29-30% while the company has guided to a first half margin of 31-32%. The reason for this is that marketing, investment and costs are likely to be weighted to the second half.

The fact that gross margin drove the upgrade to the overall outlook is positive, UBS suggests, as it indicates a2 Milk is not discounting its product in order to create more volume, amid some concerns about inventory levels. UBS has become incrementally more positive after channel checks regarding inventory levels.

The main issue the company faces is about what is a realistic long-term share of the Chinese infant formula market and what level of profitability can be achieved. UBS forecasts long-term share of 11% and group operating earnings margins of 30%. This should mean this business delivers around 16% five-year compound growth.

Citi reiterates a Sell case, although acknowledges momentum appears strong. The broker believes margin expectations from FY21 do not reflect the impact of increased investment and are too optimistic. Competition is also heightened, as multiple operators enter the segment, although this will take time to play out as switching is not significant at present.

Morgan Stanley agrees, assessing the majority of the margin upgrade can be attributed to price/channel mix benefits and an earlier forecast that was conservative. Management has indicated that store velocity drove the majority of growth in China in the first half to date. Moreover, the broker suggests infant formula sales data, while imperfect, signals softer end-market pricing, which implies demand is slowing.

CLSA, not one of the seven stockbrokers monitored daily on the FNArena database, downgrades to Sell from Underperform. The broker implies, from the update, that the second half operating earnings margin will fall to around 28%. The issue is whether this is a reliable gauge for FY21 margins. While some recovery is expected it is not enough to turn CLSA bullish and a target of $12.80 is in place.

Bell Potter, also not one of the seven, sticks with a Hold rating and $13.55 target, noting, for the first time, the company has not released a four-month trading result but instead provided an update to guidance. First half guidance implies infant formula revenue growth in Australia is stronger than Bell Potter previously expected while China and US revenues are softer.

Wilsons, not one of the seven, takes a different view and upgrades to Overweight, believing the current share price represents an attractive entry point, retaining a target of $15.30. The broker is encouraged by the trading update, coming 10 months after the launch of China's new e-commerce law, as it demonstrates a smooth transition from the daigou-led market to a more direct sales model.

Wilsons had been uncertain about this aspect, as well as regarding returns from increased marketing expenditure, but now believes the renegotiated supply contract with Synlait Milk ((SM1)) provides a buffer. A2 milk has extended its contract to five years, with the main impact being improved pricing from FY21 and Macquarie expects this will drive gross margin expansion.

There was no reference to the 12% marketing-to-sales ratio which could otherwise be used to anchor revenue. Still, Macquarie assesses the size of price increases taken in FY20 reflect confidence in the outlook for demand.

FNArena's database has two Buy ratings, two Hold and three Sell. The consensus target is $13.28, suggesting -3.5% downside to the last share price. Targets range from $10.80 (Morgan Stanley) to $16.20 (Macquarie).

AUSTRALIA

Qantas Sets Ambitious Targets

Qantas asserts that its dominant position in the domestic market and dual brand advantage will support ambitious targets for margin expansion.

-Disciplined capacity growth from all domestic operators critical to achieving targets
-Transformation benefits of $400m expected to be ongoing
-International targets may be very optimistic, Credit Suisse suggests

By Eva Brocklehurst

Margins were the highlight of the Qantas Airways ((QAN)) investor briefing as new ambitious targets were set. Targets for earnings (EBIT) margins of 18% and 22% by FY24 have been set for Qantas domestic and Jetstar domestic, respectively.

Management believes the company's dominant position in the domestic market and its dual-brand advantage will support margin expansion. While the targets appear optimistic, UBS assesses they are based on realistic assumptions for 2.5% unit revenue growth per annum and unit costs growth of 1% per annum.

The broker acknowledges disciplined capacity growth from all domestic operators remains critical to achieving targets, noting this is occurring, with Virgin Australia ((VAH)) removing -2% of near-term capacity over the past week. Citi also assumes the domestic market remains rational as many of the short-term catalysts play out for Qantas stock.

Credit Suisse observes these targets are 5-6 percentage points higher than historical peaks and based on rational capacity, revenue per available seat kilometre (RASK) growing at 2.5% per annum and available seat kilometres (ASK), ex fuel costs, growing by 1.0%.

Further momentum in the share price is likely to be driven by earnings revisions and multiple expansion and the targets represent significant upside to Morgan Stanley's long-term forecasts. Macquarie, too, assesses profitability improvements over the next five years in the domestic airline businesses could be significant, albeit subject to economic conditions.

Management previously guided to a minimum of $400m in transformation benefits in FY20, largely based on cost reductions, and now expects this to be ongoing via technology, operating efficiencies and supplier management.

Loyalty Target

A loyalty target for earnings of $500-600m by FY22, through membership growth and higher membership engagement, has been reiterated. This implies annual growth of 7-10% from FY17. Morgan Stanley believes the **value in the Qantas loyalty business is hard to ignore**, noting the new business additions and momentum.

UBS agrees but finds the target ambitious compared with FY19 earnings of $375m. The 5% growth anticipated from core partnerships is expected to be topped up by a doubling of the contribution from new business, such as insurance, by FY22. This implies annual growth of 7-10% from FY17. The broker points out visibility on the contribution from new business, such as insurance, is low.

Qantas is still committed to a decision on Project Sunrise by the end of 2019. The project remains subject to consideration of the minimal capital requirements for the fleet, the appropriate configuration and expected load factors. Moreover, new enterprise bargaining agreements must be put in place for pilots and crew members.

The company's financial framework assumes capital expenditure of $2bn is required to maintain its current fleet and, brokers note, this does not incorporate expenditure for long-range flights associated with Project Sunrise.

Morgan Stanley has always considered this capital expenditure guidance an 'average', with scope for some lumpy items year-on-year. Still, maintenance of the figuring should be viewed favourably, in light of some investor concerns regarding higher expenditure and lower free cash.

Macquarie asserts that, if Project Sunrise proceeds, it would likely remove the capital management option as balance-sheet capacity is reallocated. However, UBS does not believe the replacement of the domestic fleet should affect capital management assumptions as there is some flexibility regarding timing.

International

Qantas has also reiterated targets for returns on invested capital (ROIC) of over 10% for Qantas international and over 15% for Jetstar international. Credit Suisse calculates these targets equate to a Qantas group earnings margin of 15%.

This compares with the average group margin over the past 25 years of 6.5%. Qantas has hit double digits in this regard only twice, in FY16 and FY18. Hence, the broker suggests the airline may only achieve these targets in an "lucky year" and they are not sustainable.

As a side issue, Credit Suisse suspects the company's success in cost cutting and the strong financial performance over recent years could precipitate increased demands from employees. Hence, cost inflation could surprise to the upside.

FNArena's database has four Buy ratings and one Hold (Credit Suisse). The consensus target is $7.30, suggesting 2.2% upside to the last share price. Targets range from $6.60 (Credit Suisse) to $8.00 (Macquarie).

Disclaimer: the writer has shares in the stock.

AUSTRALIA

Aristocrat Leisure Remains On Winning Streak

Aristocrat Leisure has built a strong track record and brokers found little to dislike about the company's FY19 results. The focus is now on a promising digital strategy.

-Narrows its digital target to more profitable user growth
-Australian margin expansion underpinned by favourable commercial mix
-Significant scope for accretive acquisitions/capital management

By Eva Brocklehurst

Aristocrat Leisure ((ALL)) continues its winning streak, with results in FY19 ahead of most expectations. The main engines of growth are North America and the digital business.

Brokers found little they didn't like in the results, although Macquarie notes social casino growth was disappointing. That said, the trend is improving and healthier revenue is considered likely in FY20, albeit skewed to the second half.

The company has built a strong track record and the US remains the spearhead of growth, Citi asserts. As growth in this market begins to mature, the broker notes drivers pivot to adjacent land-based opportunities and online video game RAID. Adjacencies could contribute US$59m in incremental earnings from FY19-21, Citi estimates, which is equivalent to almost half of the Americas segment earnings growth.

UBS found it hard to fault the results. The Australian margin expansion of 120 basis points was underpinned by a favourable commercial mix towards recurring revenue/bundle offers. Churn is currently slower and this situation is expected to continue in FY20. Meanwhile, the EMEA (Europe, Middle East, Africa) installed base grew 23% and offset some of the declines in other regions.

Credit Suisse is more muted in its appraisal, making only modest upgrades to FY20 estimates. Net profit in FY19 of $894.4m was up 22.6%. The company has 12 new games on the development board, including four in test mode. Ord Minnett is confident of another 12 months of land-based dominance by Aristocrat Leisure, where the company's performance as well understood and predictable.

The focus turns now to the promising digital strategy. Aristocrat Leisure has curtailed investment in lower-quality players in order to grow profitability later on. Because of the ever-changing costs, **Ord Minnett suspects Aristocrat Leisure will not provide guidance on margins or expenditure in this business**. This is not poor management but rather the unpredictable nature of the bid/ask mobile advertising market, the broker adds.

The RAID game delivered around US$110m in revenue in FY19 and Credit Suisse expects it to grow to US$350m by FY24. Citi has a similar expectation for RAID and continued investment is anticipated for the next 6-12 months, while UBS suspects Aristocrat Leisure is looking at the long-term value of this title, not short-term profit.

Capital Management

The company expects to continue with its current dividend policy in conjunction with managing debt repayments, retaining the potential for bolt-on acquisitions. Redeploying the balance sheet could provide another leg of growth, Citi suggests, through capital management and/or acquisitions.

The broker continues to forecast a $600m share buyback from FY21 in the absence of acquisitions and calculates Aristocrat Leisure could internally funded a $2.5bn acquisition. Morgans agrees there is significant scope for accretive acquisitions and these are likely to be in the digital space where the company is growing its skills and product.

Macquarie observes **the company is generating in excess of $1bn in operating cash flow that is supporting rapid deleveraging** . Despite rapid deleveraging, Aristocrat Leisure is yet to formalise its optimal capital structure.

The broker believes this stems from a view that growth by acquisition is more attractive than capital management and assesses there is more than $1.5bn available for capital management/acquisitions. Macquarie also believes these qualities are not appropriately reflected in the share price and, while only qualitative guidance was provided, forecasts $1.04bn in net profit in FY20.

Wilsons considers the stock a structurally sound investment and does not believe the growth outlook is fully priced into the equity. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, has an Overweight rating and $36.96 target.

Credit Suisse simply believes the stock has hit a "valuation wall". At 19x FY21 estimates, the PE (price/earnings) ratio is not a stretch and, given the company's excellent fundamentals, the broker suspects investors may move to more comparative valuations and abandon DCF valuations.

The database has six Buy ratings and one Hold (Credit Suisse). The consensus target is $37.29, suggesting 9.9% upside to the last share price. This compares with $34.44 ahead of the results. Targets range from $35.00 (Credit Suisse, Morgan Stanley) to $39.60 (UBS).

COMMODITIES

Material Matters: Iron Ore, Base Metals & Coal

A glance through the latest expert views and predictions about commodities. Guinea; iron ore; base metals; and coal in China.

-Shaw and Partners relieved Fortescue did not win bid in Guinea
-More stability for iron ore expected in 2020
-Citi suggests pairing long copper with short zinc & lead
-Subdued economic outlook weighing on coal sentiment

By Eva Brocklehurst

Fortescue Metals & Guinea

Guinea hosts some of the largest and highest-grade iron ore deposits and **Fortescue Metals** ((FMG)) had put its hat in the ring for the recent auction process. The crucial word is 'deposits', as Shaw and Partners notes there has been a long and arduous journey for those, such as **Rio Tinto** ((RIO)), aspiring to develop deposits in Guinea over the past decade, emphasising there is no current production.

The government has announced a preferred bidder for Simandou blocks 1 and 2, a consortium representing China, France, Singapore and Guinea interests, which put a US$14bn offer on the table, including 650km of rail. Fortescue Metals is understood to have offered well below the winning bid and did not formally promise to build the railway.

The initial response from Shaw and Partners is "phew". The reason given is the general lack of understanding of what the company was doing in Guinea and why. The broker acknowledges, at the right price/structure, such a province is an opportunity for an iron ore major. Nevertheless, Guinea is not Western Australia, either geologically, politically or fiscally.

Iron Ore

Vale will resume operations at its Alegria mine, adding 8mtpa to its system capacity, which now stands at 357mtpa. JP Morgan notes Vale should arrive back at 400mtpa by the end of 2021 if it delivers on guidance.

Meanwhile, Rio Tinto has announced it will not reach 360mtpa until after Koodaideri ramps up in 2021. JP Morgan maintains a forecast of US$85/t for the iron ore price in the first quarter of 2020 amid positive near-term drivers such as improving global PMI and stronger steel spreads.

Macquarie also assesses positive signs are emerging in the iron ore market as steel margins improve. Premiums for high-grade iron ore have remained relatively stable at 110%, the broker adds. Low-grade prices have been more volatile. While port stocks of iron ore have remain flat, suggesting a re-stocking of inventory is yet to occur, this presents a near-term catalyst for prices.

The broker notes Rio Tinto has cut its Pilbara guidance twice in three months from weather disruptions and operating issues and maintains a long-term forecast of 340mtpa. Meanwhile, **BHP Group** ((BHP)) shipments are running in line with the top end of guidance of 265-270mt. Fortescue Metals expects to ship 170-175mt in FY20.

ANZ analysts point out traders are becoming more bearish on iron ore amid compression in steel margins and the rising supply of high-grade Brazilian ore. These issues are affecting Chinese trader sentiment as a recent trip to China confirmed.

Steel traders appear to be running down stocks in case demand retreats further as winter arrives. Hence, with November being traditionally the weakest monthly year for steel output, iron ore prices are likely to explore the downside support level of US$70/t before the end of the year.

ANZ analysts warn the market is getting too far ahead and overly confident on Vale's ability to return to capacity, which the company has indicated is 1-2 years away. A more stable backdrop is expected in 2020 because of Chinese stimulus measures and ongoing supply constraints in Brazil.

National Australia Bank analysts maintain iron ore forecasts, expecting Chinese landed spot prices will average US$93/t in 2019 and ease to around US$74/t in 2020.

Base Metals

For those thinking of going long on **copper**, amid tightening scrap availability, Citi suggests pairing with **zinc & lead**, which are in bearish territory. The broker notes clients have been bearish on zinc & lead but were yet to go short, owing to upside risks from improving macro sentiment.

Above US$2,500/t Citi considers the risk to the outlook for zinc skewed to the downside and, while an improving macro environment could lift prices a little in the near term, the larger sell-off is not far away. Lead prices have also further to fall on news of the return of Port Pirie lead smelter, although those with lower risk appetite may want to wait for spread tightness emerging on the London Metal Exchange (LME), the broker suggests.

National Australia Bank analysts note recent trends in base metals have been mixed with **aluminium**, copper and zinc tracking higher while **nickel** has eased. That said, prices are still well below mid 2018 levels, with the exception of nickel. The poor outlook for economic growth and global trade is depressing base metal demand in 2020, the analysts suggest.

Morgan Stanley notes the resumption of nickel ore exports from Indonesia and rising inventory in Shanghai have brought the price below US$16,000/t. A correction appears overdue. After suspending exports two weeks ago, Indonesia has allowed exports to resume from nine companies, at least until January 1, 2020. Morgan Stanley estimates output at around 60,000t per month.

The partial lifting of the suspension plus rising Chinese imports from elsewhere supports the broker's view that China will have sufficient inventory to maintain nickel pig iron production through 2020 at around 500,000t. Given this and growing production from Indonesia, as well as weakening demand for nickel in **stainless steel**, Morgan Stanley expects the price to come under further pressure in 2020. Some upside risk maybe evident in the withdrawal of inventory from the LME.

Coal & China

A slide in the price of **coal** in China implies further deterioration in the fundamentals, Macquarie suggests. Prices slumped in the domestic coal market and the broker's reasoning is that the industry has been oversupplied in the second half of 2019, amid robust domestic production and stable imports.

The recovery in Shanxi production after a fatal accident in January disrupted the first half is adding supply pressure to the thermal coal market. Macquarie estimates supply growth for both thermal and coking (metallurgical) coal a similar, as the biggest coking coal producer, Shanxi, has been performing strongly and contributing 48% of China's domestic supply.

However, coal production from both Shanxi and Inner Mongolia fell marginally in September, which the broker considers worth noting. All up, it appears to Macquarie that market sentiment is reflecting concerns over supply growth vs relatively subdued demand growth, a function of weakening economic activity.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 15-11-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday November 11 to Friday November 15, 2019
Total Upgrades: 9
Total Downgrades: 11
Net Ratings Breakdown: Buy 37.59%; Hold 45.77%; Sell 16.64%

The ASX remains a share market polarised by rising share prices and lack of broad earnings momentum.

For the week ending Friday, 15th November 2019, FNArena registered nine upgrades for individual ASX-listed stocks and eleven downgrades. The difference in favour of downgrades is caused by Incitec Pivot and OZ Minerals who received three and two downgrades respectively while Domain Holdings remained the sole receiver of multiple (2x) upgrades.

Good news stems from the observation eight of the nine upgrades shifted to Buy (or an equivalent) while five of the eleven downgrades moved to Sell.

Confusing for investors, no doubt, is that high flyers such as Afterpay Touch and CSL continue to receive fresh upgrades to Buy. On the negative side of the ledger, AusNet Services, Cromwell Property Group, Incitec Pivot, OZ Minerals and REA Group all received a fresh Sell recommendation.

Positive adjustments to valuations and price targets remain rather benign, also because the out-of-season corporate results releases have not been stellar thus far. One might argue the disappointment from the August results season has simply been extended into November. Domain Holdings received the largest increase during the week (up 5.9%), followed by Stockland and Incitec Pivot.

On the negative side, the adjustments look slightly larger, but here the good news comes with the observation only few stocks truly deserve to be highlighted. Those three are Flight Centre, a2 Milk, and AP Eagers. Both Flight Centre and AP Eagers warned their shareholders about subdued operational dynamics.

The unusual observation is that aggregate amendments to earnings forecasts had a bias to the positive side for the week past. This is not something that occurs on a regular basis in Australia. While one swallow does not a summer make, it is nevertheless something to keep an eye on. For all we know we are witnessing the early signs of a trend change that might have significant consequences down the track.

Investors will be holding their fingers crossed, especially those with portfolios filled with laggard names such as industrial cyclicals, banks, materials and energy producers.

Major honours for the week go to Incitec Pivot, followed by Zip Co, Afterpay Touch, Ardent Leisure, EclipX Group and National Australia Bank. Note the prominent absence of the sectors mentioned in the preceding sentence, NAB being the exception.

For once, the negative side has less weight to throw in the scales, though the top end (bottom) still carries large negative adjustments, including for Nearmap, Nine Entertainment (profit warning), Flight Centre (profit warning), REA Group (subdued market update) and News Corp (see REA).

Australia's out-of-season corporate results season continues this week but companies reporting are of a different calibre, which opens up a different kind of question: are these companies still enjoying the better operational momentum?

Upgrade

AMCOR LIMITED ((AMC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/2/0

The first quarter revealed volume growth in medical flexible packaging and liquid flexible pouches, areas not immediately evident. There is no change to company guidance, with Amcor reiterating FY20 estimates for earnings per share of US61-64c.

Plastic volumes increased and Credit Suisse cannot, therefore, conclude that environmental concerns are affecting overall plastic consumption. Rating is upgraded to Outperform from Neutral and the target raised to $15.50 from $14.75.

AFTERPAY TOUCH GROUP LIMITED ((APT)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/0/1

Citi analysts have dug deeper into web site traffic and app downloads for the Buy Now, Pay Later sector in general. Their conclusion is that Afterpay Touch had a solid October in the USA.

In addition, Citi expects the recent launch of a number of marquee brands to result in strong merchant sales over the upcoming holiday period.

The analysts continue to see fierce competition as the key risk for the company, but given the recent share price retreat, and the above analysis, they have decided to upgrade to Buy from Neutral. Price target $31.10 (was $33.70).

Minor amendments have been made to forecasts.

AUB GROUP LIMITED ((AUB)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 2/0/0

The company has reaffirmed its FY20 guidance. Credit Suisse was encouraged by the update and notes the share price has underperformed the market by around -30% over the last 12 months following a series of earnings downgrades.

Company specific issues have had an impact and offset a favourable operating environment. With this risk passing, the broker upgrades to Outperform from Neutral. Target is raised to $12.75 from $11.45.

CATAPULT GROUP INTERNATIONAL LTD ((CAT)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Catapult Group has renewed and expanded its deal with Rugby Australia, in the wake of renewing its deal with the NRL, meaning no more material renewals upcoming in the near future.

The key to RA's renewal was the technology, Morgans notes, not the price, suggesting R&D investment is paying dividends.

The broker now expects Catapult to achieve FY20 sales, earnings and cash flow targets, and has upgraded to Add from Hold in anticipation of outperformance ahead.

De-risking means the broker has also lowered its cost of capital assumption, leading to a target price increase to $2.19 from $1.56.

CSL LIMITED ((CSL)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/2/0

As industry continues to collect plasma, UBS notes the average fractionator has the option of increasing the immunoglobulin price and/or reducing the price of albumin to stimulate demand.

As US albumin pricing is arguably at a floor, the broker believes using the immunoglobulin price lever is more likely to be used.

As CSL has embarked on plasma expansion well in advance of its peers it is likely to grow ahead of the market, in the broker's view. UBS upgrades to Buy from Neutral and raises the target to $295 from $265.

DOMAIN HOLDINGS AUSTRALIA LIMITED ((DHG)) Upgrade to Outperform from Neutral by Macquarie and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/1/2

Macquarie observes cost management has offered more protection than previously expected against the headwinds to volume. Trading was slightly weaker than expected in July to October but offset by strong cost-cutting.

While some of the costs will return, the broker assesses the business has significant operating leverage. Trends are expected to improve in December.

Rating is upgraded to Outperform from Neutral. Target is raised to $3.60 from $3.20.

FY20 trading was stronger than Ord Minnett expected and a new pricing structure to be rolled out on January 1 should help improve yields and depth penetration.

Ord Minnett expects a recovery in the real estate listings environment in the second half of FY20 and prefers Domain to REA Group ((REA)) , as the former is more leveraged to improvements in Sydney and Melbourne.

Rating is upgraded to Accumulate from Hold and the target raised to $3.65 from $3.15.

ELANOR INVESTORS GROUP ((ENN)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 1/0/0

The company has announced the IPO of the Elanor Commercial Property Fund and the establishment of the Elanor Wildlife Fund along with a placement of $31m and a $5m share purchase plan at $2.10.

The Wildlife Fund will be seeded from the Featherdale Wildlife Park, which Ord Minnett considers an inflection point for the business, as it re-casts the company as a pure-play fund manager as opposed to a diverse alternative investor.

The broker upgrades to Accumulate from Hold, believing the business is now a more accessible investment. Target is raised to $2.32 from $2.28.

SPARK INFRASTRUCTURE GROUP ((SKI)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 0/5/1

Morgan Stanley assesses the share price has now incorporated the FY21 re-basing of the distribution. The stock is down -9% over the year to date so valuation has become undemanding and the risk/reward is more balanced.

The broker upgrades to Equal-weight from Underweight. Target is reduced to $2.15 from $2.24. Industry view is Cautious.

Downgrade

AP EAGERS LIMITED ((APE)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/1/0

Ord Minnett was underwhelmed by the trading update, which indicated pre-tax profit for the first 10 months of 2019 declined -6%. The broker likes the business model over the medium term but is not over confident about 2020.

This leads to a downgrade to the rating to Hold from Accumulate. The broker points out the economics of dealerships have changed and are likely to continue to evolve and AP Eagers is ideally positioned to participate in consolidation and leverage its market leadership.

Yet, Ord Minnett is cautious about consensus expectations, which imply a market recovery and/or meaningful merger benefits in 2020. Target is reduced to $11.50 from $12.50.

AUSNET SERVICES ((AST)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/4/2

AusNet Services' first half result was weaker than Morgans expected, even after including a one-off boost from a sale of inventory. The broker has materially downgraded forecasts, re-basing to the weak first half performance, and including assumptions of lower-for-longer interest rates and inflation.

Target falls to $1.58 from $1.74. Morgans now calculates a forecast total shareholder return of -10%, hence a downgrade to Reduce from Hold.

CROMWELL PROPERTY GROUP ((CMW)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/1/1

Cromwell Property will acquire a portfolio of seven Polish retail properties for around $1bn on an estimated capitalisation rate of 5-5.25%. The transaction will settle in November and the company intends to reduce its interest to 20-30% over the next 18-24 months.

Cromwell Property already manages the assets on behalf of third-party investors. The company has not disclosed its gearing post the transaction, nor its covenants.

Given real estate investment trusts have a chequered history when it comes to leverage during the global financial crisis, Ord Minnett suspects the buffer to covenants will be too tight for some equity investors.

Rating is downgraded to Lighten from Hold. Target is $1.10.

CSR LIMITED ((CSR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/2/3

Macquarie retained Outperform in the wake of CSR's recent earnings result, but believes valuation has now become full. The stock has rallied 63% year to date, and risk/reward is evenly balanced.

There remain residual uncertainties both at the macro and stock-specific level, the broker notes, and FY20-21 forecast PEs are in line with historical averages. The broker awaits signs of improvement in the residential building market and for now pulls back to Neutral, retaining a $4.80 target.

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Neutral from Buy by Citi and Downgrade to Underweight from Equal-weight by Morgan Stanley and Downgrade to Hold from Buy by Ord Minnett.B/H/S: 2/4/1

Bottom line: Citi analysts believe market forecasts might be due for a reset lower as fertiliser sales remain sluggish. For Explosives, the analysts believe pricing leverage will likely only show up in FY21 (due to longer term contracts).

The release of FY19 financials resulted in a disappointment, not because of FY19 numbers, but because of FY20 guidance. Citi analysts reduced forecasts by -22% and -11% for FY20-21. These cuts have a direct impact on forecast dividends.

The analysts observe drought conditions had a material impact with demand for the company's highest margin ammoniac product literally drying up (that's probably a pun intended). Downgrade to Neutral from Buy. Target price steady at $3.55.

FY19 earnings were 4% ahead of Morgan Stanley's estimates. This was supported by a land sale without which earnings would be in line. North American explosives also surprised to the upside, particularly after declining volumes were experienced in the first half.

The broker does not believe the issues that greatly affected FY19 will persist into FY20. However, delivery of a clean FY20 is crucial for the company and, regardless of the outcome, there are headwinds from challenging fertiliser markets and domestic seasonal conditions.

Hence, the broker considers the stock expensive and downgrades to Underweight from Equal-weight. Cautious industry view. Target is raised to $3.20 from $3.10.

FY19 earnings (EBIT), while down -45.4%, were ahead of Ord Minnett's forecasts. The stock has reached a level where the broker considers the risks and rewards are balanced.

Louisiana earnings and improved explosives demand are expected to support growth, although weak fertiliser pricing and poor weather are likely to remain headwinds.

Rating is downgraded to Hold from Buy as the stock has traded through the new target of $3.40, reduced from $3.45.

OZ MINERALS LIMITED ((OZL)) Downgrade to Lighten from Hold by Ord Minnett and Downgrade to Neutral from Buy by Citi.B/H/S: 3/2/1

The Carrapateena reserve grade has been cut to 1.6-1.8% (-11%) after a re-design of the sub-level cave footprint.

The company has pointed to a one-month delay in first production at Carrapateena while adding one year to the mine life of Prominent Hill. Incorporating the changes, reduces Ord Minnett's valuation by -4%.

This leads to a downgrade to the rating to Lighten from Hold. Target is reduced to $9.60 from $10.10.

Citi has downgraded OZ Minerals to Neutral from Buy with a reduced price target of $12, down from $12.40. The analysts are trying to balance opposing risks with delivering a big project such as is Carrapateena on time and budget with signs the price of copper might be stabilising.

Citi remains of the view this remains a stand-out against other copper exposures, on the ASX and elsewhere. The analysts suggest investors should look through short term set backs at Carrapateena.

QBE INSURANCE GROUP LIMITED ((QBE)) Downgrade to Neutral from Buy by Citi .B/H/S: 4/3/0

Citi downgrades to Neutral from Buy, maintaining a $13.45 target. The broker now believes it highly likely that US crop insurance will endure an adverse outcome in 2019. Both Chubb and Zurich have hinted at adverse outcomes.

The broker also notes a significant second half vs first half headwind for QBE's claims ratio. Potential volatility is envisaged in the stock price as the market assesses the issues, which Citi suspects may lead to a better opportunity.

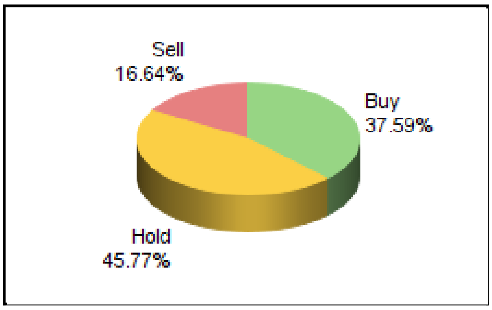
REA GROUP LIMITED ((REA)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/2/2

First quarter results reflected weakness in residential listing volumes, amid a revenue decline of -9%. Credit Suisse finds the valuation difficult to justify, although agrees there is likely to be a recovery in the second half.

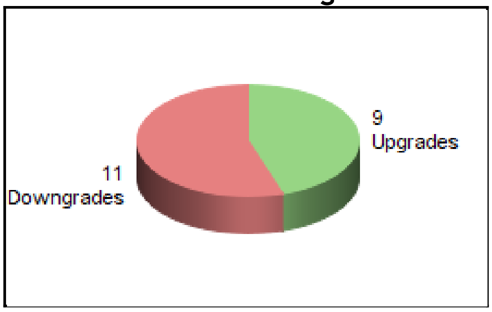
The main issue for the broker is whether the contribution to revenue growth from higher depth penetration is now close to a top and, while this is unlikely to be a structural factor, lower developer volumes will probably remain a headwind in the near to medium term.

Rating is downgraded to Underperform from Neutral and the target lowered to $90.00 from $90.50.

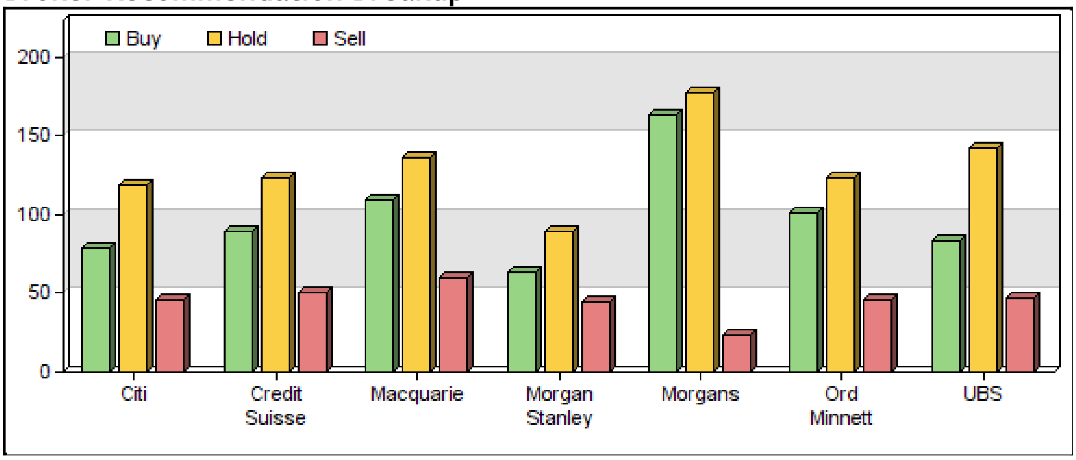
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	AFTERPAY TOUCH GROUP LIMITED	Buy	Neutral	Citi
2	AMCOR LIMITED	Buy	Neutral	Credit Suisse
3	AUB GROUP LIMITED	Buy	Neutral	Credit Suisse
4	CATAPULT GROUP INTERNATIONAL LTD	Buy	Neutral	Morgans
5	CSL LIMITED	Buy	Neutral	UBS
6	DOMAIN HOLDINGS AUSTRALIA LIMITED	Buy	Neutral	Macquarie
7	DOMAIN HOLDINGS AUSTRALIA LIMITED	Buy	Neutral	Ord Minnett
8	ELANOR INVESTORS GROUP	Buy	Neutral	Ord Minnett
9	SPARK INFRASTRUCTURE GROUP	Neutral	Sell	Morgan Stanley
Downgrade				
10	AP EAGERS LIMITED	Neutral	Buy	Ord Minnett
11	AUSNET SERVICES	Sell	Neutral	Morgans

12	CROMWELL PROPERTY GROUP	Sell	Neutral	Ord Minnett
13	CSR LIMITED	Neutral	Buy	Macquarie
14	INCITEC PIVOT LIMITED	Neutral	Buy	Citi
15	INCITEC PIVOT LIMITED	Sell	Neutral	Morgan Stanley
16	INCITEC PIVOT LIMITED	Neutral	Buy	Ord Minnett
17	OZ MINERALS LIMITED	Neutral	Buy	Citi
18	OZ MINERALS LIMITED	Sell	Neutral	Ord Minnett
19	QBE INSURANCE GROUP LIMITED	Neutral	Buy	Citi
20	REA GROUP LIMITED	Sell	Neutral	Credit Suisse

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	Z1P	ZIP CO LIMITED	83.0%	17.0%	66.0%	3
2	SGP	STOCKLAND	-33.0%	-60.0%	27.0%	6
3	DHG	DOMAIN HOLDINGS AUSTRALIA LIMITED	8.0%	-17.0%	25.0%	6
4	APT	AFTERPAY TOUCH GROUP LIMITED	60.0%	40.0%	20.0%	5
5	SKI	SPARK INFRASTRUCTURE GROUP	-17.0%	-33.0%	16.0%	6
6	AMC	AMCOR LIMITED	64.0%	50.0%	14.0%	7
7	CSL	CSL LIMITED	64.0%	50.0%	14.0%	7
8	GMG	GOODMAN GROUP	50.0%	40.0%	10.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	IPL	INCITEC PIVOT LIMITED	14.0%	57.0%	-43.0%	7
2	DOW	DOWNER EDI LIMITED	50.0%	75.0%	-25.0%	4
3	OZL	OZ MINERALS LIMITED	21.0%	43.0%	-22.0%	7
4	CMW	CROMWELL PROPERTY GROUP	-50.0%	-33.0%	-17.0%	3
5	API	AUSTRALIAN PHARMACEUTICAL INDUSTRIES	-67.0%	-50.0%	-17.0%	3
6	REA	REA GROUP LIMITED	-25.0%	-8.0%	-17.0%	6
7	CSR	CSR LIMITED	-58.0%	-42.0%	-16.0%	6
8	AST	AUSNET SERVICES	-33.0%	-17.0%	-16.0%	6
9	A2M	THE A2 MILK COMPANY LIMITED	-7.0%	8.0%	-15.0%	7
10	FLT	FLIGHT CENTRE LIMITED	57.0%	71.0%	-14.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	DHG	DOMAIN HOLDINGS AUSTRALIA LIMITED	3.147	2.970	5.96%	6
2	SGP	STOCKLAND	4.487	4.284	4.74%	6
3	IPL	INCITEC PIVOT LIMITED	3.539	3.423	3.39%	7
4	QBE	QBE INSURANCE GROUP LIMITED	13.159	12.844	2.45%	7
5	Z1P	ZIP CO LIMITED	4.203	4.103	2.44%	3
6	CSL	CSL LIMITED	253.986	249.700	1.72%	7
7	REA	REA GROUP LIMITED	98.402	97.762	0.65%	6
8	AMC	AMCOR LIMITED	15.996	15.929	0.42%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	FLT	FLIGHT CENTRE LIMITED	44.317	48.299	-8.24%	7
2	A2M	THE A2 MILK COMPANY LIMITED	12.910	13.888	-7.04%	7
3	APE	AP EAGERS LIMITED	13.624	14.530	-6.24%	5
4	API	AUSTRALIAN PHARMACEUTICAL INDUSTRIES	1.417	1.450	-2.28%	3
5	AST	AUSNET SERVICES	1.783	1.818	-1.93%	6
6	OZL	OZ MINERALS LIMITED	10.786	10.943	-1.43%	7
7	GMG	GOODMAN GROUP	15.350	15.508	-1.02%	6
8	APT	AFTERPAY TOUCH GROUP LIMITED	32.080	32.360	-0.87%	5
9	SKI	SPARK INFRASTRUCTURE GROUP	2.263	2.278	-0.66%	6

10	DOW	DOWNER EDI LIMITED	8.400	8.445	-0.53%	4

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	IPL	INCITEC PIVOT LIMITED	16.317	8.510	91.74%	7
2	Z1P	ZIP CO LIMITED	-1.867	-3.800	50.87%	3
3	APT	AFTERPAY TOUCH GROUP LIMITED	6.220	4.660	33.48%	5
4	ALG	ARDENT LEISURE GROUP	-0.200	-0.300	33.33%	3
5	ECX	ECLIPX GROUP LIMITED	12.720	9.980	27.45%	5
6	NAB	NATIONAL AUSTRALIA BANK LIMITED	204.229	178.267	14.56%	7
7	OZL	OZ MINERALS LIMITED	49.263	47.520	3.67%	7
8	JHX	JAMES HARDIE INDUSTRIES N.V.	118.451	114.432	3.51%	6
9	BIN	BINGO INDUSTRIES LIMITED	9.800	9.600	2.08%	4
10	IDX	INTEGRAL DIAGNOSTICS LIMITED	17.157	17.023	0.79%	3

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	NEA	NEARMAP LTD	-4.767	-3.767	-26.55%	3
2	NEC	NINE ENTERTAINMENT CO. HOLDINGS LIMITED	11.633	13.890	-16.25%	4
3	FLT	FLIGHT CENTRE LIMITED	234.286	261.700	-10.48%	7
4	REA	REA GROUP LIMITED	246.833	267.000	-7.55%	6
5	NWS	NEWS CORPORATION	60.683	64.086	-5.31%	4
6	SWM	SEVEN WEST MEDIA LIMITED	7.072	7.380	-4.17%	5
7	APE	AP EAGERS LIMITED	46.774	48.774	-4.10%	5
8	SKI	SPARK INFRASTRUCTURE GROUP	8.235	8.452	-2.57%	6
9	ALQ	ALS LIMITED	38.494	39.312	-2.08%	5
10	A2M	THE A2 MILK COMPANY LIMITED	42.879	43.617	-1.69%	7

Technical limitations

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WEEKLY REPORTS

Uranium Week: Buyers Scramble

The sudden burst of buying interest appearing two weeks ago in the uranium market continued last week as producers stepped in.

-No news on Working Group report
-U3O8 spot price jumps for a second week
-Uranium producers join utilities on the buy-side

By Greg Peel

In last week's Uranium Week I noted:

"Clearly trade talks are again reaching a crescendo, so maybe November 14 will not be timely for other issues to be considered."

The November 14 deadline for recommendations of President Trump's nuclear Working Group came and went without a murmur last week, although it is believed the report has been delivered to the White House. The deadline followed a 90-day extension granted at the request of the Working Group, so now it's up to the White House to find the time to give the recommendations a glance.

The White House might have other things on its mind right now, which may mean the uranium market again remains in limbo until all is revealed. However, clearly as the year winds to a close, buyers are not taking a risk.

Two weeks ago, seven transactions totalling 2.2mlbs U3O8 equivalent were reported in the uranium spot market by industry consultant TradeTech and the consultant's weekly spot price indicator rose US50c to US$24.65/lb. Last week saw ten transactions totalling 1.2mlbs, and TradeTech's indicator has risen another US60c to US$25.25/lb.

This sudden burst of activity has followed weeks in the doldrums of uncertainty. Yet uncertainty remains.

Producers Jump In

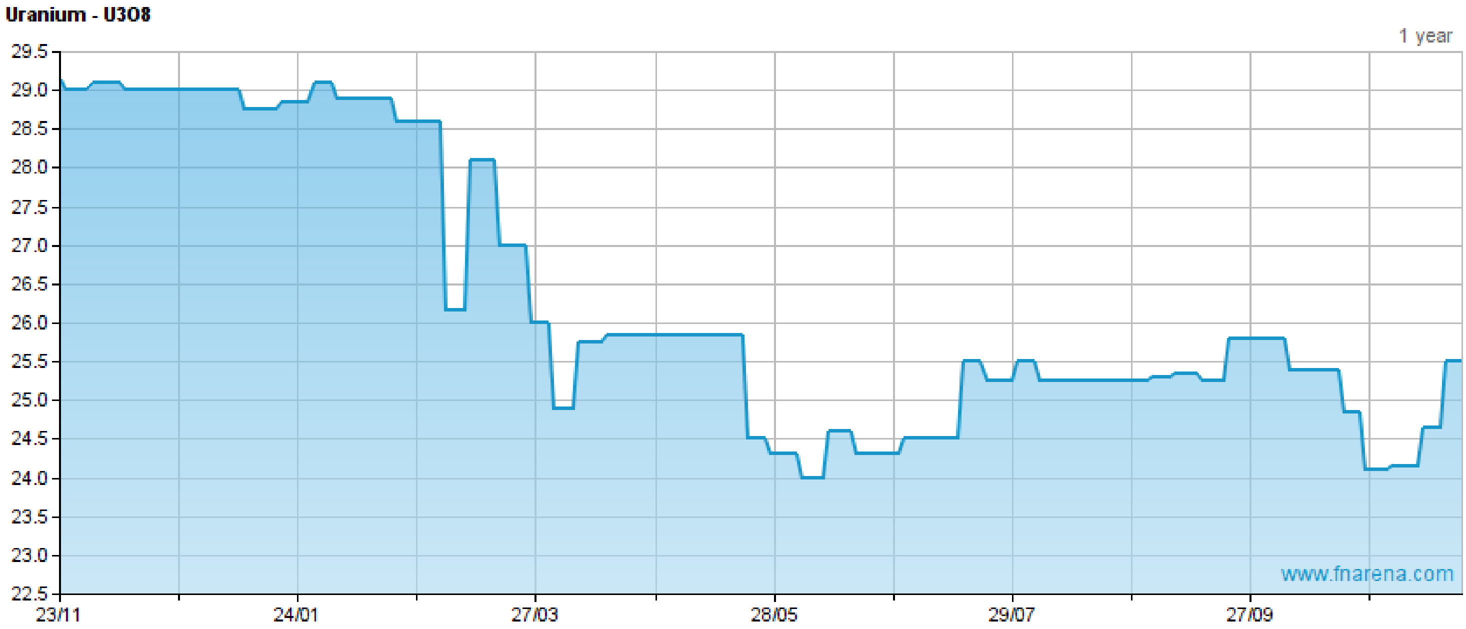
Producers were among the buyers scrambling for material last week, with utilities having led the charge the week before. The question was raised in last week's report as to whether typical end-of-year buying had begun. Or is it buying to get in ahead of typical end-of-year buying? Or is there really not much difference between the two?

Producers are buying in the spot market because for many, including the likes of leading miner Cameco, uranium prices are currently below the cost of production, hence it is cheaper to satisfy term delivery obligations with material bought in.

With producers now joining utilities, who were also in there buying again last week, there is somewhat of a self-fulfilling risk when it comes to end-of-year buying.

It is quite possible the year ends without any response from the White House with regard the Working Group's recommendations, and it is becoming increasingly possible the year will end without any US-China trade deal. Then the typical new year quiet period takes over.

For now though, it appears both utilities and producers are keen not to miss out in terms of satisfying inventory requirements and delivery contract obligations.



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WEEKLY REPORTS

The Short Report - 21 Nov 2019

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

Summary:

Week ending November 14, 2019

Last week the ASX200 finished where it had started, at around 6700, with a little foray up to 6760 in between. The past two weeks have featured extensive day to day volatility akin to the proverbial paddling duck. Today's trade is a rare case of stringing two days together in the same direction.

Such volatility is possibly why there was only one stock seeing a move of one percentage point or more in short position last week. And that was Kirkland Lake Gold ((KLA)).

Three weeks ago Kirkland shorts fell from 12% to 7% and then two weeks ago it was back to 12% and last week back to 7%.

Not even going to try.

No Movers & Shakers this week. Apologies for a short...ahem...report, but sometimes nothing happens.

Weekly short positions as a percentage of market cap:

10%+
SYR 16.7
GXY 16.4
GWA 15.4
ORE 13.9
ING 13.9
SDA 13.0
CGC 12.4
NXT 12.4
BOQ 12.3
JBH 11.4
WEB 10.9
BGA 10.5
BKL 10.4
DMP 10.3
HUB 10.1

In: BGA Out: KLA

9.0-9.9

NEA, MIN, MTS, IVC

In: MIN, MTS Out: BGA, BIN

8.0-8.9%

BIN, PPT, BAL, SUL, CGF

In: BIN, CGF Out: MTS, MIN

7.0-7.9%

HVN, A2M, SAR, KLA, CLH, NCZ, PLS, DCN, NUF, IFL, BWX, SLR, MYR, RSG, OML

In: KLA, RSG Out: CGF, RWC

6.0-6.9%

RWC, SGM, CMW, CUV

In: RWC, CMW Out: RSG

5.0-5.9%

AMP, CLQ, NWL, CTD, COE, PGH, RFF, NEC, LNG, CSR

Out: CMW

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.6	0.7	RIO	4.6	4.3
ANZ	0.6	0.6	S32	1.5	1.5
BHP	3.5	3.3	SCG	0.4	0.3
BXB	0.2	0.2	SUN	0.2	0.4
CBA	0.7	0.7	TCL	0.4	0.4
CSL	0.2	0.1	TLS	0.2	0.2
GMG	0.3	0.2	WBC	0.8	0.8
IAG	0.5	0.5	WES	0.6	0.6
MQG	0.4	0.3	WOW	0.7	0.8
NAB	0.6	0.5	WPL	1.0	1.0

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: Banks, Casinos, Hospitals & Health

Weekly Broker Wrap: Australian banks; Australian casinos; China; Costa Group; private hospitals; and private health insurance.

-Australian bank boards edge towards reining in management rewards
-Despite cautious outlook lack of supply discipline among Chinese steel makers evident
-Extended drought likely to jeopardise Costa Group's water levels
-Incrementally positive trends continue for Ramsay Health Care
-Margin headwinds continue to build for private health insurers

By Eva Brocklehurst

Australian Banks

Boards on Australian banks have moved to appease investors by reducing the performance rewards for management. Poor structures, accountability and criteria have been directly linked to serious issues in the sector since the GFC.

After a series of record-breaking first-strikes against remuneration reports among the major banks both **National Australia Bank** ((NAB)) and **Westpac** ((WBC)) CEOs have received no short-term award.

Citi considers 2018 was the low point for sector remuneration. Inappropriate remuneration structures were central to the conduct issues identified by the Hayne Royal Commission.

The findings have forced APRA (Australian Prudential Regulatory Authority) to address the issues, although Citi notes there has been open resistance two key proposals such as (1) 50% of variable remuneration should be based on non-financial measures and (2) 60% should be deferred for at least seven years.

The broker asserts remuneration structures need reforming and better transparency and less board discretion is the only way forward. Yet Citi is cautious about the willingness to correct scorecards via board discretion and notes a lack of transparency still prevails.

Australian Casinos

Citi remains cautious about the outlook for the Australian casino industry as around $4bn of total expenditure is being deployed to projects that are delivering returns below the cost of capital.

Moreover, following a very challenging FY19, the outlook for the Australian VIP market remains tough. Citi forecasts a return to growth in FY21 with **Crown Resorts** ((CWN)) more leveraged to a potential recovery.

The domestic consumer is likely to be the driver of Australian casinos, accounting to 50-60% of earnings and valuation and a recovery is underway following fiscal and monetary stimulus, in the broker's view. On a relative basis, Citi prefers Crown Resorts over **Star Entertainment** (SGR)) given relatively superior asset quality and an undemanding valuation.

China

Almost all industry participants Morgan Stanley met on a trip to China were fairly bearish, particularly on the property market. An economic slowdown has been widely acknowledged but little mention was made of trade tensions.

Views regarding demand centred on low growth. The main risk is a slowdown in property starts. High property prices and a shift to rural buyers are making sales more difficult, while developers have financing difficulties and need to keep building and selling to generate cash, hence the elevated level of new starts.

Despite the cautious outlook for demand, the broker encountered a lack of supply discipline in the steel industry. Although total capacity is still falling, effective capacity could increase over 2019-21, as idle capacity is used in swaps. Moreover, Tangshan-based steelmakers were finding ways to increase capacity at existing plants.

The mills are sustaining lower iron ore inventory versus the usual 20-40 days, not wishing to buy in a falling market. Near-term demand has the potential to turn out better than the steel mills expect and, hence, Morgan Stanley suspects a re-stocking cycle may be on the way.

Tangshan steelmakers generally expect the iron ore price to fall to US$70-75/t by the end of the year, although Morgan Stanley suspects a US$90/t price is more likely.

Macquarie also spent time in Tangshan, the biggest steel city in China, and agrees the sector appears strong at present given the fall in inventory, although few believe the situation will last. The broker agrees feedback was generally cautious about demand. The broker notes policy makers are expected to lower the GDP target to 6.0% next year, allowing activity to moderate.

This is not expected to create significant issues in employment, and conditions are supported by increased fiscal expenditure, finance support to industry and a more flexible exchange rate. Nevertheless, in the long run, structural change in Chinese demographics suggests to Macquarie a further slowdown in growth is inevitable.

Costa Group

Credit Suisse believes **Costa Group** ((CGC)) is at a critical juncture. An extension of drought into the next rainy season jeopardises yields for 12-18 months. A -10% reduction in citrus yield equates to -$26m in revenue and, the broker notes, competitive advantages only count for so much when volumes are in decline.

The price per million litres of water is increasing at 9% per month and average spot prices hit $940/ML recently. The Bureau of Meteorology outlook is for a 20-30% chance of median rainfall and an 80% chance of temperatures in excess of the median until February 2020.

However, the company's 2020 guidance is underpinned by a moderate improvement in water levels and, if the drought continues into the first quarter of 2020, this implies a severe deterioration in dam levels, Credit Suisse points out. Moreover, the broker is sceptical a crop portfolio can be diversified in such a way or to such an extent that production volatility from weather extremes can be avoided.

Private Hospitals

APRA data show benefits paid to private hospitals were up 6.4% in the September quarter. Private hospital episodes increased 4.2%. Benefits paid for private patients in public hospitals grew 1.1%. While the growth in quarterly private hospital benefits is positive for operators, such as **Ramsay Health Care** ((RHC)), UBS points out the question remains as to who will ultimately pay.

Presumably, insurers will be seeking a higher level of premium increases from the government and, if this is not forthcoming, it will probably result in more stressed contracting negotiations with hospital groups.

JPMorgan points out leakage to the public system remains subdued as the number of private patients treated in public hospitals fell again. This highlights efforts made to slow this trend appear to have been effective.

However, this has not led to a noticeable pick-up in episode growth in private hospitals, which suggests a portion of patients treated as private in the public system were never reasonably going to be treated in a private hospital.

Macquarie suggests the data highlight incrementally positive trends relative to the prior quarter. The broker believes deployment of capital for Ramsay Health Care at several of its largest sites will support above-industry growth in the near to medium term. Moreover an improved tariff environment in France and the UK will support growth in FY20.

Health Insurance

A sharp uplift in claims inflation over the September quarter has compressed industry gross margins to 13.3%. With affordability still an issue, and resulting in falling participation in private health insurance, UBS believes these margin headwinds will continue to build and lower premium rate rises are likely from April. Net margins could fall further, to 2.4% in FY21.

The broker suggests earnings per share of both **Medibank Private** ((MPL)) and **nib Holdings** ((NHF)) are likely to decline, an outcome at odds with PE (price/earnings) ratios above 20x.

Health fund membership grew sequentially in the September quarter, although membership relative to the population continued its downward trend, JPMorgan notes. The downward trend seems to have levelled out but the broker remains wary of the downgrading of cover, which is less visible.

The data suggest to the broker that premium inflation is now running behind claims inflation, noting the pressures identified by the listed insurers appear to be broadly shared across the industry. This means that all may struggle to push through 3% price increases.

The main positive is that margins are higher for the listed insurers versus peers so the pain can be sustained for longer. Credit Suisse agrees, noting the industry was hoping for a large decline in gross margin in order to convince the government of the need for higher premium rate increases.

While a squeeze is happening the broker suspects it is not enough to force premium rates higher. Credit Suisse also suggests the APRA data demonstrate the cycle has peaked for private health insurers and the question is now about how hard and fast the cycle unravels, and when is the time to consider getting back into the listed stocks.

The broker maintains Underperform ratings on both listed insurers, believing the near-term risk is skewed to the downside and the medium-term risk unclear. Macquarie also expects Medibank Private (Underperform) and nib Holdings (Neutral) will outperform peers although margin contraction appears likely in FY20.

The broker notes the Lifetime Health Cover loading that was introduced in 2000, which penalises those joining the private health insurance system later in life, now finds itself in a conundrum.

The number of those joining the system is less than the number of existing policyholders paying the loading that are finishing their penalty period of 10 years, or are leaving the system altogether. The broker calculates, should this trend continue for the next 12 months an additional -100 basis points of margins could be removed from the industry.

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SMSFUNDAMENTALS

SMSFundamentals: ETF Flight To Safety

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals website.

ETF Flight To Safety

October saw strong demand for Australian fixed income and gold ETFs, while in the US, investment in passive equity ETFs has outstripped that in active ETFs for the first time.

-Australia investors pour into fixed income
-And out of Australian banks
-US gold ETFs enjoy a surge

By Greg Peel

The Australian exchange-traded fund (ETF) market set yet another record in the month of October, rising to $57.2bn in funds under management, reports the BetaShares Australia ETF Review, even as the equity market suffered an early tumble.

Funds under management increased by $1.0bn in the month, net of $1.2bn of inflows. In the twelve months to October, total ETF market cap increased by a record $16.4bn.

The month of October began in typical October fashion – with elevated stock market volatility. One lone US data release – the September manufacturing PMI – set off a major panic as once again Wall Street feared a US economy headed into recession. The Australian market responded in kind.

It didn’t take long for Wall Street to start fighting its way back again, on the assumption one PMI reading does not a winter make, and on supposedly positive news on the trade front. Australia’s recovery was a little more stunted, after another round of announced remediation provision increases at big banks, one month ahead of bank reporting season.

Provision increases only served to heighten expectation one or more banks would be forced to cut their dividends.

ETF flows over the month painted the perfect picture. Investors dived for cover in fixed income products as recession fears grew not just in the US, but here as well as the RBA again cut its cash rate. Fixed income ETFs saw the greatest inflows, $372m, of which $317m went into Australian bond products.

Which would go down the gurgler first? The Australian economy or the US economy? The second highest inflows were reserved for international equity ETFs, at $368m, despite outflows from European equity products. We are reminded that Brexit was in complete shambles in October.

ETF outflows in the month were relatively limited, but no surprises the biggest outflows were seen in Australian financial sector products.

<u>All Too Hard</u>

The US ETF market also posted a record, in the September quarter. Funds under management reached US$5.8trn, up 20% in 2019. And for the first time in ETF history, funds in passive ETFs exceeded those in active ETFs.

Your classic “passive” ETF is one which simply tracks an index or some other benchmark, such as the S&P500, take it or leave it. Managers of an “active” ETF attempt to outperform the index, or some other benchmark, by actively tweaking portfolio composition over time.

They haven’t been doing very well lately.

While passive products leave the investor open to general market volatility, they potentially remove some angst as a “set and forget” investment rather than one for which underperformance forces an investment rethink.

The pattern in the US was similar in the September quarter as was seen downunder, with the greatest flows being into fixed income products. Fixed income received 48% of total inflows, albeit this was well down on the 61% of flows in the June quarter.

In the June quarter, 0.3% of total flows were directed to commodity ETFs. This jumped to 10% in the September quarter, with a specific surge into precious metal ETFs.

Again, no surprises. The US dollar gold price rallied US$200/oz over the quarter, sparked by the US ten-year bond yield falling to an equivalent level of core US inflation, meaning zero real return. Were bond rates to fall much lower (they did briefly, but have since recovered), gold’s 0% return would become quite attractive, notwithstanding gold’s role as a safe haven in times of geopolitical uncertainty.

And there was plenty of that in the quarter.

RUDI'S VIEWS

Is It Rotation Or Risk We Should Worry About?

<u>Dear time-poor reader:</u> Amidst forecasts for share market outperformance by cheaper 'Value' stocks, investors in Australia better watch out for ongoing profit warnings

In this week's Weekly Insights (published in two parts):

-Is It Rotation Or Risk We Should Worry About?
-Conviction Calls
-Are Dividends Telling The Story?
-Rudi On Tour

[*The non-highlighted items will appear in Part Two on Friday*]

<u>Is It Rotation Or Risk We Should Worry About?</u>

By Rudi Filapek-Vandyck, Editor FNArena

As we approach the final weeks of calendar year 2019, the global investment community remains as polarised as ever on what to expect next and how best to position portfolios.

According to industry consultant bfinance, large institutional investors globally and in Australia are increasingly opting for a lower risk portfolio positioning, preparing for the end of this cycle and seeking safety through ongoing diversification, including in non-listed assets.

A number of technically-oriented experts on the other hand remain confident equities are set-up for an end-of-year rally, as is usually the case. Market researchers at ANZ Bank published research this week offering further support to this view. For equities, points out the ANZ Bank team, Santa Claus comes bearing gifts more often than not.

On ANZ Bank's historical analysis, Australian equity indices finish the annual holiday period higher no less than 75% of times from where they started it. Their analysis has extended into related currencies and here the picture/correlation seems less clear. The Kiwi dollar (NZD) tends to benefit from the upward bias in equity markets into year-end, but not so much the AUD.

Investors should note: the team at ANZ Bank is of the view that a so-called Phase One deal between the Trump administration and China looks more likely than not. The researchers also believe the annual Santa rally for equities is often but a self-fulfilling prophecy.

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Unsurprisingly, in an environment that looks nearly as polarised as during the opening months of 2016, expert opinion about which sections of the share market are likely to perform best remains equally sharply divided.

While it remains true that laggard stocks, otherwise known as "cheaply priced", have staged somewhat of a come-back since August, with stocks including Nufarm, Lendlease, Janus Henderson and BT Investment making up a lot of ground inside a relatively short window, opinion remains highly divided whether this is simply a direct result of bond yields correcting higher, on top of various idiosyncratic reasons for the sudden resurrections, or whether we are indeed witnessing the early signals of a profound rotation in market leadership?

As most active managers have found 2019 an extremely tough year, following broad underperformances throughout 2017 and 2018, many are hoping there is more substance to this attempted rotation in equities leadership. It would mean active "Value" managers have finally a good story to tell the investors who remained loyal throughout the tough years past.

Their most preferred point of reference right now is Europe where "Value" has significantly outperformed "Growth" as financial markets priced out the prospect of an imminent recession. In Australia, however, re-positioning for a similar switch remains fraught with danger. This much has again be proven by events this month.

One of the prime examples of the dangers in owning cheaply priced laggard stocks in the Australian share market is perennially disappointing childcare centres operator, G8 Education ((GEM)). The stock has looked cheap on numerous occasions throughout the years past, but every time management has found a way to disappoint and to cause yet another pull back in the share price.

G8 Education fell below $2 during the broad-based market meltdown of late 2018. Following its second profit warning in three months, the share price has again sunk below the $2 mark. This is where G8 Education shares were trading at in early 2013, nearly seven years ago.

In contrast, a lot of market attention and commentary has been spilt on the fact that smaller cap technology stocks have lost a great deal of their gains in recent months. Even so, on Monday one of the most doubted in the local sector, Appen ((APX)), increased guidance for the year and its shares have shot up no less than 13% in an overall down market.

Irrespective of active funds managers' desire to see yesterday's winners turn into losers and vice versa, the simple observation remains that for many of those market outperformers the operational momentum continues to look favourable, while making similar assumptions for laggard stocks remains fraught with danger.

Last week I wrote about how current market dynamics continue to favour CSL ((CSL)) in the global blood plasma market. Aristocrat Leisure ((ALL)) and TechnologyOne ((TNE)) have yet to report their FY results, but analysts remain convinced both can continue growing at double-digit percentage speed in the years (multiple) ahead.

Last week, highly priced Xero ((XRO)) managed to once again beat market expectations. Macquarie Group's ((MQG)) FY results release the week prior was universally well-received, as was James Hardie's ((JHX)) quarterly update.

In contrast, three of the five banks that reported in recent weeks (excluding Macquarie) cut their dividend and had very little optimism to share for the year ahead. The attempted surge in the BlueScope Steel ((BSL)) share price was promptly met by analysts downgrading their recommendation for the stock (indicating they do not believe it is sustainable nor warranted).

I could cite many more examples, but I think the general observation stands: this is a share market heavily polarised because certain segments are enjoying strong operational momentum, and other segments are not. The difference between these two extreme opposites -and let there be no misunderstanding: the difference in operational dynamics are opposites into the extreme- are reflected in equally opposing valuations; "expensive" versus "cheap".

It is not impossible to imagine a scenario whereby the switch of investor funds flow out of "expensive" outperformers into "cheaper" underperformers can gain more traction and build genuine, lasting momentum. Continued bond market weakness (rising yields) will do exactly that, up until a point where it becomes a negative for all segments of the share market.

Genuine progress in the on/off negotiations between the USA and China, which might prompt expectations for economic growth in 2020 to rise substantially, is another factor that can further stimulate such market switch.

An economic recession however, the elephant in the room, will reduce growth for those that are growing and thus make share prices look bloated while those with no growth will increasingly be at risk of issuing the next profit warning.

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Investors are conditioned to look for earnings growth and sustainability of dividends but sometimes the key story lies within the market itself.

Equity strategists at JP Morgan remain convinced market momentum is starting to turn in favour of cheaper priced laggard stocks and an important factor in their forecast is the observation that market positioning has once again reached extreme polarisation. In line with trends observed by bfinance, JP Morgan strategists find the current bull market has been built upon investors favouring "risk off" portfolio positioning.

In practice, this means most of global funds have flowed into defensives such as infrastructure owners and lower-risk bond proxies, as well as in ever-reliable healthcare stocks and other structural growth stories.

If these investors are given enough confidence to take on more risk, a savage rotation a la late 2016 should be on the cards.

Such a scenario, of course, requires a different economic and geopolitical context and, indeed, it is JP Morgan's forecast that global economic momentum is turning already. By this time next year, the global economy will be experiencing its third wave in this cycle which shall see growth recover to above trend. At least, such is JP Morgan's forecast.

To underline the conviction behind their outlook, **JP Morgan strategists in Australia** have made several key changes to the broker's **Model Portfolio**; Financials have been upgraded to Overweight, Healthcare has been downgraded to Underweight and the existing exposure to Materials has been pushed further into Overweight. Inside "Materials" ("Commodities") the strategists in particular like Energy.

Another observation that features prominently in the JP Morgan outlook for 2020 is that the relative valuation differential between the polar opposites in equities has fully blown out beyond two-standard deviations from the 15-year average. Equally interesting is the observation that, in between the battle between "Growth" and "Value" in global equity markets, the ultimate outperformance has been achieved by "Quality" (as can be witnessed through the performance of CSL in Australia).

The underlying view is that "Value" has a lot further to rise in the months ahead (at least including Q1 next year, predict the strategists) and that the switch in relative momentum will become too large to ignore for professional investors, which then becomes a self-reinforcing momentum process.

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Looking into the finer details of the revised JP Morgan Model Portfolio, the strategists have selected Caltex Australia ((CTX)), Origin Energy ((ORG)), Santos ((STO)) and Worley ((WOR)) in the Energy sector while the Financials basket has been populated with Macquarie Group, National Australia Bank ((NAB)), QBE Insurance ((QBE)) and Westpac ((WBC)).

The Overweighted Materials sector is represented by Amcor ((AMC)), BHP Group ((BHP)), James Hardie, South32 ((S32)) and Rio Tinto ((RIO)).

Note that the Model Portfolio does not completely shy away from long-lasting outperformers. It still includes Aristocrat Leisure under Consumer Discretionary, Treasury Wine Estates ((TWE)) under Consumer Staples, Seek ((SEK)) and Transurban ((TCL)) for Industrials and with CSL and Sonic Healthcare ((SHL)) representing healthcare. (And, of course, Macquarie Group among the Financials).

Link Administration ((LNK)) is the sole representative in an otherwise underweighted IT sector.

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It probably won't surprise the JP Morgan outlook for the year ahead is not widely supported. Plenty of experts around who believe economic momentum is deteriorating instead and in Australia there won't be a positive impact on consumer sentiment and spending because the recovery in housing is driven by foreign inflows from Hong Kong and China.

Strategists at Morgan Stanley offer an alternative view. They too believe the underlying trend is improving for the US economy, but contrary to JP Morgan they don't believe the recovery will be strong enough to continue this bull market for equities. Morgan Stanley has long held the view (since early 2018) there is no fundamental justification for the S&P500 index to sustainably trade above 3000. This forecast has been upheld.

The updated view now is that US risk assets (technology stocks on the front row) will prove too expensively priced for the pending pick up in economic momentum. It is their view investors will instead seek to achieve returns through rotation. Value is expected to outperform Growth.

Globally, Morgan Stanley recommends portfolios should be market neutral at best as far as equities are concerned, but in the US the recommended allocation is heavily underweight, with above average levels of cash and government bonds. Copper is preferred above oil and gold.

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In Australia, for self-managing investors who shouldn't be concerned about outperforming or underperforming the index on a short term horizon, the main focus is probably best kept to avoiding booby traps and torpedoes.

The prognosticated return of "Value" as a winning strategy might look appealing, if it proves sustainable, in daily reality vulnerable Australian companies are still issuing profit warnings, with direct consequences for share prices.

On Monday, as I am writing this Weekly Insights update, this tangible risk was again put on investors' radar by

Coronado Global Resources ((CRN)) -profit warning pushed the share price to its lowest level since IPO- and by Monash IVF ((MVF)) -profit warning- by Smartgroup Corp ((SIQ)) -profit warning and CEO exiting- and by Prospa Group ((PGL)) -profit warning while the IPO was only five months ago.

In line with my earlier analysis and observations, I believe there are good reasons in many cases as to why share prices look "cheap" in Australia. The least desirable way to find out is through another bad news announcement which triggers instant share price shellacking. Better to be warned and act accordingly.

Rudi On Tour In 2020:

-ASA Hunter Region, near Newcastle, May 25

(*This story was written on Monday 18th November 2019. 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. Part Two shall follow on Friday morning).*

(**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's View: Rotation, Dividends & Money 3

Dear time-poor reader: strategists are increasingly advocating investors adopt a bias towards cheaper "Value" stocks, plus dividends are growing globally, just not in Australia

In this week's Weekly Insights (this is Part Two):

-Is It Rotation Or Risk We Should Worry About?
-Are Dividends Telling The Story?
-Conviction Calls
-*NEW* Research To Download
-Rudi Talks
-Rudi On Tour

[The non-highlighted items appeared in Part One on Thursday]

Are Dividends Telling The Story?

By Rudi Filapek-Vandyck, Editor FNArena

You gotta enjoy it when research conducted by others offers more confirmation of your own share market insights and conclusions.

Local investment managers at **DNR Capital** dug deeper into the concept of buying cheaply priced blue chips on the Australian share market. Their main reference was the 1991 US Top Hit 'Dogs of the Dow'.

For those who are not familiar with the concept: US investor Michael O'Higgins published back then his discovery that buying share market underperformers was likely to generate market beating results as the laggards from last year turned into outperformers the next.

No, of course it doesn't work all the time, everywhere and under all circumstances. If it did, we'd all be rotating our complete portfolios at the end of each calendar year. Though that sounds counterintuitive by itself. The way the share market operates, all participants simply cannot be doing the same thing at the same time.

Returning to DNR Capital's research, typically a cheap blue chip in Australia is the one that offers a high yield, hence DNR's stock selection remained limited to the **high yielders inside the ASX20**.

In the words of DNR Capital, "the results were stark".

The Dogs of the ASX20 would have underperformed by circa -60 basis points over the ten years up until late 2018. Over the prior five years, that underperformance blew out to no less than -560 basis points.

Over the past year (2018), total return -even with the high yield and including special dividends- was a negative -7.3%. To which a cheeky DNR adds "fees excluded".

Year to date, meaning we started buying on December 31st last year and held onto the shares until the final day of September (when the analysis was concluded), the underperformance versus the broader market was yet another -2%.

On DNR's calculations, holding ANZ Bank ((ANZ)), BHP Group ((BHP)), CommBank ((CBA)), National Australia Bank ((NAB)), Rio Tinto ((RIO)), Scentre Group ((SCG)), Suncorp ((SUN)), Westpac ((WBC)), Wesfarmers ((WES)) and Woodside Petroleum ((WPL)) -the Dogs of the ASX20 at the end of last year- would have delivered 3% in additional income, including franking, but -5% less in capital growth.

One more additional insight from the DNR research: Over the last five years, yields from Materials and Energy companies have substantially increased, whilst for Consumer Discretionary, Utilities, Telstra ((TLS)) and Industrials companies, dividends have significantly declined.

And as I have been warning since the recent August reporting season: dividends from resources companies are now under threat because of lower commodity prices, plus the expectation that higher-for-longer iron ore prices won't be sustained.

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Janus Henderson also released some research on dividends recently. On its numbers, total dividends paid out to shareholders hit an all-time record high in the US during the September quarter, while shareholders in Canada and Japan enjoyed record receipts for the quarter.

Now for the not so good news. Both Australia and China revealed their weakness throughout Q3. **Shareholders in Australia were hit with a noticeable decline in dividends**.

In China, nearly half of all companies in the index reduced their payout. In aggregate, there was still modest growth in Chinese dividends paid out, but that was dependent on large increases by two companies, reports the wealth manager.

In Australia, two out of every five companies in the index has been cutting dividends. Total dividends paid out have dropped to $18.6bn which, on Janus Henderson's numbers, represents the lowest pay out in US dollar terms since Q3 2010. Underlying, the decline was -5.9%.

It is Janus Hendersons' assessment that Australian companies have the lowest dividend cover in the world among the bigger economies. The direct consequence of this is that when the economy lands in a rough patch, corporate profitability goes backwards and without a sufficient buffer, those dividends cannot be maintained.

In similar vein, income investors in China feel more pain in the short term when economic adversity hits due to the fact that many companies in China have adopted a fixed payout-ratio policy.

Outside Australia, reports Janus Henderson, growth in dividends is slowing. The deceleration started in Q2 this year, continued in Q3 and is likely to slow further in 2020 as the global economic environment remains challenging. For the whole of calendar year 2019, Janus Henderson is sticking by its estimate that US$1.43trn will be paid out to shareholders globally. This would mark an increase at the headline of 3.9%, but underlying growth looks more like 5.4%.

While this is down from 8.5% underlying growth in 2018, it will still mark the tenth consecutive year of underlying growth in global dividends. Janus Henderson doesn't seem too worried about 2020, forecasting further slowing, but still growth in global dividends.

No specific forecast was given for Australia, but I think we can safely predict the picture for income investors in ASX-listed companies continues to look treacherous.

Conviction Calls

Jonathon Higgins, analyst at **Shaw and Partners**, really likes consumer loans provider Money 3 Corp ((MNY)). He thinks the stock can triple in value by FY23. That's in four years from now.

Post the recent AGM, where the company provided a "likely conservative" guidance for the running financial year, Higgins decided to elevate his Buy/High Risk call for the stock to "high conviction" status. The twelve month price target sits at $2.40. Now that the share price is falling, in line with the broader market, the distance between share price and twelve month target is looking more attractive by the day.

But Higgins' conviction goes beyond the next twelve months. As management at Money 3 is working on better debt and rates structures, including the option of securitising loans, the analyst suspects total assets can grow a lot higher than current expectations of $580m by FY23. He thinks $880m instead is not out of the question.

As these scenarios go, if Higgins' suspicion proves correct, this will have a material impact on the bottom line, which means upgrades will follow, which translates into a higher valuation for the company, add a higher quality/longer duration loan book, rising Net Interest Margin (NIM), Return on Equity (ROE) lifting... eventually management will have created the option to de-risk the balance sheet and increase distributions to shareholders via securitisation.

And investors will love every bit of it.

Before we know it this share price could triple, possibly quadruple in four years' time. Higgins thinks an extra $6 on top of a $2 share price seems possible. Now all investors need is for someone to hand that Shaw research report to management and tell them this is how you do it. Unless, of course, that information was already passed over from company management to the analyst at Shaw.

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The view that investment portfolios might be best served through a bias towards cheaper "Value" stocks is not gospel for everyone, but we did notice the change in **Macquarie**'s latest strategy report. In it, the strategists changed their view. They are now in favour of adding more weight to "Value" and reduce exposure to outperformers such as Goodman Group ((GMG)), REA Group ((REA)) and CSL ((CSL)).

The reasoning behind the move is that Macquarie sees enough evidence that a trough in global growth is near or maybe already behind us. This means the outlook for 2020 is looking better.

Normally at this point in the cycle, equity returns are negative and valuations considerably lower, point out the strategists. This time around, however, the Price-Earnings (PE) ratio for ASX Industrials is close to the highest level since the Internet Boom of the late 1990s. It is at the 99th percentile since 1960.

Macquarie's **Model Portfolio** has added BHP Group and Worley ((WOR)) to increase exposure to Resources. Other adjustments are switching out of Goodman Group and into Lendlease ((LLC)) instead; out of Stockland ((SGP)) and into Flight Centre ((FLT)) and out of APA Group ((APA)) and into Spark Infrastructure ((SKI)).

Positions that have been reduced include CSL, REA Group, and Ramsay Health Care ((RHC)) while positions that have increased include Nine Entertainment ((NEC)) and Aristocrat Leisure ((ALL)).

Clearly, what Macquarie is suggesting is that an improving economic outlook is going to force investors into cheaper priced "Value" stocks and cyclicals, including miners and mining services providers. But as the Model Portfolio holds on to stocks like James Hardie ((JHX)), Transurban ((TCL)), CSL, and a2 Milk ((A2M)), not everything trading on an above market valuation should be thrown out with the bathwater.

Macquarie's Model Portfolio holds no exposure to the local IT sector with the strategists commenting they are watching the sector closely for potential opportunities that might pop up.

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In Part One of this week's Weekly Insights, I explained how **strategists at Morgan Stanley** do not see any upside for US equities next year. They believe valuations are way out of kilter for an economic recovery that will prove to be benign by all measurements.

Unfortunately, for Australian investors, Morgan Stanley holds no high expectations for the ASX200 either. The forecast is for the local index to remain range bound with a target of 6700 by year-end 2020. The index closed below that level on Thursday, but only after two days of relentless selling.

In general terms, Morgan Stanley finds local equity valuations look quite stretched, with any upside now closely linked to further growth in profits, while plenty of downside risk remains regarding consumer spending (or not spending).

Morgan Stanley's **Model Portfolio** too has added exposure to the "Value" end of the share market (read: Energy and Materials) while also shifting to Neutral on banks (from Underperform) now that a lot of the bad news has come out during the recent reporting season.

The forecast is that the dire situation locally will translate to a more coordinated monetary and fiscal response; but that won't happen until the second half, predict the strategists.

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Model Portfolios over at **stockbroker Morgans** have taken profits on Macquarie Group ((MQG)), as that stock was growing into the largest holding in the Balanced Model Portfolio.

Additional shares in Corporate Travel ((CTD)) were bought upon weakness. The exposure to Energy was re-weighted through selling off Oil Search ((OSH)) and buying Woodside Petroleum instead.

The Growth Model Portfolio has locked in profits from Megaport ((MP1)), as well as from AP Eagers ((APE)). NextDC ((NXT)) was added.

-*NEW* Research To Download

We receive far more research here at FNArena than we can possibly use for our news reporting. Some of the research reports are allowed to be passed on to investors.

Below is a selection of recent reports that might be useful for a selective audience. This initiative is partly an attempt to gauge whether this can be a useful addition to our service, so don't be shy to provide us with feedback.

Indicative update on listed managed investment vehicles:

https://www.fnarena.com/downloadfile.php?p=w&n=9CA98FF0-9012-FB75-935454E642D3B1AC

Report on Navarre Minerals ((NML)):

https://www.fnarena.com/downloadfile.php?p=w&n=9CB7FF31-E04A-BCB5-99AFB9DA2EC65A32

Report on Bardoc Gold ((BDC)):

https://www.fnarena.com/downloadfile.php?p=w&n=9CB279E7-CFE7-0A6D-35630FF5CEF32EF2

Report on Talisman Mining ((TLM)):

https://www.fnarena.com/downloadfile.php?p=w&n=9CBFB575-D080-90D1-9A8BBFCF09398F10

Report on Theta Gold Mines ((TGM)):

https://www.fnarena.com/downloadfile.php?p=w&n=9CBC0004-F665-FAD7-2C913FE22359ADF0

Report on Lepidico ((LPD)):

https://www.fnarena.com/downloadfile.php?p=w&n=9CF67067-A807-C210-6B263A62A7EED5F7

All feedback and comments welcome at info@fnarena.com

Rudi Talks

Audio interview on Thursday: Threats And Preferences For This Year's Santa Rally:

https://www.youtube.com/watch?v=PIh-fmbkvPA&list=PLVMOgaPqrk1s55RujzgMerIzdOX2RrXl9

Rudi On Tour In 2020:

-ASA Hunter Region, near Newcastle, May 25

(*Part One of this story was written on Monday 18th November 2019. 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. Part Two was written on Thursday*).

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

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- Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
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