WEEK 27

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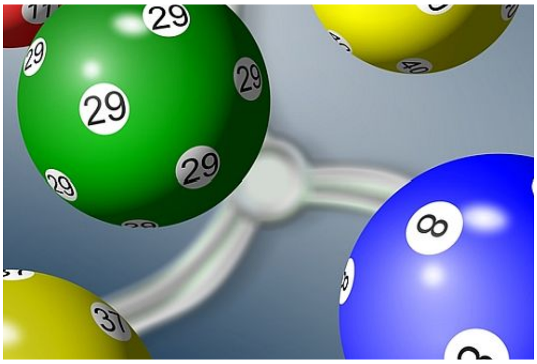
Friday, 3 July 2020



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AUSTRALIA

Perenti Global Supported By Metals Exploration

Concerns over the balance sheet and work in hand at Perenti Global have dissipated, with the company's update supporting a robust outlook.

-Management considers the worst behind the business now
-Favourable outlook because of gold exposure
-Several substantial new tenders coming up

By Eva Brocklehurst

Perenti Global ((PRN)) (formerly Ausdrill) has provided more clarity surrounding its drilling business in the wake of the pandemic, and removed some uncertainties surrounding FY20 earnings.

Wilsons suggests investor sentiment should be buoyed by the fact management assesses the worst is behind the business now. The broker considers concerns over the balance sheet are overdone, particularly as **the board has also elected to pay the deferred first half dividend of 3.5c in July**.

The company's net profit guidance of $106-110m for FY20 is only -4-8% below the low end of guidance previously provided and subsequently retracted, UBS notes. Perenti Global has brushed aside the impact of the pandemic but, nevertheless, it has been material. UBS points to direct shutdowns of sites and reduced productivity, especially in underground mines.

FY21 guidance is expected at the results in late August. While erring on the conservative side and suspecting continued travel and roster impacts could affect productivity, UBS still considers the valuation attractive.

There is good visibility on the company's book across FY21-22 and the broker notes **recent activity in terms of gold exploration and the forecasts for gold prices remain supportive** of client profitability, and hence

Perenti Global's outlook.

UBS revises down estimates for FY20 by -9%, in line with guidance. FY21 is downgraded by -13% to reflect lower expected underground margins and a Buy rating and $2 target are maintained. Canaccord Genuity, too, continues to view the stock favourably because of gold exposure, which is around 70% of revenue, and maintains a Buy rating and $1.81 target.

Improving Outlook

Although guidance implies a material fall in earnings in the fourth quarter, the broker considers it is reasonable, given the challenges. To date most of the impact has been isolated.

The Panoramic Resources ((PAN)) Savannah project and the Hindustan Zinc Rampura Agucha project both experienced disruptions. Barminco has now ended work at the latter and Panoramic Resources has undertaken a recapitalisation.

Moreover, Perenti Global has indicated there are several substantial tenders in the offing that could generate earnings from the second half of FY21. Canaccord Genuity highlights the Sukari mine in Egypt, which has open pit work, as well as potential work with Sandfire Resources ((SFR)) in Botswana.

Wilsons believes the business is on an improving trajectory while end markets, particularly gold, are very strong, and retains an Overweight rating and $2 target. This shift in the market outlook is under appreciated, the broker adds, obscured by the African operating risks and the potential spread of the coronavirus.

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AUSTRALIA

Are Bank Provisions Sufficient?

Are bank provisions sufficient to cover the extent of the downturn in the economy? What happens when government stimulus is removed at the end of September?

-Impairment provisions could, potentially, rise in FY21
-Major banks likely to regain market share in home lending
-Banks less likely to require additional capital

By Eva Brocklehurst

What will happen to banking in the December quarter, when a substantial policy stimulus in response to the outbreak of coronavirus is removed? Are bank provisions sufficient to cover the extent of the downturn?

The Australian Bureau of Statistics has delivered a sobering assessment that 30% of businesses don't have liquidity in place to support operations for more than three months. The worst hit industries are accommodation & food services and retail trade. The same survey indicates that in around 70% of businesses which have experienced a weakening of revenue, the declines are by more than -25%.

Around 10% of the bank mortgage books and around 15% of small-medium enterprise (SME) loans have had payments deferred, and this payment holiday will expire from late September, with a great deal of uncertainty in the lead up to this date.

As a result, with limited information, UBS acknowledges bank credit impairment charges may fall sharply up to September but then provisions could potentially rise in FY21 as households and SMEs feel the pressure of having to meet repayments.

A large cohort is being supported by the federal government's JobKeeper package and rent relief yet, as Citi points out, **banks will only offer support as long as these business operations are viable** over the longer term.

Banks are well aware that, when interest rates do start to rise, if there is too much debt on a company's books this only compounds problems. Citi suspects defaults will be dominated by the SME sector because of this viability issue.

Banks have resorted to calling customers at the three-month deferral point - around now, UBS notes - to find out their financial position, but this may be of limited use as many could be worried about telling the truth.

Industry estimates state that around 20% of deferred books are unlikely to meet contractual requirements from October and the broker assesses this to be a fair estimate. This would imply mortgage delinquencies could rise significantly.

Significant credit charges are likely to be required in FY21 as the full impact of the downturn is experienced and particularly as Australia faces a “fiscal cliff", given $100bn of policy stimulus will be removed in the December quarter.

<u>Bad Debts</u>

Morgans asserts the bad debts being factored into major bank share prices are overdone, with the exception of **Commonwealth Bank** ((CBA)), which is why it is the broker's least preferred of the major banks. **Westpac** ((WBC)) is preferred because its bad debt provisions are greater than during the GFC.

Morgans has upgraded **ANZ Bank** ((ANZ)) to Add and believes the bad debt experience during the current crisis will not be as severe for the banks as that experienced during the GFC as the **Australian government and the Reserve Bank of Australia are cushioning balance sheets to an extent never seen before.**

Moreover, the broker suspects that if enough businesses and individuals are in stressed positions at the end of September then government and bank support measures will be extended.

Offsetting the headwinds to net interest margins are improvements in institutional lending margins, strong growth in transaction deposits and less reductions to home loan variable rates in the aftermath of the last cut to the cash rate. System credit growth is subdued and Morgans expects the major banks will regain market share in home lending during a period of funding stress for non-bank lenders.

Given changes to economic forecasts, for which the 2020 trough in the economy is now expected to be more shallow and the rebound smaller, Credit Suisse points out the expected credit losses (ECL) for the banks are also likely to change.

The rebound year has the greater influence on this measure, and the broker estimates that for every additional 10% probability weighting towards the downside scenario (from the base case of a gradual recovery), it means ECL increases $200-350m per bank.

A complete move to the downside scenario would mean an increase of $2-3bn per bank. Credit Suisse has relatively higher bad debt charges in its estimates for ANZ Bank and **National Australia Bank** ((NAB)) in the second half of FY20.

Westpac had a peak in bad debt charges in the first half because of more conservative assumptions. While there is a timing difference for Commonwealth Bank because of its June year end it has also been conservative and taken a large provision in the third quarter.

Credit Suisse believes the shift to a shallower trough and more modest recovery is captured in its forecasts. From a sector perspective the broker believes the pandemic is an "earnings event" and not about balance sheets.

Morgan Stanley estimates repayments have been deferred on more than 11% of major bank mortgages. A higher probability of default on mortgages could add $5.6bn to losses and justify a further increase in bank provisions. The broker calculates the ability of bank customers to meet repayments in the future will vary greatly, depending on changes to employment, household income and existing savings.

<u>Capital Relief</u>

UBS notes the debate regarding the potential for the Australian Prudential Regulatory Authority (APRA) to grant capital relief on deferred loans where additional support is required beyond September.

This would include considerations such as moving loans to interest only, extending terms or reducing rates.

Regardless, the market is expected to stay focused on real CET1 ratios and reward those banks that have the strongest capital, asset quality and most conservative accounting.

UBS also suspects the banks will be less likely to require additional capital and, as the economy starts to recover, the market will look through FY20 and towards a potential recovery in late FY21 and FY22.

Besides Commonwealth Bank, the broker believes the sector can recover to book value and potentially higher as dividends rebound. Nevertheless, it is likely to take until the end of December until there is an accurate view of the performance of mortgage and SME loan books.

See also, Will Banks Recover With The Economy? June 22, 2020.

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AUSTRALIA

Tabcorp Gains More Digital Lottery Power

Tabcorp has extended its digital lottery relationship with Jumbo Interactive to 2030 on a more favourable basis, emphasising its significant market weight.

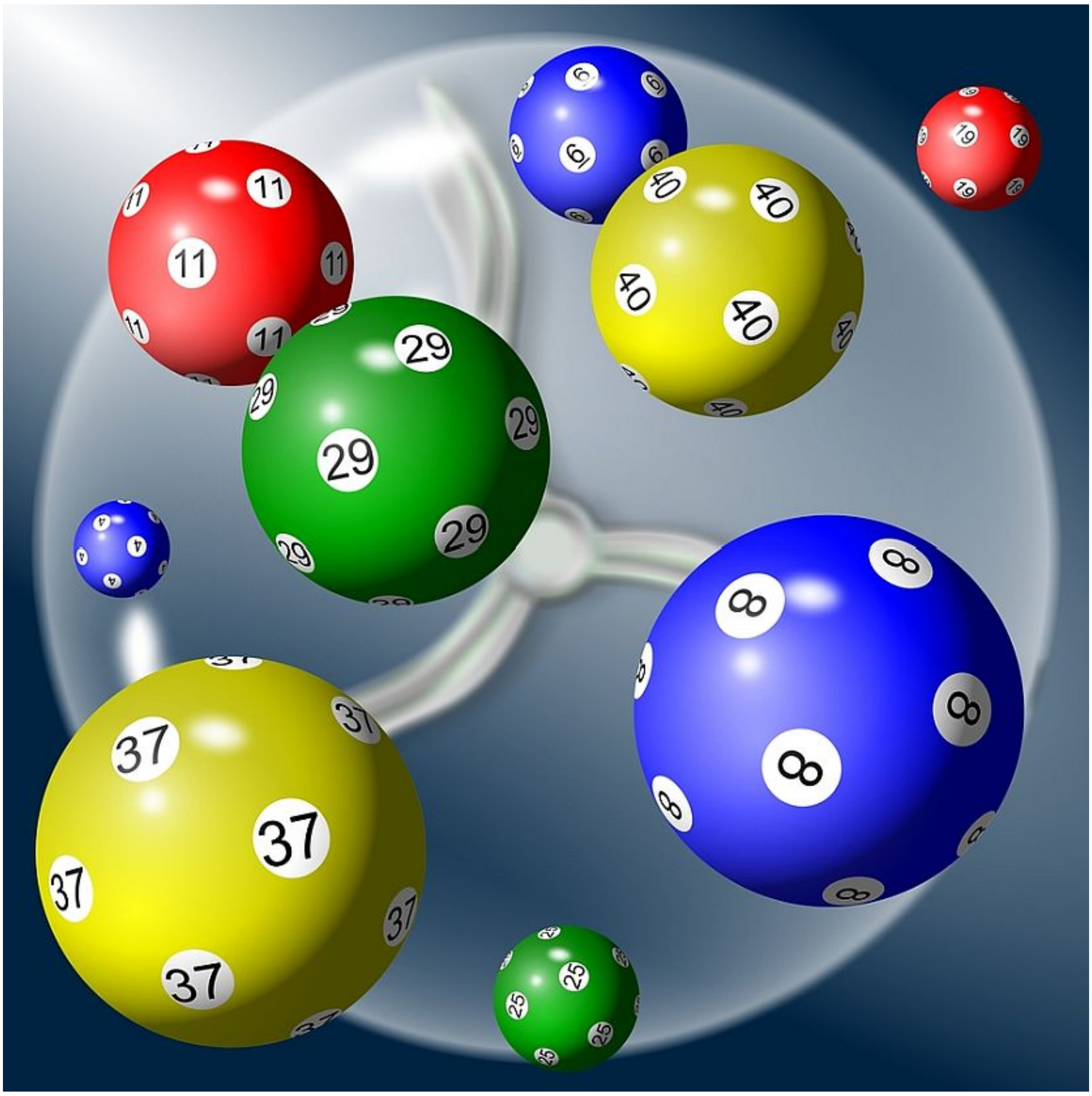
-Economics of the deal shift in favour of Tabcorp via services fees
-Australian digital lottery turnover rapidly increasing
-Race wagering solid, offsetting sport cancellations

By Eva Brocklehurst

Tabcorp Holdings ((TAH)) has wielded market power, renegotiating a more favourable digital lottery relationship with Jumbo Interactive ((JIN)). Jumbo Interactive accounts for around 20% of total digital lottery sales in Australia ex Western Australia while Tabcorp has the other 80%.

Tabcorp has extended the relationship to 2030 and effectively reduced the net commission it pays. Tabcorp will receive a fixed extension fee of $15m and ongoing services fees based on the ticket subscription price which moves up annually to 4.65% by FY24.

Citi asserts renegotiating the deal is less risky than an exit from the current agreement. The prospect of Tabcorp being the sole online lotteries option outside of Western Australia would have required a successful customer migration from one platform to another that may have proved challenging.



The economics have shifted in favour of Tabcorp via the services fee. Morgan Stanley calculates, when fully implemented in FY24, this will result in a -3.75 percentage point reduction in revenue and transaction value for Jumbo Interactive.

The broker also believes the one-off extension fee is strange, given this is a long-term deal. Importantly, while the upfront fee is a marginal benefit, this **limits Jumbo Interactive from bypassing Tabcorp as a reseller until 2030**.

Mitigation of the lost revenue is likely to be the focus for Jumbo Interactive, Citi suspects and using the price lever is an option for improving its revenue in the short term. The broker upgrades Tabcorp to Neutral from Sell, believing some of the short-term headwinds are being countered by extracting value from the lotteries chain.

While on balance the new deal is positive for Tabcorp, Goldman Sachs believes the announcement may have disappointed those who were expecting even more favourable terms, in light of Tabcorp's strong bargaining position.

The broker, not one of the seven stockbrokers monitored daily on the FNArena database, retains a Sell rating and increases the target to $2.80. The main upside risk envisaged for Tabcorp includes acquisitions, reduced wagering competition and better-than-expected lottery revenue growth.

Digital Lottery Turnover

Macquarie calculates the new deal could generate around $20m in operating earnings after FY24, noting Australian digital lotteries account for around 27% of turnover and this is rapidly increasing.

The broker envisages challenges and benefits, with a an expected increase in digital at the expense of retail. Tabcorp is likely to have generated free cash flow throughout the pandemic restrictions, given online capability. Overall, volumes have been better than the broker had expected since retail outlets were closed.

Credit Suisse calculates lottery revenue is down around -10% in the June half year. Considering the circumstances, this is assessed to be "pretty good". A number of agencies did close during the pandemic and jackpot sizes are generally smaller.

Meanwhile, the broker assumes a -19% drop in revenue for wagering in the June half. Around half of revenue is sourced from retail betting locations which were shut in April and May. However industry turnover has been solid as race wagering has offset cancellations in sport.

Macquarie forecasts Tabcorp's wagering & media revenue will still fall -15% in FY 20, with a -29% decline in the second half, and remains concerned around heightened competition because of the step-change in digital and the integration of BetEasy/Sportsbet.

Still, the broker considers the valuation attractive and a re-rating possible if lottery jackpots surprise or wagering stabilises. Macquarie expects dividends may resume in FY22 and assumes an 80% pay-out ratio.

Western Australia

The new Tabcorp transaction does not cover Western Australia and this could be the next material change as Morgan Stanley considers Jumbo Interactive's WA business is unresolved.

Scenarios could range from Jumbo Interactive losing the ability to resell tickets to retaining that ability and securing a software agreement that would power Lotterywest's operations. Incumbent Intralot has a market cap of EUR23m but, as far as Morgan Stanley can tell, the contract expired in 2019.

FNArena's database has two Buy ratings, four Hold and one Sell (Ord Minnett, yet to comment on the deal). The consensus target is $3.30, signalling -2.2% downside to the last share price.

AUSTRALIA

Sales Boost Peaking For F&P Healthcare?

Strong demand for nasal high-flow therapy in hospitals catering to the pandemic provided a strong FY20 result for Fisher & Paykel Healthcare. However, sales acceleration appears to have peaked in the first quarter of FY21.

-Higher hospital sales countered by lower margins
-Boost from pandemic may have peaked
-Stock remains overvalued

By Eva Brocklehurst

A surge in device sales for hospitals has lifted Fisher & Paykel Healthcare's ((FPH)) revenue and this continues to accelerate as demand from the COVID-19 pandemic remains heightened across the globe.

Uptake of nasal high-flow (NHF) therapy remains strong and large proportion of current OptiFlow usage is for coronavirus patients in hospitals. Moreover, there has been a material boost to physician awareness.

Management expects this new awareness will support an acceleration in market penetration, with the addressable market now assessed at 50m per annum. Credit Suisse suspects the company's first-mover advantage in hospital has become entrenched.

The company has pointed to strong customer demand for OptiFlow and Airvo because of a number of clinical trial results and the pandemic. Citi believes there remains a long ramp-up period ahead for OptiFlow, and consumables in new applications should continue to grow rapidly for a number of years.

Net profit was NZ$287.3m in FY20, up 30% and reflecting the company's highest growth rate in at least a decade. Hospital revenue grew 24% and homecare revenue rose 9%. The performance of homecare revealed lower diagnostic rates were offset by strong mask re-supply.

Higher hospital sales were countered by lower margins. The company expects gross margins will fall -200 basis points in FY21 because of higher freight transport costs caused by the pandemic. Fisher & Paykel Healthcare is using more airfreight to shift product and raw materials but has decided not to increase prices.

FY21 Outlook

The outlook for FY21 is for net profit of NZ$325-340m. This is based on the assumption hospitalisations from the pandemic peak in the first quarter and activity normalises by the end of the first half.

UBS notes hospital sales have received a boost from the pandemic in the first quarter by around 55%, although current orders suggest this may have peaked. Credit Suisse also understands growth in China has eased back to normal levels.

Similarly homecare growth is expected to normalise in the second half. Credit Suisse points out, while the uplift in mask growth in the second half was pleasing, **the benefits from greater patient compliance are difficult to disaggregate from a pulling forward of demand.**

Management has acknowledged upside risk to guidance if virus cases continue to rise and Credit Suisse agrees that the ongoing proliferation of cases provides some confidence that the top line momentum can be maintained.

Macquarie suspects new patient referrals for the obstructive sleep apnoea business could be -30-40% lower in the first quarter and suspects homecare revenue will be relatively flat in FY21.

Wilsons points out that the company was turning away prospective new customers to focus on supplying existing accounts during the pandemic. Re-engaging with these prospective customers could offer further opportunities to expand in the US in FY21-22.

Fisher & Paykel Healthcare has indicated that it is been able to manufacture products to satisfy demand although forward orders remain. Nevertheless, UBS continues to believe the extent of pandemic-related sales will eventually disappoint investors.

Overvalued

The share price has risen 52% since mid January and UBS questions the ability to sustain and grow sales at this rate from FY22 onwards. To achieve such a rate would require a step change in high-flow nasal cannula adoption rates and an unchanged dominant market share of around 70%.

While this is not impossible it runs counter to clinical studies and channel checks. While retaining a Sell rating on valuation, UBS acknowledges that positive earnings momentum means a sharp reduction in investor confidence is unlikely. In a similar way, Credit Suisse likes the quality and growth outlook but believes this is priced into the stock.

Citi considers the company has done an "excellent job" in meeting increased demand and anticipates elevated growth rates in FY21, also noting meaningful competition in the high-flow segment of the market is unlikely in the medium term. Still, the broker agrees the stock remains overvalued, conscious there will be a slowdown in FY22 post the pandemic.

The company has broadened its capital management strategy, Macquarie notes, which will result in lower dividends and enable investment in the business to support long-term growth. The company will spend $160m in FY21, doubling manufacturing capacity for both traditional humidifiers and NHF devices.

Emerging markets have also experienced strong demand for devices and these markets are relatively under-penetrated from a product perspective, largely because of lower levels of healthcare infrastructure. Hence, Macquarie suggests this represents a significant opportunity.

The broker retains the one Outperform (Buy) rating on FNArena's database for Fisher & Paykel Healthcare, with the three others having Sell ratings. Wilsons, not one of the seven stockbrokers monitored daily on the database, has placed its valuation and recommendation under review.

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AUSTRALIA

KFC Delivery A Winner For Collins Foods

Momentum in KFC Australia underpins Collins Foods as consumers readily engage with the company's delivery options and as restrictions around dining-in continue to ease.

-KFC Australia leading the sales trends
-KFC Europe should return to modest growth in FY22
-Taco Bell roll-out slowed for 12 months

By Eva Brocklehurst

Sales trends for Collins Foods ((CKF)) have picked up in FY21 amid continued momentum in KFC Australia, which in turn has benefited from consumer engagement and cost controls.

KFC Australia generated 11.6% growth in like-for-like sales in the first seven weeks of the company's new financial year while KFC Europe was down -13.4%. Taco Bell sales have gradually recovered to pre-pandemic levels.

Wilsons assumes same-store sales trends move back towards long-term norms by the end of the first half of FY21 for KFC Australia, with a temporary margin benefit from stronger sales growth, constrained by higher costs and no price increases.

KFC Europe is expected to sustain mid-single digit declines in same-store sales by the end of the first half before returning to modest growth in FY22, and Wilsons is encouraged by the momentum building in Germany. The broker has an Overweight rating and $10.47 target for Collins Foods.

Morgans believes the reallocation of capital towards the much higher returning KFC Australia business is the right move in the current environment and anticipates a **recent easing of restrictions in Europe should help trading conditions.**

Government stimulus is supporting a strong balance sheet and Morgans anticipates a 50% pay-out ratio will be reinstated, which reflects the better-than-forecast final dividend, retaining an Add rating and $10.23 target.

While incorporating the robust outlook, UBS opts for a conservative stance on sales growth in FY21, raising estimates for earnings per share by 11%. The broker also suspects net debt/operating earnings has peaked in FY20.

Earnings in the second half of FY20 beat UBS estimates as revenue in KFC was stronger and KFC Europe margins were also better than expected. Costs remain under control with chicken prices locked in until 2022. Revenue grew 8.9% in FY20 and net profit 5.1%.

The company's digital delivery strategy continues to progress, currently available in 137 KFC Australia restaurants. While there were disruptions because of the pandemic restrictions in the second half that affected shopping centre and dine-in functions, UBS notes volumes held up reasonably well.

Sizzler reported a -18% decline in revenue in FY20, with three restaurants closed and a significant impact from the pandemic into the end of the year. Six Sizzler stores in China have closed since the balance date.

Delivery continues to provide the tailwind for the company and UBS suspects a focus on value at KFC Australia, with controls on costs, will require minimal price increases. Hence, the valuation remains appealing and the broker retains a Buy rating, with a $10.65 target.

Moreover, there is operating leverage available through store expansion in Australia, Germany and the Netherlands. There is also the opportunity around the rolling out of Taco Bell in Australia. Brokers believe the decision to slow the rolling out of new Taco Bell stores for 12 months is prudent in the current environment, given the significant capital commitment required.

Taco Bell was one of the main areas that underperformed UBS estimates while Wilsons extends assumptions for a maiden profit for Taco Bell by one year, to FY23, reflecting the delayed roll-out.

AUSTRALIA

Suncorp Takes Stock Of Risk

Suncorp has signalled higher reinsurance costs have made it more economic to retain risk on the balance sheet. Brokers are wary of this, given the number of headwinds confronting insurers.

-No hard financial targets provided but downgrades are larger than expected
-Headwinds to margins compounded by low interest rates and lower CTP prices
-Responsibility for insurance in Australia to be split across two roles

By Eva Brocklehurst

Without committing to any hard financial targets, Suncorp ((SUN)) has outlined a new organisational structure and signalled higher reinsurance costs have made it more economic to retain risk on the balance sheet.

Investors will again be faced with gradual earnings downgrades, Credit Suisse asserts, rather than a re-setting of financial targets, anticipating Suncorp will deliver a 6-7% return on equity in outer years, well below the prior target of at least 10%.

The broker lowers cash earnings estimates for FY21 by -13%, because of a worse reinsurance outcome and lower bank earnings, downgrading to Underperform from Neutral as the stock has outperformed peers recently.

Macquarie considers the update reflects the challenges faced by the broader general insurance industry, although the quantum of downgrades was larger than expected. On a positive note there have been lower motor insurance claims in Australia and Morgan Stanley estimates a -25% claim frequency reduction in March-June provides $120m in savings.

However, Suncorp has indicated the benefit will be offset by provisions such as "incurred but not reported" claims on landlords, business interruptions, and increased risk margins.

Given how volatile the insurance margins have been, Ord Minnett finds it difficult to forecast earnings from FY21 with precision. The broker suspects there will be a trough in underlying earnings in FY21 because of elevated bad debt charges in the bank and as the market moves to reprice for higher reinsurance.

Reinsurance

Rising reinsurance costs have played a role in setting the new structure and the company has noted it was more economic to retain risk rather than reinsure. Reinsurance cost is rising $42m versus the original FY20 cover and a single aggregate "excess of loss" cover replaces two prior covers. The company has guided to an FY21 catastrophe budget of $910-950m compared with $820m in FY20.

UBS assesses the increased budget is a headwind to underlying margins and requires repricing initiatives to extend beyond FY21. While Suncorp will be able to push through stronger premium rate increases in home insurance other classes may prove more challenging.

Morgans assesses there is not as much P&L protection now and Suncorp will have to hold a higher level of general insurance capital because of the extra risk exposure. The broker downgrades to Hold and believes there is better value elsewhere in the sector.

The lift in reinsurance cost is significantly less than Citi had anticipated, although Suncorp is only partially through re-pricing the last lift in the allowance so the ability to re-price this latest increase is questionable.

Morgan Stanley downgrades the FY21 insurance margin by -1.5 percentage points, noting earnings volatility will rise given less aggregate cover. Still, capital is strong and the prospects for dividends have improved with better markets.

The broker points out the Bureau of Meteorology currently expects a 50% chance of a La Nina forming in the spring, which typically brings higher catastrophe losses in Australia. That said, both Suncorp and Insurance Australia Group ((IAG)) regularly exceed catastrophe budgets.

Morgan Stanley notes Suncorp's actual catastrophe losses have not been below budget since FY08. In recent years aggregate reinsurance cover has protected Suncorp from exceeding its catastrophe budget but now there is less aggregate cover from FY21.

Suncorp expects to recover the insurance margin within two years, not through price increases but by cost reductions and tighter underwriting and Bell Potter suggests this intention is being overlooked. Citi admits this may ultimately be possible but it will take time and the headwinds for margins are compounded by other headwinds such as lower interest rates and lower CTP prices.

Morgan Stanley observes, with a multi-year quota share, Suncorp could reduce its earnings volatility and improve capital flexibility, although concedes, in addressing the risk of climate change, it is hard to measure just how much general insurers can control.

Suncorp has confirmed its FY20 natural hazard costs are in line with its $820m allowance, in keeping with stronger reinsurance protection and a more benign second half. The claims risk from the pandemic remains neutral in FY20.

Business Interruption Claims

Despite higher provisions for landlords in FY21 there could be risks around landlord claims, particular if unemployment spikes once government support is withdrawn. Yet, UBS expects business interruption is unlikely to be an issue, although policy wording will be tested with regards to pandemic exclusions.

The interesting aspect of the update, in Shaw and Partners view, is the test case of business interruption insurance. The argument hinges on the reference to the Quarantine Act and whether this is sufficient to exclude claims from the pandemic but the Quarantine Act has been repealed and replaced with the Bio-Security Act.

Should the court decide an exclusion based on a reference to the previous act is ineffective then this could be expensive for insurers. However, as Bell Potter points out, Suncorp had already updated the majority of its policy wording prior to the pandemic, although there are some policies that refer to the old act.

Restructure

A new organisational structure is intended to reduce costs through eliminating duplication, and responsibility for insurance in Australia will be split across two roles, with a CEO of insurance product & portfolio and a COO of insurance who is responsible for claims management and operations.

Shaw finds it extraordinary that a company that has been through so much change still cannot sort out its cost structure while Goldman Sachs suspects Suncorp will make more tactical changes when efficiency opportunities present rather than commit to another multi-year large program.

Nevertheless, **meaningful cost savings are not expect in the short term**. Credit Suisse also struggles with assessing where accountability ultimately lies, given a separate role for underwriting and claims.

Citi believes better returns from the new management structure are likely to be realised in the future. The restructure may make the stock an attractive opportunity at some stage but, in the broker's opinion, not at present. Both Citi and Bell Potter suggest the reorganisation should make the banking arm easier to spin off, although a sale is considered unlikely in the short term.

Macquarie points out, although the restructure draws a line between the bank and general insurance, management has indicated this does not mean any shift of intent regarding the role of the bank.

Among those brokers not monitored daily on the FNArena database Shaw has a Buy rating and $10.00 target, Goldman Sachs a Buy rating and $10.80 target and Bell Potter a Buy rating and $10.50 target.

The database has three Buy ratings, three Hold and two Sell. The consensus target is $9.64, suggesting 10.5% upside to the last share price. Targets range from $8.10 (Morgan Stanley) to $11.82 (Ord Minnett). The dividend yield on FY20 and FY21 forecasts is 4.1% and 5.7% respectively.

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BOOK REVIEWS

FNArena Book Review: Warren And Charlie's Bedtime Story

FNArena Book Review: Warren And Charlie's Bedtime Story, by Adam Robinson

By Rudi Filapek-Vandyck

In the end... someone was always going to do it. When I was offered a copy of "Warren and Charlie's Bedtime Story" the first thing that sprang to mind was: of course!

In the end... it was only a matter of time before someone would actually do it. It turns out, that someone is New Yorker Adam Robinson.

Second time author Robinson wrote a children's book for adults, weaving the best quotes from and investment principles developed by Warren Buffett and Charlie Munger in an easy-to-read and equally easy-to-understand "bedtime" story featuring one highly talented young boy who's being coached by his grandfather.

One does not have to be a scholar of Buffett and Munger to identify the many references. One thing this story does very well, it highlights how much of Buffett & Munger's investment success stems from pure and plain common sense.

Only this time you'll absorb the secrets behind great investing through the mind and mouth of twelve-year-old Billy Smith.

Robinson is clearly in awe of Buffett and Munger, "the greatest investment team of all time", inspired by the sixtieth anniversary of their annual shareholder meeting together, which this year was not business as usual because of the coronavirus pandemic.

The author is gifting all royalties to children's charities. More info can be found through his website https://iamadamrobinson.com/

To add to the educational aim of "Warren and Charlie's Bedtime Story", below are possibly the 25 most quoted investment rules from the philosophical partnership that made Berkshire Hathaway's annual shareholders gathering one of the most talked about events in global finance.

Eager readers can hold a contest to find out who can identify the most quotes in the book.

Rules

1. "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

2. "Price is what you pay. Value is what you get."

3. "It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."

4. "A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful."

5. "The important thing is to know what you know and know what you don't know."

6. "You cannot make a good deal with a bad person."

7. "Just buy something for less than it's worth."

8. "Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."

9. "Uncertainty actually is the friend of the buyer of long-term values."

10. “As in the case with marriage, business acquisitions often deliver surprise after the ‘I do’s.’”

11. “Wall Street makes its money on activity. You make your money on inactivity.”

12. “Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold.”

13. “Don’t pass up something that’s attractive today because you think you will find something better tomorrow.”

14. “The sillier the market’s behavior, the greater the opportunity for the businesslike investor.”

15. “You only learn who has been swimming naked when the tide goes out.”

16. “The best way to think about investments is to be in a room with no one else and to just think. If that doesn’t work, nothing else is going to work.”

17. “What we do is not beyond anyone else’s competence. I feel the same way about managing that I do about investing: It’s just not necessary to do extraordinary things to get extraordinary results.”

18. “Rule No. 1 is never lose money. Rule No. 2 is never forget Rule No. 1.”

19. “When seeking directors, CEOs don’t look for pit bulls. It’s the cocker spaniel that gets taken home.”

20. “Our experience with newly-minted MBAs has not been that great. ... It’s difficult to teach a new dog old tricks.”

21. “It’s always been a mistake to bet against America, since 1776.

22. “I have every possession I want. I have a lot of friends who have a lot more possessions. But in some cases, I feel the possession possesses them, rather than the other way around.”

23. “A very rich person should leave his kids rich enough to do anything but not enough to do nothing.”

24. “My wealth has come from a combination of living in America, some lucky genes, and compound interest.”

25. “Your best investment is yourself. There is nothing that compares to it.”

Warren and Charlie’s Bedtime Story, by Adam Robinson, 111 pages.

COMMODITIES

Material Matters: Copper Concerns And Iron Ore

Copper price not reflecting economic conditions; iron ore supply constraints easing up as shipping volumes rise for Australian miners; steel output for most geographies continues to contract.

- The recent red metal rally may not reflect on the ground reality
- Iron ore supply concerns easing with Vale back in the game
- Global steel demand remains China-dependent

By Angelique Thakur

Copper: Wrong end of the stick

Copper is seen as a proxy for global economic health, a barometer of sorts for financial markets.

Citi's proprietary China copper end-use tracker has seen an increase for the first time since May. The tracker, which fell -28% in February year-on-year grew by 1.6% in May. Citi analysts note this to be led by construction activity and automotive sales.

Copper prices are up 25% since the peak of the pandemic and it appears demand for the metal seems to be doing well, backed by strong Chinese imports with inventories falling sharply in the last few months. This is also supported by a steady increase in industrial activity.

However, ANZ Bank's research team believes this rally may not be giving a true picture of the global economy. They believe the current rally is not demand driven.

The ANZ Bank Copper Demand Index, which tracks activity in downstream sectors, shows no sign of improvement, instead falling -20% (yoy) in May, the lowest since the global financial crisis.

There are also indications of a build-up in finished goods, on the expectation of increased demand from China due to its stimulus measures.

The ANZ Bank Downstream Copper Demand Indicator, which turned negative in January to March and has been falling steadily throughout the pandemic, points to weak underlying conditions. It indicates sales of consumer durable items like air conditioners and washing machines are weak.

Citi analysts also corroborate stockpiling by traders, which started during the covid-19 lockdowns and continued into the second quarter, helped by low copper prices and reduced borrowing costs.

This stocking may turn to de-stocking in the third quarter, fear Citi experts, pushing down refined markets and weighing down the ongoing end-use recovery.

China's end-use copper consumption is predicted to fall by -1.8% in 2020, state Citi analysts.

ANZ reports supply-side constraints have been the main driver of the recent rally, led by rising covid-19 cases in South America, now considered the epicentre of the pandemic by the World Health Organisation.

With 40% of total global mine supply coming from this region, the risk to production will remain for the rest of the year, comments ANZ.

Leading producer countries, Chile and Peru, have been hit the hardest with major operations in both countries impacted. Other countries like the US, Mexico and Zambia are also facing mining closures.

Citi anticipates a recovery in end-use demand in the second half to the tune of 3-5%, less than what would be expected in normal times. This also means there is an upside risk to the analysts' figures if covid-19 issues are resolved earlier than expected.

ANZ expects prices to come under pressure once the supply issues are worked out, and will depend on how successfully China's stimulus measures boost demand.

Iron Ore: Easing supply constraints and increasing shipping volumes

The recent rally in iron ore is mostly underpinned by supply concerns from Brazil, grappling with an outbreak that is worsening by the day. Vale was ordered to shutdown operations in its Itabira complex from June 5, after 188 workers tested positive to covid-19. The Itabira operations make up about 10% of the miner's total output.

Vale has now resumed operations and reports impact on production to be less than -1mt. The miner has not made any changes to its FY guidance of 310-33mt.

Shaw and Partners expects the supply issues to mellow down in the coming times with Brazil already reporting an increase in iron ore exports in the first few days of June.

The analysts also expect demand from China, another key driver, to moderate in the coming months. Offsetting this somewhat will be increased demand from other parts of the world in the second half, predicts Shaw.

The analysts have downgraded Fortescue Metals Group ((FMG)) to Hold, expecting pricing tail winds to become headwinds supplemented by Brazil's improving supplies.

Macquarie reports all major Australia miners to be on track to achieve guidance even as the latest weekly shipping figures were a mixed bag, with volumes for Rio Tinto ((RIO)) and BHP Group ((BHP)) increasing while Fortescue shipments saw a decline of -10%. Vale shipments, at 4.7mt, remain below the circa 6mt per week level needed to achieve its guidance.

Macquarie highlights that while shipping volumes for Australian majors were impacted by Cyclone Damien in the first quarter of 2020, all ports recovered by March and this strength carried over into April and May. Shipping in June so far has been strong for the miners at 986mt, with almost no damage from the pandemic.

There has been a jump in freight rates, with the Australia-China freight rate increasing by 125% since May while the Brazil-China rate has shown an increase of 186%.

This jump can be attributed to factors like oil price recovery, growing demand from China, strong Australian shipments and increasing Brazilian shipments.

For FY21, Macquarie foresees significant upside for Australian miners including Fortescue Metals, Mount Gibson Iron ((MGX)), Champion Iron ((CIA)), Mineral Resources ((MIN)), Rio Tinto and BHP.

In fact, earnings upside for FY22 and beyond are expected to be 100% for pure-play stocks like Champion Iron, Mount Gibson Iron, Fortescue and Mineral Resources.

Stocks favoured by Macquarie analysts are Fortescue and Rio Tinto in the large-cap segment and Mineral Resources with its leverage to iron ore price.

Champion Iron, due to its long life and expansion potential, is preferred over Mount Gibson Iron.

Steel: Subdued global ferrous scrap demand

According to the World Steel Association, global crude steel production decreased by -8.7% (yoy) in May while production in China grew 4.2% (yoy). The fall was broad-based, driven by contraction in steel output across geographies including the US, Japan, India, EU and Australia (among others).

On a monthly basis, there is an improvement of 5.5% in global production from April. Goldman Sachs anticipates a gradual recovery in production with easing of lockdowns although it expects volumes to remain subdued (except in China). The US, EMEA and Japan continued to post negative growth month on month.

Goldman Sachs remains cautious on the broader ferrous scrap demand outlook. Broad-based weakness in global steel demand is likely to put downward pressure on electric arc furnace (EAF) production. This idea is supported by data for the month of May which shows production declines to be skewed towards EAF-heavy markets like Turkey, India, the US and Mexico.

Goldman Sachs has a Neutral recommendation for Sims Metal Management ((SGM)).

COMMODITIES

Robust Outlook For Lithium Despite Obstacles

As the global economy contracts over 2020 lithium, already suffering surpluses, is now affected by a hiatus in demand. How low will prices go?

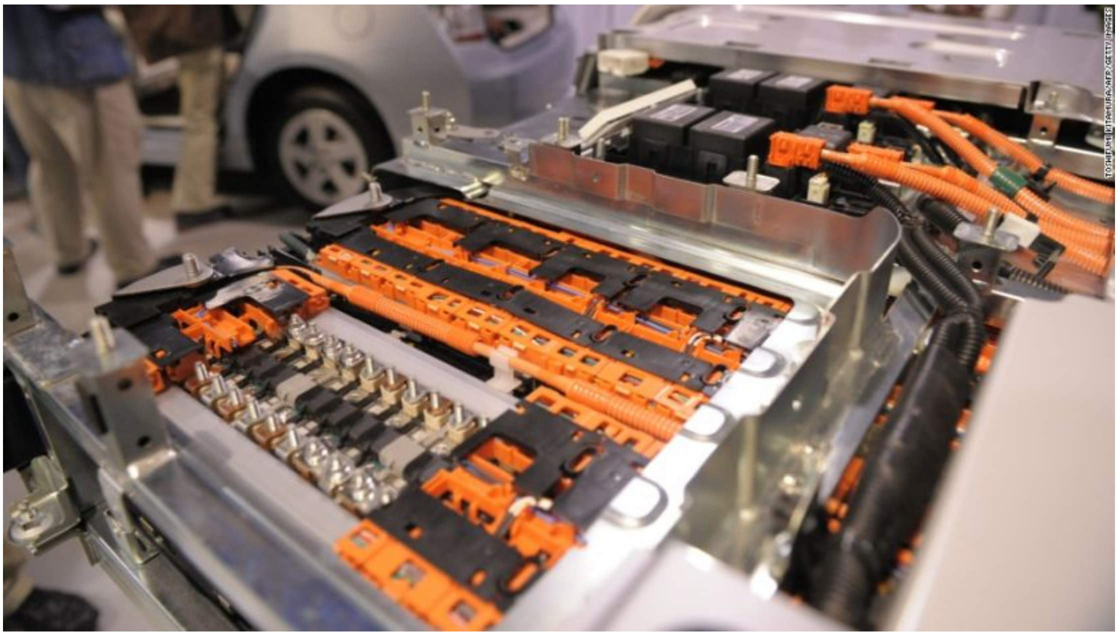
-A trough may be forming in lithium prices
-Demand outlook remains strong
-Repeat of 2016-18 is unlikely

By Eva Brocklehurst

Lithium prices were under sustained pressure from the outset in 2020 and then along came the coronavirus, prolonging weakness in the market as supply chains were de-stocked.

Now, the global economy is forecast to contract in 2020 and industrialised countries to suffer the most. Industrial usage for lithium represents around 40% of demand and this is expected to contract over 2020 before rebounding in 2021.

Have prices hit their lows? Morgan Stanley had expected the price in China would stabilise on a recovery in demand but it has continued to fall, having touched a low near US$5000/t. As Citi points out, the relatively automated production process for EV batteries has held up much better than either production or sales of electric vehicles through the initial stages of the coronavirus outbreak.



Hence, a gradual de-stocking of batteries has weighed on demand and moved the surplus from batteries to lithium. In an oversupplied market, where costs are lower because of weak energy prices, there is scope for downside. While prices may slip a little further Citi suspects a trough is forming and remains bullish over the longer term. Battery grade carbonate prices are forecast to be up 42%, at US$7200/t in 2022.

Morgan Stanley points out **a supply response has emerged and, together with government stimulus, should provide some support in 2021** . Prices are starting from very low in the cost curve but at the same time the demand outlook is still strong.

Latin American brine operations represent almost half of current primary lithium supply and these assets are operating under restrictions at present. Yet the broker notes there have only been limited adjustments to actual operations. Suspensions in Argentina have been brief and Chile's producers are building inventory rather than cutting output. Albemarle has also noted its order book is firm in terms of battery-grade lithium.

Australian Producers

Morgan Stanley forecasts a -7% fall in lithium output in 2020, with the biggest cuts to production in Australia as spodumene pricing has fallen -15% in the year to date and demand from China has evaporated.

For example, Australia's **Galaxy Resources** ((GXY)) is running its Mount Cattlin spodumene operation on campaign mode, in order to control costs. Credit Suisse forecasts a 2020 spodumene price of US$415/t.

The broker has downgraded the stock to Neutral, factoring in a weak demand environment that is compounded by the disruption caused by the pandemic but acknowledges a restructured Mount Cattlin should reduce any strain on cash flow.

There is Sal de Vida under consideration, with the company targeting a final investment decision in the second half of 2020. Citi assesses Galaxy Resources is in a position to execute on the initial phase once approved.

UBS points out the latest sales data from **Orocobre** ((ORE)) was not very positive and well below expectations. That company is also attempting to match production to expected sales.

If current volumes and pricing persist through to the end of the year, UBS estimates Orocobre will have a cash shortfall in the September quarter of 2021 and may need to consider an equity raising/corporate debt or seek approval to access US$135m of restricted cash.

Credit Suisse also recently downgraded Orocobre to Neutral, citing the difficulties facing the industry amid weak sales and prices, exacerbated by the disruption caused by the pandemic to logistics and end-user demand.

Demand Expanding

Modestly higher prices are required to avoid deficits opening up. That said, Cit ascertains margins will remain under pressure in some areas as there are several years of surpluses ahead.

As supplies exceed demand, industry rationalisation has been accelerating and the broker suspects tightness will hit the lithium market by 2024. **Lithium is approaching a transition, as long-term demand remains high and the challenges for supply have become more pronounced.**

While a sizeable surplus weighs on spot prices Citi believes current levels will prove unsustainable and there will be a trend towards incentive pricing to avoid a potential deficit and fulfill expanding demand from the electric vehicle battery market.

Electric vehicles have become the biggest demand driver for lithium and should dominate the growth trajectory as the share of market increases. Citi forecasts a modest -3% fall in lithium EV battery demand in 2020 because of policy support that will drive a second-half recovery and a continuing boost to lithium battery intensity per vehicle.

Outside of China, the broker anticipates modest growth in Europe, which is the epicentre of new supportive policies and subsidies. Germany has doubled its EV subsidy and provided temporary VAT relief on new car purchases.

Still, Credit Suisse believes it will take time for subsidies and stimulus to procure the sales growth necessary to bring any tension to supply/demand dynamics. Sustained demand growth is needed to absorb inventory and latent production capacity.

Citi agrees, asserting a repeat of the "euphoria" in 2016-18 is also unlikely, because of lithium's natural abundance, sufficient latent capacity and the emergence of "fast-response" hard rock miners.

Morgan Stanley concludes that, as lithium producers continue to delay new projects and expansions, the net number of additions to the market over the next five years will have a significant impact on whether there is a surplus or a move to deficit.

COMMODITIES

Material Matters: Lithium, Copper And Oil

Lithium supply expected to increase by 2025; Copper mines in Latin America resuming operations; future uncertain for the North West Shelf

-Lithium prices are low and unsustainable
-Copper production beginning to ramp up, but risks remain
-Global oil supply balance expected to shift to a deficit in June

By Angelique Thakur

Lithium – low prices expected to improve

JP Morgan expects demand for lithium hydroxide to soon outstrip that for lithium carbonate. This will be driven by demand for electric vehicle batteries and will also increase demand for the source mineral – **spodumene**.

On the supply side, the current price of US$400/t for spodumene is considered unsustainably low by JP Morgan analysts. This becomes clearer when the current price is compared to the US$1,000/t levels seen in 2018.

While JP Morgan does not expect a material rebound, it does expect the price to increase to US$550/t in the longer term, noting industry experts also expect a rise between US$500-650/t.

The Australian lithium sector is still in its infancy with operations at Wodgina and Pilgangoora yet to ramp up. JP Morgan suggests costs will be defined by concentrate quality and plant recoveries.

The market, already oversupplied in 2019 with demand falling, was expected to improve in the second half of 2020, but it seems any improvement has been pushed out due to the pandemic-led disruptions.

Galaxy Resources' ((GXY)) Mt Cattlin mine and **Pilbara Minerals'** ((PLS)) Pilgangoora are operating well below capacity. **Mineral Resources'** ((MIN)) Wodgina also remains on care and maintenance and the broker notes a number of projects are at their final investment decision stage (FID).

JP Morgan expects more than 5mpta of spodumene supply by 2025, driven by a ramp-up in production by mines including Greenbushes ((LIT)), Pilbara Stage 1 and 2 and Wodgina. The broker feels it is too early to be bullish on the metal.

JP Morgan rates Pilbara Minerals as Underweight while being Neutral on Galaxy Resources, Orocobre ((ORE)) and Mineral Resources.

Copper – Supply worries easing gradually but risks remain

Morgan Stanley pegs the loss of copper supply through March-June (led by the lockdowns) at -565kt, with Peru accounting for one-third of this (-200kt).

Many of the mines are ramping up to full capacity now, with the recovery centred on Peru. Morgan Stanley notes the majority of the industry there is expected to operate at 100% by July-end.

One major operation that remains offline is the 350ktpa Cobre Panama mine (Panama), where operations have been suspended for almost three months now, with no potential date set for resuming production. The analysts expect a full year production of just 200kt.

Chile has avoided suspensions till now and is trying to maintain its output. However, the risk to mining is growing with Codelco announcing the suspension of its 300ktpa Chuquicamata smelter operations, following the death of a worker due to the virus.

Morgan Stanley feels, given the continued spread of the virus, operations will not return to normal until later in the quarter third which will negatively impact the fourth quarter.

This may not necessarily hit supply as there is sufficient spare smelting capacity globally, with the broker forecasting Chilean production to fall -250kt to 5.6mt in 2020.

Continued risks to copper supply include the pandemic continuing to engulf Latin America along with the fear of a second wave cropping up in other places, which could suspend operations again.

Morgan Stanley expects supply to remain impacted beyond the second quarter of FY20 as mines catch up on maintenance activities and predicts volumes will remain impacted till 2021.

Project development has also been hit; potentially derailing supply growth forecast till 2023.

Joining their peers at Morgan Stanley, analysts at Macquarie see near term upside risk for copper prices owing to these supply concerns.

Macquarie prefers OZ Minerals ((OZL)) which has the longest mine life and Sandfire Resources ((SFR)) over Turquoise Hill Resources ((TRQ)).

Oil: Upside risk

The research team at Longview Economics notes WTI and Brent crudes are ranging between US$35-US$40/bbl, which is high enough to encourage additional production.

However, a question around the global demand outlook remains, especially with a second wave of covid-19 infections emerging in many parts of the world.

Longview tries to assess how the demand-supply scenario will play out over the coming months and suggests global oil inventories peaked in May and will likely fall sharply over the next six months, falling by around -100m barrels by the end of 2020.

The analysts forecast oil production to increase in the second half, spurred by the expiry of OPEC-plus quotas in August.

On the other hand, demand has recovered by almost 50% in just two months from the lows seen during the first-half, they point out but remain conservative and assume a slowdown in recovery going forward.

On the whole, Longview forecasts the global supply balance to switch to a -2mbpd deficit in June from a 6mbpd surplus in May, expecting deficits to continue for the rest of 2020 and potentially leading to price gains.

This essentially means the rise in supply is expected to be less than the increase in demand. This is also supported by a fall expected in US oil production due to high stress levels in the shale industry.

Longview believes inventories may fall faster than expected notwithstanding downside risks like second wave-led disruptions.

Sector analysts at Macquarie have also pared down their crude oil price assumptions over the next 18 months through 2021. Even as they expect the oil rally to lead to more than US$50/bbl within the next year, Macquarie analysts expect less upside in 2021.

Impairments are expected to increase in the Australian energy sector in the second half, following large impairments announced by oil behemoths like BP and Occidental globally.

Chevron's recent announcement concerning the sale of its stake in the North West Shelf (16.67%) bodes well for Woodside Petroleum ((WPL)), suggests Macquarie.

The North West Shelf is Australia's largest LNG project and jointly owned by Chevron, Woodside Petroleum, Mitsubishi, BP, BHP Group ((BHP)) and Shell.

Woodside Petroleum may either acquire Chevron's stake or re-engage the joint venture to agree on third party gas access terms for its Scarborough project.

The broker is Neutral on Santos ((STO)) led by the company's higher financial leverage and a more gradual price recovery through 2021.

Oil Search ((OSH)) recently sold down its Alaska north slope oil interests, easing the forward funding burden and prompting Macquarie to maintain its Outperform rating.

With undemanding valuations and expected recovery in prices within the next year, the broker is overweight on the sector and prefers Oil Search ((OSH)) and Woodside Petroleum.

A long term price estimate of US$56/bbl remains unchanged.

<u>Aussie miners feel the heat</u>

A strengthening Australian dollar translates to headwinds for Australian miners, points out Macquarie's strategy team. It has taken the shine off Australian gold producers, leading to earnings cuts, made worse by prospects of limited growth in FY21.

Macquarie has downgraded Newcrest Mining ((NCM)), Regis Resources ((RRL)), St Barbara ((SBM)), Resolute Mining ((RSG)), Capricorn Metals ((CMM)), West African Resources ((WAF)) and Dacian Gold ((DCN)) to Underperform while Saracen Mineral Holdings ((SAR)) and Alacer Gold ((AQG)) are rated Neutral.

Nickel's medium-term prospects look good with the broker advocating for Western Areas ((WSA)), Nickel Mines ((NIC)) and Mincor Resources ((MCR)).

There is upside risk to earnings led by buoyant iron ore prices, suggests Macquarie, which within the large-cap miners, prefers Fortescue Metals Group ((FMG)), Rio Tinto ((RIO)) and BHP Group over South32 ((S32)), because of South32's exposure to alumina, nickel and thermal prices.

The broker prefers Mineral Resources ((MIN)) and Mount Gibson Iron ((MGX)), among the bulk miners, over Champion Iron ((CIA)) which has been impacted by a decline in premiums on high grade.

Lower alumina and coal prices have hit earnings of Whitehaven Coal ((WHC)), New Hope Corp ((NHC)) and Alumina Ltd ((AWC)), exacerbated further by exchange rate headwinds.

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COMMODITIES

Material Matters: Silver, Lithium And Copper

Rebound in silver price led by investment demand; Electric vehicle battery demand to push up lithium prices; Copper markets to be in deficit by 2021.

-Strong investment demand to continue for both gold and silver
-Lithium supply glut a temporary blip
-Current iron ore prices may be unsustainable
-Favourable long-term outlook for copper

By Angelique Thakur

All that glitters is not gold (some of it is silver too)

TD Securities points to an increase in **silver** prices since the sell-off in March, driven by a rebound in industrial demand and central bank stimulus measures.

The analysts forecast the precious metal's price to shoot to peak at US$22/oz before stabilising at US$20/oz in 2024.

Pandemic-disrupted production in Mexico and Peru forms about 35-40% of global production of silver and TD Securities estimates the lost supply at circa -40moz to-date.

Even as the mines resume functioning, many are yet to attain full capacity.

With Purchasing Managers' Indices (PMIs) on the rise globally, the broker forecasts industrial demand for silver to rebound by 6% in 2021, at a level similar to 2019.

Contrary to the relatively gradual increase in industrial demand, **ETF holdings** have increased by 25% year to date, to a record level of 765moz.

TD Securities predicts investment demand will remain strong for the next several years driven by the Fed's quantitative easing measures (among other factors).

For investors worried about a resurgence of coronavirus cases, **gold** remains a key safe-haven investment.

ANZ Bank expects this to remain the case, with the uncertain macroeconomic outlook and stimulus measures helping gold's cause.

UBS's preferred pick in gold is **Saracen Mineral Holdings** ((SAR)) with its strong growth prospects in production, followed by **Newcrest Mining** ((NCM)) which is still seen as attractively valued.

The broker advocates a move away from **Northern Star Resources** ((NST)) and **Evolution Mining** ((EVN)), both rated Sell.

Lithium: Only a matter of time

Citi analysts are bearish on **lithium** in the short term and expect demand to drop -6% this year, led by a **supply glut** which is expected to last till 2024.

This situation, however, is considered unsustainable and Citi forecasts prices to improve, driven by the rising **electric vehicle** battery demand.

Over the medium-term, Citi forecasts a compounded annual growth in demand of 19% till 2025 while admitting there will be no re-run of the euphoria witnessed during 2016-18.

Even so, the broker believes It is only a question of when and not if for lithium demand to hit 1mtpa.

While this is expected to happen by around 2027, Citi highlights a price increase to US$9,000/t is needed in the long run to help achieve this level of supply.

Citi prefers **Orocobre** ((ORE)) and suggests a move away from **Pilbara Minerals** ((PLS)).

Base metals: Supply issues to remain for now

Contrary to UBS's expectations, the second quarter did not see a decline in metal demand. Rather, the faster than expected recovery in China and production disruptions around the world kept the supply of metals tight.

This can be seen from the MSCI World Metals & Mining Index which was up 25% over the second quarter against the MSCI World Equity Index's 19%.

The ASX300 Metals & Mining Index was also up 27% in the second quarter (to June 24) versus the ASX 300, which was up just 18%.

For now, UBS prefers **iron ore,** although it does consider current prices (around US$100/t) unsustainable and forecasts a drop to below US$90/t before this calendar year is over.

This is corroborated by commodity analysts at ANZ Bank who feel that while iron ore supply remains vulnerable, the market may be overpricing the risk of supply disruptions.

UBS's top picks are **BHP Group** ((BHP)) which is considered attractively valued with a diversified portfolio (will also be paying dividends), along with **Alumina Ltd** ((AWC)) and **South32** ((S32)), both of which offer exposure to alumina.

Coronado Global Resources ((CRN)) is upgraded to Buy owing to its attractive valuation and exposure to **metallurgical (coking) coal**.

Production disruptions in South America coupled with a ban on ore exports by Indonesia have also hit **nickel** supply pretty hard. UBS expects the full impact to materialise by the end of 2020.

UBS suggests a recovery on the global front will support nickel prices and forecasts a recovery to US$7/lb in 2021.

While **IGO** ((IGO)) is UBS's go-to stock for nickel, **Western Areas** ((WSA)) has been downgraded to Neutral from Buy.

Copper Conundrums

With the world moving towards electric vehicles that use about 80% more copper than a traditional internal combustion engine, **copper** is expected to play a crucial role in coming times.

Wilsons pegs the demand increase due to the new segment at roughly 20%.

Currently, the largest consumer of the industrial bellwether is China which consumes a little more than 50% of global demand.

The week ending June 19 saw copper prices on the London Metals Exchange (LME) trading above pre-pandemic levels.

In fact, the copper contracts were trading in backwardation – meaning spot price was higher than the future price - with premiums being paid for the prompt delivery of the metal.

This has led to global stockpiles falling to levels not seen in over a decade, observes Wilsons.

Copper stockpiles on the Shanghai Futures Exchange rose by three times to 380kt from 124kt between January and March, falling back to just 128kt, the speed astonishing many.

It is the same on the London Metal Exchange with inventories depleted materially, leading many to ask what exactly is going on?

Half the answer lies in a recovering China, with rising demand leading to an expansion in credit, automotive output, new property and investment in fixed assets (seen in May).

The other half can be explained by the pandemic-induced supply issues. This includes the scrap copper or recycled copper market with collection centres closing.

Wilsons reveals that even before the onset of the pandemic, copper markets were projected to be in deficit by 2021.

The pandemic only seems to have aggravated the situation, impacting new exploration projects for the metal, further increasing supply woes.

Today, copper has one of the tightest supply/demand outlooks of any base metal, points out Wilsons. Whereas UBS expects the copper market will move to a deficit of about -300kt in 2020 from the current surplus of around 900kt, and reach a balance in 2021.

UBS expects copper prices to move in the US$3.20-US$3.30/lb range over the coming years, up from US$2.50-US$2.60/lb level, and remain well supported in the future.

Among the miners, Wilsons likes **OZ Minerals** ((OZL)) which is in process of doubling its production between 2019 and 2023 along with **Rio Tinto** ((RIO)) with 10% of earnings from copper and looking to increase its exposure to the metal.

UBS prefers **Sandfire Resources** ((SFR)) and rates it a Buy. Even more preferred is **OZ Minerals** owing to its longer mine life (more than 20 years) at Carrapateena.

ESG FOCUS

ESG Focus: Impact To Join Risk and Return At The Hip

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

The Responsible Investment Association of Australia's most recent report on impact investment augurs major changes to fundamental investment principles, and to government policies and investment flows over the next decade.

By Sarah Mills

-Impact investing to join risk and return as a third paradigm
-Government policy and funds to play a key role
-Trajectory for 2020 and beyond

The Responsible Investment Association of Australia has published its Benchmarking Impact 2020 report.

The survey of 125 investment groups shows that impact ESG investment (as opposed to best-in-class investment) is experiencing strong growth.

But more on the numbers later. What was interesting about this report is that it also outlines the likely path and role for impact investing in Australia, and the world.

Impact investing the third paradigm

The report's executive summary starts with an interesting quote:

"2020 is like no other, with the global COVID-19 pandemic impacting communities and economies worldwide, on the back of Australia's most devastating bushfire season in history. These events have brought the interdependencies between our society, environment and economy into sharp focus, and reaffirms the relevance of impact as the third paradigm of investing, alongside risk and return."

This is a big call. To rank impact investing alongside risk and return as an investment driver suggests a complete rewrite of the way in which the world views investment, and a commitment from the most powerful levels of society.

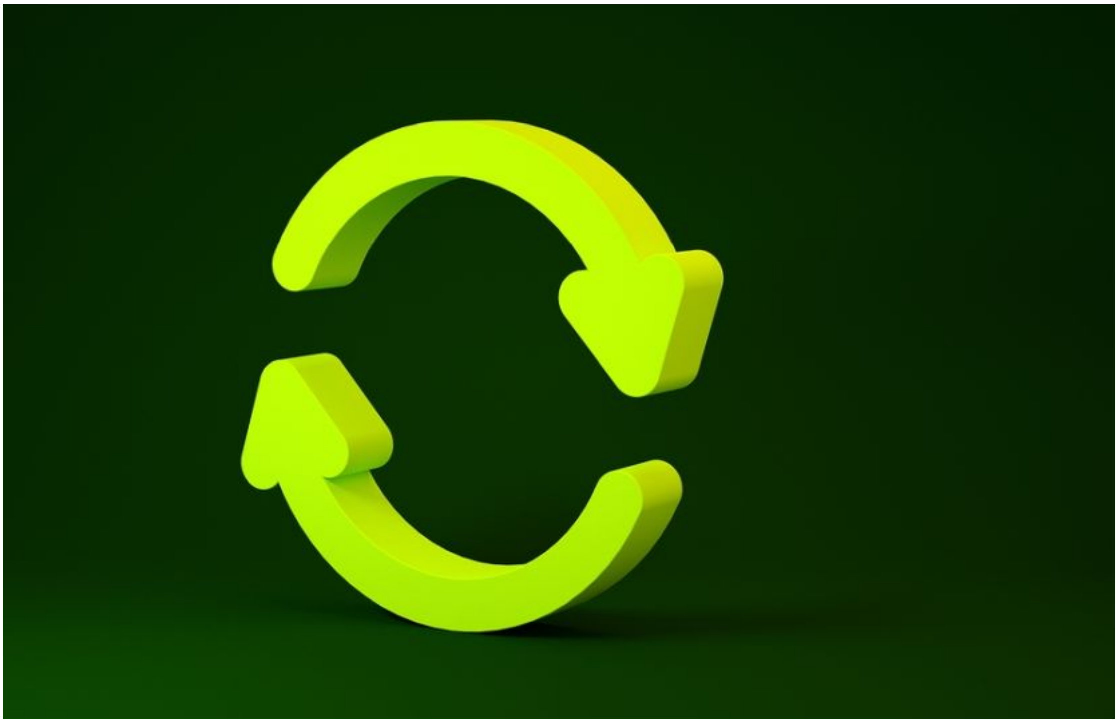
From a political perspective, this is consistent with conservative aims to outsource traditional government social functions to the private sector, and an attempt to fill the social gap that has emerged over the past 30 years as a result of unfettered capital flows. This is a trend that is likely to continue globally.

As the survey states: "*Impact investing has emerged as a powerful strategy for investors to intentionally direct capital towards economic, social and environmental outcomes and is at the forefront of this growing awareness and shift in thinking.*

"The impact investing community is championing innovative approaches that demonstrate how capital can be directed towards delivery of measurable positive social and environmental outcomes.

"It is leading the development of market infrastructure, including development of a shared language, frameworks and tools for measuring and managing impact more comprehensively and consistently."

These sentiments also align with the stated determination of governments and big business to underpin the fourth industrial revolution with sustainability.



Australia’s impact investing respondents and stakeholders

The RIAA Benchmarking Impact report was funded by AMP Capital and the Department of the Prime Minister and Cabinet, and was conducted by the Deakin Business School.

It surveys 125 respondents across several investment categories and explores motivations, intentions and perceived roadblocks.

The report positions itself as a guide for major institutional investors and other investing bodies:

“*This report is prepared for investors, asset managers, intermediaries, advisers, enterprises, not-for-profit organisations, government agencies and others who have a stake in and/or seek to better understand the impact investment market in Australia.*

“It can help investors understand aggregate performance figures and trends and provide insights into the interests, experiences and challenges of other investors in the Australian market.”

Government policy for impact investing

Survey respondents agreed that government should play a key enabling role through initiatives and tax incentives, providing capacity building for impact businesses, clarifying fiduciary duty to include consideration of impact and improve impact reporting and measurement by providing access to government data.

The Commonwealth Government has several measures in place to support the development of the domestic social impact investment market.

In 2017, it published a social impact investing discussion paper and the Australian Government Principles for Social Impact Investing.

Since the 2017-18 Budget, the Commonwealth has announced $57m in initiatives. This is relatively small fry but is expected to increase at the next budget in October and may well form part of the government’s covid-19 response.

According to the survey, initiatives include:

• $22.3 million over 10 years to partner with state and territory governments on social impact investing projects;

• $8 million over four years towards a Sector Readiness Fund to grow the social impact investing market by providing capability-building grants to impact businesses looking to become investment ready;

• $6.7 million over four years to build the capacity of the Australian social impact investing sector to measure its outcomes and impacts;

• $15.7 million over three years to fund the co-design, implementation and evaluation of three payment-by-outcomes funding trials in the social services sector; and

• $5 million to establish a Social Impact Investing Taskforce to provide evidence-informed recommendations on a strategy for the Commonwealth's role in the social impact investing market – in particular, how social impact investing can provide solutions to address entrenched disadvantage and some of society's most intractable social problems.

Much of the above funding appears to be preparatory funding for the management infrastructure to channel further government funds flows over the next decade.

Industry's response to government policy

Industry is positioning itself to align with government policy. In 2019, it established the Australian Sustainable Finance Initiative (ASFI) in 2019, a collaboration of Australia's major banks, superannuation funds, insurance companies, financial sector peak bodies, civil society and academia.

According to the RIAA report: "ASFI intends to develop a Sustainable Finance Roadmap in 2020 to recommend pathways, policies and frameworks to enable the financial services sector to contribute more systematically to the transition to a more resilient and sustainable economy and to help Australia meet its commitments in relation to the SDGs (Sustainable Development Goals), the Paris Agreement and the Sendai Framework for Disaster Risk Reduction. "

State government policy in this area is fledgling and varied.

The RIAA survey notes that the UN Sustainable Development Goals are the most widely used framework for measuring and communicating impact.

Nuts and bolts: Market posts strong growth

According to RIAA, the Australian impact investment market tripled in the two years to December 31, 2019 to nearly $20bn, with the number of products available increasing to 111.

This compares to the global market of US$502bn, according to the Global Impact Investing Network.

Overall, including impact investment, the total responsible-investment market in Australia grew 13% in 2018 to $980bn, or 44% of professionally managed assets under management.

The RIAA expects that demand for impact investments from Australian investors over the next five years could increase at least five-fold to $100bn (4% of assets under management from 0.7% now), given respondents expected they would allocate five times their current funding to the category over that period.

Investors identified the major brake on investment as the lack of social impact investment opportunities. There is some expectation that government policy and budget support should be used to build this market.

Impact investing yields solid returns

The survey says 93% of impact investors believed their financial expectations were being met or exceeded by these investments, which returned a weighted average annualised return of 5.3% across products in different asset classes. About 75% of investors expected competitive or above market-rate returns.

Only 25% of investors were willing to accept below market rates of return and only 1% of investors targeted capital preservation.

Despite the overriding financial prerequisite, impact remained the primary motivation for investment (76%) followed by mission alignment (60%) and financial returns (35%).

Investors happy with their impact

The survey says that 93% of respondents also believed the resulting impact from their investments had met their expectations.

The majority of impact investment products were overwhelmingly directed towards conservation, environment and agriculture ($16.8bn or 84%).

Green investment trumps social investment

About 87% of available products target environmental outcomes – green bonds and environmentally focused investment.

The survey notes a rapid scaling of the green bond and environmental markets as a result of financial performance and strong product development.

Social investment on the rise

Nevertheless, the number of products targeting social outcomes jumped tenfold to $2.5bn from $250m.

The weighted average annualised returns (net of fees) between January 1, 2018, and December 31, 2019, ranged between 3.5% for private debt and 11.3% for public equity. Green Social Sustainability Bonds (GSSs) averaged 5.1% and real assets returned 7.4% and Social Impact Bonds (SIBs) returned 3.9%.

Financial returns on impact investments targeting environmental impacts were 5.5% on a weighted average basis for 2018-2019, outpacing investments targeting social outcomes at 4.4%.

Much of the social impact investment comprised asset-based housing investment and AUD-denominated impact investment in developing nations.

Global comparisons

The global impact investing market hit US$502bn in 2018, with more than 13,000 deals being managed across 1,340 organisations globally, according to the Global Impact Investment Network's (GIIN) ninth annual impact investor survey.

The market is expected to reach US$1trn by 2024 – a very "impactful' figure.

According to the GIIN survey, two thirds of impact investing products are managed through specialist impact intermediaries. Two thirds of investors target market-rate returns, one third target concessional rates of return, with 15% of investors targeting returns that are closer.to capital preservation than market rate.

The majority of investors (56%) target both social and environmental outcomes, 36% target only social objectives and 7% target only environmental objectives. Overall, investors are satisfied that the impact outcomes and financial performance of their impact investments are in line with their expectations.

What impact-investors want

The RIAA report finds motivations of impact investors remain primarily financial, although impact is the first priority. While 24% cited ethical reasons, 76% expected competitive or above market rate returns on their investments.

Measurable impact, mission alignment and financial returns were cited as the leading motivators for allocating funds to impact investments.

Investors also called for more investable deals; and evidence and track record of social impact and financial performance.

Their main focus is on early-stage products such as seed capital/start-ups and venture-stage companies, however, there is a dearth of these products in the Australian market.

It is interesting to note that early-stage investments will likely be in hot demand by the broader market as the fourth industrial revolution roles out.

Investments that have both a 4IR and sustainability profile should be in particularly high demand.

It is this lack of seed product, and reliable information and research, that are proving the main barriers to attracting new participants to the market, the survey finds.

For existing investors, the most important catalysts to investing more funds was reported to be investable deals, evidence of social impact, evidence of financial performance, or a longer track record.

Final sentiments: beneficiaries

The report closes with a section about how and whom its findings may benefit:

" It can provide product manufacturers and deal makers with evidence that may support decision-making on product development.

" It can provide asset consultants and wealth advisers insights on investor interest and demand that can assist in understanding their evolving needs.

"It can also help asset managers by providing a benchmark from which to assess market activity and their own performance and investment strategies.

"It can help for-purpose businesses seeking to understand the market dynamics of the impact investment market as a potential source of capital.

“It can help inform government and other policy makers with data and insights that highlight potential areas for policy development.”

Trajectory for 2020 and beyond

Meanwhile, BetaShares reports that its three ethical exchange-traded funds attracted an increase in inflows in 2020, suggesting continued demand for ESG products this year. This year’s October budget should start to clarify government intentions and direction in this area.

The suggestions that product manufacturers and deal makers stand to benefit from impact investing was clearly articulated in the survey, and is also a strong indication of where funds and government subsidies are likely to flow in 2020 and beyond.

Investors can expect an expanding suite of products and opportunities and better impact measurement frameworks, in what is shaping up as an early mover’s market.

The focus is likely to grow to “impact at scale” on specific social and environmental solutions and early movers are likely to benefit. Scaling Impact by Impact Investing Australia is an early source of information on this.

At this stage, it appears highly likely that impact investment will prove profitable over the next five years, given underlying trends and intentions.

However, there is a growing debate about the efficacy of impact investing given investors are increasingly being primed for “investment opportunities” over solutions to problems.

Questions are already being asked about who decides the priorities for investment, and whether funding recipients are worthy; and so on.

True impact investors will need to see genuine social and environmental change to justify their investments, as opposed to incremental and slightly abstract adjustments in figures such as CO_2 levels.

Similarly, governments will need to prove their stripes in allocating funds to businesses in an independent and impactful manner to avoid accusations of misdirection of taxpayer dollars.

Only the next five years will tell whether the social/environmental investment experiment has any hope of success. In the meantime, the funds will flow.

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

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 26-06-20

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 June 22 to Friday June 26, 2020
Total Upgrades: 9
Total Downgrades: 15
Net Ratings Breakdown: Buy 49.50%; Hold 40.94%; Sell 9.57%

When it comes to stockbroking analysts updates on individual ASX-listed stocks, the balance between negative adjustments and positive amendments remains skewed towards the positive, with exception of investment recommendations.

Upgrades to valuations and price targets outweigh the downgrades, and the same observation can be made for changes to earnings forecasts, one month out from the August reporting season.

But the local share market has experienced one hell of a rallyf rom its sell-down low in the third week of March, and this is increasingly being reflected in more rating downgrades than upgrades being issued.

For the week ending Friday, 26th June 2020, FNArena registered nine upgrades in ratings against 15 downgrades.

Logistics services provider Qube Holdings stole the limelight during the week, receiving no less than four downgrades, of which only one moved to a Sell.

Freshly announced new customer Woolworths for the company's flagship development near the main airport in Sydney is triggering higher capex spending for the years ahead.

Only one upgrade didn't lift to Buy, with Sigma Healthcare the lonely stand-out amidst fresh Buy ratings for salary packaging firms, miners, an oil producer, and one bank.

The week's overview of downgrades only contains three new Sell ratings, with Sydney Airport and Altium responsible for the additional two.

Scandal hit Freedom Foods and smaller mining stocks feature prominently.

The week's table for positive revisions to price targets has three stocks enjoying double digit percentage increases; Seek, EclipX Group, and Premier Investments.

Freedom Foods is the exception in an otherwise more subdued looking table for the week's negative revisions, with FrexiGroup and Coronado Resources suffering notable reductions too.

There are some genuine fireworks on display in the table showing positive updates for earnings estimates, led by Nufarm, Air New Zealand, Qantas, and Wagners Holding Co.

The first nine of the week’s top are all enjoying double digit percentage increases.

The opposing side of the week’s ledger has notable decreases, but the numbers are significantly lower for companies including Metcash, Whitehaven Coal, Sydney Airport, and OceanaGold.

This week will see Fisher & Paykel Healthcare and Collins Foods (tomorrow) report out-of-regular-season financial results after which analysts and investors will redirect their focus towards the upcoming August reporting season.

Upgrade

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Upgrade to Add from Hold by Morgans .B/H/S: 5/1/1

Morgans has a positive view on the major banks at current share prices, with the exception of Commonwealth Bank ((CBA)).

While system credit growth is subdued, the major banks are expected to regain home lending market share amid funding stress for the non-bank lenders.

Low interest rates are expected to continue being a headwind to net interest margins.

ANZ Bank is upgraded to Add from Hold. A final dividend is expected to be declared in November. Target is steady at $17.

CLASS LIMITED ((CL1)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/0/0

The share price has fallen -37% since the peak in February, including -17% in the past week, Ord Minnett notes.

The company has not formally updated guidance since the first half result but the broker retains forecasts broadly in line with previously provided targets and is comfortable these can be achieved.

The stock has now fallen far enough and the broker envisages good value amid several catalysts on the horizon, upgrading to Buy from Hold. Target is reduced to $1.50 from $1.76.

CORONADO GLOBAL RESOURCES ((CRN)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/0/0

While lowering forecasts for coal in line with spot prices, UBS notes prices are now well into the cost curve and further downside is likely to be limited.

Chinese import restrictions are a headwind for thermal coal, but India is emerging from lockdown which should benefit coking coal demand.

Coronado Global is upgraded to Buy from Neutral given its discount to valuation and because of its metallurgical coal exposure. Target is reduced to $1.80 from $2.05.

ECLIPX GROUP LIMITED ((ECX)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/1/0

Morgan Stanley looks for names in the sector that exhibit differentiated growth and resilience in their business model along with re-rating catalysts.

The broker's top pick is EclipX Group as it has the strongest growth potential and a unique funding model that peers are replicating.

The valuation remains attractive and the broker upgrades to Overweight from Equal-weight. Target is raised to $1.70 from $1.10. Industry view is In-Line.

MCMILLAN SHAKESPEARE LIMITED ((MMS)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 1/3/0

Morgan Stanley observes McMillan Shakespeare is trading below historical averages and a macro rebound remains the key catalyst.

An alternative revenue stream from PlanPartners helps offset novated headwinds.

Rating is upgraded to Overweight from Equal-weight. Target is lowered to $11.50 from $14.00. In-Line sector view.

SANDFIRE RESOURCES NL ((SFR)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/3/0

UBS upgrades to Buy from Neutral. Target is steady at $6.

The stock has fallen -20% in the year to date because of weaker perceptions of global growth and the impact of the copper price.

UBS assesses the copper price has started to improve and Sandfire Resources is well-placed to benefit.

The company has also added growth projects in the US and Africa that may address concerns about the short mine life at DeGrussa.

SIGMA HEALTHCARE LIMITED ((SIG)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/3/0

UBS estimates a combined earnings benefit of $8m for Sigma Healthcare from 2021 on the basis of the pharmacy wholesale funding in the seventh Community Pharmacy Agreement.

Earnings forecasts are updated accordingly, resulting in upgrades of 11-12% over the forecast period.

Any benefit, nevertheless, will be required to offset PBS price reductions and higher logistics/freight costs.

Rating is upgraded to Neutral from Sell as the stock is now considered fair value. Target is raised to $0.61 from $0.53.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 4/3/0

A significant recovery in Brent crude oil since the end of April has made growth projects far more viable, Ord Minnett notes.

The broker now has greater confidence in Woodside Petroleum's balance sheet and options to divest and/or acquire assets.

Rating is upgraded to Buy from Hold and the target lifted to $26.50 from $25.50.

WESTERN AREAS NL ((WSA)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 4/3/0

Ord Minnett reviews the valuation for Western Areas and has become more positive on the nickel sector. Odysseus mine assumptions are updated and exploration value has increased.

Western Areas has greater leverage to a positive longer-term nickel price compared with what the broker had been previously modelling and the rating is upgraded to Buy from Hold. Target is raised to $3.30 from $2.20.

See also WSA downgrade.

<u>Downgrade</u>

ALTIUM LIMITED ((ALU)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/2/0

The company has downgraded again - Ord Minnett counts five times since December - citing weaker June sales and a potential softness in renewal activity.

This reinforces the view for the broker that Altium is primarily a licence-driven software company which benefits from strong margins in good times but lacks the visibility on revenue in hard times.

Given the headwinds, Ord Minnett downgrades to Lighten from Hold. Target is reduced to $29.50 from $31.70.

CASSINI RESOURCES LIMITED ((CZI)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/1/0

OZ Minerals ((OZL)) has launched a $73m scrip takeover bid for Cassini Resources. Management and major shareholders support the transaction and Ord Minnett envisages limited chance of a fresh or higher bid emerging.

Importantly, shareholders will retain the Yarrawinda project option via a new vehicle. The broker reduces the target to $0.16 from $0.30 to reflect the offer price and downgrades to Hold from Speculative Buy.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/4/2

The results of grade control drilling at Evolution Mining's Mt Carlton project have led to a -75koz reduction in the earlier gold production life-of-mine plan, and a subsequent -$75-100m impairment of the project's carrying value.

Macquarie is not overly surprised, but downgrades to Neutral from Outperform and drops its target to $5.40 from $5.60.

The Cowal underground study will be a key catalyst later this year, the broker notes, while the divestment of Cracow will reduce group costs.

FREEDOM FOODS GROUP LIMITED ((FNP)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/2/0

A conference call has revealed to Citi that Freedom Foods is in a complete mess, worse than feared. The company needs to divest non-core assets, raise equity, address board composition and governance, and focus on earnings quality and cash conversion, the broker suggests.

Citi will wait for the findings of an investigation before adjusting forecasts but has applied a -40% risk discount to valuation and downgraded to Neutral (High Risk) from Buy. Target falls to $3.27 from $5.30.

FLEXIGROUP LIMITED ((FXL)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/3/0

Credit Suisse assesses the pandemic has clouded the outlook for FlexiGroup.

There are some advantages for the company in that its customer base is predominantly over 35 years in age and there is high home ownership penetration.

Still, the broker does not believe it is ideal to be launching new products and playing catch up in Buy Now Pay Later in a time of economic disruption.

Rating is downgraded to Neutral from Outperform. Target is reduced to $1.50 from $2.00.

HELLOWORLD LIMITED ((HLO)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/0

Ord Minnett notes, following a market update in May, the share price has risen sharply. At the same time the market has focused on the opening up of the domestic travel market and what earnings could look like in a post-pandemic world.

While comfortable with the long-term investment view, Ord Minnett downgrades to Hold from Buy, based on the rise in the share price. Target is raised to $2.58 from $1.98.

OROCOBRE LIMITED ((ORE)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/1

Provisional June quarter sales indicate lithium carbonate pricing has fallen to a record low of US$4015/t. Volumes are also weak.

Credit Suisse notes the industry was already in difficulties prior to the pandemic. This is now exacerbated by the disruption to supply chain logistics and end-user demand.

Rating is downgraded to Neutral from Outperform. Target is steady at $2.50.

QUBE HOLDINGS LIMITED ((QUB)) Downgrade to Neutral from Buy by UBS and Downgrade to Hold from Buy by Ord Minnett and Downgrade to Reduce from Hold by Morgans and Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/1

Woolworths ((WOW)) will take a lease across two sites at Moorebank.

Qube Holdings is expected to spend between -$420-460m to fund the warehouse infrastructure, receiving revenue of around $30m from 2025.

UBS considers the transaction a positive development in that the company has locked in a major tenant with low counterparty risk.

Rating is reduced to Neutral from Buy as the stock is now trading in line with valuation. Target is raised to $2.80 from $2.70.

Qube Holdings has agreed to fund $420-460m in construction costs to develop two distribution centres for Woolworths ((WOW)) in Moorebank, leased over 20 years.

Ord Minnett believes Woolworths can attract other such customers to the precinct, de-risking assumptions surrounding warehouse utilisation.

The company is on track to generate an 18% development margin through the transaction.

However, Ord Minnett downgrades to Hold from Buy, given the current headwinds for transport and the increased capital expenditure. Target is raised to $2.95 from $2.58.

Qube Holdings has signed Woolworths ((WOW)) as a tenant at its Moorebank logistics terminal. The trade off is an increase in Moorebank's ultimate construction budget.

Morgans has lifted its target to $2.45 from $2.38 but as this is still well short of the trading price, which included a big jump on the news, the broker downgrades to Reduce from Hold.

The risk for the broker is it may be undervaluing Moorebank but as a high beta stock, Qube is vulnerable if a broader market decline transpires, the broker notes.

Citi notes the share price has risen 34% since the equity raising in early May. While the near-term operating outlook remains uncertain, the broker lowers the rating to Neutral from Buy/High Risk.

Qube Holdings has announced Woolworths ((WOW)) as its next major tenant at Moorebank, further defining the path to realisation of the project.

Capital expenditure at Moorebank continues to expand, with the company funding more of the development and warehousing for tenants than originally expected.

Citi awaits further clarification on the capital intensity in the FY20 results. Target is raised to $3.15 from $2.71.

SONIC HEALTHCARE LIMITED ((SHL)) Downgrade to Hold from Add by Morgans .B/H/S: 3/3/1

Management has reinstated FY20 guidance, expecting underlying operating earnings (EBITDA) growth to be flat. Testing volumes in most of the company's divisions have returned to pre-pandemic levels.

Morgan is encouraged by the recovery in volumes but notes base revenue across around 35% of the business is subdued, and the pandemic is far from over.

This suggests cost savings and government support are doing the heavy lifting. Rating is downgraded to Hold from Add and the target is raised to $28.63 from $27.84.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/2

Passenger numbers fell -97% in May. On the positive side, Ord Minnett notes Standard and Poor's retained its credit rating of BBB-plus with a negative outlook, given the range of measures undertaken by the company.

Ord Minnett reduces international traffic forecasts for 2020, given a reduced likelihood of broader international travel until 2021.

The stock is trading ahead of the target, which has been reduced to $5.10 from $5.60, and the rating is downgraded to Lighten from Hold.

TRANSURBAN GROUP ((TCL)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/4/2

Transurban's update has revealed steadily improving traffic on Australian roads. This has given the company confidence to allow a June half distribution of 16c, ahead of UBS estimates.

The broker forecasts $0.49 in distributions for FY21 based on a 100% pay-out. Rating is downgraded to Neutral from Buy following a strong performance in the share price. Target is raised to $14.85 from $13.85.

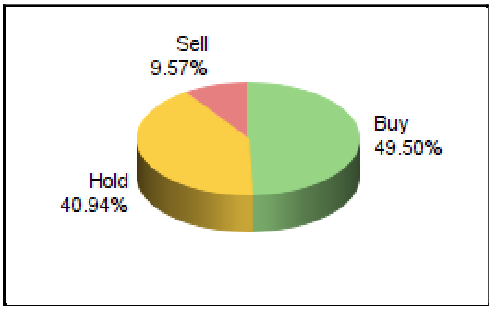
WESTERN AREAS NL ((WSA)) Downgrade to Neutral from Buy by UBS .B/H/S: 4/3/0

UBS downgrades to Neutral from Buy and raises the target to $2.85 from $2.50. The share price has lifted 42% in the second quarter.

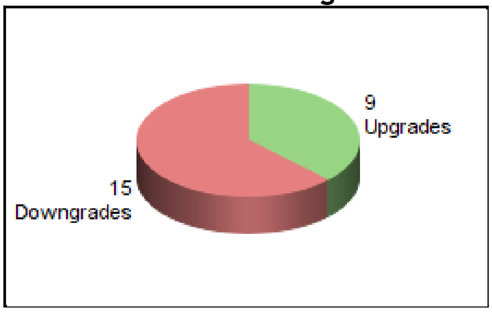
The broker, noting the share price appreciation in response to an encouraging drilling result, lifts estimates of the value of exploration assets to $150m.

See also WSA upgrade.

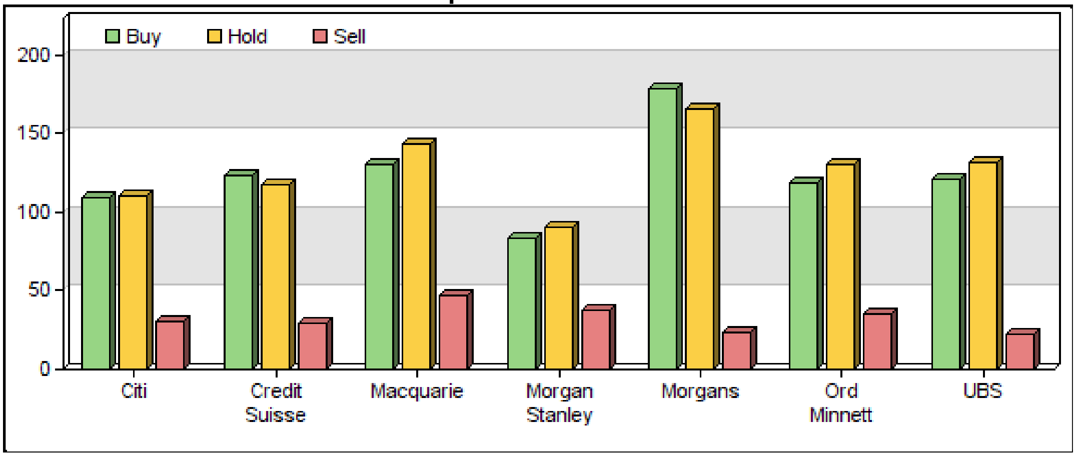
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	AUSTRALIA & NEW ZEALAND BANKING GROUP	Buy	Neutral	Morgans
2	CLASS LIMITED	Buy	Neutral	Ord Minnett
3	CORONADO GLOBAL RESOURCES	Buy	Neutral	UBS
4	ECLIPX GROUP LIMITED	Buy	Neutral	Morgan Stanley
5	MCMILLAN SHAKESPEARE LIMITED	Buy	Neutral	Morgan Stanley
6	SANDFIRE RESOURCES NL	Buy	Neutral	UBS
7	SIGMA HEALTHCARE LIMITED	Neutral	Sell	UBS
8	WESTERN AREAS NL	Buy	Neutral	Ord Minnett
9	WOODSIDE PETROLEUM LIMITED	Buy	Neutral	Ord Minnett
Downgrade				
10	ALTIUM LIMITED	Sell	Neutral	Ord Minnett
11	CASSINI RESOURCES LIMITED	Neutral	Buy	Ord Minnett
12	EVOLUTION MINING LIMITED	Neutral	Buy	Macquarie
13	FLEXIGROUP LIMITED	Neutral	Buy	Credit Suisse
14	FREEDOM FOODS GROUP LIMITED	Neutral	Buy	Citi
15	HELLOWORLD LIMITED	Neutral	Buy	Ord Minnett
16	OROCOBRE LIMITED	Neutral	Buy	Credit Suisse
17	QUBE HOLDINGS LIMITED	Sell	Neutral	Morgans
18	QUBE HOLDINGS LIMITED	Neutral	Buy	Citi
19	QUBE HOLDINGS LIMITED	Neutral	Buy	UBS
20	QUBE HOLDINGS LIMITED	Neutral	Buy	Ord Minnett
21	SONIC HEALTHCARE LIMITED	Neutral	Buy	Morgans
22	SYDNEY AIRPORT HOLDINGS LIMITED	Sell	Neutral	Ord Minnett
23	TRANSURBAN GROUP	Neutral	Buy	UBS
24	WESTERN AREAS NL	Neutral	Buy	UBS

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	CRN	CORONADO GLOBAL RESOURCES	100.0%	67.0%	33.0%	3
2	ECX	ECLIPX GROUP LIMITED	75.0%	50.0%	25.0%	4
3	PMV	PREMIER INVESTMENTS LIMITED	60.0%	40.0%	20.0%	5
4	SEK	SEEK LIMITED	42.0%	25.0%	17.0%	6
5	RMD	RESMED INC	7.0%	-7.0%	14.0%	7
6	ANZ	AUSTRALIA & NEW ZEALAND BANKING GROUP	57.0%	43.0%	14.0%	7
7	WPL	WOODSIDE PETROLEUM LIMITED	57.0%	43.0%	14.0%	7
8	SFR	SANDFIRE RESOURCES NL	57.0%	43.0%	14.0%	7
9	QAN	QANTAS AIRWAYS LIMITED	50.0%	40.0%	10.0%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	FNP	FREEDOM FOODS GROUP LIMITED	33.0%	67.0%	-34.0%	3
2	FXL	FLEXIGROUP LIMITED	25.0%	50.0%	-25.0%	4
3	CAR	CARSALES.COM LIMITED	33.0%	50.0%	-17.0%	6
4	ORE	OROCOBRE LIMITED	14.0%	29.0%	-15.0%	7
5	SHL	SONIC HEALTHCARE LIMITED	29.0%	43.0%	-14.0%	7
6	ALU	ALTIUM LIMITED	30.0%	40.0%	-10.0%	5
7	SYD	SYDNEY AIRPORT HOLDINGS LIMITED	7.0%	14.0%	-7.0%	7
8	NUF	NUFARM LIMITED	14.0%	17.0%	-3.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	SEK	SEEK LIMITED	21.292	18.758	13.51%	6
2	ECX	ECLIPX GROUP LIMITED	1.315	1.165	12.88%	4
3	PMV	PREMIER INVESTMENTS LIMITED	15.226	13.728	10.91%	5
4	SHL	SONIC HEALTHCARE LIMITED	30.040	28.213	6.48%	7
5	QAN	QANTAS AIRWAYS LIMITED	4.175	4.040	3.34%	4
6	ANZ	AUSTRALIA & NEW ZEALAND BANKING GROUP	21.164	20.593	2.77%	7
7	RMD	RESMED INC	24.733	24.150	2.41%	7
8	CAR	CARSALES.COM LIMITED	16.290	16.067	1.39%	6
9	WPL	WOODSIDE PETROLEUM LIMITED	25.233	25.070	0.65%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	FNP	FREEDOM FOODS GROUP LIMITED	4.117	4.793	-14.10%	3
2	FXL	FLEXIGROUP LIMITED	1.158	1.283	-9.74%	4
3	CRN	CORONADO GLOBAL RESOURCES	2.033	2.217	-8.30%	3
4	ALU	ALTIUM LIMITED	35.800	36.620	-2.24%	5
5	SYD	SYDNEY AIRPORT HOLDINGS LIMITED	6.259	6.396	-2.14%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	NUF	NUFARM LIMITED	-1.710	-3.578	52.21%	7
2	AIZ	AIR NEW ZEALAND LIMITED	-7.154	-12.757	43.92%	3
3	QAN	QANTAS AIRWAYS LIMITED	-3.888	-6.028	35.50%	4
4	WGN	WAGNERS HOLDING COMPANY LIMITED	0.427	0.327	30.58%	3
5	AX1	ACCENT GROUP LIMITED	10.700	8.433	26.88%	3
6	SHL	SONIC HEALTHCARE LIMITED	106.343	86.414	23.06%	7
7	OZL	OZ MINERALS LIMITED	25.319	21.379	18.43%	7
8	HVN	HARVEY NORMAN HOLDINGS LIMITED	32.353	27.953	15.74%	6
9	JHX	JAMES HARDIE INDUSTRIES N.V.	112.754	100.315	12.40%	6
10	QBE	QBE INSURANCE GROUP LIMITED	-18.992	-20.691	8.21%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	MTS	METCASH LIMITED	20.122	22.827	-11.85%	6
2	WHC	WHITEHAVEN COAL LIMITED	7.286	8.143	-10.52%	7
3	SYD	SYDNEY AIRPORT HOLDINGS LIMITED	-4.883	-4.517	-8.10%	7
4	OGC	OCEANAGOLD CORPORATION	4.409	4.780	-7.76%	4
5	SIQ	SMARTGROUP CORPORATION LTD	45.418	48.738	-6.81%	5
6	FXL	FLEXIGROUP LIMITED	13.800	14.800	-6.76%	4
7	AWC	ALUMINA LIMITED	7.656	8.152	-6.08%	6
8	ILU	ILUKA RESOURCES LIMITED	53.505	56.005	-4.46%	5
9	CMW	CROMWELL PROPERTY GROUP	7.900	8.233	-4.04%	3

10	URW	UNIBAIL-RODAMCO-WESTFIELD	52.501	54.697	-4.01%	3

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: Issues Of Supply And Demand

Global uranium production is significantly curtailed while utilities have been running down inventories due to uncertainty. Something soon has to give.

-Utilities have been under-purchasing uranium
-Legacy delivery contracts running off
-Production remains shut down

By Greg Peel

Nuclear power utilities are traditionally guarded about what inventories of uranium are mobile for commercial use, notes Canaccord Genuity, and what is strategically held back for a supply disruption, such as a global pandemic. Whatever that amount may be, it is unlikely those strategic inventories will enter the spot market, Canaccord believes.

Utilities have been under-purchasing since 2014, the US Energy Information Agency has reported, and US inventories are down -30% over the last twelve months, leaving around 2.5 years of forward coverage. While different countries have varying sensitivities, a potential extension of the Russian Suspension Agreement should in Canaccord's view see market activity pick up in the second half of 2020.

Major global uranium producer Cameco began shutting down its Canadian operations based on low prices, before shutting down further due to virus risks. Until there is more visibility on term contract pricing, Canaccord suggests the shut-down of Cameco's flagship Cigar Lake mine is likely to be extended.

The conundrum is that were uranium prices to improve to levels that justify Cameco, and/or global swing producer Kazatomprom, restarting operations, the impact on supply must surely drive prices lower once more. Unless restarts can be justified by sufficient demand-side growth.

To that end, Canaccord notes no major contracting for term deliveries has occurred since Fukushima (2011). Utilities have relied on longer term delivery contracts still in play since before the tsunami, while allowing inventories to wind down. But the time is nigh. Deliveries to utilities from legacy contracts will "fall precipitously", Canaccord points out, starting in 2021.

Canaccord anticipates rising concern over inventory levels. There has been minimal activity in term markets in 2020 to date, which also supports the expectation of activity picking up in the second half.

As for future demand, despite anticipated reactor closures in the likes of the US, France and Germany, among others, Canaccord continues to see increasing demand for nuclear base load energy, primarily driven by emerging markets, particularly China, India and Russia. On that basis, even restarted supply may struggle to keep up.

Returning to the aforementioned, and lingering source of uncertainty that is the Russian Suspension Agreement, industry consultant TradeTech notes most market participants have assumed an extension to the Agreement is a given, as it was created to prevent Russia dumping cheap uranium into the US. However…

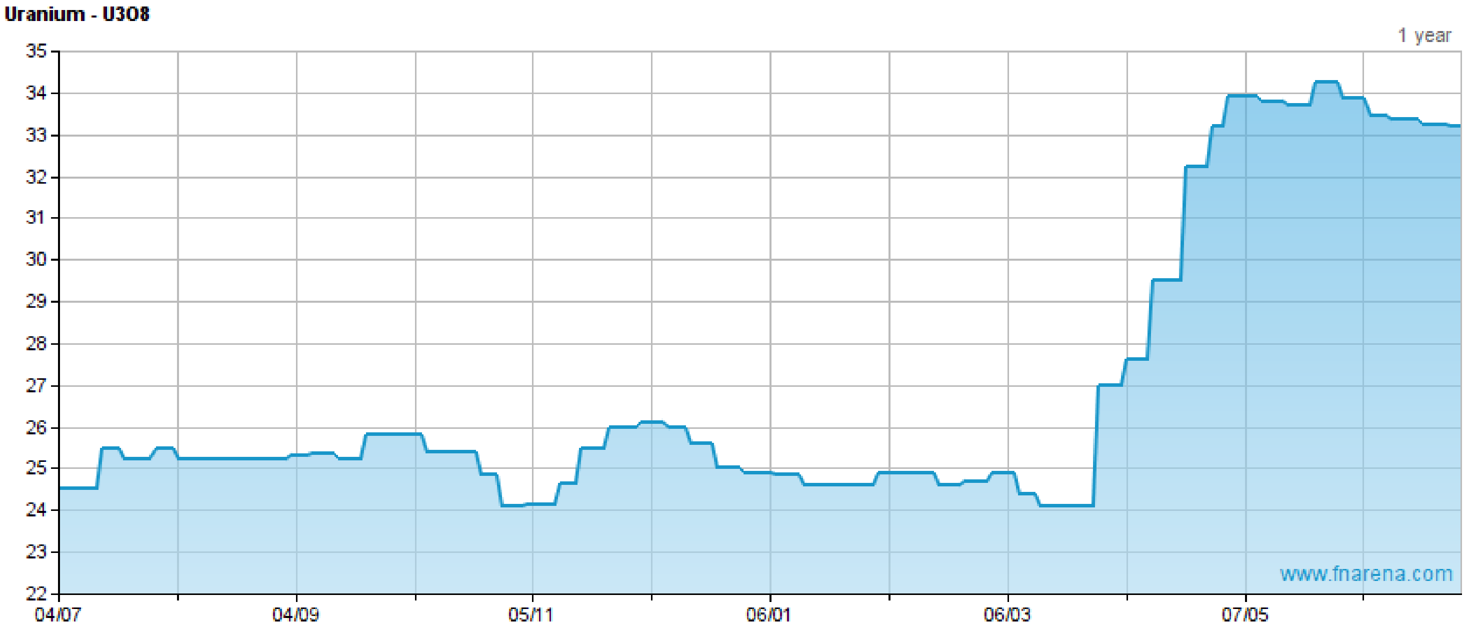
An investigation by the US Department of Commerce concluded the Agreement has really made little difference, and is failing to prevent uranium price suppression due to Russian imports. If the US and Russia are unable to agree upon an amendment to the Agreement which resolves this issue, then the DoC would be obliged to terminate and investigate the matter further.

More lingering uncertainty would thus prevail, at a time, as suggested above, utilities will start to become increasingly anxious about their dwindling inventories.

In the meantime, the spot uranium market continues to wallow in limited activity, drifting down another -US5c last week to US$33.20/lb on TradeTech's weekly spot price indicator.

In term markets, several utilities are poking around, TradeTech reports, but buying remains limited due to ongoing concerns not only over the RSA, but also the virus.

TradeTech's term price indicators remain at US$37.25/lb (mid) and US$39.00/lb (long).



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WEEKLY REPORTS

The Short Report - 02 Jul 2020

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

Summary:

Week ending June 25, 2020

Last week saw the ASX200 bounce around like a ping pong ball to eventually go nowhere.

It's getting very thin at the top. While the number of stocks 5% shorted or more remained relatively static last week, the dispersion of positions became increasingly stark, with only eleven stocks now shorted by 7% or more and 24 stocks in the 5-7% range.

We still can't get down to only one stock in the 10%-plus range nevertheless. Perpetual ((PPT)) dived out last week, but Webjet ((WEB)) stepped up. Indeed, with Victoria walled in and a return to international travel looking ever more distant, all three major travel agents saw ticks up in shorts last week.

We will note *numero uno* Myer's ((MYR)) share price shot up 18% on the last day of the financial year, which is nothing special when trading around 20c, but next week's Report may be interesting.

There were some big moves in individual positions to note last week, including those of Perpetual, FlexiGroup ((FXL)), Freedom Foods ((FNP)) and Super Retail ((SUL)).

Time to bring back Movers & Shakers. See below.

We might also note a couple of new kids on the 5%-plus shorted block, in the form of theme park operator Ardent Leisure ((ALG)) and panel beater AMA Group ((AMA)). Queensland reopening should help one, and more cars back on the road the other.

Shorters don't agree.

Weekly short positions as a percentage of market cap:

10%+
MYR 12.6
WEB 10.1

In: WEB Out: PPT

9.0-9.9

ING

Out: WEB

8.0-8.9%

BOQ, NEA, SXL, CUV

In: SXL Out: SUL

7.0-7.9%

GXY, JBH, FXL, ORE

In: FXL Out: PLS, SEK, MTS

6.0-6.9%

FNP, MTS, SEK, PPT, PGH, PLS, SGM, FLT, JIN, CTD, LOV

In: PPT, MTS, SEK, PLS, FNP, FLT, CTD Out: NCZ, Z1P

5.0-5.9%

LYC, Z1P, IVC, CLH, MSB, SUL, CGF, IFL, BEN, NCZ, ALG, AMA, CLQ

In: SUL, Z1P, NCZ, MSB, CGF, IFL, ALG, AMA

Out: FLT, CTD, CSR, HUB, MYX, NEC

Movers & Shakers

Super Retail enjoyed a big share price jump after providing a surprisingly positive trading update mid last month, but the company also announced a capital raising. Shorters playing the arbitrage (short the stock and apply for new shares at a discount) moved in, taking shorts to over 10%.

Raising completed, shorts fell to 8% and then last week to 5.5%.

Shorts in fund manager **Perpetual** rose to 10.3% two weeks ago from 8.2%, but last week fell to 6.6%. The company had a bump up last week on the completion of its acquisition of ESG specialist Trillium, which may explain the volatility.

Finance company **FlexiGroup** is shaping up its presence into the increasingly popular BNPL space, which the market seemed to like but Credit Suisse didn't, suggesting now is not the ideal time and downgrading the stock to Neutral.

Shorters clearly agree. FlexiGroup shorts rose from under 5% to 7.1% last week.

Also jumping from below 5% on to the table last week, at 6.9%, was the current nightmare that is dairy and cereal producer **Freedom Foods** ((FNP)). First the CFO resigned, then the CEO went "on leave", then he came back, then he resigned, all over the failure to account for out of date inventory that is now expected to be written down by some -$60m.

The stock is in a trading halt until July 9.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	3.9	4.1	NCM	0.3	0.3
ANZ	0.7	1.0	RIO	2.3	2.2
BHP	4.1	4.4	SCG	0.5	0.7
BXB	0.1	0.3	SUN	0.7	0.7
CBA	0.5	0.5	TCL	0.7	0.8
CSL	0.2	0.2	TLS	0.2	0.2
GMG	0.4	0.5	WBC	0.8	0.8
IAG	0.6	0.6	WES	0.5	0.7
MQG	0.3	0.3	WOW	0.3	0.6
NAB	0.8	0.9	WPL	1.1	1.2

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: Consumer Survey, TPG Merger And Supermarkets

A survey on the lingering aftereffects of the pandemic; The merged TPG Corp to have strong growth prospects; Managing margins will define FY21 for supermarkets

-A consumer survey clarifies how life is expected to be post-covid-19.
-Plenty on the new TPG Corporation's plate
-FY21 top-line growth prospects look constrained for supermarkets
-Upside risk to earnings for pathology operators

By Angelique Thakur

Covid-19 and the winds of change

The pandemic has impacted practically all aspects of our lives – from the way we work to what we eat. These shifts have been huge with far-reaching implications for numerous sectors and industries.

JPMorgan recently surveyed over 500 Australians to understand the impact of covid-19 on their lives and what they feel lays in the future.

Almost 50% of the surveyed people do not consider flying an option - either domestically or internationally - even with restrictions easing. 68% said they will not fly internationally until a vaccine is found.

People now prefer to spend holidays either at home or a driving holiday rather than flying. This bolsters JP Morgan's conviction with respect to its Underweight view on **Sydney Airport Holdings** ((SYD)) while preferring **Ampol** ((ALD)), **Super Retail Group** ((SUL)) and **Viva Energy Group** ((VEA)) among consumer exposed companies.

Surprisingly, only a small proportion of people expect to visit shopping centres less post covid-19, a big positive for retailer landlords. **GPT Group** ((GPT)) is JP Morgan's preferred retail-exposed REIT.

Consumers are moving towards online shopping for food post-covid-19 although have also shown a willingness to eat out more frequently. The broker is Overweight on **Coles Group** ((COL)) and **Metcash** ((MTS)).

The number of people working from home (WFH) for at least one day has increased by 50% while the average number of WFH days is expected to increase to 1.3 from 0.9.

Consumers are also looking to spend more on tech and gardening, which supports **JB Hi-Fi**'s ((JBH)) Overweight rating. JP Morgan is Underweight on **Wesfarmers** ((WES)) and **Harvey Norman Holdings** ((HVN)).

TPG Telecom: A force to reckon with

The $15bn merger between TPG Telecom and Vodafone Hutchison Australia has led to the formation of Australia's third-biggest telecom firm - **TPG Corporation** ((TPG)). The merger is slated to be finished on July 13.

Goldman Sachs analysts consider the telecom well-positioned to benefit from the ongoing convergence between fixed (TPG Telecom) and mobile (Vodafone Australia), while doing it more efficiently.

The ideal strategy for the behemoth, point out the analysts, is to participate in the current mobile market repair, stabilise subscriber losses and monetise the increase in mobile network capacity.

Deploying fixed wireless, targeting wholesale contracts and reducing future capital requirements are some of the activities that could be taken up and are considered a better alternative by Goldman Sachs to any aggressive price-led strategy which is unlikely to deliver meaningful share gains.

Headwinds from the ongoing pandemic and NBN prompts the broker to forecast an operating income decline of -8% for 2020.

However, this may also be an opportunity to grow operating income by 5% (compounded annual growth rate) across 2020-25, aided by operating expenditure synergies of $134m, roll out of fixed-wireless to offset NBN headwinds and subscriber growth through bundling.

Growth post-2020 is predicted to be strong once the period of the initial investment is followed by improvement in capital efficiency and operating income.

With TPG looking to support market repair, there will only be a limited impact in the branded mobile space even though the company is a formidable opponent for market leaders **Optus** and **Telstra** ((TLS)).

The analysts see risks in the wholesale mobile space, in particular for Optus which will lose its iiNet wholesale agreement and maybe even the material amaysim ((AYS)) contract while **Vocus ((VOC))**, which does not tender in these contracts, will not feel the heat too much.

Spark New Zealand ((SPK)) owns a 10% stake in Hutchison Telecommunications Australia ((HTA)), a holding company owning 25% of TPG Corp, and may be able to monetise this, expects the broker.

Goldman Sachs retains its Neutral rating for TPG.

Auto parts: defensive

Bapcor ((BAP)) enjoys a resilient DIY category along with a defensive auto parts business. The latter will also benefit **GUD Holdings** ((GUD)) which is a key supplier to Bapcor, explains Citi.

Citi's preferred pick in the small-cap auto sector is Bapcor with the auto parts sold by it less discretionary as compared to **ARB Corp** ((ARB)), along with having a clearer long-term growth strategy.

While Citi remains conservative in its estimates, expecting like-for-like sales growth of 3% for the first half of FY21, the broker does acknowledge potential upside if the demand for cars increases, with people avoiding public transport and preferring cars for domestic holidays.

Being one of the top 15 suppliers for Bapcor, GUD Holdings is well placed to benefit from an increase in demand from the trade channel, with its brand commanding a huge market share in the auto aftermarket, highlight Citi analysts.

Even though GUD Holdings has exposure to the DIY category, Citi expects it to benefit less as most of its products in this segment lean more towards the do-it-for-me channel.

Citi forecasts demand will likely increase over the medium term with higher unemployment leading to people holding onto their existing vehicles for longer and rates the company as Buy.

Bapcor is also preferred by Citi with the end of JobKeeper likely to have only a limited impact on its profitability. The company will also benefit from an increase in the use of personal cars.

Investment Platforms: Expecting a strong fourth quarter

While the ASX200 is still nowhere near the pre-pandemic highs, it did recover about 16% in the June quarter.

Heading into FY21, Morgans expects this to translate to higher funds under administration (FUA) levels for both **Netwealth Group** ((NWL)) and **HUB24** ((HUB)).

The broker notes both platform operators are witnessing higher client cash levels currently which, if sustained, are likely to more than offset any hit to the margins on their cash balances due to the RBA cash rate cut in March.

Morgans estimates a rise in cash levels to 8.5% will neutralise the lower cash margin impact for Netwealth Group.

Higher cash levels were seen in the third quarter and are likely in the fourth quarter. These are expected to support revenue for Netwealth Group. Fourth-quarter net inflows are predicted to be around $2.2bn while operating income is estimated at $64.8m by the broker.

HUB24 is expected to report FUA growth of around 15% to $17.4bn for the quarter, driven by investment performance and flows.

Morgans prefers HUB24 (rated Buy) and expects continued flows driving growth in the short-term with scale benefits being realised from FY22. Netwealth Group, while high quality, is considered fully valued and rated as Hold.

Supermarkets: Staples retail favoured over discretionary retail

FY20 was an unexpectedly good year for food and liquor retail but Goldman Sachs expects top-line growth in FY21 to be constrained to 2.4% versus the ten-year average rate of 3.8%, driven by changes in underlying growth factors including population, inflation and temporary consumption shifts.

The opportunity then, according to Goldman analysts, lays in improving margins. They believe there is considerable scope to reduce costs as FY20 contained material cost increases, mostly temporary, like additional staffing to meet the short-term demand spike.

Operating margin expansion for **Woolworths** ((WOW)) by 20bps and **Coles Group** ((COL)) by 35bps between FY19 and FY21 does not look unreasonable to the analysts.

Over the long term, Goldman expects physical stores to lose market share to discounters and the online channel, while in the short term consumer behaviour has shifted towards larger basket sizes, more online penetration and more localised shopping.

Staples retail remains the broker's preferred exposure amidst increasing sectoral risks. Discretionary retailers will experience material volatility in sales and profit in FY21, especially in the absence of further fiscal measures beyond September 2020.

The analysts maintain their Buy on Coles Group and **Metcash** ((MTS)) while having a Neutral stance on Woolworths.

Smaller companies gaining traction in pathology

Approved plasma collection centres (ACC) have shown a modest increase of 8 centres to 6,124 till June from February, with ACCs for **Sonic Healthcare** ((SHL)) decreasing by -3 while **Healius** ((HLS)) saw a decrease of -56 centres. The largest increase was seen by **4Cyte** which added 54 centres with **Australian Clinical Labs** (ACL) increasing its count by 6.

Both Sonic Healthcare and Healius appear to be maintaining a more rational approach to centre deployment, comments UBS, which should translate to just a mild increase in rental costs.

However, with smaller operators trying to expand their referral base, this may not be the best strategy, suggests the broker.

Market share, when seen in terms of the number of ACCs, has 4Cyte’s share at about 5% while Australian Clinical Labs stands at circa 16%.

UBS notes upside risk to short term earnings with pathology operators benefiting from a faster recovery in routine testing and ongoing covid-19 PCR screening, but questions the government’s proclivity and willingness to fund uncapped diagnostics in the longer term (assuming a decline in covid-19 cases).

TREASURE CHEST

Treasure Chest: Time To Buy Whitehaven Coal?

Whitehaven Coal is a quality Australian coal producer but under pressure as coal prices are very low. Is it time to buy the stock?

-Australian coal exporters need to cut supply
-Flexibility in the timing of Vickery development
-Is Whitehaven Coal a value play?

By Eva Brocklehurst

Coal prices are very low and Whitehaven Coal ((WHC)) is likely to be loss-making in FY21. Most Australian thermal coal producers are barely expected to cover cash costs at the current spot price of US$52/t. Prime hard coking coal may be around US$114/t, Citi points out, but spot semi-soft prices are just US$59/t.

Thermal coal prices are affected by weak gas prices and factors relating to the pandemic, while metallurgical (coking) prices have been impacted by soft steel demand as global production ex China is down -13%.

While China has held its ground for much of 2020, imports are now near last year's annual levels and ports are imposing restrictions again. At current prices, the broker points out, it makes no sense for Hunter Valley producers to wash thermal coal and they cannot divert semi-soft into thermal markets as India still struggles with the impact of lockdowns.

The US remains the swing supplier and its exports of both thermal and metallurgical coal have reduced sharply. With China stepping out of the market, Citi believes major coal exporters, including Australia, will still need to cut supply to balance the market and support prices.

Wilsons asserts Whitehaven Coal's management should be reducing costs, controlling capital expenditure and preserving cash. Although mine production rates have picked up in both Maules Creek and Narrabri, the broker trims sales forecasts for FY20 to 17.5mt, at the lower end of guidance, and reduces its second half dividend estimate to just 1c for a full-year pay-out of 2.5c.

Citi forecasts earnings of $62m in FY21 for Whitehaven Coal, which compares with $830m in FY19, and this would allow the business to break even at the net profit level. No dividends are expected. Net profit is expected to recover in FY22 on improved volumes for thermal coal, at a forecast price of US$69/t.

Depending on coal markets, the broker expects Whitehaven Coal to retain flexibility around the timing of capital expenditure at Vickery.

Wilsons points out, with committed capital of $2bn for growth projects over the coming four years, the company is somewhat constrained despite ample debt facilities. That said, the broker still expects Vickery will proceed but capital constraints will determine how it is funded, and whether this comes ahead of the Winchester development.

Meanwhile, Morgan Stanley is of the view that the market is more than compensated for the issues surrounding Narrabri and Maules Creek and Vickery is a worthy expansion project.

Value Play

Citi believes this is the best time to invest in cyclical mining stocks as risk appetite is low and the shares are trading at a deep discount to valuation. Excluding value for Vickery and Winchester South, the life-of-mine valuation would be $2.42 compared with the current share price of $1.40. The broker reduces the target to $1.75 and upgrades to Buy from Neutral.

Wilsons anticipates investors can expect a more normal production year in FY21 and more normalised trading markets, and the development program should mean significant production and earnings growth is available in coming years.

The broker, not one of the seven monitored daily on the FNArena database, maintains an Overweight rating and $4.75 target and believes investors should focus on the year ahead and the rapid expansion that is unfolding. Wilsons concedes the imminent removal from the ASX100 may weigh on the stock in the near term but asserts that, as production issues recede, earnings multiples over the next year are attractive.

The main issue facing Whitehaven Coal, in Citi's view, centres on its long-life thermal assets. Equity investors in public markets are now unwilling to pay full value for these assets because of the uncertainty surrounding the future use of coal in a carbon constrained world.

While demand will continue for some years to come, **thermal coal production may not be a growth industry for Australia**, although the broker anticipates the country will continue to export around 200mtpa.

While those with quality thermal coal projects in areas of less-productive farming country and distant from population centres may have room to expand output, whether Whitehaven Coal can ever obtain full value for its potential Citi considers is another matter.

The database has five Buy ratings, one Hold and one Sell (Macquarie) for Whitehaven Coal. The consensus target is $2.46, suggesting 71.8% upside to the last share price

TREASURE CHEST

Treasure Chest: Options Aplenty For Orora

Orora has divested its fibre business and Morgan Stanley believes the ongoing review is an opportunity to unlock value, in North America in particular.

-Bulk of the remaining $600m likely to be returned in FY21-22
-Limited impact from coronavirus outbreak to date
-Review an opportunity to unlock value in North America

By Eva Brocklehurst

The divestment of the company's fibre division provides several options for Orora ((ORA)) including acquisitions, returns to shareholders and a reworking of its American business.

The focus in Australia is now on the beverages business, as the company has more than 60% market share in wine and cans. Australasian beverage consumption was strong in March and early April although this has eased back.

Wine demand has been soft, with Australian wine exports down -7% over the year to March 31. Yet UBS suggests investment in can/glass beverage assets in Australasia is the most probable option for growth over the short term.

Orora is undertaking a review of its strategy for the continuing businesses, intending to pursue growth opportunities and, without these, return excess capital to shareholders.

Morgan Stanley had anticipated a larger portion of the proceeds from the sale of the fibre business would be diverted to shareholders in FY20. Orora has returned $600m, comprising a $450m special dividend and $150m capital return. The bulk of the remaining $600m is likely to be returned over the course of FY21-22 via an on-market buyback, the broker believes.

The company has sustained a limited impact from the coronavirus outbreak to date and the majority of this is in North America. **Orora expects a second-half earnings reduction from the pandemic of around -$25m.**

This is predominantly in those businesses that service retail, entertainment convenience and manufacturing. Morgan Stanley, as a result, reduces North American earnings (EBIT) estimates to $80m and, overall, has reduced FY20 group earnings estimates by -10% to $234m.

The broker believes the review is an opportunity to unlock value in North America, particularly in underperforming segments such as Orora Packaging Solutions and Orora Visual.

The focus is on a recovery, Macquarie agrees, although highlights that the **potential for a second wave of COVID-19 needs monitoring**, as Texas, a reasonably sized market for the company, has experienced an acceleration in cases.

Orora has undertaken a share consolidation at 0.8:1. Macquarie notes there is no change to overall market value but the value per share increases because of the lower share count. As a result the broker has raised its target to $3.05 from $2.44.

Morgan Stanley believes Orora is an attractive defensive exposure and retains an Overweight rating, the only one among six Hold ratings on FNArena's database. The broker's price target had increased to $4.38 following the share consolidation but is now lowered to $3.30, because of lower earnings estimates for FY20.

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RUDI'S VIEWS

Lessons Learned From 5.5 Years Of All-Weather Portfolio

Lessons Learned From 5.5 Years All-Weather Portfolio

By Rudi Filapek-Vandyck, Editor FNArena

Excluding any unforeseen calamities with the June 30 finish line in sight, the **FNArena-Vested Equities All-Weather Model Portfolio** should finish financial year 2020 with a positive return of circa 4% and only a slight negative performance for those turbulent past six months.

This will be well-above the performance of the ASX200 Accumulation index over both periods, which remains deep in the negative on both accounts.

On my observation, most professional investors have found beating the index over the year past a tough challenge. In many cases the relative underperformance has now been stretched to 3-5 years, which is a long time in today’s 24 hours news cycle-driven world.

5.5 Years ago, the All-Weather Portfolio started off on the promise of an average total investment return of 7-8% and it is pleasing to note that, three mini-bear markets down the track, total return is keeping up with that promise.

For many investors, 7-8% on average over time may not sound like an extremely attractive proposition, but when the industry numbers will be released post FY20, many achieved returns over the past five years will be noticeably slimmer.

This is the point where I could pump up my chest and tell you all how fantastic my skills are in reading market sentiment and trends, but the opposite is likely more accurate.

In fact, if I compare the actions and strategy behind the All-Weather Portfolio with the ruling narratives that dominate daily news cycles in and around financial markets, the Portfolio could never possibly have done as well as it has.

For starters, there is no black box wizardry going on behind the scenes. We don’t use technical analysis. We don’t even try to assess where the next burst in positive momentum is likely taking place.

Because the Portfolio is carried by a specific focus on quality and sustainability, its composition is limited to a small group of stocks only, with resources stocks and other cyclicals off limits.

We don’t buy low and sell high. In true old Warren Buffett-style tradition, we often buy on above market average Price-Earnings ratio, and then keep the stock for many years in the Portfolio.

Buy “expensive” and hold on?

If you think about it for more than a few seconds, this should not be a Portfolio that is performing as well as it has.

So what exactly is The Secret?

I don’t think there is a “secret” as such, but below are a number of observations and conclusions I have drawn from the past 5.5 years of managing the All-Weather Portfolio.

1) Quality Beats Valuation

Too many market participants are too focused on scooping up “cheap” stocks. Sure, we all like a bargain, and a share price that falls to an extremely low price level will (at some point) rally higher, but sustainability and continuity are usually not included.

Cheap stocks, according to the value-investor's narrative, are most beneficial entry points for long-term returns.

But when societies go through tectonic changes, and economies and business models are being disrupted on a daily basis, "cheap" looking stocks are simply the equivalent of the price discounted block of cheese at the local supermarket.

The expiry date is near. Don't plan too far ahead. It's a short-term fix, at best, not a long-term sustainable value creator.

Instead, it pays to identify high quality companies with a multi-year runway for growth, don't get too spooked when valuations get temporarily a little bit bloated, and stay the course.

The best performing stocks in the Portfolio were trading on a PE multiple well above the market average when purchased, and they are still owned today.

2) Don't Lose Your Focus Because Of Technical Analysis

I'd be homeless and roaming the streets by now with an empty coffee cup in hand, begging for change if I had to pay a dollar each time one of the stocks in Portfolio got hit by a negative trading signal stemming from technical analysis.

On my observation, technical analysis works best for low quality, highly speculative, small cap stocks. Probably because most of such stocks have nothing else going for them.

Quality, larger cap stocks can fall through the 200 moving average, or be rejected at a certain pivot, but as long as profits and fundamentals remain intact, it's nothing but short-term market noise.

Pay attention, because so many others do, but don't lose your focus or conviction because of short-term trading impacting on the share price. Positive fundamentals shall prevail.

Plus, of course, Quality companies surprise positively more than they do not. The latest example, as I am writing today's story, is provided by Fisher & Paykel Healthcare ((FPH)) shares rising by more than 6% after releasing FY20 financials on a day when screens are almost universally coloured red.

3) Timing Trends Is Really Difficult

Plenty of books and newsletters out there that educate investors about cycles, changing trends and the investment clock, but putting it in practice proves a lot more difficult most of times.

At the beginning of the year the general idea was to jump on board oil and gas stocks, which then fell the hardest.

Only a few weeks ago strategists were re-weighting model portfolios towards more exposure to banks and miners.

Guess which sectors are among the weakest performers in June?

Robust, non-cyclical all-weather performers won't keep up with those high beta, cyclical exposures when sentiment moves into Risk On mode, but on the other hand, they don't fall as deeply when market sentiment sours either.

The latter means the Portfolio doesn't need to make up as much to turn positive after a period of extreme volatility and heavy down-draught.

In simple terms, Quality and robust businesses are more resilient during tough times, and quicker to recover. These core characteristics are mirrored in how their share prices behave during downturns and bear markets.

This, I believe, is one of the key factors supporting the Portfolio's performance.

A second factor lays with mega-trends; they run for many years, and create long-lasting mega waves along the way.

It's so much easier for any management team to obtain labels of quality and excellence when their business is carried by such positive mega-trends. But every investor should be aware that the opposite very much holds true as well; irrespective of a "cheap" looking share price.

4) Accept Your Mental Barriers

Suppose you are convinced a share price has overshot to the upside, why would you not sell all your shares?

Because if the long-term growth trajectory of the company remains intact, that share price will end up a lot higher in years to come.

In other words: today's over-valuation is but a temporary, short-term phenomenon and if the share price doesn't pull back far enough, you won't get back on board.

On my observation, quality companies in great shape are most likely to surprise on the upside, and they will take you by surprise shortly after you sold out.

Selling all your shares automatically creates a mental barrier, which makes it much harder to get back on board.

Taking profits in Xero ((XRO)) at $48 in September 2018 would have generated a nice profit, but today the shares are trading at $87. What if I subsequently had failed to quickly buy back in during the pullback?

I could potentially have missed out on the next 80% in additional upside (and the shares have been higher).

Many investors, on my observation, are too easily guided by short-term considerations. Of course, it's only worth sticking around when companies deliver on their promise and potential, and there will be doubt and disappointments along the way.

One of the ways to deal with constant uncertainties is to adopt a holistic, portfolio-oriented approach. This means you can deal with falling share prices, and small disappointments, because the Portfolio as a whole is performing.

Keep the following motto in mind: for an underperforming company, it's never too late to sell, while for a consistent, solid performer it's seldom too late to buy.

5) Risk Management, Not Trading

Irrespective of what transpires inside or outside the share market, you will be selling and buying shares, irregularly or otherwise.

There is, however, a difference between trading the Portfolio or simple risk management.

Over the past 5.5 years I have mostly sold shares to reduce risk when the odds seemed to move in favour of a large drawdown (when Cash is King), or to skim a bit off the top of a temporary overheating market darling.

I sell out completely when I believe the future trajectory of a company has been severely damaged, or when I have to conclude that buying in was a misguided decision.

We all make errors, but the worst one is sticking around because the share price is now lower than when we joined the register.

We must accept things do not always turn out the way we envisage them. Changes are happening every day. Some cannot be anticipated; in other cases, we might have been blinded by whatever.

I tend to sell quickly, without regret, and move on.

Part of my Portfolio management also consists of getting rid of dead wood and disappointments when another bear market hits (we had three since 2015) in order to concentrate on the High-Conviction holdings.

6) Know Your Stocks

Marcus Padley once wrote a story about the one stock portfolio. The idea is to get to know everything about that one company, so you know what moves it, what is important and what is merely noise or market tribulation.

It's a rather extreme concept, but I see a straightforward similarity as to how I keep track of the companies I own in the Portfolio.

You first select them because you believe in their growth prospect, and once you own them you keep track of them, so you get to know them better as time goes by, learning new things, discovering fresh insights.

The true value of investing with a long-term horizon is that you accumulate knowledge and insights about the investments you own. On the premise, of course, that you continue reading and paying attention to research updates and fresh developments.

As the old saying goes, you can copy somebody else's stock tip, but you cannot copy their conviction. That conviction to not sell out when Xero shares hit $48 can only come from your own knowledge and personal insights.

7) Regrets, We All Have A Few

The best comparison for investing is a round of golf. It's never about being perfect. It's about making sure that the mistakes you make don't destroy all the positive achievements.

Not being perfect also means we all end up with a few regrets, every now and then, in hindsight. In golf parlance: that's simply par for the course.

My regret is called Macquarie Group ((MQG)), without any doubt the highest quality financial institution in this country.

When the covid-19 lockdowns arrived, and a new bear market seemed to have been thrown upon us, I sold out of Macquarie shares because I envisaged multiple years of asset write-downs and challenging deal-making conditions.

Of course, things turned around rather quickly since, and as yet another example of the human brain creating barriers, the Macquarie share price simply rallied away from me.

Regrets, we all have a few. That's simply the nature of this game. But if the overall performance of the Portfolio isn't too bad, we should not dwell upon them for too long.

The share market being the fragile, unpredictable and mercurial beast it is, there will be opportunities to get back on board, patience permitting.

But before that can happen, we must have Macquarie on our radar in the first place. This too is where my personal narrative differs from the ones that are dominating the general focus and commentary.

I don't look for "cheap" stocks, and then jump on board. I have a pre-selected list of quality stocks I'd like to own. Then the story begins…

(This story was written on Monday 29th June, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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