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Stories To Read From FNArena
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Minimal Volume Growth Besets Insurers

A positive premium rate cycle should bring elevated revenue growth for general insurers but brokers note this is being offset by a loss of volume.

-Vulnerability to low interest rates differs across general insurers -Perception that business opportunities are fewer for general insurers -Cost inflation could be the last straw for non-listed health insurers

By Eva Brocklehurst

An absence of negative news in the insurance sector and no major disappointment at the FY19 results have been unable to offset the myriad issues stemming from previous regulatory investigations, and fierce competition is rearing again. Hence, brokers observe share prices, overall, have been stymied by caution.

Revenue growth has been minimal, although margins have improved. Credit Suisse notes a positive premium rate cycle should bring elevated revenue growth and higher margins but this is being offset by a loss of volume. All insurers are effectively just paying out close to 100% of earnings rather than undertaking "capital management", because of the minimal volume growth being achieved.

Still, balance sheets are strong and the broker assesses Insurance Australia Group ((IAG)) is the one most likely to be in a position to return excess capital. Citi concurs with the likelihood of a buyback, although this is dependent on a satisfactory exit from the company's Indian joint venture.

Nevertheless, the broker considers the valuation full and FY20 likely to be more challenging. Meanwhile, execution on AMP's ((AMP)) strategy is likely to take several years and remains far from guaranteed.

AMP is the only Outperform-rated insurer for Credit Suisse, amid valuation support, even if only partial credit is given for implementing its strategy. There is potential for a significant re-rating over the medium term, in the broker's opinion, as actions are implemented.

Despite firming commercial premium rates, underlying returns are still below target for the insurers and UBS points out a low investment yield outlook may continue to be challenging for general insurers in terms of investment income. There is an offset. Usually a low interest rate environment is coupled with low inflation. If inflation is below what is assumed in setting reserves, and the difference is released from reserves, this will benefit margins.

There are differences between the companies. UBS envisages greater longevity and underwriting margin expansion for QBE Insurance ((QBE)) and, although QBE carries higher interest-rate leverage, lower inflation should support stronger reserve releases for longer.

QBE now has cover for weather-related volatility which Credit Suisse assesses is balanced. A benign second half in 2019 could mean the company delivers 10-20% earnings upside, while there is -30-35% risk on the downside from extreme weather conditions.

Suncorp ((SUN)), on the other hand, is more exposed to lower interest rates than IAG. This stems from the latter's lower CTP mix, because of a lack of Queensland exposure, and quota reinsurance cover in NSW. The company also has smaller reserves relative to pre-tax profit because of the quota share.

Both IAG and Suncorp have exceeded natural perils allowances in FY19, having done so in the last nine or 10 out of the past 12 years. However, the degree has been less significant and, at the risk of being found wrong, Credit Suisse considers the downside earnings risk in FY20 is less than in previous years.

Suncorp has increased its natural hazard allowances by further $100m in FY20 and added $200m in stop-loss cover. Hence, events that are more extreme than those experienced in the past decade would be required for the company to downgrade earnings on weather-related claims in FY20.

Upside is limited too, Credit Suisse acknowledges, as a lot of the protections are in the reinsurance cover and not in the allowance itself. Such comprehensive downside protection is not present for IAG and this allows for more earnings upside potential in a benign year.

Competition

Competition has intensified across the insurance industry as new contenders enter the market for Australian personal lines. Coupled with a slowdown in the economy, Macquarie suggests this heightens the importance of cost reductions for both IAG and Suncorp.

An early disruptor, Youi Australia continues to invest in new expansion strategies while even more new entrants are appearing. Both IAG and Suncorp identified a lack of new business opportunities in their FY19 results yet Macquarie notes new business premium written by Youi increased 20.1%.

The broker believes this perception of few business opportunities was caused by a combination of factors, including a lack of weather events that slowed industry churn, and weaker construction activity and motor vehicle sales, which have constricted overall volume growth.

Macquarie points out there is also a misconception the original challenger brands are the largest threat to incumbents. These brands such as Youi, Holland and Auto & General have grown from nothing 15 years ago to a 10% market share in FY19. However, a new breed of challengers have entered with a focus on the broker channel and are making up ground quickly.

Macquarie points to figures that show almost every insurer outside the top five grew faster than the industry average in FY19 and there are many that were only established in the last 24 months that are underwriting around $100m.

There are also the automobile clubs, which have strong capital bases and lack a desire to make excess profits, posing a different type of threat to incumbents. Macquarie notes each of the four main automobile clubs have been growing faster than industry averages for the last few years and a geographic focus has provided a comfortable price advantage.

Health Insurers

Health insurers may be executing well on what they can control but lower rate increases and falling participation levels dampen Citi's enthusiasm. The broker expects Medibank Private ((MPL)) will reach 27% market share by FY22 but top-line growth will be constrained by lacklustre industry growth and gross margins are likely to fall. Nib Holdings' ((NHF)) earnings guidance may prove conservative but the stock appears too expensive to the broker.

The two health insurers are confident about the trends in chronic disease management, the acquisition of healthier lives and a greater share of new entrants. There are also more facilities to take claims out of the hospital setting.

As a result, Macquarie suspects both listed providers will be well placed to capture a disproportionate amount of new business, and consolidation of the sector is likely to accelerate. Company-specific costs are considered just as important as industry trends. Cost inflation is strengthening and this could be the last straw for non-listed funds, the broker asserts.

The number and percentage of policyholders paying the lifetime health cover loading has been declining since 2015 as younger lives leave the system. Macquarie assesses, should this trend continue for the next 12 months, an additional -100 basis points of industry margins may be removed from the industry.

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Disruption Ahead For Mobile Operators?

TPG Telecom is at a crossroads, awaiting a decision on its proposed merger with Vodafone Australia, and there are significant implications for Telstra as well.

-Merger likely to create a strong third operator, increasing competition -If unsuccessful, TPG Telecom could extend the scope of its 5G spectrum JV -Merger likely to constrain Telstra's mobile subscriber growth

By Eva Brocklehurst

Significant catalysts are looming for the telecommunications sector, with a decision by the Federal Court on the merger of TPG Telecom ((TPM)) and Vodafone Australia expected by October 1.

The proposed merger has been opposed by the Australian Competition and Consumer Commission on the basis it would substantially lessen competition in the supply of mobile services, and the two companies have appealed.

UBS points out, simplistically, success in the appeal hinges on Vodafone Australia/TPG Telecom arguing that having a strong third player is better than having four operators. Morgan Stanley believes a merger would create a stronger third mobile operator and this should lead to an increase in competition.

For TPG Telecom, the share price is likely to be meaningfully affected whichever way the decision goes. If the court approves the merger then there is potential for market share gains in mobile, along with cost reductions from synergies.

TPG Telecom would have access to Vodafone's mobile infrastructure and its broadband subscriber numbers would rise and margins increase. There is also upside for the business if the mobile roll-out in Singapore is profitable.

Macquarie envisages Singapore will launch early in 2020 as a commercial service, so start-up losses are likely to be higher in the second half, noting FY20 guidance takes no account of the merger nor associated transaction costs.

Having ceased building a mobile network, TPG Telecom has started to amortise spectrum licenses and there will be no further capitalisation of interest relating to Australian mobile.

Catalysts

Hence, if the court opposes the merger this leaves TPG Telecom as a weak fourth operator, without vertical integration and no mobile business other than as a re-seller. There is also the potential of further appeals to a negative decision by the court prolonging the process further and UBS suspects the share price currently is factoring in a 25% probability of the deal succeeding.

The company has indicated it could, if unsuccessful in the Federal Court, extend the scope of its 5G spectrum joint venture with Vodafone Australia. UBS assesses this may involve vending spectrum and sunk mobile network investment.

The company could also lease more fibre either directly to Vodafone Australia or to the joint venture. Morgan Stanley values TPG Telecom at $8.70 a share, implying 25% upside to the stock if the merger is given the green light and there is no subsequent challenge. Should the merger be blocked, the broker values the stock at $5 a share, implying -28% downside.

FY20 is expected to be a challenging year for TPG Telecom at any rate as NBN headwinds peak, providing pressures on margin from higher price inputs. Macquarie suggests there is room for improvement if the NBN pricing review leads to relief on entry-level pricing.

NBN Outlook

NBN Co now estimates 1.5m incremental connected premises in FY20, down from 2.0m in its FY19 corporate plan and stemming from delays in the migration of subscribers. Subscriber payments of $2.3bn are expected for NBN in FY20, down from $2.6bn in the FY19 plan. However, FY21 subscriber payments are estimated at $1.3bn, up from $1.1bn previously.

NBN has not disclosed an overall blended ARPU (average revenue per unit) metric in its FY20 plan but projects residential ARPU of $49 by FY23, compared with a $51 overall ARPU in the FY19 plan and a $44 residential ARPU currently.

Morgans suggests there are a number of positive dynamics in play that could ease the pressure on telcos, noting that the 60% mark on NBN migrations has passed and competitive intensity is lessening. The price to access the NBN continues to track higher but telecommunications providers are starting to charge consumers more for access to the NBN/fixed line as well as for mobile services. This, the broker asserts, signals a return to more rational economics.

The latest corporate plan from the NBN also highlights the competitive nature of the corporate and enterprise market, as Credit Suisse notes NBN is competing against Telstra ((TLS)) for market share and putting pressure on the data and IP segment.

Mobile is the largest contributor, 40-50%, to Telstra's operating earnings (EBITDA) and growth in mobile subscribers is likely to be constrained, Morgan Stanley points out, if the merger of the other two goes ahead.

This, in turn, would put pressure on the company's margins and add downside risk to dividends. If, however, the court opposes the merger then this would entrench Telstra's leadership in mobile, the broker asserts, and increase the potential for upside to ARPU in the medium term.

Furthermore, if the court decision is appealed, and court action continues, this could be construed as positive for Telstra's near-term earnings, providing more time to build a leadership position in 5G. On a 50% chance of the merger ultimately proceeding Morgan Stanley retains a target of $3.20 for Telstra.

There are two Buy ratings, three Hold and one Sell (Morgan Stanley) for Telstra on FNArena's database. The consensus target is $3.90, signalling 9.6% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.5% and 4.4% respectively.

TPG Telecom has one Buy (Ord Minnett), three Hold and one Sell (Credit Suisse). The consensus target is $6.42, suggesting -6.9% downside to the last share price.

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Sims Metal Thwarted By Global Uncertainty

Several issues have combined to thwart Sims Metal Management and a substantial downgrade to the first half outlook is the result.

-Further deterioration in the macro economic environment cannot be ruled out -Trade war reducing demand for steel & aluminium and, in turn, scrap -Caution prevails around customer scrap purchases for the remainder of FY20

By Eva Brocklehurst

Steel mills have significantly reduced their scrap purchases this month and downgraded the outlook for scrap demand. Hence, Sims Metal Management ((SGM)) has materially reduced forecasts for the first half of FY20, stating the result would be "materially lower" versus the first half of FY19.

A rise in deep-sea freight prices has also occurred. Normally, the company would be able to recover these costs through pricing but this is not possible in the current environment. Ord Minnett calculates a reduction in margins for the company of more than -50% is likely.

Forecasts for FY20 are downgraded and the broker suspects the worst half-year performance since the company was loss-making in the first half of FY16 now looms. A recovery before the end of 2019 is considered unlikely and a further deterioration in the macro-economic environment cannot be ruled out.

Challenges

Management highlighted challenges from the US/China trade war, low Turkish steel demand and soft automotive demand at its results, a bare three weeks ago, but had expected to be able to overcome these with strategic execution.

It appears concerns have rapidly been realised and the outlook deteriorated to the point where, as Credit Suisse notes, the company's ability to overcome the issues is swamped by market declines that are beyond its control.

The trade war has reduced demand for steel and aluminium and, in turn, the reduced scrap demand drove the slump in scrap prices over September. The price in the company's key export market, Turkey, is down -16% from the August average and US prices of US$224/t are down -10%.

The company has signalled that scrap prices at these levels are below what is economic for a number of its suppliers to gather and sell, thereby reducing volumes. Macquarie notes, to relieve margin pressures, Sims Metal usually seeks to reduce buying prices but this may be limited by some suppliers choosing to hold inventory until prices recover.

Scrap volume and price reductions are occurring across the entire business and not just isolated to the US. Moreover, US twitch volumes have declined because of reduced automotive demand.

There is no ability to make comparisons with previous periods regarding the earnings contribution between twitch (a higher grade of non-ferrous scrap) and non-ferrous, Credit Suisse asserts, or the volume changes in twitch capacity after the recent non-ferrous upgrades.

Projections Difficult

Projecting earnings for the company is akin to guesswork, the broker laments, and there is material variability in earnings between quarters. The company is reluctant to provide a guidance range, despite its superior market insights, and this compounds the difficulties in forging estimates.

Credit Suisse reduces first half earnings estimates by -50% and leaves the second half unchanged. Citi reduces FY20 estimates by -32% and downgrades to Neutral from Buy. Markets are expected to recover over the medium term, and the broker defers to management's assessment that it is too early to project the impact of issues on the second half.

Macquarie also downgrades, to Underperform, concerned about earnings given the weak global conditions. While the cycle is likely to be heading to a trough, the broker remains cautious around customer scrap purchases for the remainder of FY20.

FNArena's database has one Buy rating (Credit Suisse), two Hold and three Sell. The consensus target is $10.60, suggesting -2.8% downside to the last share price. Targets range from $9.30 (Macquarie) to $12.90 (Credit Suisse).

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New Hope Needs Coal Price Catalyst

Unless thermal coal prices improve and there is some progress on New Acland stage 3, brokers suspect New Hope Corp may struggle to find momentum.

-Genuine cost reduction prospect at Bengalla -Current operations at Acland now being scaled down -Strong opportunity to capture upside as coal prices recover

By Eva Brocklehurst

The outlook for New Hope Corp ((NHC)) remains highly dependent on a recovery in coal prices and government approvals for its expansion at New Acland. Unless thermal coal prices improve and there is some progress on New Acland stage 3, brokers suspect catalysts will be difficult to find.

In its FY19 results commentary New Hope remarked on the growing threat of seaborne supply from Russia, also alluded to by Whitehaven Coal ((WHC)) recently. This is something the market will need to follow, Credit Suisse advises.

New Hope has a diversified revenue base, with most of its revenue emanating from sales to Japan and Taiwan rather than China. Hence, Macquarie points out, there is less exposure to Chinese thermal coal pricing.

However, reconciling price realisation during a coal correction is made more difficult, Morgans asserts, because of the company's exposure to both the premium Japanese power utility market and higher ash, lower energy markets that are affected by import controls and abnormal discounts.

Bengalla

Bengalla is expected to provide much-needed support for the stock. Bengalla revenue was lower than Macquarie expected in FY19 although the increased stake, now 80%, is a long-term positive for the operations.

The miss on revenue versus the broker's forecasts was largely because of lower realised coal prices and the difference in timing of the increase from 40% to 80% ownership. The company has indicated that Bengalla is in the lower quartile of the cost curve and costs should be reduced further because of sustained higher production.

Management appears excited about the opportunity at Bengalla, Wilsons observes, and this is one of the mines where there is a genuine cost reduction prospect in the near term.

The joint venture with Lenton Burton is proceeding and the company expects first coal in 2022. Slippage in the development timeline, because of delayed infrastructure access, is disappointing for Morgans, which suspects the project is marginal at current prices in the context of its overall contribution to the New Hope business.

New Acland 3

There is no clarity on New Acland stage 3. Delays have meant workers are being made redundant, as the project still requires a mining lease and associated water licenses in order to proceed, and the company was unable to secure this by the end of August.

Current operations are being reduced at New Acland over the next 18 months and a production gap is now envisaged between the ramping down of current operations and commencement of stage 3. Credit Suisse continues to hold the risk weighting for stage 3 at 50% and pushes out first production to the first half of 2021.

New Hope expects production for FY20 at New Acland to be at 60% of that reported in FY19 and Macquarie forecasts saleable production of 2.8mt.

Mining is expected to cease in the second quarter of FY21 and the mine placed on care and maintenance until stage 3 is approved. The market appears to be ascribing no value to non-operating assets, such as New Acland stage 3, which Morgans believes is excessively bearish.

The broker remains comfortable about accumulating the stock through the lows in the coal price and is on the look out for any relaxation of Chinese import controls and ongoing producer responses, as well as any price recovery in spot LNG driven by oil sentiment.

Wilsons calculates New Acland stage 3 is worth $1.20 a share and, having been largely set aside by the market, incorporates a free option for investors.The broker also points out New Hope has lagged the domestic coal sector which has performed strongly over the past two years.

A strong opportunity is therefore in front of investors to capture upside, as risks unwind with a coal price recovery and as the New Acland stage 3 approvals process proceeds.

With more consistent signs around recovery in thermal prices into the end of this year, Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, envisages the risk/reward firmly on the upside and maintains a Buy rating and $3.60 target.

The database has two Buy and two Hold ratings. The consensus target is $2.74, suggesting 11.7% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.9% and 3.9%, respectively.

Material Matters: Iron Ore, Coal & Rutile

A glance through the latest expert views and predictions about commodities. China infrastructure; iron ore miners; Indian industry; coking coal; oil; and rutile.

-Steel margins likely to be the main driver of recovery in iron ore prices -India likely to become more reliant on the seaborne market for iron ore and coal -Oil price forecasts rise to take into account geopolitical uncertainty -Yet price response to attack on Saudi Arabian supply considered muted -Iluka Resources receiving a premium for rutile sales in China

By Eva Brocklehurst

China

ANZ analysts suggest the focus on increased infrastructure expenditure in China may be starting to bear fruit. The value of China's approved infrastructure projects hit RMB963bn in the first eight months of this year, up 309%. Special government bonds used to fund these projects have doubled from a year earlier.

China's steel production hit 87.3mt in August, up 8.6%, the analysts note. Moreover, a fall in steel inventory is over the past two months indicates this is not just a re-stocking phase ahead of expected stimulus-related demand.

A small pick-up in infrastructure expenditure should offer the iron ore and steel market some solace, the analysts suggest, and keep prices relatively well supported. Iron ore prices are envisaged staying around US$85-90/t in 2019 amidst robust fundamentals. Supply losses in Brazil appear structural and the market is deemed under-supplied until 2020. However, improving exports from other countries and narrowing margins for steel mills could drag on prices.

Iron Ore Miners

Shipments from Australian iron ore companies have increased following major port maintenance in July. The shipping volumes for the September quarter, as implied by port data, are currently ahead of Macquarie's forecasts for both Rio Tinto ((RIO)) and BHP Group ((BHP)) but below estimates so far for Fortescue Metals ((FMG)).

Rio Tinto is currently signalling 2019 shipments of 320-330mt. Major rail maintenance scheduled to occur in October will affect the fourth quarter shipments and thus put pressure on guidance, Macquarie suspects.

BHP Group's shipping has improved to above target for the September quarter, having started the quarter well below updated guidance. Guidance for FY20 is for 273-286mt. Fortescue Metals has provided FY20 guidance for shipments of 170-175mt of iron ore in FY20.

Macquarie believes the modest recovery in port stocks indicates the iron ore market remains relatively tight and inventory re-stocking cycle along with heavy maintenance plans for both BHP Group and Rio Tinto could mean port stocks start to fall in the next few months.

Meanwhile, Brazil's Vale is shipping below the levels needed to achieve guidance based on its current shipping rate. The company has reiterated 2019 guidance of 307-332mt.

Macquarie suggests an improvement in steel margins is likely to be the main driver of a recovery in iron ore prices. Margins have swung higher, to US$33/t for hot rolled coil and US$54/t for rebar. The broker expects improved margins will enable mills to look at increasing inventory. Falling coking (metallurgical) coal prices have also aided the margin improvement.

India

Citi, after a visit to several industries in India, assesses the country's supply of iron ore and coal is likely to be disappointing in the next 2-3 years and it will become more reliant on the seaborne market.

Demand conditions, however, have clearly deteriorated and weakness is evident across consumption and the industrial and construction sectors. While some build up in inventory could cushion India's supply disruption in iron ore, net imports are likely to rise if global prices come down significantly.

Citi points out it may be more economic for Indian industry to buy seaborne iron ore rather than pay the full cost of iron ore including the premium to the government. The penalties for not producing at a mine, the broker assesses, are not punitive and, for some mines, cessation of production is a realistic option.

India imports over 200m tonnes of coal and Citi foresees this volume continuing in the medium term. Demand for coking coal should continue to grow in line with Indian steel production growth of 6-7% per annum. India has no more hard coking coal resources and is dependent on imports for most of its requirements.

Coking Coal

Coking coal prices have continued to drop, despite a recovery in steel demand in China and a rally in iron ore. Macquarie notes top-grade hard coking coal prices have fallen below US$150/t for the first time since 2016. The main reason is a downturn in demand outside of China, which comprises 80% of the metallurgical coal seaborne market.

Macquarie suggests a recovery in India's automotive sector is only likely from mid next year, implying further short-term pain for Indian steelmakers. The broker finds little reason to doubt that further slides will occur in the hard coking coal price index.

Japan, a significant buyer of Australian coking coal, is struggling with weak demand and a loss of market share in its export market, particularly in Southeast Asia where more steelmaking capacity is being brought online.

Oil

The spike in oil prices from the attack on a Saudi Arabian oil facility, which removed around 5% of global supply, has divergent implications for global assets, in Morgan Stanley's view.

While the broker's analysis points to a soft oil price response from the attack, which reflects the presiding weak fundamentals that were pointing to a surplus in 2020, forecasts for Brent in the fourth quarter have been lifted to US$65/bbl from US$60/bbl. The risk of further outages means the bull case scenario rises to US$80/bbl from US$70/bbl.

Morgan Stanley reiterates a cautious market outlook and retains a preference for Oil Search ((OSH)), Santos ((STO)) and WorleyParsons ((WOR)) in the sector.

ANZ analysts suggest oil prices will stay high, in order to take in an increased risk premium after the recent drone attack. The market may have enough capacity to compensate for the production outage, but geopolitical tensions are on the rise in the Middle East and this should mean volatility remains extreme in the short term.

Mineral Sands

To ascertain broader market trends in the pigment industry Morgan Stanley reviews the Chinese mineral sands industry. The rutile exposure of Iluka Resources ((ILU)) is concentrated in western markets yet the broker's channel checks suggests its sales into China are receiving a premium relative to the second half reference price, and could rise by around US$100/t over the next three months.

The company's first half high-grade rutile reference price was US$1107/t and its commentary indicated a 6-8% rise in the rutile and synthetic rutile prices is expected in the second half. Meanwhile,China's ilmenite is sufficient to supply its market and there is almost no imported high-quality ilmenite stocks.

China's domestic market continues to be affected by fluctuations in the currency, impacting the import price of titanium ore and export price of titanium dioxide. Globally, Morgan Stanley observes demand for titanium dioxide declined slightly in the second quarter of 2019 as China's exports to the US fell, offset by an increase in exports to other markets.

ESG Focus: Institutions Gunning For CEO Bonuses

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/

Institutions Gunning For CEO Bonuses

An interview with ACSI CEO Louise Davidson suggests bonuses will be a point of contention during the 2019 AGM season.

-ACSI's 18th survey of executive pay shows a "persistence of bonus" culture -Institutions to focus on bonuses at 2019 annual general meetings -There are signs investor pressure is working. -Top paid CEOs

By Sarah Mills

Executive bonuses are expected to be targeted in the next round of annual general meetings, after the Australian Council of Superannuation Investors (ACSI) came out swinging with its latest investigation into chief executive officer (CEO) pay in Australia.

Its September 2019 ACSI Annual Survey of S&P/ASX200 Chief Executive Remuneration was accompanied by a scathing press release that singled out executive bonuses.

"The way bonuses are being handed out suggests there is a culture of entitlement whereby supposedly 'at risk' pay is not very risky at all," says ACSI CEO Louise Davidson.

"You have a situation where only one CEO missed out on a bonus … You only have to look at the stock exchange to see that that is not the sort of performance you would expect from those figures."

"These payments occurred in a year when the Financial Services Royal Commission was in full swing, revealing evidence that executives were not being held accountable for poor conduct, and in the wake of soaring 'first strike' votes against remuneration reports."

"Clearly, corporate Australia is not getting the message that bonus payments should be variable and awarded for stretch performance, rather than being fixed pay under another name. This is a failure of both discipline and leadership."

Bonuses ring of "fixed pay". Everyone wins a prize.

The survey shows the median ASX100 CEO received 70% of their maximum bonus entitlement – a figure almost unchanged in four years. Less than 7% of CEOs received less than 30% - a record low.

A stand-out was the fact that the median bonus awarded to an ASX100 CEO in FY18 was $1.61m – the second-highest in the history's survey despite the departure of several handsomely paid CEOs during the year.

The survey says that bonuses as a proportion of the maximum illustrates that there is minimal evidence that annual bonuses in large companies are genuine 'at risk' payments. Half of ASX100 CEOs received more than 70% of maximum but even CEOs who received less than the median were unlikely to receive less than half of maximum.

The median value of realised pay rose to $4.5m.

Institutions to focus on bonuses at 2019 annual general meetings

In an interview with FNArena, Davidson says her members will be in discussions with boards and making decisions and announcements on which CEO bonuses they believe are inconsistent with performance, and by how much, during the 2019 annual general meeting season.

Davidson singled out the banks: "Last year bank investors exercised their displeasure over the way bonuses were paid at ANZ, Westpac and NAB yet. Those three banks insist on paying bonuses."

"Our members believe that ESG risks and opportunities have a material impact on investment outcomes. As fiduciary investors, they have a responsibility to act to enhance the long-term value of the savings entrusted to them," says Davidson.

ACSI members include 38 Australian and international asset owners and institutional investors. Collectively, they manage more than $2.2 trillion in assets and own on average 10 per cent of every ASX200 company.

In 2018, the number of ASX100 companies to receive a strike against their remuneration tripled on 2017, and there were many close shaves. In 2018, large strikes were received against National Bank ((NAB)), Mineral Resources ((MIN)), Westpac ((WBC)), Telstra ((TLS)), and AMP ((AMP)).

Under the two strikes rule, shareholders have the power to spill the board if at least 25% of shareholders vote against the board's decision on executive pay in two consecutive years.

So this year institutional investors will have a rare opportunity to exercise unprecedented leverage at the AGMs.

How they will exercise this, and the fruits of their labours, will be keenly observed.

Bank shares have rallied strongly in the past quarter, suggesting the banks also have ammunition up their sleeves. Although much will depend on who's buying. NAB shares have been particularly well sought in September.

Three clear trends in remuneration

Overall, the survey examined what proved to be a moving feast for the 2018 financial year. A large number of CEO turnovers muddied the picture but three trends emerged:

That there remained little connection between bonuses and performance; and That fixed pay and cash pay remained fairly stable. CEOS were deferring bonuses and opting for equity over cash, and ensuring incentives were subject to malus or claw-back provisions where there has been poor performance. On a more specific level, the average bonus awarded increased despite a decrease in the median - up 1.7% to $2.12m, to reflect a move to a combined incentive plan model where either an enlarged annual incentive replaces the long-term incentive (NAB, QBE Insurance ((QBE))), or where an enlarged annual incentive is then allocated as a mix of cash bonuses, deferred equity and long-term incentives (Woodside Petroleum ((WPL)), Telstra ((TSL)) and Iluka Resources ((ILU))). Woodside's report included both annual bonus awards and long-term incentive allocations, and a sharply reduced cash bonus relative to prior years.

The median and average cash bonus in FY18 fell sharply despite persistence of bonus outcomes relative to maximum. The median cash bonus fell -16.5% to $927,000 the lowest since 2004, while the median bonus awarded, which includes deferred components, fell from $1.76m to $1.61m (the second highest in eight years). Newer entrants with lower bonus opportunities drove some of the decline.

The average cash bonus fell almost -15% in FY18 to $1.09m, and the lowest since for several years, and the average bonus fell from a record $2.3m in FY18, to $2m, behind only FY16 and FY17 averages.

Signs investor pressure is working

Davidson says that with the exception of bonuses and median pay, results are promising and suggest investor pressure is forcing changes in behavior.

"I do think that investors are having an impact," she says. "Fixed pay is stable. I think you will see changes over the next year or so in terms of pay."

"We have seen a trend among leading companies to lower base pay for incoming CEOs, reducing their cash pay by deferring a portion of awards into equity that is delivered over time, and implementing malus or claw-back provisions to deal with situations where poor performance and behaviours emerge after rewards have been delivered."

In the press release, Davidson suggests "downward adjustment is in order", a term that is also used by the Australian Regulation and Prudential Authority (APRA).

When asked in the interview to define "downward adjustment", she says: "if performance, both financial and non-financial, is not strong – there should be no strong bonuses. Bonuses should be used as incentive schemes that award executives for exceptional performance."

Whether the term is viewed through the same lense by APRA will be interesting. Davidson suggests as much: "This year's CEO pay survey confirms these concerns and lends weight to recent observations by the Australian Prudential Regulatory Authority 'that there has been an absence of significant downwards adjustment to remuneration at executive level'." Bonuses were the main issue in the report given fixed and cash pay were flat and falling in real terms (again muddied by CEO departures).

Concessions on non-financial metrics?

At the last round of annual general meetings, investors exhibited clear resistance to the use of non-financial metrics but Davidson says some non-financial measures will be necessary to avoid the focus on short-term profit that triggered the Haynes Royal Commission into the finance sector. She expects these will be regulated by APRA.

"We believe non-financial measures can be effective if there is enough rigour around the way those are assessed.

"I think it's an interesting area and I don't think there are answers yet. We expect a lot of movement over the next couple of years: what are appropriate measures, and how are they (APRA) going to set them? How will they be reported and disclosed?"

"One of the main concerns about non-financial metrics is that there is not much disclosure, leaving it to board discretion. So long as they have reasonable degrees of rigour and reasonable stretch in them, we support them."

Davidson expects that APRA will drive equity, malus (the opposite of bonus) and claw-back provisions, and expects boards we will increasingly opt for deferral of remuneration in shares.

Global trends

In a recent environmental, social and governance (ESG) paper on remuneration, Morgan Stanley expects global trends are likely to include a shift between the percentage of fixed versus at-risk pay. However, the ACSI survey suggests that there has not a big shift in overall balances between these components.

CEO's reeling in the bonuses

Five ASX100 CEOs received 100% of the maximum bonus. CSL's ((CSL)) Paul Perreault, nabbed the highest bonus of $3.89m. The others included Treasury Wine Estates' ((TWE)) Michael Clarke, Crown Resorts' ((CWN)) John Alexander, TPG Telecom's ((TPM)) David Teoh, and Adelaide Brighton's ((ABC)) Martin Brydon, which was an unusual form of termination which drew ASCI scrutiny.

The highlights of the ACSI report are as follows:

FY18 was a record year for the ASX200 sample in terms of bonus outcomes. Across the 158 CEOs in the sample, of the 147 eligible for a bonus, 140 received one. Only one CEO received no bonus. The median bonus outcome as a proportion of maximum in FY18 was 70%, effectively in line with FY17, FY16 and FY15. Only one eligible ASX100 CEO did not receive an FY18 bonus, compared with six in FY17. The median ASX100 bonus was $161m, the second-highest in the history of this report, down 9% on the FY17 record. There was a continued trend towards equity over cash, the median cash bonus falling -16.5% to $927,159, showing an increasing trend to bonus deferral. Median ASX100 realised pay rose to $4.5m (includes the actual value of equity vested during the year). The ASX100 hit its second successive record for median realised pay, moving from $4.36m in FY17 to $4.5m in FY18. Median fixed pay for ASX100 rose 1% to $1.79m in FY18, having increased by just 0.2% over the prior decades Average realised pay dropped to $5.66m from $6.23m following the departure of several highly paid CEOs and the fact that only two CEOs realised more than $20m in FY18 – Qantas' ((QAN)) Alan Joyce and Macquarie Group's ((MQG)) Nicholas Moore. Average fixed pay fell -1.3% from $1.91m to $1.88m following exclusion of the retiring Westfield Lowy brothers. Average ASX100 CEO fixed pay has fallen 0.3% since FY08. Among ASX101-200 average median fixed pay both fell -2% and -1.5%, although the FY18 median was still the second highest recorded in the eight years the survey has included. Termination costs rolled in at to $25.15m in FY18, down from $33.63m in FY17 due to a decline in terminations from 20 to 15. Only eight terminations topped $1m in FY18, down from 13 in FY17, the highest going to former Adelaide Bright CEO Martin Brydon at $4.43m in addition to $1.47m bonus. After jumping substantially in FY17 to a record of $6.23m, average realised pay for ASX100 CEOs fell in FY18 to $5.66m in line with the averages for FY14-FY16. In FY18 average ASX100 CEO realised pay represented 65.8 years of average adult earnings down from 74.4 in FY17 land the lowest in the five years they have been collecting the data. The increase in average realised pay levels for the ASX101-200 sample was because in FY17 only one ASX101-200 CEO received realised pay above $10m, Sigma Healthcare's ((SIG)) Mark Hooper, while in FY18 there were three above $11m. Median reported pay, at $2.03m, was the highest recorded in the eight years of the ASX101-200 study, up 8.4 per cent on FY17, the previous highest median. Fixed pay for the ASX100 was largely flat. Median pay topped out at $1.95m in FY12 and tracks well below inflation. In FY18, the median incumbent CEO received a 4.5% increase to $1.84m and the average incumbent a 3.7% increase. Fixed pay for incumbents was -15% lower in absolute terms than the immediate predecessor, and at least -13% lower than the previous to the predecessor.

Top paid CEOs for 2018

Qantas' Alan Joyce topped the ASCI Top-10 Highest-Paid CEO chart, just pipping Macquarie Group's Nicholas Moore at the post thanks to a large long-term incentive allocation granted in 2014.

SEEK's ((SEK)) Andrew Bassat, and Sonic's Colin Goldschmidt also prospered.

New entrants to the top 10 included Treasury Wine Estate's Michael Clarke, Challenger's ((CGF)) former CEO Brian Benari, CSL's Paul Perreault, Newcrest Mining's ((NCM)) Sandeep Biswas, Transurban's ((TCL)) Scott Charlton, and Goodman Group's ((GMG)) Greg Goodman (thanks to the vesting shares).

As in FY17, almost no Big Four bank CEO made the reported or realized pay top 10 in FY18. Thorburn was the highest paid of the three.

The FY18 reported pay Top 10 list for the ASX101-200 cohort was easily topped by head of operations at Afterpay Touch ((APT)), David Hancock. This was due to a one-off option grant to Hancock with an unusual history.

On taking up his executive role in July 2017, APT promised to grant Hancock two million options with terms to be determined but then did not seek approval for this grant of options until the 2018 AGM. Due to the rapid increase in Afterpay's share price over the course of 2017 and 2018 and the personal tax difficulties this would create for Hancock on issue of options on the original terms, the company eventually received shareholder approval to grant Hancock 2.7m options at the 2018 AGM with an exercise price of $2.70.

Some signs of corporate self-regulation

Meanwhile, Macquarie Wealth Management's ESG Equity Strategy report notes that there have been some moves towards self-regulation in CEO remuneration in 2019.

AMP has announced that its CEO's remuneration package was readjusted to "better reflect the challenges currently facing the company, with share price hurdles lowered but with the value of the awards also lowered."

At Platinum Asset Management ((PTM)), as a result of underperformance of the funds relative to indices, no awards were made under the profit share plan, and the CEO elected not to receive any variable awards in 2019.

According to Macquarie, companies are about to embark on a series of enterprise bargaining agreements. However, APRA has noted as an area of concern that employees at lower levels of organisations tended to receive downward adjustments to pay that were not always matched by corresponding adjustments at an executive level.

Former remuneration high-flyer Domino Pizza's ((DMP)) CEO Don Meij was the sole ASX100 CEO not to receive a bonus.

Weekly Ratings, Targets, Forecast Changes - 16-09-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday September 9 to Friday September 13, 2019 Total Upgrades: 25 Total Downgrades: 5 Net Ratings Breakdown: Buy 37.98%; Hold 46.37%; Sell 15.65%

At face value, it appears Australian stockbroking analysts went on an upgrade frenzy as September moved into its second week. FNArena registered no less than 25 upgrades in recommendations for ASX-listed stocks against only five downgrades.

The big spike in upgrades marks a significant turnaround in market views about the outlook for gold in a world wherein one third of global government bonds are yielding negatively, and with central banks expected to pull down cash rates further towards zero.

The higher price outlooks for bullion reflect positively on Australian gold miners. Stocks that had looked egregiously overbought only a few weeks ago, suddenly looked "attractive" again post pull back and with analysts revising their forward looking numbers.

In between the tsunami in upgrades for mostly small cap gold producers, we find the occasional upgrade for Goodman Group, Ramsay Health Care (twice), and Mirvac Group (twice) .

On the negative side, two downgrades out of the five shifted to Sell, with Sims Metal Management and Vicinity Centres the unlucky receivers.

The table for target prices increases is equally dominated by gold producers, with TPG Telecom the first exception on spot number six, followed by two small cap energy producers.

There is very little happening in terms of target reductions. The week's table has New Hope Corp, Mayne Pharma and Bingo Industries as its Bottom Three, but all reductions are relatively benign at -2%-plus.

A ginormous increase for Myer means the week's top ten table for positive revisions to earnings estimates does not have a gold producer on top, while nickel exposures Western Areas and Independence Group make sure the first gold producer, Evolution Mining, is only found on spot number four.

There is decidedly more happening in terms of adjustments to earnings estimates as the week's top ten table for positive revisions only contains three gold producers in total.

The top ten overview for negative revisions shows equally large reductions with forecasts for Senex Energy, TPG Telecom, Cooper Energy and Mayne Pharma all suffering in double digit percentages.

The short term outlook for equities remains dominated by macro factors, including bond yields correcting from over-exuberance and security risks for global energy supplies, while out-of-season corporate results releases are continuing.

Apart from selective mining segments such as gold and nickel, the underlying trend for earnings estimates in Australia remains negative.

Upgrade

ALACER GOLD CORP ((AQG)) Upgrade to Outperform from Underperform by Macquarie .B/H/S: 3/0/0

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Rating is upgraded to Outperform from Underperform. Target is raised to $7 from $6.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Outperform from Underperform by Macquarie and Upgrade to Neutral from Sell by Citi .B/H/S: 1/4/2

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Macquarie retains a preference for the greater leverage in growth but understands the attraction of the superior margins being offered by Evolution Mining.

Rating is upgraded to Outperform from Underperform and the target raised to $5.40 from $4.20.

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. Evolution Mining is hereby upgraded to Neutral from Sell. Target price lifts to $4.70 from $4.20.

GOODMAN GROUP ((GMG)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/1/1

UBS believes there are enough structural developments to overcome global economic uncertainty. Going forward, the company's portfolio strategy should mean a high level of sustainable performance fees.

In FY19 Goodman Group generated $600m in development profits, expected to drive performance fees later on. UBS estimates development gains will generate roughly one third of performance fees over the medium to long term.

The broker upgrades to Buy from Neutral, maintaining a steady target of $15.60.

GOLD ROAD RESOURCES LIMITED ((GOR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/0

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Rating is upgraded to Outperform from Neutral. Target is raised to $1.60 from $1.40.

MIRVAC GROUP ((MGR)) Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Buy from Neutral by Citi .B/H/S: 2/1/1

Credit Suisse reiterates a positive view on the quality of the company's office portfolio, expecting that operating income growth will be healthy and derived from rent reviews and the rolling out/completion of the commercial development pipeline.

The sustainability of distribution growth is also well supported by recurring revenue streams and a low pay-out ratio. Rating is upgraded to Neutral from Underperform. Target is steady at $3.04.

Citi analysts have used a general update on AREITs to express their ongoing bearish assessment for retail landlords, for which they believe the outlook continues to deteriorate further.

Looking back to the recent August reporting season, the analysts observe sharp differences remain in operating conditions across sub-sectors. In other words: earnings growth and upside surprises have become more concentrated.

Lendlease ((LLC)) has become the new Top Pick in the sector. Mirvac Group is the sole recipient of an upgrade; to Buy from Neutral, inspired by valuation. Price target moves to $3.50 from $3.41. No changes have been made to forecasts.

NEWCREST MINING LIMITED ((NCM)) Upgrade to Neutral from Sell by Citi and Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/3/3

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. Newcrest Mining is hereby upgraded to Neutral from Sell. Target price increases to $36.90 from $31.05.

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage.

While upgrading to Neutral from Underperform, Newcrest is the broker's least preferred gold stock, because of declining production. Target is raised to $35 from $24.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Buy from Neutral by Citi and Upgrade to Outperform from Underperform by Macquarie and Upgrade to Neutral from Sell by UBS .B/H/S: 2/1/2

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. Northern Star is hereby upgraded to Buy from Neutral. Target price lifts to $13.30 from $11.50.

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. The broker flags Northern Star as an "unashamed growth story". Rating is upgraded to Outperform from Underperform. Target is raised to $14.20 from $10.00.

Northern Star has the most near-term production and earnings momentum of the gold stocks under coverage, UBS assesses. Production is expected to grow to 884,000 ounces in FY20 and towards an aspirational target of over 1m ounces per annum.

The main component in the turnaround will be Pogo. Pogo has declared a maiden reserve of 1.5mt and 7.5g/t.

UBS upgrades to Neutral from Sell and raises the target to $11.50 from $10.00.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Buy from Neutral by UBS and Upgrade to Buy from Neutral by Citi .B/H/S: 4/1/0

The business is highly leveraged to the gold price yet the shares have not rallied with the sector because of recent operating and regulatory issues. UBS notes the share price has declined -29% in 2019 to date.

A cessation of mining at Didipio in the Philippines remains the biggest headache for the company, although lower-grade stockpiles are still being processed.

UBS does not believe the share price is factoring in much value for Didipio but upgrades to Buy from Neutral as the stock is considered fair value based on the value of the NZ and US assets. Target is reduced to $4.00 from $4.40.

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. OceanaGold is hereby upgraded to Buy from Neutral. Target price climbs to $4.85 from $4.45.

PERSEUS MINING LIMITED ((PRU)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/2/0

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Rating is upgraded to Outperform from Neutral. Target is raised to $0.90 from $0.80.

RAMSAY HEALTH CARE LIMITED ((RHC)) Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Buy from Neutral by Citi .B/H/S: 1/6/0

Since the beginning of August the stock has underperformed the healthcare sector by -11% and the broader market by -9%, Credit Suisse observes.

While maintaining a negative stance on the Australian private hospital industry and assessing margins & returns to be diluted by recent offshore acquisitions, the broker suggests the current price reflects this and there is no longer a catalyst for a de-rating.

Rating is upgraded to Neutral from Underperform. Target is steady at $65.

Citi analysts, who've kept a positive long term view on Ramsay Health Care throughout the challenging few years past, have used a general sector update to lift their recommendation to Buy from Neutral.

The analysts believe the August reporting season was overall positive for the sector, but elevated valuations for many of the star performers remain a problem.

While headwinds remain in the Australian hospital environment, Citi expects Ramsay Healthy Care to increase its market share. In addition, momentum should build in the recently acquired Capio business. Target price unchanged at $74.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Neutral from Sell by Citi and Upgrade to Buy from Sell by UBS and Upgrade to Outperform from Underperform by Macquarie .B/H/S: 2/1/2

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. Regis Resources is hereby upgraded to Neutral from Sell. Target price increases to $5 from $4.70.

UBS upgrades to Buy from Sell, taking a new valuation approach and given the -5% decline in the share price over 2019. The company has not shared in the rally from the 20% increase in the Australian dollar gold price.

The business generates cash and has relatively low operating risk. While economics at Duketon are becoming more challenging and there is risk of a delay at McPhillamys, UBS believes this is more than fully captured in the share price. Target is raised $5.30 from $4.85.

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Rating is upgraded to Outperform from Underperform. Target is raised to $5.60 from $5.10.

SARACEN MINERAL HOLDINGS LIMITED ((SAR)) Upgrade to Outperform from Underperform by Macquarie and Upgrade to Neutral from Sell by Citi .B/H/S: 1/1/0

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Macquarie retains a preference for the greater leverage in growth and upgrades Saracen Mineral to Outperform from Underperform. Target is raised to $4.30 from $3.30.

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. Saracen Mineral is hereby upgraded to Neutral from Sell. Target price has gained 10c to $3.65.

ST BARBARA LIMITED ((SBM)) Upgrade to Neutral from Sell by Citi and Upgrade to Outperform from Underperform by Macquarie .B/H/S: 1/1/1

Commodities analysts at Citi this week revised their price forecasts for gold bullion, now predicting US$2000/oz in the medium term should be regarded as a genuine possibility.

In response, analysts in Australia have upgraded their views on domestic gold companies. St Barbara is hereby upgraded to Neutral from Sell. Target price remains unchanged at $3.00 despite increased forecasts.

Macquarie's commodity strategists have updated gold price forecasts. The revised forecasts envisage a correction early in FY20 and a peak in late FY20 of US$1650/oz. Long-term assumptions are upgraded 11% to US$1400/oz.

The new price deck drives material upgrades to earnings estimates for all gold stocks under coverage. Rating is upgraded to Outperform from Underperform. Target is raised to $3.50 from $3.00.

TPG TELECOM LIMITED ((TPM)) Upgrade to Neutral from Sell by UBS .B/H/S: 1/3/1

FY19 results were in line with UBS estimates. The broker suggests the NBN aspirations could begin to affect forward earnings. The company expects FY20 to be the peak in headwinds from the NBN with the drag on earnings lifting to -$110m.

Uncertainty about the merger process with Vodafone Australia is also having its impact. The Federal Court hearing is scheduled for September 10, although UBS envisages the potential for appeals to prolong the process further.

As the stock has underperformed over the last 12 months the broker upgrades to Neutral from Sell. Target is raised to $6.60 from $5.80.

Downgrade

BEACH ENERGY LIMITED ((BPT)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/0

Citi analysts have used a general sector update to downgrade their rating for Beach Energy to Neutral from Buy. The move was inspired by valuation, the analysts explain. They suggest there will be better entry points ahead.

Citi still isn't keen on LNG exposure and, for investors seeking exposure to the theme/sector, the analysts continue recommending oil producers and/or exposure to domestic gas in Australia. Sector favourite remains Santos ((STO)).

Target price for Beach Energy has risen to $2.48 from $2.33 on revised forecasts.

BLUESCOPE STEEL LIMITED ((BSL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 3/3/0

The recent strong performance from BlueScope Steel has been contrary to a deterioration in steel spreads, trade concerns and scrap pricing/demand.

As a result, Ord Minnett, noting the full valuation and falling price momentum, downgrades to Hold from Accumulate. Target is steady at $14.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/2/1

The recent strong performance from Sims Metal has been contrary to a deterioration in steel spreads, trade concerns and scrap pricing/demand.

As a result, and amid heightened macro economic risks, Ord Minnett downgrades to Lighten from Hold, reducing the target to $10.50 from $11.00.

The broker believes the recent appreciation in the share price is unjustified. Non-ferrous automobile shred, called twitch, is now priced at multi-year lows of US$0.39/lb.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Neutral from Buy/High Risk by Citi .B/H/S: 2/3/0

Citi analysts have used a general sector update to downgrade their rating for Senex Energy to Neutral from Buy/High Risk. The move was inspired by valuation, the analysts explain. They suggest there will be better entry points ahead.

Citi still isn't keen on LNG exposure and, for investors seeking exposure to the theme/sector, the analysts continue recommending oil producers and/or exposure to domestic gas in Australia. Sector favourite remains Santos ((STO)).

Target price for Senex Energy has risen to $0.46 from $0.43 on revised forecasts.

VICINITY CENTRES ((VCX)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/3/1

Vicinity Centres has pointed out capital expenditure levels continue to increase, with an -$80-90m incentive expenditure for tenants in FY20. Macquarie notes, at the upper end of the range, this is an 8% increase on FY19 and 18% increase on FY18.

The extra expenditure comes despite the business divesting -5% of assets. Considering the asset sale program, Macquarie believes the extension of the buyback is a strange undertaking.

The broker remains cautious about the returns on capital expenditure, noting capital intensity in malls generally continues to rise and remains a drag on free cash flow. Rating is downgraded to Underperform from Neutral. Target is $2.34.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ALACER GOLD CORP Buy Sell Macquarie 2 EVOLUTION MINING LIMITED Buy Sell Macquarie 3 EVOLUTION MINING LIMITED Neutral Sell Citi 4 GOLD ROAD RESOURCES LIMITED Buy Neutral Macquarie 5 GOODMAN GROUP Buy Neutral UBS 6 MIRVAC GROUP Buy Neutral Citi 7 MIRVAC GROUP Neutral Sell Credit Suisse 8 NEWCREST MINING LIMITED Neutral Sell Macquarie 9 NEWCREST MINING LIMITED Neutral Sell Citi 10 NORTHERN STAR RESOURCES LTD Buy Sell Macquarie 11 NORTHERN STAR RESOURCES LTD Buy Neutral Citi 12 NORTHERN STAR RESOURCES LTD Neutral Sell UBS 13 OCEANAGOLD CORPORATION Buy Neutral Citi 14 OCEANAGOLD CORPORATION Buy Neutral UBS 15 PERSEUS MINING LIMITED Buy Neutral Macquarie 16 RAMSAY HEALTH CARE LIMITED Buy Neutral Citi 17 RAMSAY HEALTH CARE LIMITED Neutral Sell Credit Suisse 18 REGIS RESOURCES LIMITED Buy Sell Macquarie 19 REGIS RESOURCES LIMITED Neutral Sell Citi 20 REGIS RESOURCES LIMITED Buy Sell UBS 21 SARACEN MINERAL HOLDINGS LIMITED Buy Sell Macquarie 22 SARACEN MINERAL HOLDINGS LIMITED Neutral Sell Citi 23 ST BARBARA LIMITED Buy Sell Macquarie 24 ST BARBARA LIMITED Neutral Sell Citi 25 TPG TELECOM LIMITED Neutral Sell UBS Downgrade 26 BEACH ENERGY LIMITED Neutral Buy Citi 27 BLUESCOPE STEEL LIMITED Neutral Buy Ord Minnett 28 SENEX ENERGY LIMITED Neutral Neutral Citi 29 SIMS METAL MANAGEMENT LIMITED Sell Neutral Ord Minnett 30 VICINITY CENTRES Sell Neutral Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AQG ALACER GOLD CORP 100.0% 33.0% 67.0% 3 2 EVN EVOLUTION MINING LIMITED -14.0% -57.0% 43.0% 7 3 OGC OCEANAGOLD CORPORATION 70.0% 30.0% 40.0% 5 4 MGR MIRVAC GROUP 10.0% -30.0% 40.0% 5 5 NCM NEWCREST MINING LIMITED -50.0% -83.0% 33.0% 6 6 TPM TPG TELECOM LIMITED -10.0% -42.0% 32.0% 5 7 RHC RAMSAY HEALTH CARE LIMITED 14.0% -14.0% 28.0% 7 8 GMG GOODMAN GROUP 40.0% 20.0% 20.0% 5 9 PLS PILBARA MINERALS LIMITED 67.0% 50.0% 17.0% 3 10 MYX MAYNE PHARMA GROUP LIMITED -25.0% -33.0% 8.0% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 VCX VICINITY CENTRES -10.0% 10.0% -20.0% 5 2 BPT BEACH ENERGY LIMITED 20.0% 40.0% -20.0% 5 3 NHC NEW HOPE CORPORATION LIMITED 50.0% 67.0% -17.0% 4 4 BIN BINGO INDUSTRIES LIMITED 33.0% 50.0% -17.0% 3 5 WOW WOOLWORTHS LIMITED -60.0% -50.0% -10.0% 5 6 SXY SENEX ENERGY LIMITED 40.0% 50.0% -10.0% 5 7 SGM SIMS METAL MANAGEMENT LIMITED 8.0% 17.0% -9.0% 6 8 BSL BLUESCOPE STEEL LIMITED 50.0% 58.0% -8.0% 6 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NCM NEWCREST MINING LIMITED 30.652 26.843 14.19% 6 2 AQG ALACER GOLD CORP 6.867 6.167 11.35% 3 3 EVN EVOLUTION MINING LIMITED 4.324 4.017 7.64% 7 4 PLS PILBARA MINERALS LIMITED 0.533 0.500 6.60% 3 5 OGC OCEANAGOLD CORPORATION 4.860 4.660 4.29% 5 6 TPM TPG TELECOM LIMITED 6.418 6.225 3.10% 5 7 BPT BEACH ENERGY LIMITED 2.248 2.218 1.35% 5 8 SXY SENEX ENERGY LIMITED 0.446 0.443 0.68% 5 9 MGR MIRVAC GROUP 3.200 3.182 0.57% 5 10 VCX VICINITY CENTRES 2.566 2.560 0.23% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NHC NEW HOPE CORPORATION LIMITED 2.805 2.890 -2.94% 4 2 MYX MAYNE PHARMA GROUP LIMITED 0.543 0.557 -2.51% 4 3 BIN BINGO INDUSTRIES LIMITED 2.467 2.525 -2.30% 3 4 WOW WOOLWORTHS LIMITED 32.166 32.733 -1.73% 5 5 SGM SIMS METAL MANAGEMENT LIMITED 11.333 11.417 -0.74% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 MYR MYER HOLDINGS LIMITED 87.260 3.810 2190.29% 5 2 WSA WESTERN AREAS NL 25.273 19.905 26.97% 6 3 IGO INDEPENDENCE GROUP NL 27.938 22.493 24.21% 4 4 EVN EVOLUTION MINING LIMITED 24.386 21.129 15.41% 7 5 MYX MAYNE PHARMA GROUP LIMITED 2.310 2.013 14.75% 4 6 BIN BINGO INDUSTRIES LIMITED 10.133 9.000 12.59% 3 7 AQG ALACER GOLD CORP 40.932 37.216 9.98% 3 8 SM1 SYNLAIT MILK LIMITED 49.428 45.538 8.54% 4 9 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 14.090 13.120 7.39% 4 10 NCM NEWCREST MINING LIMITED 164.949 154.620 6.68% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SXY SENEX ENERGY LIMITED -7.118 1.103 -745.33% 5 2 TPM TPG TELECOM LIMITED 27.362 37.056 -26.16% 5 3 COE COOPER ENERGY LIMITED 14.567 16.267 -10.45% 3 4 SIG SIGMA HEALTHCARE LIMITED 1.838 2.048 -10.25% 4 5 WPL WOODSIDE PETROLEUM LIMITED 179.899 185.686 -3.12% 7 6 OSH OIL SEARCH LIMITED 36.644 37.757 -2.95% 7 7 ORG ORIGIN ENERGY LIMITED 56.949 58.634 -2.87% 7 8 STO SANTOS LIMITED 56.412 57.529 -1.94% 7 9 BPT BEACH ENERGY LIMITED 26.578 26.958 -1.41% 5 10 CIM CIMIC GROUP LIMITED 243.733 245.033 -0.53% 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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Uranium Week: Ups And Downs

Last week was a volatile one in the spot uranium market, for little end result.

-Global support of nuclear energy growing -IEAE projections released -Volatility in spot market

By Greg Peel

The importance of nuclear energy for the transition toward a clean and affordable energy system was highlighted at the 24th World Energy Congress in Abu Dhabi this week, industry consultant TradeTech reports. During a nuclear industry panel, Mohamed Al Hammadi, CEO of Emirates Nuclear Energy Corp, noted that nuclear technologies are "proven, economically viable, safe, and clean."

In Asia, Japan's new industry minister said that exiting nuclear power is unrealistic. “There are risks and fears about nuclear power,” Industry Minister Isshu Sugawara told reporters. “But ‘zero-nukes’ is, at the moment and in the future, not realistic,” he added. South Korea and the United Arab Emirates hope to gain projects to build new nuclear capacity. This week, South Korea's Ministry of Trade, Energy, and Industry and the UAE agreed to work together on securing new reactor projects overseas.

“Global electricity demand is expected to rise sharply in coming years as countries need more power for development,” said International Atomic Energy Agency (IAEA) Deputy Director General Mikhail Chudakov, head of the Department of Nuclear Energy, on the release of the agency’s new nuclear power projections. He noted that "without a significant increase in the deployment of nuclear power, it will be difficult for the world to secure sufficient energy to achieve sustainable development and to mitigate climate change.” In 2018, nuclear power produced about 10% of the world’s electricity, accounting for approximately one-third of all low-carbon electricity. Presently, the world’s 450 operating power reactors have a near record level of 399.7 GWe total net installed capacity.

IEAE projections see nuclear generating capacity declining by approximately -8% in the low case and increasing by 25% in the high estimate by 2030. By 2050, nuclear capacity is forecast to fall -6% in the low scenario and increased by 80% in the high case.

It is unclear what one is supposed to do with such information.

Volatile Week

For if the world is becoming more excited about nuclear power, it is not currently reflected in demand for uranium. After rising to US$25.35/lb U3O8 equivalent on the heels of an optimistic outlook, following the World Nuclear Association symposium the week before, the market fell early last week to US$25.05, then to US$24.80 on Thursday, before rebounding on Friday to close at US$25.25/lb.

TradeTech’s weekly spot price indicator thus ended the week down -US10c. Total transaction volume came close to 1mlbs U3O8 equivalent.

The drop in the price over the course of the week was led by a few sellers that needed to clear positions due to risk management and financial limits.

In the term market, a US utility, seeking offers for a minimum of 100,000lbs U3O8 equivalent, to be delivered by September 2022, concluded its evaluation. Two other US utilities are evaluating potential entry into the term uranium market.

TradeTech’s term market indicators remain at US$28.00/lb (mid) and US$30.00/lb (long).

The Short Report - 19 Sep 2019

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

Summary:

Week ending September 12, 2019

Last week saw the ASX200 track a choppy path gradually higher.

There are a few reds and greens in the table below but nothing remarkable. Two stocks saw moves of over one percentage point or more, both residing in what we might call the "battery space".

One is graphite Miner Syrah Resources ((SYR)), which rose to 15.7% shorted from 14.5%. The other is lithium miner Pilbara Minerals ((PLS)), which fell to 7.8% from 9.6%.

The Pilbara Minerals story is straightforward – the company raised capital, thus providing shorters an opportunity to buy back at a discount. There's a bit more to the Syrah story nonetheless. See below.

Otherwise we might point out that as of last week, Tasmanian dairy product producer Bellamy's Australia ((BAL)) was 15.0% shorted. The next day, a Chinese state-owned company made a takeover offer and the stock jumped 55%. There would have been some blood on the short-side floor.

As to whether the government will let Beijing takeover our baby formula industry to avoid having to pay the margins, at what we might call a somewhat "sensitive" time in Sino-Australian relations and the public's perception of them, is another matter.

Weekly short positions as a percentage of market cap:

10%+ NUF 17.7 ORE 16.2 GXY 16.0 SYR 15.7 ING 15.3 BAL 15.0 NXT 14.7 JBH 13.4 GWA 11.7 HUB 11.1 BWX 10.4 DMP 10.3

No changes

9.0-9.9

IFL, BKL, MTS, CGC, SGM, BGA, BIN, HVN, IVC, BOQ

In: BKL, CGC , IVC Out: PLS, RWC 8.0-8.9%

RWC, PPT, SDA, SUL, DCN

In: RWC, SDA Out: BKL, CGC, IVC , OML

7.0-7.9%

PLS, PLS, CGF, CLH, AMP, MYR, CSR

In: PLS, OML Out: SDA

6.0-6.9%

SAR, A2M, NEA, PGH, SFR, GEM, NEC, CTD

In: SAR, NEA Out: NCZ, KGN, COE

5.0-5.9%

CUV, CLQ, KGN, NCZ, COE, FMG, GMA, ALG, MSB, WEB, ELD, BAP, NWL, EHL

In: KGN, NCZ, COE, BAP Out: SAR, NEA, LNG, WSA, SXY, SEK

Movers & Shakers

Syrah Resources will cut graphite production by -30% because of a sudden decrease in the spot price of natural flake graphite in China. Inventory levels have also built up and affected price negotiations and contract renewals.

This is attributed to increased domestic supply in China and supply from Madagascar. Purchases in China have been delayed as customers draw on inventory. Similar behaviour has also been seen in the lithium sector.

UBS noted in its report a sudden and unexpected deterioration across a number of commodities as the US/China trade war continues, creating challenges for the short term.?

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 1.0 0.7 RIO 4.9 4.6 ANZ 0.6 0.6 S32 1.0 1.1 BHP 3.6 3.6 SCP 0.9 0.9 BXB 0.1 0.1 SUN 0.7 0.9 CBA 1.0 1.1 TCL 0.3 0.4 COL 0.9 0.9 TLS 0.2 0.2 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.5 0.6 WES 0.9 1.0 MQG 0.5 0.5 WOW 0.8 0.9 NAB 0.5 0.4 WPL 0.8 0.9 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.

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

The Wrap: Aged Care, Housing & Theme Parks

Weekly Broker Wrap: Aged care; advertising; housing; and theme parks.

-Government may move on reforms for aged care but unlikely ahead of the FY22 budget -Muted impact on sales volumes from stronger house prices -Mini-boom in house prices could impede reserve bank's willingness to cut -Price increases at Dreamworld may adversely impact attendances

By Eva Brocklehurst

Aged Care

As just 1% of aged care providers now account for 56% of the sector's pre-tax profit, UBS envisages the financial viability of the majority of providers remains tenuous. Sector pre-tax profit declined -57% in FY18. Expansion of the sector has probably slowed while consolidation has continued.

The number of provider exits have risen to 130 since FY14, representing a -3.4% decline. Despite the decline in operators, the number of operating places continues to expand, with an additional 6453 beds in FY18.

No relief for the sector is likely to be forthcoming in the short term. The government has granted a six-month extension to the Aged Care Royal Commission and the final report is now due in November 12, 2020.

After recommendations have been tabled, the government may move on longer-term sector reforms and address the funding framework. UBS suspects this could involve a replacement for the aged care funding instrument (ACFI) and some level of of resident funding deregulation.

Still, in the absence of any one-off packages, it is unlikely the sector will achieve funding relief ahead of the FY22 budget. UBS believes aged care stocks are pricing in a long-term continuation of the status quo.

The broker considers Regis Healthcare ((RHC)) generates the best returns of the listed operators, with the highest quality portfolio. Japara Healthcare ((JHC)) offers most upside in terms of earnings growth while Estia Health ((EHE)) offers the best gross dividend yield.

Advertising

August was another tough month for advertising. Metro TV bookings were down -6.6% according to SMI data. UBS notes this is an improvement on the July decline of -10.9%.

The market has been cycling relatively solid comparables and these will start to weaken next month and deteriorate into the end of the year. The main drivers of weakness within the TV advertising market were domestic banks, food/produce/dairy, household supplies and gambling.

Overall, advertising bookings declined -10.1% in August while the strongest categories were insurance and communications.

Housing

UBS suspects much of the multiplier effect from stronger house prices to the real economy will be muted in the current cycle. There is very little recovery being seen in housing sales volumes, and a record low turnover rate is dragging on renovations and related consumption.

New housing activity typically follows higher house prices with a short lag of six months but UBS points out building approvals in July fell to a six-year low and a leading indicator, land sales, reveals ongoing weakness.

Rising house prices can lead to a positive wealth affect but the broker suspects the wealth affect is likely to be much smaller this time around, as savings have fallen to just 2.3%, the lowest rate since 2007, and household debt-to-income ratios are already at record highs.

Hence, a mini-boom in house prices could materially impede the Reserve Bank of Australia's willingness to cut official rates again. The key input to another rate reduction in October (UBS expects -25 basis points) will be unemployment data and any easing by other central banks.

Regardless of the timing, the broker suggests the direction of the cash rate is likely to be lower, highlighting the fact the regulators stand ready to use macro prudential tightening.

The broker considers it possible the RBA could cut the cash rate and, if needed, then tighten credit. This would narrowly target home loans, if prices are found to be rising more than is helpful, but at the same time support record low consumption and limit the upward pressure on the Australian dollar as other central banks ease further.

Theme Parks

Ardent Leisure's ((ALG)) Dreamworld has revamped its ticketing structure on the Gold Coast and increased the prices for adult annual passes by 8% for locals and 47% for non-locals. Citi is concerned that the price increases may adversely impact attendance as, arguably, the Dreamworld product remains inferior to the Village Roadshow ((VRL)) theme parks.

Moreover, there is potential for further downside in attendance when the coroner's recommendations are announced later this year, and ride closures are likely over the next few years,in the broker's view.

Citi would have preferred Dreamworld raise prices once the new $30m steel rollercoaster is completed in 2021. The broker retains a Buy rating for Ardent Leisure, given the long-term potential in Main Event and Dreamworld and assesses the outlook is improving in both areas. However, the US family entertainment industry remains challenged and there are headwinds to attendances at Dreamworld which may require investors to exercise patience with the stock.

Meanwhile, Village Roadshow, also Buy rated, is considered well-placed to deliver net profit growth of 28% over the next two years because of a favourable outlook for its cinema exhibition & theme parks divisions, and the balance sheet is no longer of concern.

Treasure Chest: Wagners Expansion Resonates

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. The expansion strategy of concrete producer Wagners is resonating with several brokers.

-Opportunity ahead as consumption of new generation building materials increases -Value uncovered after stock de-rating but near-term challenging -Upside envisaged over the medium term, given the cyclical low point in the construction cycle

By Eva Brocklehurst

Wagners Holding Co ((WGN)) is rolling out its concrete plants with greater diligence, in tandem with a return of the Boral cement volumes in the first half of FY20. Yet competitive cement import capacity is being introduced into the company's markets and a lack of major infrastructure demand is likely to weigh over the next few months.

Segment margins are forecast to be down -12% over the next year, affected by lower volumes. There is a shift in mix towards lower-margin transport for concrete consumption and a competitive pricing environment in south-east Queensland where the company does most of its business.

That said, the company's commentary around the speed and urgency of the roll-out of concrete plants provides Wilsons with confidence that internal targets will be achieved. Wagners has outlined an additional contribution of $2.1m to operating earnings (EBITDA) in FY20, as a result of increased sales, rising to $4.2m in FY21.

Wilsons upgrades forecasts materially for FY21 and, as a result, increases its valuation, although acknowledges conditions will stay challenging for a while. Credit Suisse also believes there is opportunity ahead of the company, forecasting consumption of new generation building materials will be up 25% in FY20, as Wagners continues to grow its composite fibre technology, particularly in international markets.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, upgrades the stock to Buy, with a target of $2.86, encouraged by the recent internal developments. The broker's forecasts now include more product from the rolling out of concrete plants and a likely win at the Mozambique LNG contract.

Concrete is still expected to be loss-making in the long-term, irrespective of the improvements in capacity, but the larger footprint will pull through higher-margin cement and aggregate volumes and provide some offset to the loss of the Neilsens contract in FY20, in the broker's view.

Wilsons estimates the pipeline of work in Queensland that has received funding totals $3.6bn. This still largely represents projects that were various stages of seeking fund in December 2018. Moreover, the broker points out, this does not improve the near-term outlook for the sector in south-east Queensland, as non-residential expenditure in the area continues to underperform on a national basis.

Morgans acknowledges the recent de-rating of the stock, amid weakness in east coast construction activity, has uncovered value, but remains cautious ahead of the upcoming court decision on the dispute with Boral ((BLD)).

The Boral court hearing is scheduled for September 16-17. Cement supply to Boral is expected resume regardless of the court outcome, and at a price likely to be lower than the price before the supply disruption. There is little risk of volumes not returning, given the supply agreement was recently extended to December 7 2031.

Macquarie has only factored in the potential suspension of Boral volumes for the six-month period to the end of September, with no carry-forward of the price impact. An unfavourable outcome for Wagners could influence the price it receives, nevertheless. According to the company, Boral has an obligation to recommence cement offtake and meet contractual obligations until 2031.

Concrete Expansion

In an effort to retain and build out market share, Wagners is taking an aggressive stance and widening its footprint. While not a new entrant in the Queensland market, the company is intent on expanding its share. Nine concrete plants will be in operation by the second half of FY20 versus four plants previously.

To be most effective, concrete supplies need to be accessible to customers in a wide geography, Wilsons notes, estimating an average utilisation rate of 50% for the nine plants at end FY20. Boral has 67 concrete plants in Queensland.

To help lower the impact of investment, the company has switched its operating model to selling and leasing back concrete plants and has stated it is comfortable with its debt balance in the near term.

Wagners has also elected to suspend its pre-cast operation, expecting to re-start once large projects commence. If successful in winning work for Queensland's Cross River Rail project in FY20, the company does not expect the earnings to materialise until FY21.

Mozambique

Wagners has been involved with early stage works at the Mozambique LNG project and has had a team on site. A final investment decision was announced on June 19 and the company has met with the contractor in Milan in order to prepare for initial stages. Wagners anticipates revenue of $200m and operating earnings (EBITDA) of around $70m from the project over the three-year life of the contract.

FNArena's database has a foot in all three ratings, one Buy (Credit Suisse), one Hold (Morgans) and one Sell (Macquarie). The consensus target is $1.74, suggesting -7.3% downside to the last share price. Targets range from $1.20 (Macquarie) to $2.40 (Credit Suisse).

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

Treasure Chest: Primary Care For Ramsay?

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Could Ramsay Health Care benefit from expansion into the Australian primary care business?

-Several large medical centres in Australia could provide acquisition fodder for Ramsay -Opportunity to diversify revenue stream from private hospitals? -Volume growth in private system supported although price increases likely to be reduced

By Eva Brocklehurst

Ramsay Health Care ((RHC)) intends to further integrate its business with out-of-hospital care and Citi poses the question of whether it could acquire an Australian primary care business.

While Ramsay owns a small network of pharmacies, it could also partner with other organisations or ventures adjacent to the core hospital business. For example, through the acquisition of Capio, the company entered the primary care market in Scandinavia.

The primary care business can provide GP referrals to specialists that work in the Ramsay Health private hospitals, and in Australia there are several large-scale medical centres with a variety of owners that could provide acquisition potential, Citi observes.

Given a multiple of 10x operating earnings a transaction could be accretive, albeit dilutive in terms of return on invested capital (ROIC). Still, with strategic benefits such financial outcomes should be acceptable to shareholders, the broker adds.

Assuming the strategic benefits, ownership of a primary care business by a highly regarded brand like Ramsay Health Care in Australia would also create value over time. The funding of primary care through the federal government can provide a revenue stream that is not under the same pressures as the private hospital industry faces.

The company has invested $563m in its brownfield assets over the last three years and Citi expects this should start to contribute meaningfully from FY20, resulting in higher profitability.

Continuing to forecast the company completing $200m per annum in brownfield projects, Credit Suisse is more cautious about whether there will be demand for this level of investment in a subdued operating environment. The broker also questions whether Ramsay can continue to earn the same level of returns (15% ROIC) it achieved historically, and ascertains that margins and returns have been diluted by recent acquisitions.

Private Hospitals

The latest data from APRA indicates growth in private hospitals decelerated to 2.8% in the second half of FY19 compared with the 3.3% growth reported by Ramsay, which signals growth the company is gaining share. UBS considers the outlook for private hospital volumes and price is the driver of the stock, as Australia represents around 78% of FY20 group earnings forecasts.

An ongoing deterioration in private health insurance participation is expected to pressure the public hospital system and ultimately lead to sustained volume growth for private operators. Hence, the risk for private hospital operators such as Ramsay centres on price not volume, UBS believes, and whether increases from insurers are sufficient to offset cost inflation.

Citi agrees that,\ while the private health stream should support volume growth and governments cannot afford the number of procedures in private hospitals to drop much lower, this is negative for the private health insurers and, ultimately, should result in lower price increases for private hospitals.

Credit Suisse recently upgraded to Neutral from Underperform, as the shares are trading in line with the target and there is no longer a catalyst in sight for the stock to de-rate from these levels. Having assessed the utilisation of public hospitals on the eastern seaboard to determine if the public system is keeping up with higher demand, the broker maintains a negative stance on the Australian private hospital industry.

Demand for elective surgery in public hospitals has continued to rise but, as long as the system is coping, there is limited near-term upside for Ramsay Health, in the broker's view. There are no signs that demand trends are likely to change and, anticipating weaker private hospital volume growth,Credit Suisse was gold believes Ramsay needs to focus on procurement savings in order to maintain flat Australian hospital margins.

Offshore

Meanwhile, in France and the UK, tariff increases should be of benefit to Ramsay and Citi suspects the integration of Capio could result in higher synergies beyond the forecast EUR20m. UBS estimates UK NHS e-referrals represent around 79% of Ramsay's UK admissions and, combined with the tariff increase on April 1, should provide for reasonably strong growth in UK revenue.

Citi may have a Buy rating but the remainder of FNArena's database comprises six Hold ratings. The consensus target is $68.30, suggesting 10.3% upside to the last share price. Targets range from $61 (Morgan Stanley) to $74 (Citi, Ord Minnett).

Treasure Chest: New CEO Holds Key To NAB

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Several brokers suggest National Australia Bank's new CEO may be arriving at just the right time to steer improvements in the retail and business bank.

-New CEO will review retail banking strategy -To maintain flat costs further reinvestment considered likely -Branch closures considered a distinct possibility

By Eva Brocklehurst

Productivity and efficiency have not been the hallmarks of National Australia Bank's ((NAB)) retail and business banking performance, in Bell Potter's view. Is this about to change?

The broker estimates net interest margins lag peers by -36-73 basis points for the retail bank and by -8-23 basis points in the business bank. One small positive is that ANZ Bank ((ANZ)) and Westpac ((WBC)) are not much better when it comes to productivity.

The broker notes incoming CEO Ross McEwan is emerging from a successful stint at Royal Bank of Scotland, where several trends turned positive under his leadership. This provides a good indication of, in the broker's words, "what can go right for NAB over the next few years".

Morgan Stanley agrees Ross McEwan will be prioritising 2020 targets and restoring regulatory and community trust. The retail bank strategy will also be reviewed in a lower interest-rate environment.

The challenges for NAB appear more manageable versus Royal Bank of Scotland as well, as Bell Potter notes there is no Brexit scenario and interest rates remain positive, while asset quality is "stable".

Asset Quality

However, UBS disagrees, believing a deterioration in NAB's asset quality, revealed at the August update, requires close attention, especially as higher mortgage delinquencies were not observed in the recent Commonwealth Bank ((CBA)) results.

Morgans attributes a higher trend in Australian mortgage delinquencies to the switch to principal & interest home loans from interest-only loans, and the longer time being taking for those in arrears to sell their houses.

The broker suggests the major banks are focused on risk-adjusted returns in the institutional space, which bodes well for sector returns as well as CET1 ratios. There is a continued downtrend in risk-weighted assets, largely the result of lower domestic and offshore interest rates.

Rising impairments are also of most concern for Macquarie, particularly in the context of improving trends at Commonwealth Bank. The broker understands this disparity may be partially attributable to differences in hardship recognition and slower book growth but, on face value, the trend indicates underlying conditions remain challenging.

Given subdued volume trends and the focus on expense management, Macquarie does not expect a material earnings contribution from growth in FY19 and calculates the bank will recognise a $600m remediation charge in the second half.

Ross McEwan is likely to deliver on cost guidance yet Morgan Stanley suspects, in order to maintain flat costs, further reinvestment will be required, while there is potential for another restructuring charge of over $500m and for annual investment expenditure to remain above $1.5bn.

Branch Closures

The main driver of value for NAB is likely to be branch closures, as Bell Potter notes Royal Bank of Scotland shut down more than one third of its UK branch network.

NAB's 719 Australian branches cost an average of $3.4m per annum to operate and the closure of 13% would save $300m per annum pre-tax, on the broker's calculations. Under a closure scenario of 20%, this would save $480m.

Given the attractive prospect of cost reductions, Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, reaffirms a Buy rating and $30.80 target. The broker notes there are also further opportunities to be found in strengthening the revenue base through margin and non-interest income discipline that should narrow the gap with major bank peers.

Ord Minnett, too, expects National Australia Bank will show more resilient revenue trends versus its peers, while its strong position in small business should be a differentiating factor.

There are three Buy ratings, three Hold and one Sell (UBS) on the database for National Australia Bank. The consensus target is $26.93, signalling -7.6% downside to the last share price. Targets range from $23.00 (UBS) to $29.60 (Ord Minnett).

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Bonds Add To Uncertainty

Dear time-poor investor: an assessment whether the bond market induced momentum switch for equities spells more trouble ahead?

In this week's Weekly Insights:

-Bonds Add To Uncertainty -Dividend Cuts, They Are Coming -Rudi Talks -Rudi On Tour

Bonds Add To Uncertainty

By Rudi Filapek-Vandyck, Editor FNArena

Investors should draw an imaginary elastic band between share prices of, say, Goodman Group ((GMG)) and Scentre Group ((SCG)) as that will help them in understanding current dynamics in the local share market.

We've all heard and read it before: the share market is heavily bifurcated; general indices no longer tell the full story about what is going on in equities. What we are not often told about is that the gap between the Winners and Losers in the share market, between those shares that are fully participating in this year's bull market and those that are not, the laggards, that gap at times stretches out too far.

Hence why I think the comparison with an imaginary elastic band is but apposite. Whenever the gap stretches out too wide, next follows a snap back that closes the gap, somewhat, and up until this month only temporarily.

I picked Goodman Group versus Scentre Group because, to be honest, those were the two opposites that first came to mind. As the chart below shows, since January the share price of the laggard (Scentre Group, in orange) has weakened slightly while Goodman Group shares (blue line) torpedoed onwards and upwards to a gain, excluding dividends, of no less than 90% by the time FY19 results were released in August.

Maybe I should emphasise this gap between both share price performances captures no more than eight months. That's how pronounced the differences in relative performance have been between the Haves and the Have Nots in today's share market.

And here comes the ultimate surprise: according to the stockbroking analysts covering both stocks, one is currently representing good value, and the other is not. Post the pull back in recent weeks, it is Goodman Group that looks like excellent value with the shares now trading some -14.5% below FNArena's consensus price target whereas shares in Scentre Group, despite not having performed too well thus far in 2019, are trading ABOVE consensus target price.

In days gone, both stocks would have been treated as beneficiaries from falling yields on government bonds. These days, Goodman Group is seen as a leveraged beneficiary from growth in online retailing (it is a direct contractor to Amazon) as well as from investors' hunger for yield (through the company's funds management operations).

Scentre Group, on the other hand, is facing serious fall-out from smaller retailers falling victim to changing spending patterns and competition from online, while big box retailers including David Jones, Myer, Big W and Kmart are renegotiating better leasing terms, while also reducing their floor space inside shopping malls.

Property analysts at BIS Oxford Economics recently predicted owners of shopping centres might be facing a decade of intense pressure affecting their cash flows, profitability and asset valuations. Research likes that perfectly explains as to how the broader investor community currently views the diverging growth paths, and overall risk profiles, for opposites inside the broad property sector in Australia.

As said, there are clear Winners and Losers. Value investors should not automatically assume the latter represent the better investment opportunity, not even after the gigantic gap in performance as illustrated above.

Investors should note also, Goodman Group's story has been supported by higher growth and management upgrading forward guidance while Scentre Group's earnings per shares have been trending south and still analysts see no growth acceleration on the horizon.

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Quality bond proxies that have seen their growth accelerate, such as Goodman Group, but also including the likes of Charter Hall ((CHC)), Transurban ((TCL)), Atlas Arteria ((ALX)) and Viva Energy REIT ((VVR)), are not the only ones that have enjoyed the tailwind from falling bond yields in the share market.

Quality, reliable, structural growth achievers have equally been among the Winners. Investors only have to look up price charts for companies including CSL ((CSL)), ResMed ((RMD)), REA Group ((REA)) and Seek ((SEK)) to provide plenty of evidence, as have been emerging business models with a long-winded growth profile, including WiseTech Global ((WTC)), Jumbo Interactive ((JIN)), Altium ((ALU)) and Afterpay Touch ((APT)).

It can even be argued that reasonable dividend payers have been among the Winners, as long as they didn't carry too obvious problems or obstacles. Think Telstra ((TLS)) post TPG Telecom and NBN threats, and QBE Insurance ((QBE)), as well as Star Entertainment ((SGR)) post restructuring, and supermarket owners Woolworths ((WOW)) and Coles ((COL)).

In each case, our imaginary link with laggards such as Boral ((BLD)), Whitehaven Coal ((WHC)), Vicinity Centres ((VCX)), Unibail-Rodamco-Westfield ((URW)), Incitec Pivot ((IPL)), BlueScope Steel ((BSL)), Cimic ((CIM)), and many others had arguably stretched out too far.

This is why the August reporting season story has been disrupted in September. Usually, the Winners of the season continue enjoying the halo-effect for many weeks after releasing positive results. But those Winners of the season already were mostly trading at multi-year highs, at an oversized premium vis-a-vis the loser-laggards.

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What we are experiencing in the share market this month is a narrowing of the stretched out elastic band between Winners and Losers; call it a "correction" if you like. The last time something similar happened was in September last year, when more or less the same set-up was achieved during the preceding August reporting season.

That particular correction quickly morphed into a severe downwards maelstrom that pulled equity markets globally down by double digit percentages, and it didn't spare the Laggards, so investors will be just a tad nervous upon the repeat this year, looking out for any signs that share markets in general might possibly pull back much deeper in the days, weeks, or months ahead.

Value investors whose portfolios are filled with Laggards must be hoping for a repeat of late 2016 when a five-month long readjustment in market positioning pushed down share prices of CSL, REA Group, Goodman Group and the likes by -20% or more while pushing up share prices of Laggards by similar magnitude.

One observation that should concern us all is the rally in bank shares over the past weeks had pushed share prices for the Big Four in Australia above consensus targets, with CommBank's ((CBA)) valuation premium stretched out beyond 11%. I am well aware of the better signals coming from housing markets in Australia, and of consumer spending picking up a little, but I am not convinced there is a whole lotta improvement around the corner for Australian banks.

CommBank's consensus target declined a little in August. Just saying.

During times of less share market polarisation, I discovered one way to gauge whether investor sentiment had become too exuberant was through comparing share prices for all Big Four banks with respective consensus price targets. If they are all trading above target, it is time to adopt a more cautious approach.

This used to be an extremely accurate indicator pre-GFC. This time around, investors will be hoping any exuberance that has crept into bank share prices in Australia will only affect banks as a sector, and not the share market in general.

I know, valuations don't count for much when macro and geopolitical uncertainties dominate, but just as an observation, on Monday Rio Tinto ((RIO)) shares are still -7.5% below consensus target, CSL shares are -5% below target, and the earlier mentioned Charter Hall shares are by now more than -19% below target.

From a pure valuation perspective, it doesn't seem there is a lot of irrational exuberance priced into this share market, a few pockets here and there potentially being exempt from this generalised observation.

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Similar as last year and in 2016, the trigger for this month's correction in the relative valuation gap between share market Winners and Laggards is the US bond market. The yield on 10 year Treasuries had tumbled from 2.60% in April to 1.46% in August (meaning bonds have rallied strongly). That yield has now quickly risen back above 1.90%.

The Big Question now is whether this bond market "correction" has much further to play out, or not?

Short term further developments are anyone's best guess due to momentum trades, robotic execution, shorts and longs, and multiple factors impacting, including portfolio positioning. Medium to longer term, however, I'd still be expecting lower bond yields. This because central bankers are still loosening, there is no sign of governments joining in with fiscal stimulus, and inflation should not be an imminent problem either.

An economic recession might not necessarily be on the horizon, but the global economy is slowing. A sudden spike in oil prices, irrespective of how long it may last, is hardly a positive in this context.

Arguably, bond investors/traders had pushed the theme of global deceleration and monetary loosening too far too quickly, and that is now being corrected.

For what it's worth, Amundi, Europe's largest asset manager operating from France, recently tried to define a range for ten year US Treasuries for the year ahead. On Amundi's assessment, the US ten year yield should range between 1.60% and 1.80% by this time next year. If even remotely correct, this suggests the August-September US bond market correction might already have gone too far.

Amundi did have one stern warning for investors in equities: watch those corporate earnings. If they fall, equities are likely to follow (in particular if, for whatever reason, bond yields are rising at the same time).

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For investors the message is clear: it might be best to stay cautious and not too risk-exposed, but don't see the current switch in relative momentum as a lasting new trend. Share prices that are falling today can easily land back in buyers' favour tomorrow, or next week.

Meanwhile, the risk for a general risk-off pull back is always present. In particular with so many uncertainties yet to be resolved, including the risk for further deterioration in economic data and corporate earnings.

The August reporting season has clearly spelled it out for investors: large parts of corporate Australia are under intense pressure. This creates tangible and elevated risk. August hasn't been labelled the worst reporting season post-GFC for nothing.

Fittingly, perhaps, Sims Metal Management ((SGM)) issued a profit warning on Monday, with its share price subsequently squandering most of the gains booked on the back of a less-bad-than-feared result update in August.

Make sure you read Part Two of this week's Weekly Insights: "Dividend Cuts, They Are Coming", to be published on the website on Friday morning.

Rudi Talks

Audio interview about the share market last week:

https://www.youtube.com/watch?v=bdF_Ygh_nxc

Last week's video interview with Peter Switzer:

https://www.youtube.com/watch?v=tu3tE08bL2c

(I appear around minute 11 for circa 12 minutes)

Rudi On Tour In 2019

-AIA and ASA, Perth, WA, October 1

In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday, 16th September 2019. It was published on the Monday in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part Two this week will be written on 18 September and published on Friday).

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Rudi's View: Dividend Cuts, They Are Coming

A closer examination of analysts' forecasts post the disappointing August reporting season in Australia suggests dividend cuts are on the increase, with plenty more to come.

Rudi's View: Dividend Cuts, They Are Coming

By Rudi Filapek-Vandyck, Editor FNArena

At face value, the August reporting season in Australia was disappointing, but not quite negative enough to spook investors into a general flight out of Australian equities. Enough evidence came from the likes of JB Hi-Fi and Super Retail that consumer spending might be on a little up-swing, and the general expectation remains the downturn in property markets should prove relatively short-lived.

In the background, central bankers are still re-stimulating economies and financial markets are sharing the view the recessions many see coming will be avoided on the back of low bond yields and ever lower cash rates.

Against this backdrop, corporate earnings in Australia managed to squeeze out a tiny gain from twelve months ago, on average, albeit heavily supported by higher-for-longer iron ore prices and a resurgent gold sector. Expectations are the year ahead is likely to simply offer much of the same; low growth for most companies, in particular from the old economy stalwarts, with mining and energy the potential swing factor.

So far not too bad, or so it appears, but maybe the true story is hiding in the dividends?

FY19 Dividends Look Like 'The Peak'

Again, at face value, aggregate dividends in August were up 4.9% from last year, even though we needed special dividends from the likes of Rio Tinto and Fortescue Metals as well as additional payouts on the back of asset sales (Brambles, etc) to get there. Even including these "extras", the contrast with the context one year ago is rather stark. Last year, aggregate dividends were growing by 14%.

Underlying, total dividends corrected for such one-offs actually went backwards. Because most of the attention during reporting season goes out to profits and company outlooks, and the subsequent response in the share price, most investors would have missed the fact that, at the individual level, no less than 23 members of the ASX200 index either cut or completely scrapped dividends in August.

Among the companies whose shareholders received less than they were probably expecting are the likes of IOOF Holdings ((IFL)), Perpetual ((PPT)), Suncorp ((SUN)) and AGL Energy ((AGL)); in each case the running yield this year and in years past is high enough to assume many a yield-seeking investor was affected.

On the flipside is the observation that while August 2019 in many regards represents the worst reporting season for Australian companies post-GFC, a noticeable number of surprises came in the form of a larger-than-expected dividend payout. On UBS analysts' assessment, a net 21% of large cap surprises came in via a higher dividend (or a share buyback).

The implicit suggestion from UBS's observation that company boards have sought to placate shareholders by paying out more than otherwise might have been the case falls in line with CommSec's observation that 88.4% of full-year reporting companies elected to pay out a dividend in August. This percentage is above the 86.3% average over the 19 reporting seasons covered by CommSec.

Note that total dividends increased by 4.9% from a year ago in August but growth in costs outpaced sales increases over the period, and many large caps reported profits going backwards.

This realisation triggered my investigation into what might lay ahead for the income hungry investor in the next twelve months. Judging from analysts' forecasts, it would appear investors better not casually dismiss the beneath-the-surface dividend message from August; there are more cuts coming, and relatively soon too.

Knock. Knock. Who's There? Your Next Dividend Cut!

Somewhat surprising, maybe, there appears to be a higher proportion of anticipated dividend cuts among the out-of-season reporters; companies that release financial results between September and year-end. And yes, this also includes CYBG ((CYB)), Bank of Queensland ((BOQ)) and Westpac ((WBC)) among the banks.

Investors should note National Australia Bank ((NAB)) already cut its dividend earlier in the year while CYBG issued a profit warning in early September.

Other companies that are slated to reduce dividends from last year's payout, according to analysts' expectations, are Pendal Group ((PDL)), EclipX Group ((ECX)), Nufarm ((NUF)), Incitec Pivot ((IPL)) and Graincorp ((GNC)). I suspect this list hasn't raised many eyebrows given most of these companies have either issued a profit warning or already indicated their intention to pay out less to shareholders this year given corporate hardship. Not many shareholders would be on these registers looking for steady income.

But this is how quickly the 23 dividend cuts from August can accumulate to 33. And analysts are expecting at least ten more from companies that close off their financial books in December, meaning they should announce lower dividends before or in February next year.

Here the list includes G8 Education ((GEM)), AMP ((AMP)), Alumina ltd ((AMP)), Iluka Resources ((ILU)), Caltex Australia ((CTX)), oOh!media ((OML)), Spark Infrastructure ((SKI)), OZ Minerals ((OZL)), Costa Group ((CGC)) and Adelaide Brighton ((ABC)). Note that if all these forecasts prove correct, a total of 43 companies will have reduced shareholder dividends from a year earlier by the time financial year 2019 has been put to rest for all companies that make up the ASX200.

Still, this story is not over yet. If current expectations are accurate, there will be more cuts forthcoming in 2020. Companies that are expected to join the negative trend in dividend payouts by August next year include South32 ((S32)), Fortescue Metals ((FMG)), Boral ((BLD)), Inghams Group ((ING)), Challenger ((CGF)), Harvey Norman ((HVN)), Metcash ((MTS)), Link Administration ((LNK)), Insurance Australia Group ((IAG)), Brambles ((BXB)), and others.

Investors Should Heed The Dividend Message

To be fair, there is probably little to be gained from selling out of stocks simply because of these projections. In particular for those companies that are scheduled to report their financial results relatively imminently (Pendal Group, the banks). Remember, these are all forecasts by stockbroking analysts. The professionals in the market are aware of it.

Nevertheless, I think investors should heed the message of the underlying trend, which shows a clear and resounding: more bad news is coming, the risks remain to the downside. Don't forget: while analysts forecasts can be too negative, they also can underestimate the extent of a company's weakness and vulnerability. Most companies that end up scrapping their dividend were initially expected to only temporarily reduce their payout.

Next comes the great unknown: with so many companies projected to reduce or suspend their dividend, who could possibly make such a move out of left field? Arguably, this can potentially have a significantly larger impact on the share price, as the announcement will be unexpected.

Equally possible is that investors are solely concentrating on where bond yields are with the ongoing prospect of further RBA rate cuts, which might imply some of the share prices mentioned could be artificially supported and only face consequences later on. After all, these are mostly forecasts at this stage (not necessarily supported by all analysts).

Equities Move In Correlation With Cash Dividends

From a macro-perspective, I think the scene is set for a contraction in aggregate dividend harvest for Australian investors in the year ahead. This is not something that happens regularly. Post GFC, it only happened in 2015 and I am sure most investors remember that was not a buoyant time for the share market. Coincidentally, the RBA was equally cutting the cash rate back then and plenty of worries about the international outlook dominated investor sentiment.

Of equal importance is that research published by analysts at Citi earlier this year (see "All About Dividends", Rudi's View, May 16, 2019) suggests quite a close correlation exists between cash dividends paid out to shareholders and the performance of equity markets in general.

Irrespective of whether further RBA cuts will manage to stave off economic recession in 2020/21 (and most importantly: ditto for the Fed and the US economy), if the identified close correlation remains in place, then maybe investors should temper their expectations for the local market, unless the economic picture improves considerably.

A recent update by quant analysts at Credit Suisse suggests updated forecasts post August imply total dividends in the year ahead could drop by as much as -12.8%, with mining companies continuing to contribute positively (as they have over the past two years).

As for whether the outlook for Australian dividends will improve by this time next year, we all simply have to wait and see. For a large number of companies, dividend cuts are usually a one-off, followed by stabilisation or a resumption of growth. Look at the local banks, for instance. But in some cases one cut marks the start of a more prolonged period of downward pressure.

The latter seems to be the case currently for companies including IOOF Holdings, Inghams Group, Suncorp, Bank of Queensland, Platinum Asset Management ((PTM)), Sims Metal Management ((SGM)), New Hope Corp ((NHC)), CSR ((CSR)), Blackmores ((BKL)), Aveo Group ((AOG)), Sigma Pharmaceuticals ((SIG)), G8 Education, Iluka Resources, Caltex Australia, oOh!media, and AGL Energy.

On a related, but slightly off-topic subject, Bell Potter's Richard Coppleson reports next week sees the by far largest payout in dividends from the August reporting season in Australia. At an estimated payout of $12.7bn next week dwarfs all other weeks, representing circa 45% of the $28.28bn in estimated total payouts this month and next.

For those who like statistics: circa 180 companies in the ASX200 pay out a dividend each year to shareholders, excluding a few NZ based companies for which we have no data.

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