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Stories To Read From FNArena

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Hard For Bank Of Qld To Instill Confidence

Bank of Queensland has myriad issues to deal with and brokers expect revenue growth will be difficult over the next couple of years with the stock likely to underperform.

-Few positives in the FY19 results and the final dividend is reduced -Asset quality deteriorates, impairment charges increase -Loan growth not considered strong enough to offset margin headwinds

By Eva Brocklehurst

Bank of Queensland ((BOQ)) and its new CEO have a large task ahead to elucidate a strategy for the future that will reinvigorate confidence, amid mounting regulatory costs and pressure on interest margins. Revenue growth is expected to be difficult and the stock considered likely to underperform.

Brokers expect CEO George Frazis, who will present a market update in February, will need to focus on areas where the bank can derive an advantage, such as in Virgin Money Australia. Yet, Morgans points out, upward pressure on the cost base is very likely over the next two years given the extent of the investment required to resolve the problems.

Bank of Queensland has already flagged a potential expansion of BOQ Finance and a simplification of processes, as well as an accelerated investment in the digital roll-out of Virgin Money Australia. However, UBS warns, despite revenue growth, few in the digital banking segment have delivered strong earnings to date.

Bell Potter welcomes the "sensible" lowering of FY20 cash net profit expectations given the inevitable cost blow-out and management distractions this year. In its FY19 results Bank of Queensland announced cash earnings of $320m and reduced the final dividend to $0.31 versus $0.34 at the interim. Revenue was boosted by trading income while net interest margins eased further, to 1.92%. Credit growth was 1.6%.

There were few positives for brokers to laud. Some steps have been taken towards dealing with risk settings and capital strength, but brokers agree there is a long way to go. Morgans assesses the bank, at present, is not creating shareholder value. If the decline in the return on tangible equity is not averted then the broker may consider the stock is diminishing shareholder value.

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More Deterioration

Citi suspects earnings, the capital position and, possibly, the dividend are all set to deteriorate again in FY20 and downgrades to Sell from Neutral. The broker suggests there is little confidence in the sustainable profile of the business at this point, given the uncertainty about a resumption of growth to levels in line with peers as well as the level of returns that can be generated.

Macquarie notes the CET1 position deteriorated further in the second half, to 9.04% from 9.26%. Despite a discounted dividend reinvestment plan, the broker continues to envisage the current pay-out ratio is unsustainable.

Asset quality has deteriorated, stemming from several large commercial exposures including agriculture. This was one of the more disappointing aspects of the report, Morgans believes. Impairment charges increased by 80% versus the prior year, with $22m attributable to a rise in collective provisioning as lending growth continued in BOQ Finance. However, Citi suspects falling borrowing costs should provide relief and keep bad debts in check, for now.

Margin headwinds are likely to persist for the next three years, in Morgan Stanley's view, unless the three-year swap rate rises 40-50 basis points from current levels. Bank of Queensland is also competing hard for deposits although it appears slightly less vulnerable than peers, the broker assesses, to a squeeze on low-cost deposits from further official rate cuts.

Loan growth is not considered strong enough to offset the margin headwinds and the broker expects fee income growth will be flat. Guidance implies around 6% growth in costs in FY20 and Morgan Stanley suspects Bank of Queensland will find it difficult to adapt to change versus its peers because of a much smaller cost base.

Furthermore, the broker expects the retail bank will be under pressure as the mortgage book has shown no growth for the past 18 months. While the bank is seeking to address loan approval times, Morgan Stanley suspects the shrinking owner-manager branch numbers and under-investment in digital will take longer to resolve.

Virgin Money Australia

While the bank is diversifying its options by investing $30m in developing the Virgin Money Australia brand into a full digital bank, the launch is expected at the end of FY20 at the earliest.

Moreover, Ord Minnett is becoming more convinced that the acquisitions of BOQ Specialist and Virgin Money Australia have introduced complexity, distracting from the core retail bank, of which the owner-manager branch network decline is symptomatic. Bank of Queensland closed five branches during the second half after closing 11 in the first half and has reduced its branch footprint to 167.

The broker suggests the bank remains too complex for the size of its footprint and is suffering from a lack of past investment in core IT infrastructure and digital capability.

UBS is not anticipating a rapid turnaround, suspecting the stabilisation of the retail mortgage book is likely to be challenging, as it has already shrunk -16% from its peak in the first half of FY16. The broker expects net profit to fall a further -11% in FY20.

FNArena's database has two Hold ratings and five Sell. The consensus target is $8.49, signalling -8.4% downside to the last share price. The dividend yield on FY20 and FY21 forecasts is 6.3% and 5.9% respectively. Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, has a Hold rating and $9.10 target.

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Northern Star Dims As Pogo Disappoints

High hopes for the Pogo asset have not be realised over recent months, although brokers debate the extent to which this has dented confidence in Northern Star Resources.

-Hitting targets at Pogo remains the key catalyst for the stock -Mineralised waste being used to keep the mill full at Pogo currently -Extent of structural deterioration at Kalgoorlie hard to assess

By Eva Brocklehurst

Northern Star Resources ((NST)) missed expectations in September for the fourth consecutive quarter, particularly for its bright new Alaskan asset, Pogo. This has dented market confidence and is affecting the stock's premium valuation. A premium has become embedded in the share price, UBS assesses, after Northern Star posted several years of strong momentum for production, exploration and acquisitions.

The turnaround at Pogo is taking longer than expected to materialise. Despite the progress at Pogo, a development deficit is yet to be overcome and Credit Suisse believes the financial outlook is "ugly" as the company is caught in a cycle of presenting stretched targets that are challenging to deliver.

The broker acknowledges the operation should increasingly benefit from new high-productivity automated equipment as well as up-skilling of operators but suspects Pogo will not deliver to its potential until beyond FY20, and requires costs to fall and production and grades to rise.

Grades at Pogo were particularly disappointing, although Macquarie expects this to improve markedly as more stopes come on line. While there is some risk to near-term guidance for Pogo, the broker still considers the long-term outlook is intact.

Hitting targets remains the key catalyst and further exploration is keenly awaited. Macquarie continues to envisage outstanding potential for new discoveries at Pogo along with extensions and the possibility of expansion beyond the current 1.3mtpa upgrade. UBS agrees the turnaround is on the way, but around 6-12 months behind management's targets.

Delays

Northern Star took control of Pogo in October 2018 and has since changed the mining method. The late arrival of equipment in the March and June quarters delayed the training of staff in the new method and, as a result, there were no productivity benefits. At present, mineralised waste grading 1.7-4.3g/t is being fed into the mill to keep it full and this has reduced the weighted average grade.

Without this, the overall mined grade would have been 8.5g/t. UBS points out low feed grade will still be in evidence in the December quarter as new mining fronts are developed. Morgan Stanley asserts switching mining methods in a foreign operation is more complex than was previously anticipated and this creates risk. Stoping ore reached 37% of feed, well below the target of 60%.

Credit Suisse also points out the underlying potential of Pogo is primarily based on its geology, with the company appearing to conclude this is a repeat of the Jundee story that just requires infill and extension drilling to support higher production and deliver longer mine life.

If low grades persist, Morgan Stanley suggests FY20 guidance may be in jeopardy, although the company has flagged a stronger second half. Canaccord Genuity remains confident in the potential in the medium and longer term but also envisages a risk that Pogo will miss guidance in FY20.

The broker bases its confidence on the recent commitment to expanding the plant to accommodate the step-up in underground production rates, and will watch for exit production rates in FY20 as well as cost outcomes to get a feel for the longer-term potential.

Ord Minnett believes monthly exit run rates for key performance indicators are showing good progress and Pogo is on track. The broker sticks with a Hold rating, continuing to monitor progress closely while looking for an entry point.

Elsewhere

Grades at Kalgoorlie were also lower than expected in the September quarter, largely from Kanowna Belle, but should improve by the March quarter as access is gained to the Moonbeam area. Yet, Credit Suisse points out Kalgoorlie will always be in a reinvestment phase. What remains unclear is the extent of structural deterioration in the centre of the mine hub.

It appears that the introduction of South Kalgoorlie has been critical to achieving guidance. Consolidated reporting makes it hard, in the broker's view, to identify where the challenges are and how they may be overcome.

Meanwhile, Jundee was the main positive aspect of the report and produced 84,800 ounces, driven by much higher grades than brokers expected. Northern Star, Ord Minnett points out, has around 59% control of Echo Resources ((EAR)) and, in an area that is long on ore and short on processing capacity, suspects there are larger plans afoot for the Bronzewing asset.

The broker assesses Northern Star could be on track to well over 1m oz/pa by FY22 with extra ounces from Pogo, Bronzewing and potentially the Tanami operations, with even a re-start of Paulsens possible.

Northern Star produced 188,200 ounces of gold at an all-in sustainable cost of $1493/oz in the September quarter. Credit Suisse points out spot gold prices remain highly supportive of processing mineralised waste ore but warns this is contingent on not displacing high-grade ore that might otherwise have generated more margin.

Sustaining elevated grade from more than a single quarter has to date, in the broker's view, been the challenge for Northern Star. However, Ord Minnett notes Northern Star has had one of the more superior growth profiles in a sector where growth is hard to come by.

Canaccord Genuity, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $12 target. The database runs the gamut, with two Buy ratings, two Hold and two Sell. The consensus target is $11.82, signalling 16.4% upside to the last share price. Targets range from $9.60 (Credit Suisse, Morgan Stanley) to $15.00 (Macquarie).

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Gwalia Extension Key To St Barbara Outlook

Expansion activities weighed on the performance of St Barbara's Gwalia mine in the September quarter but increased production is likely from mid 2020.

-Removal of ventilation constraints an important catalyst -Ventilation should effectively double once extension completed -Softer near-term outlook but increased production from Gwalia likely beyond March quarter

By Eva Brocklehurst

St Barbara ((SBM)) has provided a positive outlook for its newly-acquired Moose River mine while expansion activities weighed on the Gwalia performance in the September quarter. As a result, St Barbara has reduced FY20 production guidance for the Gwalia operation by -11% to 175-190,000 ounces. This comes with slightly higher costs (AISC), now expected at $1390-1450/oz.

A step-change in production at Gwalia, Macquarie suggests, will be important in demonstrating improved operations following the removal of ventilation constraints. Existing mining and the extension activities are currently competing for limited ventilation.

Credit Suisse acknowledges the full details on the September quarter may help understanding, but suspects overly ambitious forecasts for the mine's capacity to cope with the constrained ventilation system have cause the production downgrade. While a constraint will be removed when the upgrade is delivered during the March quarter it leaves insufficient time to catch up on the shortfall, in the broker's view.

While acknowledging this is not a great start to FY20, Ord Minnett points out the extension, when completed in the March quarter, will set the mine up for its current life to 2031.

St Barbara has a competitive platform, in the broker's view, with visibility to 2030 for two 200,000ozpa mines, and one potential 100,000ozpa mine. The Gwalia extension project is effectively doubling underground ventilation and Ord Minnett expects a 25% rebound to around 220,000ozpa when completed.

Volume growth once the extension is completed could push the mine back up to 250,000 ozpa while grades are sustained. As this is a high-quality orebody it comprises more than half of the broker's valuation.

Moose River

Production and costs for Moose River, Nova Scotia, have been provided for the first time. Production guidance is broadly in line with broker estimates, with 95-105,000 ounces expected, although costs are higher. Macquarie now expects costs of $936/oz at Moose River, noting the company intends to spend $11-13m on exploring the tenements in FY20.

Ord Minnett remains positive on the prospectivity of the region and expects St Barbara to entrench its position in the operations over the next 12 months, confirming medium-term production targets and de-risking the permitting of future pits.

Added costs probably reflect an increase in sustaining capital to improve the operation but may also reflect an upward revision to unit cost assumptions, Credit Suisse suggests. If the latter turns out to be the case, this will need explanation, as projections are relatively recent.

The company has retained FY20 guidance for Simberi, PNG, at 110-125,000 ounces at costs of $1285-1450/oz. Ord Minnett awaits further drilling outcomes and the release of the sulphide strategy. Already, with 1.4m ounces in reserves, the broker believes the sulphides have potential to unlock value, as current oxide operations will wind down in FY21.

FNArena's database has three Buy ratings and one Hold (Citi, yet to comment on the quarterly). The consensus target is $3.23, signalling 25.5% upside to the last share price. The dividend yield on FY20 and FY21 forecast is 4.5% and 4.9% respectively.

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ARB Corp Decelerates

A depreciating Australian dollar and soft vehicle sales have caused ARB Corp to decelerate, with first half net profit likely to be weaker.

-Turnaround in vehicle sales/change in offshore outlook required -Flexibility from owning much of the manufacturing value chain -4x4/SUVs sales an important impetus in the Australian aftermarket network

By Eva Brocklehurst

Vehicle component manufacturer/distributer ARB Corp ((ARB)) is experiencing extended downside risk to earnings although, as the chairman remarked at the AGM, "it's not all doom and gloom". First quarter sales revenue rose 5% but the depreciation of the Australian dollar against both the Thai baht and US dollar means will be difficult to offset by price increases or cost reductions.

Moreover, there have been further declines in new vehicle sales. Hence, first half net profit is likely to be below the same period last year. However, ARB Corp has pushed through three small price increases, the latest in early October, although Baillieu points out it will take time for these to take effect.

Ord Minnett acknowledges the company's track record of profit growth has been remarkable, averaging 12% over the past 15 years. The business is high-quality but there is a lack of material upside for the share price, in the broker's view, particularly given the downside risk to near-term earnings.

Credit Suisse also believes, for outperformance beyond this point, a meaningful turnaround in vehicle sales and/or a change in the outlook for the offshore businesses is required, although hastens to add the weakness is not structural.

New vehicle sales continue to trend down and declined -6.7% in the September quarter. Hence, Baillieu assesses the fact ARB Corp managed to sustain sales growth of 5% is favourable, and driven by a large growth in export markets.

Uncertain Economy

The company has highlighted uncertain economic conditions, which could affect sales and earnings. As with many automotive parts suppliers and retailers in Australia, price increases are required to offset cost inflation.

ARB Corp has flexibility, as it owns much of the manufacturing value chain, but achieving cost reductions from suppliers is hard and the depreciation in the Australian currency has not helped. The Australian dollar has depreciated against the Thai baht by around -30% over the past five years, Ord Minnett calculates.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, is not deterred by the prospect, upgrading to Overweight with an $18.75 target. The broker assesses sales growth is robust and the recent price increases should neutralise FX headwinds.

Structural Shift

Moreover, along with Baillieu, the broker considers long-term growth drivers remain compelling, including further structural shift to 4x4 and SUVs (sports utility vehicles). The company is also making significant investment in product development and distribution.

While passenger vehicle sales declined -7.5% over FY19, 4x4 and SUV sales continued to outperform, declining a more modest -1.6%. Given the company's exposure to this end of the market, Baillieu believes this category will be an important impetus for sales in the Australian aftermarket network.

Wilsons expects sales growth to accelerate in the second half, on the back of new OEM (original equipment manufacturer) contracts and the acquisition of Beaut Utes in New Zealand. The latter has around $15m in sales of 4x4 accessories in the NZ market and distributes ARB products.

The acquisition is expected to be positive for earnings per share in FY20. The company is also developing an increased focus on the emerging mid-sized truck market in the US. Credit Suisse highlights the fact ARB Corp does not often expand via M&A, albeit its track record in this area is very strong.

The stock has underperformed the Small Ordinaries index, while the shares have fallen -14% since the peak in mid-September, and Baillieu, also not one of the seven, upgrades to Buy with a target of $18.90.

Reasons for the upgrade including weakness in the share price, amid a long-term growth profile that remains intact. Strong returns continue on invested capital and the company has a strong financial position. Meanwhile, the FNArena database has four Hold ratings. The consensus target is $17.43, suggesting 2.3% upside to the last share price.

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Whitehaven Coal Poised For Strong FY20

Several brokers consider Whitehaven Coal without peer, having successfully managed a downturn in the coal price and maintained a strong production outlook.

-Price premiums for the company's products have lifted -Whitehaven Coal able to withstand a prolonged market downturn -Approval of Vickery the next major catalyst

By Eva Brocklehurst

A build-up in inventory at Maules Creek allowed Whitehaven Coal ((WHC)) to ensure strong managed sales in the September quarter, despite softer production. Meanwhile, Narrabri staged a recovery, having been beset by longwall challenges and technical issues in the past 18 months.

Price premiums for the company's products lifted and should feature going forward, Wilsons asserts, despite the depressed prices in the current market. Management has maintained guidance for coal sales of 20-21mt and total run of mine production of 22-23.5mt.

Brokers were pleased with the thermal (energy) price realisation as the company achieved the September quarter price of US$73/t, a 7% premium to the Newcastle benchmark. Newcastle thermal coal prices have corrected by around -50% from their peak above US$120/t.

A seasonal lift in thermal prices is anticipated by Wilsons, as Asia stockpiles coal towards the end of the year. Morgans finds the tepid coal market was the main handbrake on the equity and agrees encouraging signals are emerging.

While there is no escaping the market headwinds, Credit Suisse is comfortable the company can withstand a prolonged market downturn and suggests the company's balance sheet and organic growth options remain appealing for those able to invest in thermal coal and happy to take a longer-term view.

The next longwall change at Narrabri is occurring in the December quarter and is expected to take eight weeks. The company has amassed inventory levels of around 1mt at Narrabri, Bell Potter points out, to manage the continuity of coal sales over the period.

Maules Creek

Sales in the quarter were split 80% thermal, 20% metallurgical (coking) coal but Maules Creek is expected to move metallurgical coal back towards a 30% portion, as the Braymont seam is accessed again.

The commencement of in-pit dumping can reduce costs at Maules Creek, Wilsons ascertains, while production rates and yield should rise strongly. Combined with normal rates of production at Narrabri this makes for a future scenario which has not been the case since the first half of FY18. Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, maintains an Overweight call with a $5.20 target.

Vickery

The potential approval of Vickery is the major catalyst, Morgans suggests. Whitehaven Coal expects the NSW government planning recommendation and associated draft conditions will be delivered at the end of 2019 with the Independent Planning Commission hearing in early 2020.

Overall, capital cost guidance for FY20 is $222-252m, including $150m on growth projects. Of this around $40-50m has been allocated to Vickery. A detailed mine plan is expected to be finalised for Winchester South by the end of the year.

Macquarie notes the company's confidence about approvals for Vickery and Winchester South means the production profile will likely increase to 45mtpa from 23mtpa over the next 10 years. Whitehaven Coal has also reached an agreement to acquire 7.5% of Narrabri that will increase its ownership to 77.5%.

Bell Potter considers the company's growth profile without peer, with projects that can add up to 15mtpa in managed coal production over the next eight years, and the business is highly leveraged to any recovery in the coal price. The broker, also not one of the seven, has a Buy rating and $4.80 target.

Morgans believes the company has weathered the 2019 correction in the coal price well, helped by a premium product, with some of the industry's best assets in Narrabri and Maules Creek, and stable production and reasonable costs support visibility for FY20.

The broker considers the stock to cheap at a -24% discount to net present value and has been waiting for a market catalyst to buy it more assertively. Anticipated strength from the northern winter season combined with signs of improvement in Chinese imports is now enough to get the broker excited.

The database has five Buy ratings, one Hold and one Sell (Ord Minnett, yet to comment on the quarterly). The consensus target is $3.90, signalling 14.2% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.5% and 3.5% respectively.

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Higher Revenue On The Way For Megaport

Megaport maintained a focus in the September quarter on rolling out its latest product to new metro locations, providing the potential for materially higher revenue per customer.

-Pricing for the MCR 2.0 product is materially higher than core port fee -Price increases sustained on the lower bandwidth ports -Valuation could improve as more data centres come online and more revenue is derived per port

By Eva Brocklehurst

Sales momentum continues to build for Megaport ((MP1)), which provides a dense network platform for customers to connect to cloud and software-as-a-service platforms.

Despite a softer September quarter on some metrics, monthly recurring revenue rose 13% to $4.1m, driven by strong sales across the footprint. The company has maintained its focus on enabling more metro locations for the Megaport Cloud Router (MCR).

UBS has no significant concerns and believes the focus on rolling out MCR 2.0 to new metro locations should take priority over new data centre installations. This product provides the potential for materially higher revenue per customer and creates upside, in the broker's view, over the longer term.

The hard launch of the product occurred mid September with functionality in 19 metro locations, since increasing to 27 in October. Pricing for the product is materially higher than the core port fee.

Ord Minnett likes the stock because of the high-quality business model and exposure to a strong sector. The number of installations at data centres grew to 304 and connections grew to 535. While rolling out slowed in the quarter, brokers believe this was timing related.

Ord Minnett expects Megaport to add around 80 new installations over FY20. In early October the company has raised prices on its lower bandwidth 1G ports and reduced discounting. The monthly price increase to $500 from $350.

This is a smaller portion of the book but Ord Minnett expects it will provide a tailwind in the second quarter. UBS is comfortable regarding the structural shift to the cloud amid continued growth in Microsoft Azure and Amazon Web Services.

Morgans notes investor nervousness was centred on the fact the company had only installed equipment in four new data centres in the first quarter. Yet the broker points out the focus on new product installations, which should drive higher customer usage and revenue.

Moreover, traditional installations have varied from 4 to 36 per quarter so the roll-out curve is not smooth. The broker expects 380 installations in data centres by June 2020 and 470 by June 2021.

Morgans assesses there are several upside risks to medium term forecasts and valuation could be materially higher as more data centres are online and more revenue is derived per port. The short-term valuation driver continues to be strategic progress and sales.

Forecasts already assume further capital is required to rapidly expand the platform and Morgans is also not overly concerned about the competitive landscape. FNArena's database has three Buy ratings. The consensus target is $11.06, suggesting 14.8% upside to the last share price.

See also, Megaport Storming Ahead on July 24 2019.

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Prospect For Dividend Cut At Westpac

Brokers flag heightened potential for Westpac Bank to cut its dividend and/or underwrite its dividend reinvestment plan after more remediation provisions were announced.

-Performance in the near term likely to be hampered, given retail bank weighting -Cash profit forecasts reduced further for FY19 -Brokers suspect cut to dividend and underwritten DRP likely

By Eva Brocklehurst

The updating of remediation provisions by Australia's major banks rolls on relentlessly and Westpac Banking Corp ((WBC)) is the latest to announce additional reparations.

The bank expects second half cash earnings will be reduced by -$377m because of customer remediation and the re-setting of wealth management. Of the customer remediation charges of $341m, 72% relates to customer payments with the balance for program costs.

Half of the costs are related to advice with another third from business banking and the remainder from the consumer area and New Zealand. This latest revelation brings the total remediation to $1.6bn in FY19 and compares with $1bn for ANZ Bank ((ANZ)) and $1.9bn for National Australia Bank ((NAB)).

Ord Minnett was not surprised at Westpac's announcement, given similar moves by the other two over the past few weeks, and reduces estimates for earnings per share in FY19 by -5%. The broker has become increasingly concerned about the sustainability of returns in retail banking, a sector to which Westpac is heavily exposed.

Hence, the mix on the bank's book is likely to hamper its performance over the near term and, while Westpac offers a well-balanced portfolio of businesses across the divisions, the hurdles are likely to weigh on the growth outlook. Ord Minnett is less optimistic about the bank's ability to take out costs versus its peers. In this vein Citi, too, suspects Westpac has lost momentum on mortgages.

While Westpac has outperformed its peers over the year to date the increased remediation signals to Citi the outlook has become more challenging. Capital now appears tight and the broker downgrades to Neutral from Buy.

Macquarie suggests, while the market has generally looked through the remediation activity in FY19, the aggregate cost to shareholders is becoming material. Commonwealth Bank ((CBA)) is now the last of the four major banks to top up its provisions and would require an additional $200-250m to match peer provisioning levels, although Macquarie believes this would not be significant, given that bank's surplus capital position.

Lower Dividend/Capital Raising?

All else being equal, Morgan Stanley reduces cash profit forecast by -6.5% for the second half and -3.5% for FY19 overall. The charges lower Westpac's CET1 ratio by -9 basis points and imply a pro forma FY19 CET1 ratio of 10.4% based on the broker's estimates.

Morgan Stanley forecasts a partial underwriting of the dividend reinvestment plan (DRP) to raise $2bn in capital when the bank reports on November 4 and expects a "satisfactory result". The final dividend is also expected to be reduced by -15% to $0.80, which would imply an FY20 pay-out ratio of around 75%. Macquarie also suspects an underwritten DRP will eventuate.

Ord Minnett had assumed the dividend would not be reduced, based on Westpac prioritising the distribution of franking credits to shareholders. With this new set of remediation provisions and the likelihood of more, the broker now assumes the final dividend will be reduced to $0.85 per share.

The broker also assumes Westpac partially underwrites the DRP to raise $2bn in capital, which means FY20 and FY21 forecasts are reduced by less than -1%.

Credit Suisse increases its estimates for a capital raising via the DRP to $3bn from $2bn, in order to improve the strength of the balance sheet, and accommodate regulatory changes as well as participation in an improving housing market. The broker forecasts a $0.10 reduction in the final dividend, enabling a CET1 ratio forecast of 11%.

AUSTRAC

The bank also provided an update on the contingent liability relating to an investigation by AUSTRAC (Australian Transaction Reports And Analysis Centre) which Shaw and Partners, not one of the seven monitored daily on the FNArena database, suggests is unlikely to be a cheap resolution. The broker has a Buy rating and $29 target.

Westpac reported its failure to divulge a large number of international funds transfer instructions in 2018. Ord Minnett suspects the likelihood of a fine has increased but points out it remains too early for Westpac to estimate the cost, while Credit Suisse now includes a $300m expense in FY20 in relation to the AUSTRAC matter.

FNArena's database has two Buy, four Hold and one Sell (UBS, yet to comment on the update). The consensus target is $29.06, suggesting 0.5% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 6.2% and 6.0% respectively.

Disclaimer: The writer has shares in the company.

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Building America's EV Supply Chain

Richard (Rick) Mills Ahead of the Herd

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

Building America's mine to battery to EV supply chain

In 2010 the US Department of Energy's Critical Materials Strategy included lithium as one of 14 elements expected to play a vital role in America's clean energy economy.

Lithium is also among 23 critical metals President Trump has deemed critical to national security; in 2017 Trump signed a bill that would encourage the exploration and development of new US sources of these metals.

According to the US Geological Survey, the United States last year imported around half of 48 minerals and 100% of 18 minerals.

According to Benchmark Mineral Intelligence the US only produces 1% of global lithium supply and 7% of refined lithium chemicals, versus China's 51%.

A Tesla executive earlier in the year said the company is worried about a shortage of lithium. The number of EVs are expected to multiply in coming years, but they can only progress as fast as the lithium-ion batteries can get built that go into them. Tesla CEO Elon Musk said, in June of 2019, that in order to ensure Tesla has enough batteries to expand its product line Tesla might get into mining lithium for itself.

The world's leading lithium battery companies in 2016 produced 29 gigawatt-hours (GWh) of batteries. By 2028 forecasted production is expected to hit 1,049 GWh, an increase of 3,516%!

Consider that in 2018, China sold 1.182 million NEVs (new energy vehicles including electrics and hybrids), 520,000 or 78% more than in 2017.

As China's mark on the lithium market becomes more pronounced, growth in the sale of lithium end products is taking off.

According to Adamas Intelligence, in February 2019, 75% more lithium carbonate was deployed for batteries in electric and hybrid passenger vehicles compared to February, 2018.

At Ahead of the Herd we know that the lithium market, in a few short years, is going to be in deficit as troubles ramping up production meet a mounting wall of demand. It's obvious Tesla's CEO understands that in order to grow his company he has to have a secure supply of lithium.

Lithium price explainer

Before we go any further let's take a look at the different prices of lithium; with 11 lithium products currently being assessed, it can get confusing. While the mineral used to be priced in long-term contracts like uranium, recently there has been a push by end-users, particularly automotive manufacturers, for more price transparency.

As we can see in the price chart below, short-term the lithium bears have the upper hand, with lithium prices falling in China and South America, along with the price of spodumene concentrate in Australia.

How are prices determined? There are three factors Benchmark Mineral Intelligence uses to set the industry standard reference prices: quality/ grade of lithium, shipping costs/ volumes, and the reliability of information given.

The grade and level of impurities affect the price a miner receives, for the lithium to be processed into spodumene concentrate, lithium carbonate or lithium hydroxide. Often the product is refined into the exact specifications required by the end-user.

Currently there are six prices of lithium carbonate, four for lithium hydroxide and one spodumene concentrate price:

Benchmark Minerals, Lithium Carbonate, 99%, FOB South America, USD/tonne Benchmark Minerals, Lithium Carbonate, 99%, CIF North America, USD/tonne Benchmark Minerals, Lithium Carbonate, 99.2%, CIF Europe,

USD/tonne Benchmark Minerals, Lithium Carbonate, 99.2%, CIF Asia, USD/tonne Benchmark Minerals, Lithium Carbonate, Battery Grade, 99.5%, EXW China, RMB/tonne Benchmark Minerals, Lithium Carbonate, Technical Grade, 99%, EXW China, RMD/tonne Benchmark Minerals, Lithium Hydroxide, 55%, FOB North America, USD/tonne Benchmark Minerals, Lithium Hydroxide, 56.5%, CIF Asia, USD/tonne Benchmark Minerals, Lithium Hydroxide, 55%, CIF Europe, USD/tonne Benchmark Minerals, Lithium Hydroxide, 56.5%, EXW China, RMB/tonne Benchmark Minerals, Spodumene Concentrate, 6%, FOB Australia

In July Benchmark Intelligence published an update on lithium prices titled 'Lithium's price paradox'. Current prices are a paradox because lithium investors are making decisions based on short-term supply versus long-term market fundamentals.

Indeed there has been an influx of new supply entering the market. Last year four hard-rock (spodumene) operations in Australia started production. The number of active lithium mines in Australia grew from one in 2016 to nine by year-end 2018.

A total of five new lithium conversion plants (plants that convert lithium carbonate to lithium hydroxide) have come into production and another three have expanded their output to meet market demand.

What is promised in not always delivered

Past success however is not necessarily indicative of the future. We know that between 2012 and 2016, major lithium miners planned to produce an extra 200,000 tonnes of new supply. But when 2016 rolled around, under 50,000 new tonnes came online, due to technical problems.

According to Benchmark's research, only three plants in China have reached production and full capacity. Beyond the Tier 1 producers shown in green in the table below, just two - General Lithium (16,000t) and Jiangte Motor (25,000t) - managed to meet production targets of 41,500t. That means only 87,000t of new Chinese capacity has hit the market since 2016, of a planned 481,500t:

The false narrative which emerged from these expansions and spilled over into 2019 was that the industry was awash with battery-grade lithium chemicals, sufficient to support rapid electrification over coming years.

Benchmark notes more major expansions outside China are planned this year but the timelines for completion are vague and delays are expected; thus the myth of over-supply in the face of exponentially high future demand for lithium. The research firm predicts supply would have to increase at a compound annual growth rate (CAGR) of 19% over the next six years to meet 2025 demand. From 2015 to 2018 it grew at just 11%:

While the supply response has addressed the relatively minor growth of today, it is still far from meeting the needs of tomorrow's EV expansions.

Spectators that flocked to the market in 2016 on the promise of an EV super-cycle have left before the warm up, let alone the main event.

While a downturn in prices has reflected a necessary correction towards near-term market fundamentals, it fails to represent the increasing possibility of another major deficit in the market by the early-2020s, creating a deceptive narrative in both share prices and surrounding markets.

Another important point is that, despite the hundreds of thousands of tonnes more lithium chemical production capacity, only a small percentage will make it into lithium-ion batteries. Why?

Lithium carbonate contained in brines must have contaminants removed before it can be considered battery-grade quality; the process of removing impurities can be expensive.

Technical-grade lithium used in applications other than for EV batteries such as glass and ceramics, is cheaper than battery-grade material, but it has to have low concentrations of iron to be upgraded. There may also be teething problems at new operations. Says Benchmark:

As with any new lithium chemical production, only a proportion of this material will likely be sold into the battery sector from the outset. Even leading producers have problems meeting specs in the initial stages of production.

Both lithium carbonate and hydroxide can be used in the EV battery cathode. Lithium for the cathode and electrolyte materials is produced from lithium carbonate. In brine deposits, the lithium chloride is concentrated by evaporating lithium-rich brines in shallow pools from 12 to 18 months. It is then treated with sodium carbonate (soda ash) to precipitate out the lithium carbonate.

Lithium carbonate can also be produced from clay deposits and spodumene, a silicate of lithium and aluminum.

All lithium batteries contain some form of lithium in the cathode and electrolyte materials. The battery anode is generally graphite-based, containing no lithium.

Lithium carbonate derived from brine operations can be used directly to make lithium-ion batteries, but a hard-rock, spodumene concentrate needs to be further refined before it can be used in batteries, adding costs and complexity.

Despite being more expensive lithium hydroxide is becoming more popular as a battery feedstock because it is said to produce cathode material more efficiently and is necessary in certain cathode combinations such as nickel-cobalt-aluminum (NCA) oxide batteries and nickel-manganese-cobalt (NMC) oxide batteries.

About 75% of the 65,000 tonnes of lithium chemical production expected to come online this year is targeting lithium hydroxide.

While brine operations that suck up the lithium in a salt-water solution and then evaporate it in large ponds have historically been cheaper than hard-rock spodumene operations like Greenbushes in Australia, that is beginning to change. A higher royalty structure in Chile and a plant's ability to make lithium hydroxide directly from spodumene are two factors challenging this assumption.

But according to Benchmark, the case for lithium hydroxide being the more competitive lithium-ion battery feedstock is predicated on the battery market adopting high-nickel, hydroxide-dependent cathode chemistries" (a proposition that looks increasingly unlikely in the near-term) and secondly, that all spodumene producers are integrated lithium chemical suppliers. So far none of the new lithium assets are owned by chemical converter companies:

The question in the lithium market is no longer whether spodumene or brine resources will be developed – both are needed to take us anywhere near the growth estimates of the next 2-3 years. The new question is what other channels of supply will be developed to take us close to the demand forecasts for 2025 and beyond.

Indeed if these new spodumene mines fail to meet production costs, they will either cut output or close, which would tighten the lithium market even further than expected. Already we are seeing some spodumene producers in Australia balk at the prices they are currently receiving, preferring to stockpile material instead.

Reuters reports, Converters of hard rock lithium into battery chemicals in China were holding around four months' worth of stocks, or double usual levels... This has slowed sales from overseas suppliers. Galaxy Resources ((GXY)) sold 44,630 tonnes in the first half of 2019, against more than 90,000 tonnes a year earlier, at an average price of $584, down from $940 a year ago.

If Australia's spodumene producers are priced out of the market, where would the lithium come from to meet surging market demand?

The way things are going, it's not likely to be the United States. Despite having several properties at the development stage, no new lithium mine has entered production on US soil for over 50 years. The only producing mine is Albemarle's Silver Peak in Nevada - which has been going since the 1960s and is rumored to have falling lithium brine concentrations.

China resource lock-up

We know from previous articles that China has been extremely active in acquiring ownership or part-ownership of foreign lithium mines and inking offtake agreements.

By 2025, the Chinese government wants EVs to represent 20% of all cars sold.

By comparison, the US sold 361,307 EVs in 2018, just under a third of China's volume.

China of course, has also locked up the rare earths market and is the primary player in a number of critical mineral markets including cobalt, graphite, manganese and vanadium.

For years the United States and Canada didn't bother to explore for these minerals and build mines. Globalization brought with it the mentality that all countries are free traders, and friends. Dirty mining and processing? NIMBY. Let China do it, let the DRC do it, let whoever do it.

China recognized opportunity knocking and answered the door, seizing control of almost all REE processing and magnet manufacturing, in the space of about 10 years.

Earlier this year, as part of its trade war strategy, China raised the prospect of restricting exports of these commodities, that are critical to America's defense, energy electronics and auto sectors.

Over half of the world's cobalt - a key ingredient of electric vehicle batteries - is mined as a by-product of copper production in the Democratic Republic of Congo (DRC). In a $9 billion joint venture with the DRC government, China got the rights to the vast copper and cobalt resources of the North Kivu in exchange for providing $6 billion worth of infrastructure including roads, dams, hospitals, schools and railway links.

China controls about 85% of global cobalt supply, including an offtake agreement with Glencore, the largest producer of the mineral, to sell cobalt hydroxide to Chinese chemicals firm GEM. China Molybdenum is the largest shareholder in the major DRC copper-cobalt mine Tenke Fungurume, which supplies cobalt to the Kokkola refinery in Finland. China imports 98% of its cobalt from the DRC and produces around half of the world's refined cobalt.

In 2018 the United States produced just 500 tons of cobalt compared to 90,000t mined in the DRC. The US did not produce any vanadium either; the top three producers of the steel additive are, in order, China, Russia and South Africa.

As Quartz notes, in order to maintain its dominance in the EV market, Chinese manufacturers need a lot of cheap lithium. That explains why its largest lithium miner, Tianqi Lithium, owns 51% of Australia's Greenbushes spodumene mine - the world's dominant hard-rock lithium mine. And why China bid for, and got, a 23.7% stake in Chilean state lithium miner SQM, the second largest in the world, for $4.1 billion.

China produces roughly two-thirds of the world's lithium-ion batteries and controls most of its processing facilities.

Russia goes after lithium

This week the Uranium One Group, a subsidiary of Rosatom, Russia's state-owned nuclear company, signed a deal with Wealth Minerals (TSX-V:WML) which has a lithium property in northern Chile. The Vancouver-based junior sold 51% of its Atacama lithium project to U1G.

It's unclear what Uranium One - the same company at the center of a scandal involving the Clintons - plans to do with the 42,600-hectare property. WML would only say it's interested in partnering with U1G to "accelerate the development of lithium projects by using modern technology and moving away from outdated solar evaporation to a more efficient and environmentally friendly sorption technology," the company's president, Tim McCutcheon, remarked in Monday's news release.

We do know that Russia is paying more attention to electric vehicles, despite petroleum being its number one export by far. According to the Russian Ministry of Industry and Trade, EV sales in the largest cities particularly Moscow and St. Petersburg, grew 150% between 2017 and 2018, despite a 40% price increase.

The most popular model is the Nissan Leaf, accounting for some 40% of all sales in 2018, followed by the Mitsubishi i-MiEV and the Tesla Model S. Minister of Energy Alexander Novak reportedly said that EVs should represent 8-10% of Russia's total car fleet by 2025- which would be a huge increase from the 10,000-11,000 EVs estimated to be on Russian roads at the end of 2018, Automotive Fleet reported earlier this year.

It's certainly curious, if not alarming, that Russia is already locking up lithium supplies, even though its EV penetration rate is paltry compared to the top electric vehicle use countries. Canada for example has about eight times more.

We can't help but notice Uranium One is doing the same thing with lithium, that it has done with uranium - be the Russian government's Trojan horse in dominating the world's uranium supply.

Is it possible that Russia wants to be a price-setter of lithium too, which even in oil and gas-soaked Russia is likely to be a major new growth industry? It's easy to see offtakes developing between Russia and South American lithium brines, or maybe Russia partnering with Chinese companies as they have done in the energy sphere, as the country ramps up production of lithium batteries and electric vehicles.

A run through the latest uranium mine closures reveals the strong likelihood that Russia, through its Kazakhstan proxy, aims to seek and destroy any threats to its dominance. Besides Cameco's mine shutdowns and US uranium production controlled by Americans reduced to almost nil, other casualties of low U prices and high-cost mining include French state-owned nuclear juggernaut Areva. West Africa-focused Areva went bankrupt and had to be restructured into a new company, Orano.

Australia's Paladin Energy placed its Langer Heinrich mine in Namibia on care and maintenance in May 2018, following the mothballing of its Kayelekera mine in Malawi.

Rio Tinto's Rossing uranium mine in Namibia is an example of a high-cost mine that was carved up by the Russians and handed over to the Chinese. The world's longest-running open-pit uranium mine, opened in 1976, produced the most uranium of any mine. However, with production costs over $70 per pound, and the uranium price still limping

along at around $20/lb, it was only a matter of time before too much red ink had spilled; in November 2018, Rio agreed to sell its stake in Rossing to China National Uranium Corp.

With their low-cost production and state-owned enterprises doing the mining and enriching, Russia, Kazakhstan, and upcoming China can easily out-compete the private uranium industry.

For example Uranium One, the Canadian company that was swallowed up in 2013 by ARMZ, a subsidiary of Rosatom, currently mines uranium in Kazakhstan, the world's leading uranium-producing country, at an average cash cost of $8 a pound. In-situ mines operated by Uranium One and Kazatomprom dominated the first two quartiles of uranium-mining costs in 2018.

In contrast Cameco, the third-biggest uranium miner behind Kazakh state-owned Kazatomprom and Orano (formerly Areva), reports its only mine left after four closures, Cigar Lake, will be mined at $15-16/lb over the remainder of its life.

Uranium One is vitally important not only to Kazakhstan's uranium production, but Russia's.

As a wholly-owned subsidiary of Rosatom, the company is responsible for Rosatom's entire uranium production outside of Russia. That makes it the world's fourth largest uranium producer. Uranium One has part-ownership of six producing uranium mines in Kazakhstan, the Willow Creek mine in Wyoming, and a 13.9% interest in a uranium development project in Tanzania.

Russia and Kazakhstan have signed several nuclear cooperation agreements over the past decade or so.

The former Soviet satellite nation and Russia currently account for over a third of US imported uranium, effectively setting the price of the nuclear fuel.

US mine to battery to EV supply chain

The International Energy Agency is predicting 24% growth in EVs every year until 2030. The global fleet is expected to triple by 2020, from 3.7 million in 2017 to 13 million in 2020, according to the IEA.

Bloomberg forecasts there will be a 54-fold increase in EVs between 2017 and 2040, when global light-duty EV sales are expected to hit 60 million; there are currently about 4 million EVs in the world.

Globally, battery makers and automobile manufacturers are scrambling to ensure they have enough supply of the silvery-white metal.

A Reuters analysis shows that automakers are planning on spending a combined $300 billion on electrification in the next decade.

Volkswagen has said it will invest $800 million to construct a new electric vehicle – likely an SUV - at its plant in Chattanooga, starting in 2022. For more read Volkswagen to drag Tesla, making EVs in Tennessee.

Opened in 2016, Tesla's Gigafactory in Nevada is a going concern. Every day 1,000 cars sets are trucked from the Gigafactory to an assembly plant in Fremont, California. The three-storey structure, the size of a dozen football fields, has 13,000 people working for Tesla and its Japanese battery partner, Panasonic.

The company's Model 3 was the best-selling electric vehicle in the US during the first half of 2019. InsideEVs claims Tesla sold 67,650 Model 3s through June, seven times the next best-selling electric vehicle, Tesla's Model X SUV. The Chevy Bolt and Nissan Leaf were also among the top five best sellers.

GM is planning to sell its first EV this year, a 2020 Cadillac SUV, built in Spring Hill, Tennessee, in a move designed to challenge Tesla.

In 2017, Mercedes Benz announced plans to set up an electric car production facility and battery plant at its existing Tuscaloosa, Alabama plant. The $1-billion expansion will include a new battery factory near the production site, with the goal of providing batteries for a future electric SUV under the brand EQ. Six sites are planned to produce Mercedes' EQ electric-vehicle family models, along with a network of eight battery plants.

Meanwhile more battery factories are being built, driven by the demand for lithium ion batteries which is forecast to grow at a CAGR of over 13% by 2023.

There are 68 lithium-ion battery mega-factories already in the planning or construction stage. The first phase of Tesla's Chinese Gigafactory is reportedly almost complete; plans are also in the works for a Gigafactory in Europe.

Korean company SK Innovation has said it will invest US$1.6 billion in the first electric vehicle battery plant in the United States, and is considering plowing an additional $5 billion into the project, planned for Jackson County,

Georgia.

All of this explosive growth in battery plants and EVs will mean an unprecedented demand for the metals that go into them. This includes lithium, cobalt, rare earths, graphite, nickel and copper. Lithium for example is expected to see a 29x increase in demand according to Bloomberg.

How will the United States obtain enough lithium for the electric-vehicle storm of demand that is brewing?

The US only produces 1% of global lithium supply and 7% of refined lithium chemicals, versus China's 51%. The country is about 70% dependent on imported lithium.

To lessen US lithium dependency will require the building of a mine to battery to EV supply chain in North America.

The first step is to develop new North American lithium mines.

Lithium products from Albemarle's Silver Peak brine operation in Nevada are sent to its processing plant in North Carolina. This material is then loaded on ships and sent to Chinese battery manufacturers, which sell the batteries to automakers.

We don't know how much lithium hydroxide Albemarle exports from Kings Mountain (the company does not disclose the amount to the USGS in tabulating global production statistics), but we do not think it is significant in global terms. According to Visual Capitalist, Silver Peak only produces 1,000 tonnes per year of lithium hydroxide, within a current lithium market of roughly 280,000 tonnes per annum of lithium carbonate equivalent (LCE), a term that encompasses both lithium hydroxide and carbonate used in EV batteries.

Recently, oil-field services giant Schlumberger inked an earn-in agreement with Pure Energy Minerals that could see Schlumberger - normally associated with oil and gas operations - own a lithium brine project in Nevada. The company and its subsidiaries have three years to acquire 100% ownership in return for constructing a pilot plant for processing lithium brine.

Lithium Americas (TSX-V:LAC) is advancing its Thacker Pass lithium project in Humboldt County, Nevada, about 100 km northwest of Winnemucca. In 2018 LAC completed a PFS that envisions an open-pit mine that would produce 60,000 tonnes per annum of lithium carbonate, for 46 years. The two-phase project, targeted for 2022, would start with 30,000 tonnes per annum (tpa) then ramp up to 60,000 tpa. The company recently said it has completed a Plan of Operation for submission to the Bureau of Land Management (BLM), secured two partners for mining engineering, and started a definitive feasibility study (DFS).

Juniors: the next wave

Junior miners that have projects anywhere close to production between now and 2040 are bound to do well in the current lithium market, which as mentioned, is facing long-term supply shortages, despite what you read about a glut.

Remember, supply would have to increase at a CAGR of 19% over the next six years to meet 2025 demand.

Albemarle's Silver Peak mine is the only producing lithium mine in the US, but there are other properties that could become the next big producer. The old adage, "To find a mine look around a mine" applies here. Below are five companies with US-focused lithium projects under development. All are in Tesla's home state Nevada.

Ioneer ((INR)): Ioneer's Rhyolite Ridge project is a shallow lithium-boron deposit located 25 kilometers from Albemarle's Silver Peak mine. The company plans to leach lithium and boron from the host rock using dilute sulfuric acid. The project currently has a mineral resource of 4.1 million tonnes lithium carbonate and 10.9Mt of boric acid. With the resource compiled from an estimated 20% of two prospective basins, Ioneer believes it can expand the resource through further drilling. A prefeasibility study (PFS) was completed in October 2018.

Cypress Development Corp (TSX-V:CYP). Cypress' Clayton Valley Lithium Project, next to Albemarle's Silver Peak lithium mine, hosts a non-hectorite claystone indicated resource of 3.835 million tonnes LCE and an inferred resource of 5.126 million tonnes LCE. A 2018 PEA showed a net present value of $1.45 billion at an 8% discount rate, yielding an internal rate of return (after tax) of 32.7%. Payback is just under three years. Cypress has successfully produced lithium carbonate and lithium hydroxide that can be marketed to end users, like electric vehicle battery manufacturers. Metallurgical testing shows 83% lithium recovery. A Pre-feasibility Study (PFS) is expected in October 2019.

Noram Ventures (TSX-V:NRM). The perimeter of Noram's claims are located within two kilometers of Albemarle lithium brine operations. A technical report on the Zeus claim block was updated earlier this year, the result of three phases of drilling encompassing 60 drill holes. The new report identified an inferred mineral resource of 1.5 million tonnes of lithium carbonate equivalent (LCE).

Nevada Energy Metals (TSX-V:BFF). Nevada Energy Metals acquired its BFF-1 lithium project based on descriptions of geological modeling and historical drill results. The 2008 report concluded that shallow thermal-gradient drilling and exploration by previous operators demonstrated that this particular part of the Clayton Valley contained the valley's highest subsurface temperatures. The company has two other lithium properties in Nevada, Teels Marsh West located 77 km northwest of the Silver Peak mine, and Black Rock Desert, which it optioned to LiCo Energy Metals in 2016.

LiCo Energy Metals (TSX-V:LIC). LiCo Energy Metals is advancing the Black Rock Desert project it acquired from Nevada Energy Metals. Under the option agreement, LIC can earn a 70% interest in the project, and a 3% net smelter return royalty, by spending $1,250,000 in exploration within three years. A soil sampling program of 88 samples returned 73 samples containing over 100 ppm lithium, with maximum values up to 520 ppm Li.

Conclusion

This brief survey of lithium juniors operating in the United States shows there is tons of potential for building the foundation of a true mine to battery supply chain right here in North America. Doing so would put an end to US import dependence on foreign suppliers of lithium, needed to serve the burgeoning electric vehicle industry; the shift that occurred in the US oil industry, from net importer to net exporter, is analogous to what could, and should, happen with lithium.

The only way to break this dependence is to develop lithium mines in the US. And that spells opportunity for ahead of the herd investors.

Consider - Bacanora Minerals Sonora clay lithium project in Mexico attracted a buy-in from China's Ganfeng Lithium. A payment of £21,963,740 from Ganfeng in exchange for a 29.99% equity interest and a 22.5% joint venture (JV) investment, helped boost Bacanora's share price by over 50% this year.

Battery and EV manufacturers in the United States need to get out in front of the looming lithium supply shortage. Buy secure mine supply now or pay the pipers, Russia and China.

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This is the final part in a series of two. Part One was published on October 17.

By Sarah Mills

Renewable (Natural) Substitutes

A circular economy is favoured but until it can be established, the market for natural cradle-to-grave and renewable/recyclable products should benefit.

Natural renewable or compostable products that replace single-use plastic are already finding their way into distribution channels to meet growing consumer demand.

They include plant substitutes such as bamboo and hemp (for clothes, bags and cutlery), hemp, mushroom and wood (for paper, packaging and building materials), metals (for films and components) and glass (mainly for bowls, bottles, jars and storage).

Consumers in the natural substitutes market are generally happy to pay a reasonable premium for a natural product.

Merger & Acquisition activity is underway in this space as well. Orora ((ORA)) just sold its Australasian Fibre business to Nippon Paper Industries Co for $1.7bn, a premium to the company’s trading multiples.

Analysts had noted that Orora was best positioned in the packaging sector against the plastic threat because of its exposure to natural plastic substitutes.

It still owns other plastic substitute businesses: glass and aluminium in Australia and North America. Orora has also entered a five-year supply agreement with Nippon to continue supplying paper products from the B9 Paper Mill on arm’s length terms.

Packaging

At present, alternative packaging constitutes just 1% of the $1trn global packaging market, but this is expected to rise tenfold to $142bn in coming years.

Mushroom-based packaging is likely to experience reasonable demand as a substitute for polystyrene, which is unrecyclable. IKEA, for example, started using fungi packaging last year throughout its global network of stores.

Mycelium packaging can be moulded to any shape and it decomposes in weeks.

It is just one of many natural plastic packaging alternatives being experimented with. Amazon, for example, is engaging in a massive redesign of its packaging.

The paper packaging market alone was valued at US$69.91bn in 2019 and is expected to experience a compound average growth rate of 4.1% out to 2024. This could be higher depending on the rate of regulation.

Corrugated paper and cardboard packaging design is already becoming more visible and further product design in this field is expected.

The corrugated e-commerce market is growing at 14% per year to 2023 notes packaging specialist Neil Farmer of Neil Farmer Associates.

Aldi has introduced 100% recyclable cardboard discs in place of polystyrene for its pizza products.

In the United Kingdom, a company called Coveris is suppling supermarket Morrisons with an easy-peel open skinboard format pack for its premium cooked meats. These use FSC or PEFC cardboard bases replacing hard-to-recycle black plastics. It is interesting to note that technology is already available to isolate black plastics, showing how quickly the landscape can change.

In an article on Packaging Insights Rick Gross of R.A. Gross Design says: “Look for new closure developments which continue to address sustainability issues through design and materials in 2019. In addition to the past developments of environmentally-friendly materials for use on standard CT closures, look for the expansion of these into dispensing closures such as hinged lid closures.”

This is just a fraction of the action in the natural packaging substitutes market, which is expected to heat up over the next five years.

Hemp

Hemp – where do we start? Conspiracy theories aside, hemp was made illegal in the 1930s, just as carbon-hungry polymers were hitting the market. Now, just as the world confronts a plasticide of its own making, hemp has been legalised.

Hemp is plastic’s most powerful competitor. Anything that can be made of plastic can be made of hemp.

Hemp is an excellent bio-plastic source, but we will save that for another story. Hemp-crete is also a competitor for concrete (which presently uses coking coal) – but again that’s another story. In this article, we are focusing on hemp’s strength in the natural plastic substitutes market.

Critics point out that relative to plastic, growing and harvesting hemp is labour intensive, and more expensive. But as the hemp industry grows and gains economies of scale, prices are expected to fall.

Critics also say hemp production will compete for arable land for food. This is not true. Hemp can be grown in deserts, through caliche, and in caves, and in buildings if necessary, with solar-powered lamps.

Critics also say that growing hemp would incur transport costs but hemp can be grown vertically in massive warehouses, hydroponically, on separate levels near sources of processing if necessary – think cubed acres.

Hemp also has a powerful environmental profile. It requires half the amount of water as cotton, one acre of hemp produces the same amount of paper as 4.1 acres of trees, and one acre of hemp produces more oxygen than 25 acres of forest and absorbs more carbon dioxide per hectare than any forest or commercial crop, making it the ideal carbon sink.

In addition, the carbon dioxide is permanently bonded in the hemp-fibre, making it the perfect building material and bio-plastic. It is totally circular, renewable and carbon neutral.

The industrial hemp market is forecast to hit US$13.03bn by 2026 according to Reports and Data. Of that, the global hemp packaging market is expected to hit US$5.2bn, and experience a compound average growth rate of 26.4%.

Depending on regulation, the market value could be higher (or lower if the plastic lobby wins the regulation war, which is likely unless they fail to deliver a solution).

Much of any additional growth would comprise bio-plastic packaging and it is likely that the lion’s share of industrial hemp will, over time, be diverted to bio-plastic. If that fails, then the natural substitutes market would be the market depository.

This small-cap market is fledgling and a lot of money is likely to be lost before it is made. Investors will be looking to pick the winners in this space before the market matures into its three dominant players.

The Re-usable Economy - Reducing Plastic Usage

The re-usable economy is the most revolutionary of all plastic solutions. Consumer goods companies and retailers, not to mention consumers, are experimenting in this space. As models develop, it has the capacity to transform the global retail economy.

At its most basic level, converting 20% of the global disposable plastic packaging into re-use models is a $10bn business opportunity according to the World Economic Forum.

It also has a powerful carbon profile. Supplying refills for reusable containers in highly concentrated forms reduces transport costs by up to 90%.

Re-use – Rethinking Packaging, published by the Ellen MacArthur Foundation, showcases various re-use models: refill at home; return from home; refill on the go; and return on the go.

At another level, it offers opportunities in product design: such as converting liquids to tablet forms; or standardising product design to gain economies of scale in distribution and logistics; or the introduction of the

universal re-usable bottle across all brands. Amazon is undertaking a complete review of its packaging from a sustainability viewpoint as we speak.

At the other end, it presages the next stage in the evolution of retail portals, in which brands could theoretically compete with retailers and develop their own portals, or undertake mergers and acquisitions with retailers; not to mention a proliferation of e-commerce sharing platforms. In this market, supermarkets and platforms such as Amazon, Facebook and Google, have the advantage, and also offer M&A opportunities.

In between are as many business opportunities as can be imagined. This is a market for design services and product innovation.

In the United States, for example, a Swedish global leader in water purification technologies and solutions has teamed up with Colorado-based Sustainable Drinking Water Solutions FloWater to provide oxygenised alkalised and revitalised water refill stations and filtering systems to large companies such as Google.

It has eliminated 100m plastic water bottles since its launch in 2022 and plans to eliminate one billion plastic bottles by 2022. It recently received $15m from Bluewater to accelerate growth. In a world where water is becoming increasingly polluted, this type of play exists beyond the plastic.

Zero-waste shops and restaurants are popping up all over the world that require customers bring their own containers. The market for refillable cups and bottles is already on the rise, with consumers purchasing everything from water canteens to lidded coffee mugs. At a smaller level, milkman services have been resurrected: the old model in which bottles are collected and re-used. Clothes-sharing and recycling is also on the rise.

Meanwhile, retailers are experimenting with less packaging. Dutch supermarket Ekoplaza recently introduced the world's first plastic-free aisle. Coles recently introduced a zero waste to landfill supermarket. Amazon is redesigning all of its packaging to make it sustainable.

One of the most fascinating developments is a waste-management company called Loop that turns the concept of waste management on its head. It starts at the beginning of the product life cycle, rather than the end, by developing reusable packaging.

Loop offers a variety of household products from, and in partnership with, global giants such as Procter & Gamble, Unilever, Nestlé, Danone and Coca-Cola – in reusable packaging.

The items are available online or through exclusive retailers. Customers pay a small deposit, and the used containers are eventually collected by a courier or dropped off in store (Walgreens in the US, Tesco in the United Kingdom), washed, and sent back to the producer to be refilled. It is also experimenting with models that replicate home recycling models in which products are left outside in bins and collected.

Most interestingly, this industry would be served by online platforms (see retail revolution above). It is, at its heart, an e-commerce play, and a play in which manufacturers may increasingly sidestep traditional retailers. The implications are profound. Within a decade, depending on the success of initiatives, big M&A in this area could feature.

It is unlikely that this market will make its way to a public offering given it would require the buy-in of major retailers and consumer-goods companies, who are more likely to want to carve out their own opportunities, given it is an area which could prove disruptive, help build competitive moats in a period of disruption and attract the ESG dollar. Although they would be likely buyers for technology.

Again, it is a market for design. Product ideas include toothpaste tablets that dissolve in water; Hagen Daz ice cream in steel tubs, washing pods instead of liquids, deodorants with stainless steel bases and insertable refills, the same with toothbrushes and razors.

A minimum of five recycles are required for the model to outperform single-use plastics from an environmental standpoint.

Professional Services

Meanwhile, there will be huge opportunity in the professional services sphere, from design engineers, to software providers managing disclosure tools, to regulators.

For example, product design, frustration-free packaging, and packaging in e-commerce ready formats. Amcor ((AMC)) is investing in two international safe transit association testing laboratories – one in the US and one in Belgium. Amcor's packaging experts will test and certify packaging for customers from around the world.

Significant work will need to be put into developing standardized systems for waste and data collection. Tests will need to be developed to ascertain if a package is designed to protect against damage, reduce waste, be recyclable

and ship in its own container.

Then there is the investment and disclosure market. The Plastic Disclosure Project, a Clinton Foundation Initiative, “encourages measurement and disclosure and management to improve corporate, community and individual accountability on plastic manufacture, use and disposal.”

Software and human expertise will be required to manage this data collection.

Think near-field communication, QR barcode scans and augmented reality.

Connected technologies packaging opens a wealth of opportunities, including smart packaging.

Sourcing of products will also be an area of disruption as supply chains rumble.

ESG Investing

ESG investing in and around the plastics sector will comprise hundreds of billions of dollars and natural substitutes should claim a small but respectable share.

Seven sectors account for almost all primary plastic waste generation: packaging; construction; consumer and institutional products; electronics, electrical and machinery; transportation; and footwear, textiles and apparel.

These will be a key focus for ESG investing and companies making the smartest decisions around plastic are likely to represent the better investments as regulations toughen.

Impact investing will typically feature in the high-growth, IPO market, whereas best-in-class investing will be used to nudge major players in the right direction.

Impact investing is likely to feature heavily in the bio-plastics and natural substitutes markets, while best-in-class investing is likely to feature in the plastics and waste-management sector.

Recycling is likely to attract both impact investors and best-in-class investors.

The green bond issuance market for plastics is already active, and in many ways appears to be an adjunct, if not replacement, to traditional government environmental management functions.

Green bond issuance is expected to hit US$250bn globally this year, up 20% on 2018, and the Climate Bonds Initiative’s state goal is $US1trn.

This month, PepsiCo Inc priced its first green bond – a US$1bn offering, the proceeds of which are designated to cutting virgin-plastic use and replenishing the water it consumes. Interestingly, the bonds are pari passu with all unsecured and unsubordinated debt of PepsiCo in terms of pricing and risk.

The company is planning to cut virgin plastic content by -35% across its beverages by 2025.

This year, the World Bank launched a Sustainable Development Bond to draw attention to the challenge of plastic waste pollution in oceans – a relatively tiny US$20m within the context of its US40bn-$US50bn war chest to support the United Nations Sustainable Development Goals.

The mechanical recycling business is likely to receive solid support for developing products from recycled plastic. Researchers are working on turning recycled plastic into prosthetics for example.

Green issuance in the plastics market in the United States has drawn some approbation, particularly in the municipal green bond market for investing in technology that had already proven a failure. Investors will need to closely investigate the technology’s history, credentials and beneficiaries.

As with all investments, impact investing is a matter of buyer beware.

Meanwhile, a very specific blue bond market kicked off in 2018 with the Seychelles Blue Bond, and is aimed at financing resilience of coastal ecosystems, and a large percentage of this is likely to be allocated towards cleaning plastic pollution.

The World Bank provided a repayment guarantee for one third of the principal and the UN’s Global Environment Facility offered a concession loan to cover payments. The loans help de-risk the investment for impact investors (see the roll of taxes and subsidies above).

This year, the Nordic Investment Bank issued a US$220m blue bond to protect and rehabilitate the Baltic Sea, although plastic was not its main aim.

The focus of blue bonds will also be on fertiliser run-off, treatment, water pollution and waste-water management, and investments in plastic-waste would fit the brief.

All up, the taxes, subsidies, waste collection and sorting, natural substitutes, and re-usable markets are busier than a palm tree in a hurricane.

But, outside of taxes and subsidies, they are just a drop in the ocean. Our next articles will tackle the virgin chemical plastics, bio-plastics and recycling industries. Eyes open.

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

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Uranium Week: Foreign Policy Limbo

The uranium industry is still waiting to find out whether waivers of US sanctions on Iran will be extended beyond next week's expiry, ensuring activity ground to a halt last week.

-Waivers set to expire October 29 -20% of US nuclear fuel supply at risk -BHP uranium sales tumble

By Greg Peel

The uranium market remained in a holding pattern last week. The market had waited 90 days for the Trump Working Group report on the US nuclear fuel cycle but the deadline came and went. A 30-day extension has reportedly been granted as the Group further develops its recommendations.

This suggests it was the Working Group which needed an extension, not the Administration needing an extension because the report was due right in the middle of the last US-China trade talks.

Either way, this is one reason for utilities in both the US and elsewhere to hold off on major supply commitments until it is clear what if any restrictions, tariffs, or anything else may be forthcoming.

Another reason for uncertainty is the Russian Suspension Agreement with the US which both parties are currently reviewing ahead of the agreement's expiry in late 2020.

But for now the primary focus, and source of uncertainty, is the October 29 expiry of the waivers of sanctions on Iran.

When the US dropped out of Obama's deal with Iran with regard its nuclear program, sanctions were applied but waivers were also granted to those companies already invested in supporting Iran with its nuclear power objectives. If these waivers are not reinstated, sanctions would apply to said companies, jeopardizing some 20% of US nuclear fuel supply, industry consultant TradeTech reports.

The effects of secondary sanctions could reverberate through the global nuclear fuel market by isolating some major suppliers from customers in Western Europe and beyond, TradeTech warns. Should the US levy sanctions on countries providing nuclear fuel products and services to Iran, these restrictions would likely include certain Russian, Chinese, and European companies, thereby disrupting nuclear fuel imports into the US.

It is thus not hard to understand why uranium market participants are currently on the sidelines. Total weekly spot activity last week involved two off-market purchases totalling 200,000lbs U3O8 equivalent. TradeTech's weekly spot price indicator has fallen -US15c to US$24.85/lb.

The indicator is down almost -14% in 2019 and -10% year on year.

TradeTech's term price indicators remain at US$27.00/lb (mid) and US$31.00/lb (long).

Can't give it away

In other news, BHP Group's ((BHP)) uranium production at its Olympic Dam mine in South Australia – a by-product of copper mining – fell -4% in the September quarter from the June quarter but was up 30% on the September quarter last year.

Sales in the September quarter fell by -45%.

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The Short Report - 24 Oct 2019

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

Summary:

Week ending October 17, 2019

Supposedly positive developments with regard US-China trade had the ASX200 rallying for most of last week. Short activity was relatively modest in the period, as the table below attests.

There were nevertheless a couple of notable movers.

Shorters continue to gradually exit positions in Nufarm ((NUF)). Progress over the last month, post the announced sale of the company's LatAm business, has been from 17.4% to 12.7% to 10.7% and last week to 9.4%. It's not exactly a rush, which might be explained by little sign of relief on the drought front.

Bellamy's Australia ((BAL)) had been hanging around near the top of the table for some time until the Chinese put in a takeover bid and the shorts were largely wiped. Bellamy's has reappeared in the table at 7.9%, which might suggest not everyone is confident FIRB will agree to the Chinese getting into foot into our lucrative (thanks to Chinese demand) infant formula industry.

Syrah Resources ((SYR)) has spent many a month near or at the top of the most shorted list, alongside other battery-related (lithium) miners, but last week jumped back to the top with a short increase to 17.5% from 16.3%. The story is a familiar one in the land of "exotic" minerals. See below.

The stand-out move last week was that of Kirkland Lake Gold ((KLA)), which poked its head into the 5% plus shorted table the week before at 5.1% but last week suddenly shot up to 14.5%. See below.

Weekly short positions as a percentage of market cap:

10%+

SYR 17.5 GXY 17.2 ORE 15.6 ING 14.7 KLA 14.5 NXT 13.7 GWA 12.5 JBH 11.8 BOQ 10.9 HUB 10.7 SDA 10.4 DMP 10.4 BIN 10.3

Out: NUF

9.0-9.9

NUF, IVC, CGC, PPT

In: PPT Out: MTS, HVN 8.0-8.9%

MTS, BGA, HVN, NEA, IFL, DCN, RWC, SUL, BWX

In: MTS, HVN Out: OML, CGF

7.0-7.9%

BAL, CGF, MIN, CLH, WEB, A2M, PLS, OML, SAR, SGM, MYR

In: CGF, OML, BAL, MYR

6.0-6.9%

NCZ, SLR, RSG, CSR, AMP

In: SLR Out: MYR, RFF

5.0-5.9%

CLQ, ADH, COE, FMG, CUV, SFR, CTD, RFF, NEC, GEM, PGH, NWL, LNG, GUD, CMW, KGN, SEK, GMA

In: RFF, CMW Out: KLA, SLR, TGA, AWC

Movers & Shakers

History has provided many a boom/bust cycle for metals/minerals that suddenly become "flavour of the month", outside of your anodyne base/bulk suite of stalwarts. Over a decade ago it was uranium, there followed by rare earth elements and more recently anything to do with new-age batteries, and thus EVs, such as lithium, graphite, cobalt and even nickel.

The underlying tone to all these booms has been "climate change" – from nuclear power to wind turbines to EVs and a lot in between. But the common cycle is one of prices running riot in an undersupplied market, investors then getting carried away, before new supply is hastily brought forward long before the demand trend catches up.

Then it all ends in tears.

No one denies EVs are in a growth phase that will soon become exponential (no one much seems to question exactly where all the E is going to come from), but it's not an overnight pop. Syrah Resources produces graphite, and graphite prices have experienced the same above-mentioned cycle. The world is now awash with the stuff.

To that end Syrah has been forced to cut production and rationalise operations as it tries to hold on through to the demand-side catching up and graphite prices recovering. The shorters aren't giving the miner much of a benefit of the doubt.

Kirkland Lake Gold is a Canadian-based miner with operations in Canada and Australia, listed in all of Toronto, New York and Australia. The stock is not covered by FNArena database brokers but recent news all sound very positive for the company, including its cash position.

The only piece of news that might explain a sudden jump to 14.5% from 5.1% is that of US hedge funds with significant investments in the miner recently reducing their exposures. Perhaps one way to get ahead of rivals is to short the stock on the ASX ahead of cutting North American positions.

Not clear. And is all assumes this is not just another blip in ASIC data.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.7 0.6 RIO 4.6 4.9 ANZ 0.6 0.5 S32 1.3 1.4 BHP 3.3 3.3 SCP 1.1 1.1 BXB 0.2 0.1 SUN 0.6 0.5 CBA 0.7 0.7 TCL 0.3 0.4 COL 0.8 0.9 TLS 0.2 0.2 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.5 0.5 WES 0.7 0.7 MQG 0.3 0.4 WOW 0.9 0.7 NAB 0.7 0.7 WPL 0.8 0.8 To see the full Short Report, please go to this link

Guide:

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

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

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

Summary:

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.7 0.6 RIO 4.6 4.9 ANZ 0.6 0.5 S32 1.3 1.4 BHP 3.3 3.3 SCP 1.1 1.1 BXB 0.2 0.1 SUN 0.6 0.5 CBA 0.7 0.7 TCL 0.3 0.4 COL 0.8 0.9 TLS 0.2 0.2 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.5 0.5 WES 0.7 0.7 MQG 0.3 0.4 WOW 0.9 0.7 NAB 0.7 0.7 WPL 0.8 0.8 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

The above information is sourced from daily reports published by the Australian Investment & Securities Commission (ASIC) and is provided by FNArena unqualified as a service to subscribers. FNArena would like to make it very clear

that immediate assumptions cannot be drawn from the numbers alone.

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

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

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

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

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

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

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

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The Wrap: Building, Banks & Insurance

Weekly Broker Wrap: building materials; banks; general insurance; and online classifieds.

-Morgan Stanley suggests Aust residential building stocks warrant caution -APRA proposals limit banks' ability to fund offshore subsidiaries -Lack of profitability cited in ride-sharing and autonomous vehicle insurance -New pricing for Macquarie Group's wealth platforms -New pricing models for Seek and Domain Holdings

By Eva Brocklehurst

Building Materials

Morgan Stanley expects the largest decline in Australian residential construction will come in FY20 and a trough in activity occur in FY21. The broker continues to believe those stocks with exposure to Australian residential construction warrant caution. Dwelling commencements declined -20% in the June quarter and now sit at the lowest level since 2014.

Meanwhile, building approvals fell -23% in August and are now at the lowest level since 2013. The broker assesses declines are broad-based and across all states and dwelling types.

Morgan Stanley's materials intensity adjusted index signals that FY20 will prove to be a difficult year for materials providers. The broker suggests a recovery in building materials stocks is premature and reiterates an Underweight rating for CSR ((CSR)), the stock with the largest residential exposure under coverage.

The broker emphasises the importance of differentiating between house prices and new construction, noting that the stock has rallied around 15% since the Australian election result when sentiment around the housing market improved. This actually ignores the problems with demand and the earnings outlook going forward.

Weather conditions were generally favourable in Australia for building construction and improved in the US in the third quarter of 2019. Rainfall in four out of five Australian capital cities was below average levels in the third quarter. The broker assesses this should provide a favourable volume backdrop for building materials stocks.

In the US, the improvement was most evident in Texas, particularly relative to an exceptionally wet prior corresponding period. This should provide a solid earnings base for Boral ((BLD)), in the broker's opinion. James Hardie ((JHX)) is also expected to deliver a more favourable comparable in its second quarter report, due November 6.

Banks

Macquarie estimates a $4-5bn capital shortfall across ANZ Bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)) following the new APS 111 proposal from APRA (Australian Prudential Regulatory Authority), which seeks to adjust the banks' ability to fund NZ subsidiaries.

The impost for these three banks is worse than Macquarie previously expected, while for Commonwealth Bank ((CBA)) the reverse is the case. As a result, Macquarie expects Commonwealth Bank will be in a position to return capital to shareholders while the others will need to increase capital.

APRA has proposed limiting the favourable capital treatment for offshore subsidiaries to 10% of CET1. The proposal creates a lack of capital-related economies of scale for institutions that are overweight operations in offshore markets.

Macquarie expects ANZ Bank, in particular, will look to scale down New Zealand operations to minimise the potential impost stemming from regulatory changes. However, full NZ divestments are now considered less likely.

The broker also envisages a risk the Reserve Bank of New Zealand will stick to its original plan and lift capital ratios to 16% without offering much in the form of concessions.

Bank Previews

As the reporting season for the banks approaches, Credit Suisse believes outlook commentary will be crucial, considering the recent reductions to official cash rates and the pricing actions undertaken since the last reporting season.

Any commentary around a pick-up in mortgage lending and overall asset growth is likely to be well received. For ANZ Bank, progress on costs will be key, while the broker suspects the market is anticipating an upgrade to guidance at Macquarie Group ((MQG)).

Recent US bank results have shown positive momentum in comparable business lines with investment banking revenue beating expectations, an indicator for Macquarie Group.

Meanwhile, share price reaction at Westpac will be all about whether suspicions over capital, dividend and costs are confirmed and uncertainties removed. No change to guidance is expected at National Australia Bank, although the Credit Suisse suspects it may partially underwrite its dividend reinvestment plan again.

General Insurance

The first major casualty of ride-sharing insurance has been revealed, as the largest provider of insurance to US Uber drivers recently ended the partnership because of lack of profitability. Macquarie notes, after more than five years, the global insurance industry is unable to generate underwriting profits from new products for the shared economy and cannot justify autonomous vehicles.

James River Group will exit the US relationship with Uber, strengthening its capital reserve. Macquarie suggests 45% of Australian insurance industry profits pertain to motor insurance and concludes that those with lean cost bases, nimble technology and diversified portfolios will be best placed to provide local offerings for ride-sharing customers.

The broker notes QBE Insurance ((QBE)) was the first to offer insurance for Tesla in Australia but this relationship ended after 12 months, as the high cost for parts for autonomous technology made the proposition unaffordable. The broker concludes that the global insurance market remains a long way from finding an economic solution.

Wealth Platforms

Macquarie Group has announced new pricing for platforms, consistent with Citi's view that the industry will continue to come under pressure as incumbent providers use price to arrest market share losses to specialists.

The broker's analysis of Macquarie Group's new pricing indicates it is generally more expensive than BT Panorama from an administrative fee perspective. The broker does not expect the price reduction to materially affect Netwealth ((NWL)) and HUB24 ((HUB)) for large wholesale deals, although it does make Macquarie Group more competitive. Citi also expects downside risks to overall industry pricing, particularly as cash rates head lower.

Online

Both Seek ((SEK)) and Domain Holdings ((DHG)) have shifted to new pricing models. Rather than charging a flat price per classic advertisement, Seek will vary its pricing based on candidate scarcity and location. Customers will now commit to dollar expenditure levels usable across multiple advertising types.

Discounts will no longer be based on volume but based on total expenditure. UBS assesses this will have the greatest impact on recruitment agencies. The short term impacts are likely to be minor and are already factored into FY20 guidance. The broker expects yield uplifts will be felt primarily from the second half of FY21.

UBS understands Domain is also in discussions with agents on a new pricing model more closely aligned with underlying property values. Going forward, the company may vary pricing depending on a particular zone. Anecdotal feedback indicates this should have the effect of lifting average prices paid to Domain. The broker suspects the new pricing will be another mechanism to help the company achieve its targeted yield growth.

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Pressure Mounts On Syrah Resources

The drop in the price of graphite has combined with several negative factors to put substantial pressure on Mozambique producer Syrah Resources.

-Balama consuming cash in 2020, cost reduction measures instigated -Recoveries improving but remain below expectations -Commercialising BAM key to the outlook

By Eva Brocklehurst

A slump in the price of graphite has caused Syrah Resources ((SYR)) to scale back production for the remainder of 2019 and 2020. This is designed to underpin a market which has been over-run by supply.

The decline in spot prices has also been kicked along by a sharp depreciation of the Chinese currency, as well as cuts to electric vehicles subsidies and trade tensions that have weighed on sentiment. Increasingly large quantities of flake graphite are also being exported from a privately-funded Mozambique mine.

Credit Suisse describes the deterioration in market conditions as catastrophic. Whether the company's strategy allows the market to tighten, enabling prices to increase, or simply allows an alternative producer to take the company's share is yet to be seen.

Without a price increase, the Balama project is consuming cash in 2020 and the broker considers the business in an increasingly perilous position. Cash will be consumed in 2020 despite the planned -20% reduction in the cost base.

Both Morgan Stanley and UBS are concerned about cash flow. The company has guided to -US$17m in net outflows from Balama in the fourth quarter, more than offsetting proceeds from the company's US$38m convertible note. The achieved price in the September quarter was US$391/t, down -14% on the prior quarter, whereas Morgan Stanley had estimated US$436/t for the second half of 2019. Cash costs were US$571/t.

UBS notes management has not provided an indication of spot pricing, but calculates a range of over US$300/t is required at a run rate of 5000t per month to generate outflows of US$17m per quarter.

In this scenario, both UBS and Credit Suisse assess there would be sufficient cash reserves to continue operating Balama until at least the December quarter of 2020. Management has outlined measures aimed at reducing costs (C1) by -20-25%.

This will be achieved through a reduction in personnel at Balama, the streamlining of senior management in Australia, contract renegotiations and reconfiguring mining and processing.

The company is guiding to 120-150,000t of graphite production in 2020, subject to demand. First production of purified spherical graphite is now expected in the December quarter because of delays in the provision of technical support during commissioning.

Recoveries

Recovery improved to 69% in the quarter and 71% was achieved in September through better process control and operating stability. Yet, 2020 recoveries are envisaged staying at around 75% which is a concern for Morgan Stanley.

Production of coarse flake graphite increased as a result of blending/screening improvements, while the percentage of coarse flake from the mine remained constant. However, UBS points out the cut to production is not sustainable over the longer term for a plant that is designed to run at much higher rates.

BAM

Work on the battery anode material (BAM) project will continue, targeting purified spherical product and producing final anode material, whilst developing a customer base and finalising a feasibility study in 2020. One positive aspect, Credit Suisse notes, is expenditure on BAM declines materially in 2020. Moreover, Chinese graphite production continues to be in long-term structural decline.

Incorporating the production reduction and new guidance, Macquarie reduces estimates for earnings per share in 2019 by -63% and 2020 by -114%. The broker notes the company has been struggling with market headwinds for some time and scaling back Balama may mean the market is more in balance.

However, Macquarie finds it difficult to envisage how the mine can re-enter the market without a significant increase in graphite demand and an improvement in product quality. Successfully commercialising BAM remains the key to the broker's outlook and valuation.

FNArena's database has one Buy rating (Credit Suisse), two Hold and one Sell (Macquarie). The consensus target is $0.70, signalling 83.6% upside to the last share price. This compares with $0.99 ahead of the quarterly.

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SMSFundamentals: Super Members Pay Less In Fees

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

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

Super members pay less in fees

Superannuation fees charged to members have fallen for the first time in six years, while funds are using their negotiating power and paying less to external asset managers.

-Study shows super fees fall to 1.1% average in 2019 from 1.2% in 2018 -Super funds are paying less to external managers -Fees for active global equity mandates have fallen by -7% since 2013 -The onslaught of passive investment and smart beta strategies is driving fees down

By Nicki Bourlioufas

Super funds paying less to some external managers

Superannuation fees charged to members have fallen for the first time in six years, while superannuation funds are using their negotiating power and paying less fees to external asset managers to manage some of their assets, according to two new studies.

The 2019 Rainmaker Information super fund fee study analysed fees charged by more than 500 superannuation funds and 50 self-managed super fund administrators. The study found fund members are now paying 1.1% in fees on average. This is down from the 1.2% they were paying in 2018.

Of the 1.1% members paid in fees, 0.7% is on average paid for investment fees and 0.4% for administration and product-related fees. The report found that super funds are achieving greater economies of scale and reducing costs for their members as their funds under management grows. Total superannuation assets were $2.87 trillion as at 30 June, a jump of 6.2% from a year earlier.

“These reductions show an industry shifting towards a greater commitment to improving super for the members,” said Jason Ross, head of superannuation at Rainmaker Information.

“Last year’s Productivity Commission and Royal Commission have already started to prove their effectiveness,” he said.

Industry funds raise competition

The Rainmaker report found that the movement of investors to industry funds, or lower priced not-for-profit or industry funds, from retail super funds was also forcing fees lower.

In 2015, the average retail MySuper product charged 0.24% more than not-for-profit MySuper products. Today, this gap has narrowed to just 0.04%. This year, super funds with the biggest reductions in their MySuper Total Expense Ratios (TER) were for-profit funds: AMP Super Direct for Business, with a fall of -97 basis points to a TER of 1.19%, and AMP’s SignatureSuper Select and SignatureSuper funds, both which saw their fees fall -63 basis points to 1.21% in 2019 from 2018.

Even some industry funds lowered their fees, including Hostplus, LGS Division A and ACSRF Employer, reflecting a strong competition for member funds.

Super funds pay external managers less A separate report reveals that fees paid by superannuation funds to external investment managers are falling for some asset classes. Asset consultant bfinance’s biennial Investment Management Fees report showcases a selection of areas where fees have declined significantly, which in 2019 included absolute return bonds, emerging market equity, emerging market debt and fund of hedge funds.

Fees for active global equity mandates have fallen by -7% since 2013 and -4% since 2016. The median quoted fee for a $100 million mandate currently sits at 55 basis points.

The bfinance report found the onslaught of passive investment and smart beta strategies is driving down fees. “Pricing pressure is supported by investors’ need to improve portfolio diversification, which can include reducing

equity risk exposure, and the popularity of smart beta and passive equity strategies," the report said.

Larger reductions were experienced in global emerging market equities with fees down -13% since 2013 and -6% since 2016. The median quoted fee for a $100 million mandate in this space is now around 74 basis points, with considerable scope for downward negotiation when selecting managers, the report said.

However, funds with consistent stronger relative returns "tend to experience less pressure on fees than their peers," the report found.

So, the news is good for superannuation members. However, Australia's 13.5 million super fund members still pay $2400 on average each year in fees, the equivalent of the average household energy bill, Rainmaker said. The report found gross superannuation fees in 2019 were a hefty $32 billion.

Downward pressure will remain on fees. The financial regulator APRA plans to publish analysis of the performance of MySuper products in the areas of investment performance, fees, sustainability and eventually insurance. It will use heatmaps to signal good and bad results.

According to APRA, "the heatmap will present the data in a way that can be broadly understood by those who don't have a degree in applied mathematics and statistics and won't require a major in spreadsheet analysis to interpret."

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25 Years CSL: What Can We Learn?

Dear time-poor reader: what can investors learn from 25 years of CSL on the ASX?

In this week's Weekly Insights:

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25 Years CSL: What Can We Learn?

By Rudi Filapek-Vandyck, Editor FNArena

This month marks the 25th anniversary of CSL ((CSL)) as a listed company on the ASX. In fitting fashion, shares in Australia's highest quality global success story surged to an all-time high of $253 in October.

Looking back, corrected for share splits, the initial opportunity to add some CSL shares to anyone's portfolio translates to circa 76.7c per share on the first day of public trading. In other words, regardless of what the immediate future holds, the investment return from owning CSL shares over the period has been nothing short of ginormous.

This realisation becomes even more so when one considers the share price graph over the period shows what looks like a steady, gradually rising uptrend unlike, say, Fortescue Metals which also reached a new all-time high in 2019.

That steady, almost un-natural looking performance has made CSL today's third largest component of Australia's leading share market index, the ASX200. Now also consider the fact that Commonwealth Bank shares peaked in May 2015, along with the other banks, and that BHP Group shares in 2014 were trading above $40, and one can only conclude CSL's performance has been even more impressive.

If it hadn't been for index heavyweights such as CSL, Macquarie Group, Transurban and Goodman Group it would have been near impossible for the ASX200 to reach for a new all-time high in 2019. Yet, the sad fact remains most investors don't own shares in CSL, though some may have owned shares at some point throughout those 25 years.

The usual explanations heard are "too expensive" and "cannot get my head around it". This goes both for the self-managing retail crowd as for professional fund managers. The logical observation to make here is that everybody who bought shares in the company, no matter when or at what price, is today sitting on a profit.

This story is not aiming to convert the masses. With the shares trading on FX adjusted, forward looking estimate of circa 37x FY20 earnings per share, it will nearly always be too "expensive" for typical value-seekers, while the implied 1.2% dividend yield is too low for the income hungry.

Maybe, without owning shares in the company, there are some valuable lessons to be learned from CSL for investors of all kinds and various levels of experience?

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For starters, it is easy to declare CSL Top of the Pops, King of all Kings, the Ultimate Performer in the share market when total return has once again exceeded 40%, or about double the index for calendar year 2019 thus far. In the perception of many an investor and/or market commentator, a positive view on a company goes hand in hand with the performance of its shares in the here and now.

While CSL management is highly regarded, as is the business itself, it is good to realise there are other forces at work in the share market that temporarily at least can hold back, or further stimulate share prices higher. In CSL's case, the easiest identifiable external factors at play are the Australian dollar (in particular against USD and Swiss Franc), the level and direction of global bond yields, and market sentiment generally towards the healthcare sector.

In 2019, all three major external factors have ultimately aligned to push CSL shares to a new all-time high. This is not necessarily always the case. When bond yields rise strongly in a short time-span, as they did in late 2016, the CSL share price temporarily faces a formidable headwind.

When the Aussie dollar strengthens against foreign currencies this too tends to create a headache, and similar underperformance follows when investors temporarily favour cheaper looking, beaten down cyclicals like they did when the GFC bear market ended in 2009-2010.

Another complicating matter is the fact that CSL is now the number three index component in Australia which makes the stock more susceptible to general market sentiment. Whereas in the past the shares were at times able to not necessarily follow general market sentiment down, such idiosyncratic behaviour is a lot more difficult when large sell orders aiming to replicate the index hit the local market.

Most importantly, however, is that 25 years from the past show that whatever external factor is holding back the stock at any given point, as long as the business continues to perform, its shares will ultimately perform too. As such, every period of weakness or stagnation in the share price ultimately proved a profitable entry point.

This takes us to the operational reliability that has become one of the trademark characteristics of CSL. How come most businesses cannot replicate the solidity and sustainability of CSL? Never a profit warning. Seldom an operational disappointment. This company, throughout various managers, has an almost alien-like track record in a share market that regularly shocks through corporate failures and mishaps.

The answer is two-fold. Firstly, CSL has managed to transform itself into the highest quality benchmark for the plasma industry globally. In concrete terms, it operates collection centres more efficiently than anyone else, which means it can open additional centres quicker and earn its investments back in a shorter time, while also enjoying a higher return on each centre, young and old.

In addition, in line with general industry practice, CSL invests circa 10% of annual revenues back into its business to expand through new centres and to constantly develop new products. It has a rich history for discovering and developing new therapies and medical solutions, which is necessary in the fast-moving and ever evolving biotech-medical world.

Also, CSL managers have built an admirable track record in acquiring new assets and turning them into future growth engines. The latest such acquisition was Novartis' flu vaccines business which was loss-making at the time of purchase in 2014. CSL has managed to integrate these assets into its own division much quicker than most thought possible, and those losses have now become profits, which are growing.

In line with CSL's high quality operational label, the flu vaccines business sits at the forefront of new innovations in this space.

And yet, what is equally important is that the global market for plasma is growing pretty much constantly. While it could be argued plasma is a commodity, like iron ore or wheat, its market dynamics are much more favourable because supply can hardly keep up with demand - a situation not expected to change anytime soon.

As a matter of fact, the current situation whereby the US provides most of the world's plasma supply, also because the country allows blood donors to be paid for their contribution, is simply not sustainable. Ultimately, other countries will have to change their laws and regulations so that more supply can come from non-US donors. China is an emerging new market on its own.

The sum-total of all of the above is that CSL should be able to continue its path of growth and further creation of shareholder value for as long as it retains its position as best in class inside the industry, and as long as nothing fundamental changes to the underlying dynamics for the global plasma market overall.

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So what important lessons can investors draw from 25 years of CSL on the ASX?

-It is much easier to create shareholder value when industry dynamics are supportive. This is why cyclical companies can have "quality", but they cannot have consistency and/or reliability.

-A good business is not the one that milks its current opportunity to the max. True quality shines through via the ability to add new avenues for growth. CSL today is not simply the ex-government organisation from the early nineties 25 years older. New geographies, new divisions, new products and new customers all make CSL a materially different proposition today. Investors can draw a comparison with the likes of Macquarie Group ((MQG)) or Aristocrat Leisure ((ALL)); large cap locally listed companies that have successfully added additional avenues for growth in recent times.

-A good company steadfastly invests in its business. This keeps it more resilient and in better shape when adversity hits. Or to put this in a better way: companies that do not invest in their business are essentially operating by the grace that nothing ever happens to their position or industry. This is arguably why many Australian companies are finding it so hard to grow these days. Research reports in response to corporate profit warnings (like Bank of Queensland last week) often mention the true reason as to why: structural under-investment over a long period.

-A high quality performer such as CSL will never trade at a cheap valuation a la Amaysim or Galaxy Resources, but this doesn't by definition prevent it from creating plenty of shareholder value. Good things befall good companies.

Investors would be wise if they distinguished rapidly growing micro cap fly-by-nights from long-term, structural growth companies that (deservedly) trade on premium market valuations. ResMed ((RMD)), REA Group ((REA)), and Seek ((SEK)), to name but a few, share equal characteristics.

-Identifying a good investment does not equal a low Price-Earnings (PE) ratio, or a high yield, and certainly not backward looking or in isolation. It's all about understanding what makes a company tick, and whether it can be sustained. This is the true Warren Buffett way, which is also why I believe Berkshire Hathaway would be a major shareholder in CSL if Warren Buffet had been born in Australia.

-Technical analysis, on my observation, tends to work a lot better for small cap, low quality, cyclical stocks. All those predictions the CSL share price was on its way to below $100... It just reached $253 instead. Enough said.

-Don't automatically assume there is no potential left once your initial investment doubled, or tripled, or quadrupled. Admittedly, CSL is among the exceptions and its example cannot be used as a guide for most of its peers on the ASX, which is why we all have to admire those shareholders today who stuck by the company even during times when momentum was favouring others. Probably the most heard regrets among long term CSL shareholders today are "I wish I never sold part of my shares" and "I wish I had bought more".

-The human mind is extremely good at fooling us. Over the years, I have heard so many investors telling stories about how they narrowly missed out when the share price fell towards $90, or they sold when the share price doubled from $39, or when it reached $150. Harry Hindsight will tell each of you you could've bought back in, or additional shares, the next day, the next week, at the next pull back or during a general share market correction. You would still have profited handsomely.

-Small cap stocks are not by default better investments than large cap stocks.

-It never is too late to sell out of a bad investment (irrespective what your instinct tells you) and it never is too late to jump on board an excellent investment. Too many investors focus on what could possibly go wrong in the short term, and subsequently miss out on the positives long term. CSL is probably the best example of this. One strategy to circumvent this imaginary barrier is by waiting for the next share price or general market correction. When exactly is the best moment to buy? Well, how long exactly is a piece of string?

-It's always difficult to predict the future, but assuming the above cocktail of internal and external forces remains in favour, in aggregate, the CSL story about continuing to build value for shareholders should still have much longer to run. Pick your moment. Be ready.

Early in 2019 I launched the CSL Challenge: https://www.fnarena.com/index.php/2019/01/14/rudis-view-join-the-csl-challenge/

WiseTech Global Is A Target Now

Foreign short sellers are increasingly targeting ASX-listed companies in their quest to uncover opportunities to profit from significant falls in share prices. The latest to come under attack is technology icon WiseTech Global ((WTC)).

At face value, WiseTech Global seems an easy target. The share price has performed beyond everyone's wildest expectations and many a critic on the sidelines has been exclaiming "bubble" and "irrational exuberance" for at least the past 18 months.

On top of this, founder/CEO Richard White is being accused of, on one hand, being the ultimate "control freak" and on the other hand of being "full of himself".

Last week J Capital captured the market's attention by, essentially, claiming the company is nothing but a carefully constructed accountancy obfuscation aimed at hoodwinking investors so they believe the company is a fast-growing disruptor to the global logistics industry, while it is not.

As expected, the company has forcefully rejected the accusations and called upon regulators to take action against this type of baseless foreign accusation. But J Capital is not hunkering down, with the company releasing a follow-up report on Monday.

Understandably, investors have taken a sell first approach, if only because where there is smoke... you never know.

Here is where things get interesting. In recent years all of Corporate Travel Management ((CTD)), Credit Corp ((CCP)), Rural Funds ((RFF)), Treasury Wine Estates ((TWE)), and now WiseTech Global have been under attack from hedge funds and shorters; market participants who benefit from a weakening share price.

And the results have been rather mixed. Treasury Wine Estates, for example, saw its share price failing to participate in the 2019 share market rally until June, when investors decided those stories about distributors in China having way too much unsold bottles of cheap plonk didn't appear to have much credence (anymore).

In similar vein, when Credit Corp found itself under attack the share price initially took a dive, but soon it was decided the short sellers report was nothing but a low quality criticism based upon faulty assumptions and incorrect interpretations. Today its share price is near an all-time high (as was Treasury Wine Estate stock until CEO Michael Clarke announced his early retirement on Monday).

For others, the accusations have left a permanent mark, at least thus far. Just look at the share price graphs for Corporate Travel and Rural Funds since.

So in which category belongs WiseTech?

One stockbroker who covers the stock with a positive bias, Evans and Partners, was rather quick last week in releasing two responses to the accusations made by J Capital, calling them "complete utter garbage" and "between inaccurate, and purposefully misleading".

So who's right? Only time will tell. But investors need to be aware that in the short term at least this share price is not going anywhere fast, if not potentially lower. Shorters are a nasty bunch, and fear is a powerful incentive. NextDC ((NXT)) CEO Craig Scroggie has a few stories to share how shorters had been feeding inaccurate insights to journalists in their attempt to force the share price down. If there was any impact, which is not beyond doubt, it would have been rather temporary.

This is not the first time J Capital is targeting an ASX-listed company. Back in late 2014 it issued a report accusing Fortescue Metals ((FMG)) of dishonesty in its communication with investors about the company's debt and cost of production. Fortescue management at that time pretty much responded in similar fashion as WiseTech Global has done.

In Fortescue's case, a subsequent recovery in the price of iron ore, which then remained higher for longer, made investors eventually forget about the accusations. Fortescue's share price has since soared to new all-time highs.

In WiseTech Global's case, this process has only just started.

The FNArena/Vested Equities All-Weather Model Portfolio has exposure to WiseTech Global, and has had it for quite a while. As communicated earlier, risk management guided us earlier to reduce exposure to a size that won't allow such unexpected events from destroying the performance achieved throughout the rest of the portfolio. This remains the case today.

Rudi Talks

Audio interview: are investors buying "cheap" looking stocks at exactly the wrong time?

https://www.youtube.com/watch?v=EQuGHASJ1M4

On Monday last week, I was interviewed by Peter Switzer about the Trade War and where equities might be heading. A separate video fragment has been uploaded to Youtube and can be accessed here:

https://www.youtube.com/watch?v=Z6WHOKXdIak&t=790s

Rudi On Tour In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday 21 October 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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