WEEK 44

STORIES TO READ FROM FNArena

Friday, 29 October 2021

Mineral Resources: Focus Shifts To Lithium

Evergrande's Risk To The Australian Economy

Rudi's View: Australia's Share Market Sweet Spot

CONTENTS

FNArena
Financial News, Data & Analysis

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

Your editor:
Rudi Filapek-Vandyck

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

FNArena
Financial News, Data & Analysis

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

Your editor:
Rudi Filapek-Vandyck

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

INTERNATIONAL

Tesla - The Best Is Yet To Come

Tesla's latest result puts the critics and permabears firmly on the back foot, reports Danielle Ecuyer.

-Tesla's Q3 performance triggers earnings forecast upgrades among Wall Street analysts
-Company now aiming to disrupt the insurance industry
-Demand for Tesla EVs has even surprised management
-Software and insurance expected to drive higher margin sales in years ahead

By Danielle Ecuyer

The Tesla price has run up from US$600 in early June and unlike previous quarterly earnings reports, last week's Q3 results were not the usual 'sell the fact moment' with the stock price reaching a record close of US$909.25 two days after the earnings report.

On any metric the earnings result was a stand up and be counted moment for Tesla and analysts applauded the results with an average 13% upgrade in earnings for 2021 and 10% for 2022, according to Gary Black, Managing Partner at The Future Fund.

In the most challenging of times with supply chain problems for all automotive manufacturers, Tesla glided through the cost input maze with a 57% increase in automotive revenues and a gross margin ex 'green' credits of 28.8%. The operating margin at 14.8% has now exceeded the medium-term goals of the company.

The Model 3 became the bestselling luxury sedan across the world and the Model Y is expected to be the bestselling car ever; remembering that the current best-sellers notch up one million annual unit sales per annum.

The great results were also achieved with a -6% decline in the average selling price (ASP), and without the higher margin premium Model S Plaid and the refresh Model X, which are just coming back on stream at the Freemont facility in California.

Tesla investors will be looking forward to the Model Y ramp up as the new Berlin and Austin giga-factories come on stream in 2022.

In the Q3 earnings call senior management reiterated that there remain "unknown unknowns" in the ramp-ups, so between ongoing supply chain and cost challenges, the margin improvements displayed this quarter may be tested in the next 4-5 quarters.

But investors need to look beyond the short term to see the big picture.

The Big Picture

Tesla is aiming for 20m vehicles by 2030 and their current annual production rate is bumping up at around 1m EVs prior to Austin and Berlin coming on stream. The aim is to compound volume growth at 50% p.a. putting 5m EVs in range by 2026.

The standout comment from the earnings call was the admission that even management were surprised by the level of demand for electric vehicles and specifically Tesla vehicles with lead times for deliveries running at 2-6 months depending on the geographic region.

Much continues to be made on the bear case for Tesla around valuation and the constant *cri-de-coeur* of 'the competition is coming'.

The fact is Tesla is keen for the incumbents to accelerate the transition to EV's and according to the world's largest producer of lithium, Albemarle, EV demand will grow from 3.4m units in 2020 to 35m in 2030.

Plain and simple the market for EVs is growing, but the winners will be the companies with the ability to access the capital needed to invest for the transition.

Adam Jonas from Morgan Stanley calls the EV transition an arms race on technology, batteries, and talent; and at this stage of the race, Tesla is winning on all fronts.

It is very challenging for the incumbents to even attract the best engineers when Tesla is viewed as the leading light of engineering across so many aspects of their business model.

This leads me to probably the most interesting part of the Q3 conference call, the rollout of Tesla's insurance product in Texas.

The Importance Of Insurance

In the constant drive to reduce costs for consumers, Tesla worked out that insurance was one of the biggest challenges to reducing the financing costs for their EVs.

So, what if they used the data to create a personalised bespoke insurance product for Tesla drivers?

Some 150,000 connected drivers who are using the safety score on the full self-driving (FSD) beta product have produced 100m miles of data. Although the insurance industry is heavily regulated, Tesla has been able to start selling Tesla insurance to Texas drivers.

The results thus far show that the probability of a collision using the safety score is -30% lower and that the data are supporting the personalised insurance product.

Vehicle insurance based on real driving data allows for a cost reduction for those safe drivers.

The cost to decarbonise was recently estimated at US$6trn per annum by Goldman Sachs while analyst Dan Ives, MD and analyst from Wedbush calls Tesla the winner from the "green tidal wave".

Tesla's aim is to create the most technologically advanced, vertically integrated energy and transport company based on software and machine learning or put simply, computers on wheels.

The comparison with what Apple has achieved is the most cited, a hardware company that has transitioned to a software hybrid model and in Tesla's case smart, autonomous vehicles and a smart insurance business.

There are many regulatory hurdles to contend with to create the goal of an autonomous robo-taxi fleet.

Wall Street Valuations & Price Targets

Valuing a company like Tesla remains contentious on Wall Street. In the bull pen there are now seven Wall Street analysts/banks that have price targets above US$1000, as follows, New Street Research - US$1298, Piper Sandler - US$1200, Wedbush – US$1100, Oppenheimer – US$1080, Canaccord US$1040, Bank of America US$1000, Deutsche Bank US$1000, followed by Mizuho US$950, Morgan Stanley at US$900, Credit Suisse US$830 and Wells Fargo at US$860.

Gene Munster from Loup Funds argues that in 3-5 years, EVs will represent 25%-plus of total sales with software services such as the FSD and insurance products driving higher margin sales. He even goes as far as to suggest an Apple-like gross margin of 40% is possible with a shift in the sales and earnings mix.

With revenue growth from US$70bn in 2022 to US$400bn in 2027, a 6x times revenue multiple results in a stock price of $2500.

There is no denying that a lot needs to go right for that outcome, but the bulls are firmly in a similar state of opinion.

By contrast the bears continue to value Tesla like a traditional automotive manufacturer with Barclays holding the permabear underweight valuation of US$300.

Tesla will most likely be the next US trillion dollar giant and whilst the story is far from risk free, Tesla has proven its credentials in terms of earnings growth and profitability. There is one thing certain about Tesla, this story is far from over folks!

Danielle Ecuyer has been involved in share investing in Australia and Internationally for over three decades. Due to the success of her first book *Shareplicity: A simple approach to share investing (Major Street Publishing $29.95) her second book Shareplicity 2 A guide to investing in US stock markets (Major Street Publishing $34.95) was published in July 2021*. Find out more at www.shareplicity.com.au

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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

INTERNATIONAL

An Idea With Currency: The American Quest For A New Crypto Accord

The listing of a bitcoin ETF, and bitcoin becoming legal tender in El Salvador, have marked milestone moments in an asset class US regulators are still unsure how to control.

-US government is moving towards greater regulation of the cryptocurrency sector
-Precisely what this new framework looks like remains far from clear
-A great challenge for the country surrounds 'getting all its ducks in a row' in regards to the competing perspectives and activities of various stakeholders across the US government

By Ed Kennedy

Tuesday 19 October 2021 saw the first bitcoin-linked exchange traded-fund (ETF) begin trading on the New York Stock Exchange. In what was a landmark moment for the crypto industry, it came eight years after the first filing of an application for a cryptocurrency ETF. As distinct from providing exposure to bitcoin directly, the ProShares ETF (NYSE: BITO) offers investors exposure to bitcoin futures contracts.

But while the commencement of BITO's trading is undoubtedly a milestone moment, the events that surround its journey from application to approval also provides a snapshot of the current - often contradictory - perspectives at play in the US, as national authorities in the world's largest economy seek to shift towards a more coherent and cohesive policy when it comes to cryptocurrency and blockchain activity.

The Turbulence Amidst El Salvador's Historic First

A clear-cut illustration of the difficult dynamics US officials are currently wrestling with can be found not in Washington DC, New York, or Silicon Valley - but instead in a Central American country with a population of under 7 million. A historic day for the crypto world occurred on 7 September 2021 when El Salvador became the first nation in the world to adopt bitcoin as legal tender. While it was indeed a historic day, it was not one without issues.

After midnight President Nayib Bukele critiqued the fact that Chivo - the official app Salvadorans can use when they wish to transact with crypto - was not made available by the likes of Apple and Huawei. Following this, the app had to be offline for a time as it was buckling under the strain of user registrations. Bitcoin's price also crashed from US$52,000 to a low beneath US$43,000 at a point in time during the day.

Undoubtedly there's another side to the coin in this Salvadoran pioneering. Although it was unquestionably a bumpy start for Chivo, it eventually saw a widespread uptake, ultimately making its way to the top of Apple's App Store finance category.

Salvadorans have since bought Big Macs at MacDonald's and coffees at Starbucks using it. President Bukele has said the use of the world's first crypto will save Salvadorans US$400 million a year on commissions for remittances. El Salvador now also has the advantage of 'first mover' status in making bitcoin transactions legal tender, when it comes to attracting crypto investors and businesses from abroad.

Yet while the long-term outcome of El Salvador's embrace of the BTC crypto is not yet known - and there are certainly an array of distinctions between the movements made by El Salvador's government and any the US government may make in time ahead - the turbulent start of El Salvador's first official day with the crypto saw a loss of confidence among traders on the market.

This then resulted in higher trading volumes, and - amidst the perception large stakes would be sold off - some leading crypto exchanges (Coinbase, Gemini, and Kraken among them) saw trading delays and outages. This is certainly not the sort of episode the US government would wish to see replicated as a result of their own movements.

<u>Pursuing New Laws of the Land</u>

BITO launches at a time where all three branches of the US government have been busy with activity surrounding crypto. At present the US has comparatively light regulation of the sector. Crypto exchanges operate in line with the Bank Secrecy Act (BSA), and with requirements that seek to combat money laundering and other surreptitious practices. But there are now substantial efforts seeking to increase the obligations of those who're active in the crypto sector.

<u>The Big Bill Before Congress</u>

Tucked into the $1trn Infrastructure Investment and Jobs Act that has been sent to Congress as a key part of the Biden administration's agenda was a number of new provisions surrounding cryptos, including new tax reporting requirements.

At time of writing the bill is presently making its way through the House after being passed in the Senate - and thus many variables remain in play between now and it coming in law - but the movements so far show a clear signal of intent from US lawmakers in their appetite for more control over crypto.

<u>The Potential White House Executive Order</u>

It's known across from the Capitol on Pennsylvania Avenue that the White House is currently considering an executive order concerning cryptos. It's understood this is being entertained with a particular emphasis on the desire to combat the dangers of ransomware, in addition to other criminal activity in the sector.

<u>The Case Before the Courts</u>

Last year the Securities Exchange Commission commenced a suit against Ripples Labs Inc. The Commission did so contending Ripple was in breach of the law for conducting a US$1.3 billion unregistered securities offering The case is currently ongoing, but there's the expectation its outcome could set a significant precedent which informs future activity surrounding the crypto sector.

<u>The Busy Bureaucracy</u>

Alongside the aforementioned US bodies, the Treasury's Financial Crimes Enforcement Network, the Commodity Futures Trading Commission, the Office of the Comptroller of the Currency, and the Office of the Foreign Assets Control have all been making moves around cryptos. And there are other US organisations currently at work in this space too.

<u>The Undercurrents to US Government Activity Around Cryptos</u>

A number of key themes inform this present flurry of activity across the US government. First, there is a basic recognition of the need to consider modernisation. While those with a conservative approach to reform of the law in this area may well take the view 'if it ain't broke, don't fix it', that cryptos pose the potential to deliver profound systemic change means any minimalist approach to law reform is likely to face substantial pressure tests.

Efforts to enhance consumer protection and diminish criminal activity across the sector also loom large. Policymakers see greater regulation as an avenue to increase investor confidence, while also offering a new route to drive down scam activity. In turn, the fact late October saw officials from the US and Europe engage in a major bust of suspected drug traffickers on the dark web - which resulted in the seizure of more than US$31 million in cryptos and cash - is sure to further enhance the appetite of authorities for new tools to investigate and address any crypto-involved criminal activity.

The current status and anticipated growth of stablecoins is also a source of anxiety among U.S. leadership. As digital tokens with their value pegged to the USD - or another currency or asset as applicable - stablecoins make it easy for traders to transact without needing to continually convert into dollars over and over. Right now they're essentially unregulated, and the concern held by US officials is that they pose a threat to the authority and operation of central banks as tech and eCommerce companies look to develop and utilise them as part of their ecosystems going forward.

In turn, while a stablecoin should in theory be backed by reserves - which accordingly should allow for a swap back trade of the crypto for the original asset at any time - the present lack of guarantees surrounding reserves means doubts are held regarding whether the theory differs from the practice. In turn numerous stablecoins have been heavily criticised for misleading statements surrounding their holdings, essentially claiming they held a one-to-one reserve of dollars for stablecoins when it wasn't the case.

Another key tussle in this arena surrounds definitions. Securities and Exchange Commission Chairman Gary Gensler has held most crypto assets fall under the definition of securities, and thus should be within his organisation's purview to regulate. Yet Brian Quintenz, a commissioner with the US Commodity Futures Trading Commission, has said cryptos are commodities, and thus fall under his agency's authority.

For Vanessa Savino, the Deputy General Counsel of tZERO - "a technology firm with the goal of democratizing access to private capital markets" - US authorities bringing clarity to definitions surrounding the crypto sector will offer real benefits to consumers and business alike.

"I think for this industry, and for consumers to understand the products they're buying, and for innovators to understand what regulatory landscape they fall under and need to comply with, we need clear guideposts. And clear guideposts are the first step in regulatory reform and moving forward", said Ms Savino.

"I think if innovators know first-hand the products they want to bring to market, and the regulatory regime they fall under, it'll help products be brought to market, and it'll be beneficial for consumers."

<u>The Strategic Competition Between Washington and Beijing</u>

The launch of BITO comes shortly after the Chinese government declared all crypto transactions in the country illegal. Although this declaration by Beijing in late September is the latest in a long line seeking to constrain the crypto sector, this recent move is the strongest yet, and notable for the clear-cut nature of its consequences.

While - typical for crypto enthusiasts in China and around the world - efforts to get around the ban have continued despite it, the reality is that the Chinese government's stance both past and present have delivered savage blows to the sector and its future prospects domestically.

Data from the Cambridge Centre for Alternative Finance released in mid-October showed the global hash rate (the computational power that is a requirement for the creation of bitcoins) fell from 44% to zero in China between May and July of this year. A colossal drop from September 2019 when it is held China's share was as high as 75%. While other nations have seen their share of the global hash rate rise due to the decline in activity in China, the real winner is the US, which now commands a 35% share as of August, and accordingly is now the world leader in the mining of bitcoin.

There are an abundance of areas where the strategic competition between the US and China is already substantial, and indeed growing. In turn, Beijing has doubtless calculated it can afford to - or simply needs to for its own domestic priorities - cede ground to the US here. And ultimately, the decentralised nature of the crypto sector means it should not simply be placed in the same basket along with other fields in which Washington and Beijing are engaged in competition, and where a more centralised control can be easily exerted by both accordingly.

Nonetheless, just as recent events appear to evidence the future will see clear and enduring differences in the approach to cryptos by the American and Chinese governments, Washington is doubtless mindful of the opportunity to capitalise on the decline of the crypto sector due to Beijing's actions on the domestic front.

In turn, even though the precise approach by the US government is still being formulated, a clear distinction has been drawn by the SEC between how the Chinese government has approached crypto, and how the US will in future. Chairman Gensler said in early October that the US will not be pursuing a ban on cryptos as the Chinese government had done, and this followed on from comments in late September by Federal Reserve Chairman Jerome Powell who said he had “no intention” of banning cryptocurrencies.

Looking Ahead

The US government forming a coherent and cohesive policy to cryptos will inject confidence into the industry, within the US and around the world. Beyond consideration of existing issues in the crypto space today, key US authorities have also had a rolling - and again, often contradictory - conversation among themselves regarding the development of a central bank digital currency (CBDC).

While a CBDC is not a crypto - with the centralised nature of the former versus the decentralised form of the latter serving as an clear-cut illustration of this - the potential development of one in future by the US government is a live issue, and thus one that informs the current calculus surrounding crypto regulation more widely.

The undercurrent to this all is the need for modernisation of payment systems, and - while some in the US government may take a dim view towards the crypto sector generally - there can be no doubting the way in which many contemporary crypto apps offer a very user-friendly platform to invest and transact with crypto is something all interested stakeholders in this arena can learn lessons from.

For Australians who are already keen on crypto - and those with an increasing interest in it - major and well-received reform in the US would draw new attention to offerings within its markets. Additionally, it would enhance optimism surrounding the capacity of Australian authorities to implement quality policy that could serve as the foundation for the next chapter of the crypto sector’s growth Down Under.

Writer’s Note: There has indeed also been momentous events occurring in the crypto space in Australia recently, with a full analysis to follow of recent developments surrounding the Australian Senate in a sequel piece.

AUSTRALIA

Recharged Orocobre Advances Developments

Orocobre is positioning for a tight lithium market, having accumulated a number of advanced projects since its merger with Galaxy Resources

-Focus for the near term is on spodumene production at Mount Cattlin
-Orocobre's contract pricing and spot pricing converging
-Lithium prices may moderate in the northern winter

By Eva Brocklehurst

A newly enlarged Orocobre ((ORE)) is positioned for a tight lithium market. The company has accumulated a number of advanced development projects such as the Naraha hydroxide plant in Japan, Olaroz stage 2 and Sal de Vida (both in Argentina), and James Bay in Canada.

The near term centres on spodumene production at Mount Cattlin (Western Australia) and **a new strategy, post the amalgamation with Galaxy Resources, is due early in 2022**.

Upside risks to forecasts stem from the spot pricing backdrop converging with contract pricing, which Credit Suisse asserts is occurring more rapidly than previously anticipated. Spot prices remain well above the broker's medium-term forecasts of around US$850/t and signal robust demand.

Nevertheless, Credit Suisse believes, in terms of the longer term fundamentals, there is a material gap between net asset value and the company's share price, and remains cautious about the potential for overheating in the lithium sector.

The company has also indicated lithium prices may moderate in the northern hemisphere winter, largely stemming from pressure on industrial production in Canada because of a nationwide energy crisis. A reserve upgrade update at James Bay is expected in the December quarter.

Incorporating updated realised pricing and volume guidance for Mount Cattlin means a 7% lift to Macquarie's FY22 earnings forecasts and 3% to FY23. The broker highlights the progression of key projects, with the Naraha hydroxide plant about to be commissioned.

<u>Olaroz</u>

In the September quarter Olaroz was weak, as production was below expectations amid a higher proportion of battery grade sales mix (a positive aspect yet leading to lower volumes) along with an increase in gas prices. Macquarie points out the higher costs stem from a combination of lower volumes, the impact of the pandemic, higher gas prices and labour costs.

There was also inflationary pressures and the devaluation of the Argentine peso to contend with. The Olaroz stage 2 plant is 60% complete and production should commence in the second half of 2022.

<u>Mount Cattlin</u>

Now Mount Cattlin is under its belt, Orocobre will leverage a strong spot market. Production guidance for 2021 has been revised up to 210-220,000t from 195-210,000t.

December quarter realised pricing guidance has been upgraded to US$12,000/t from US$9000/t, still well below spot, Citi observes. Credit Suisse forecasts lithium carbonate prices to increase to US$17,000/t in 2022 amid fast rising demand in places where LFP (lithium iron phosphate) batteries are gaining traction.

The strong performance at Mount Cattlin was offset by soft sales volumes, lower prices and higher costs at Olaroz in the September quarter. Moreover, as head grades return to mine averages production guidance at Mount Cattlin implies a step down from the September quarter.

The company may have upgraded Mount Cattlin production guidance but, as this is largely because of grade, which has been running significantly ahead of guidance, it implies a large drop in the December quarter, Morgan Stanley asserts, which should also be negative for costs. December quarter pricing and shipments are lower than expected, because of inflation and congestion.

The main priority, Citi observes, is the expediting of Olaroz and Sal de Vida. Sal de Vida is also being assessed for the possibility of merging stage 2 and 3. Ord Minnett believes there is potential in this tightening of Sal de Vida, as Galaxy Resources intended, to a 2-stage project.

The broker envisages value in the growth opportunity that will benefit from the strengthening demand for electrification and associated lithium battery requirements. Nevertheless, Ord Minnett is keen to see the plans for sequencing and operation of the combined operations under Orocobre with the main value drivers including expediting James Bay.

Credit Suisse concludes, **with such emphasis on development that requires significant investment there is little possibility of a dividend in the short term**.

FNArena's database has three Buy ratings and two Hold. The consensus target is $10.13, suggesting 13.4% upside to the last share price. Targets range from $8.60 (Credit Suisse) to $12.00 (Macquarie).

AUSTRALIA

Banks in Oz: Margins, Buybacks And Bond Yields

Low interest margins and higher costs have dogged the banks so will the upcoming reporting season throw up any positive surprises?

-Better outlook for the banks embedded in rising bond yields
-Yet beating expectations in the upcoming reporting season may be difficult
-Impairments expected to normalise in current half year

By Eva Brocklehurst

Updates from the banks in Australia have been soberly interpreted over recent months amid the potential for lower interest margins and higher costs. The market appears to be accepting lower margins both now and in the near future, as well as higher costs over FY21.

Margins and expenses are expected to be the focus in the upcoming reporting period, and Macquarie continues to envisage a risk for pre-provision earnings to be skewed to the downside. While offsets to margin headwinds are scarce, the broker observes the impact of lower interest rates is diminishing as bond yields have risen across the 3-7-year curve over the past month.

This should provide some support for bank margins by FY23. On the expenses side, Macquarie expects short term disappointment and a better performance longer term, finding limited appeal in the sector currently but recognising the benefits from rising bond yields.

Morgans suspects subdued markets income, stemming from low volatility in currency and interest rates could be somewhat offset by M&A activity such as loan syndications and debt capital markets.

The broker assesses the pressures from low interest rates are easing amid rising swap rates, which has resulted in recent re-pricing of fixed rate loans. This is broadly neutral to margins at this stage but there is scope for re-pricing of fixed-rate mortgages if swap rates continue to rise.

Low-cost customer deposit growth is expected to stay strong relative to credit growth and this should have a positive effect on margins.

On the housing front, Morgans notes system home loan growth has been running at around 7.2% per annum and, while the recent tightening of macro prudential requirements by APRA (Australian Prudential Regulatory Authority) may temper the acceleration of home loan growth, it is unlikely to be enough to take this below 7.0%.

JPMorgan forecasts flat to negative underlying revenue growth amid subdued markets income. Net interest margins should be solid for the majors in the September quarter, with the broker noting system loan growth has rebounded strongly and recent increases in swap rates suggest the outlook is a little better.

That said, JPMorgan expects underlying net interest margins will be down on average by around -2 basis points half on half, with **National Australia Bank** ((NAB)) projected to be outperforming the others. The broker factors in margin pressure from markets income and higher liquidity.

Yet a pick up in credit growth for the major banks is expected in this current half-year, as housing growth has been particularly strong in Australasia and non-housing credit has stabilised.

Citi notes the sector has performed strongly in relative terms yet in absolute terms it's expensive. Hence, beating expectations appears difficult at this point. The broker cites regional banks, which did not do well in recent results, and the fact the gains by **Commonwealth Bank** ((CBA)) in reaction to its results were largely attributable to a record buyback and subsequently were given back.

The positive parts of the outlook such as low bad debts and capital management are now incorporated into expectations, yet share prices appear to be running counter to the soft reporting season that is expected.

The implication is quite significant and **Citi suspects the banks have provided refuge from some of the earnings downgrades in other sectors such as resources**.

Capital management initiatives already outlined have generally been in line with JPMorgan's expectations, although National Australia Bank and **ANZ Banking Group** ((ANZ)) have opted for a more immediate timeframe than previously anticipated while the buyback from Commonwealth Bank was larger.

Impairments are expected to normalise in the current half-year for the banks, reflecting a low uptake of loan deferral programs and solid economic conditions. A further removal of restrictions as well as the opening up of state and international borders should help small-medium enterprises (SMEs) deflect any potential defaults.

<u>Westpac Bank</u>

Citi believes the best way to manage the short-term risk is to look through the volatility and focus on the medium-term and this is best achieved by **Westpac Banking Corp** ((WBC)), its sole Buy rating, which has the opportunity to extract costs in the medium term.

Westpac will report its results on November 1 and JPMorgan agrees the commentary regarding the outlook for costs will be closely monitored, given the work required to reach the bank's -$8bn FY24 cost reduction target.

Still, the broker expects headwinds to margins from front book re-pricing and the impact of mix from growth in fixed-rate lending will be most pronounced for Westpac. A $5bn off-market buyback is also anticipated, to ensure there are sufficient reserves to deal with the likely negative effects from the capital changes by APRA.

While Westpac has had a volatile period recently, momentum has been restored to the balance sheet, in Credit Suisse's view, and a number of hurdles in relation to the disposal of specialist business have been surmounted.

Morgans expects Westpac's net interest margins will contract -3 basis points in the second half partly because of the drag from treasury and markets. Excluding this, the main pressure on margins will be related to home loans and the differential between the front and back books as well as the impact of customers switching to fixed rates from variable rates.

The broker expects the bank will be a greater beneficiary of rising swap rates through its replicating portfolio and will also be able to take advantage of a jump in three-year and five-year swap rates. Morgans, too, continues to expect a $5bn off-market share buyback.

<u>ANZ Bank</u>

In the case of ANZ Bank, which reports on October 28, JPMorgan expects it may do better in terms of the revenue impact from market volatility, given a diversified business, both in terms of product and geography.

The broker expects a net interest margin of 1.62% and suggests costs could be an area where the bank attracts a lot of attention. ANZ Bank aspires to cut -$8bn in costs, which JPMorgan believes is more credible than Westpac's target.

The broker is concerned, nonetheless, about the length of time it will take to turn the Australian mortgage business around, noting ANZ Bank's Australian housing balances are down -1% since March 2021.

While ANZ Bank is likely to cite higher pay-down rates, one of the reasons for this contraction in its home lending book, Morgans agrees the turnaround times remain sub-standard and this will contribute to ongoing softness in new home loans.

Credit Suisse also highlights the mortgage balance sheet has gone backwards and so expects the focus will be on repair. The critical issue is the cost and time it will take and whether this impacts on cost aspirations.

As the front book has little momentum, one positive aspect could be that margins surprise to the upside. **Credit Suisse is also wary of being too negative about ANZ Bank, given the stock's sharp discount to the sector.**

National Australia Bank

Momentum in business lending is likely to be critical in order to maintain the recent performance of National Australia Bank's shares, Credit Suisse asserts. The bank's remediation project, "Apollo", overhangs the stock and could manifest in higher costs or more punitive outcomes.

National Australia Bank will report its results on November 9 and JPMorgan expects 3% revenue growth, a flat net interest margin and 4% non-interest income growth. The main item of interest should be the outlook for SME lending, given the recent lifting of restrictions and the potential opening up of international borders.

Morgans will be looking for above-system home loan growth from National Australia Bank as APRA data have shown its Australian home lending has grown by 3.2% from March to August 2021 which compares with system home loan growth of 3.0%.

Yet, the broker expects expenses will be at the top end of guidance, at growth of 2.0%, and there is upside risk to this forecast. A credit impairment benefit of $99m is anticipated for the second half and upside risk is also envisaged to this as Morgans believes the bank can reduce its collective provision coverage of credit risk-weighted assets.

Macquarie Group

Macquarie Group ((MQG)) is due to report its half-year results on October 29. Credit Suisse believes the bank is in a sweet spot as asset realisations have yielded significant gains. While it is too early for Macquarie Group to provide full year guidance, any indication of how equity under management is being deployed should support expectations for strong earnings growth.

See also, How Will Banks Fare If Housing Market Cools? on October 4, 2021.

Disclaimer: The writer has shares in Westpac.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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

AUSTRALIA

Origin Energy Frees Cash For The Future

Origin Energy has timed the sell down of its stake in APLNG with high energy prices, freeing up cash for future opportunities

-Timing is right for the APLNG equity sale, wrapping up a seven-year de-leveraging effort
-Origin Energy maintains FY22 guidance for more than $1bn in distributions from APLNG
-Acquisition of batteries at Liddell and Mortlake can now be considered

By Eva Brocklehurst

Origin Energy ((ORG)) is working off its debt, selling a -10% stake in APLNG for $2.12bn to EIG. With no urgency to de-gear, Ord Minnett is among other brokers that believe the transaction is opportunistic because of the attractive price paid.

Credit Suisse agrees the timing was right, amid high energy prices, and comes as the company wraps up a seven-year de-leveraging effort. Debt peaked at $13bn in FY15 and led to the sale of the stake in Contact Energy and Lattice.

As a result of this transaction, gearing will reduce to 19% from 30% in FY22 and net debt to $2.3bn from $4.3bn. As part of the deal, Origin Energy will guarantee EIG obligations to satisfy any future cash calls made by APLNG with a counter indemnity provided by EIG.

The transaction is likely to be 3% accretive to value, Ord Minnett calculates, and on the remaining 27.5% stake there is a further 9% uplift to valuation. The broker also estimates pro forma gearing will fall to 18%.

Credit Suisse says the transaction implies a value for the entire 37.5% stake of $7.95bn, ahead of its valuation, too. This is dependent on the oil price, yet the broker retains its valuation formula for the residual 27.5%.

Morgans estimates the implied value of APLNG is $28.2bn or $15/mmboe of 2P reserves, and obtaining that valuation requires a long-term oil price of more than US$75/bbl.

The broker still envisages a disconnect between commodity prices and the price of oil and gas stocks, suggesting there is value to be realised when the market regains confidence in the sector, and in Origin Energy in particular given the strengthened balance sheet.

The sale will provide more flexibility to the balance sheet and allow Origin Energy to reduce its oil hedging. Macquarie calculates about -$80m per annum has been lost through hedging on average over the past five years.

Distributions

Origin Energy has maintained FY22 guidance for more than $1bn in distributions from APLNG.

UBS recognises the sale removes some investor concerns regarding the constraints on the balance sheet even though the sale price was only an 11% improvement on its prior APLNG valuation. The company can now pursue growth or consider capital management.

The broker calculates Origin Energy should have ample capacity to pay distributions at the top end of its 30-50% range and assumes the board opts for a 40% payout-out of free cash flow while deploying capital to other investments, including batteries at key generation sites such as Eraring.

Origin Energy could spend more than $500m on a buyback and still be below the lower end of its 2-3x net debt/adjusted earnings (EBITDA) target.

On the other side of the coin, **the sale reduces earnings from APLNG from FY23**. FY23 interest savings of $50m do not offset the loss of the -$200m from the APLNG distribution yet Macquarie expects this will be improved by raising the pay-out ratio to the top end of the range.

Morgans increases the assumed cash flow paid by APLNG and scales this, given Origin Energy has a lower future share. The broker also notes the company stake in Octopus Energy has increased significantly in value.

Morgans points out the sale to EIG is interesting in that the company was reportedly backing Harbour Energy when it was courting Santos ((STO)) in 2018.

The broker does not believe the stake in APLNG indicates a takeover is being considered. APLNG is not publicly traded so there may be limited pressure to push Origin Energy's share price to the benchmark that the acquisition implies.

The acquisition of batteries at Liddell and Mortlake or funding expansion of Shoalhaven can all be considered, in Macquarie's view, and given the company's measure of net debt/earnings estimates, the company has $1.0-1.7bn in capacity.

FY23 electricity futures are consolidating above guidance, although coal remains the risk and confirmation on the coal-price trajectory is required before upside can be assumed, Credit Suisse asserts.

FNArena's database has four Buy ratings and two Hold. The consensus target is $5.64, signalling 5.8% upside to the last share price. The dividend yield on FY22 and FY23 forecasts is 4.0% and 4.8%, respectively.

See also, Soggy Outlook From Origin Energy on August 2, 2021.

AUSTRALIA

Mineral Resources: Focus Shifts To Lithium

Amid iron ore price volatility and a subdued outlook for China's steel production hopes are being pinned on the Mineral Resources lithium projects

-Mineral Resources' lithium business should increase its contribution substantially from FY23
-Variations in production and cost assumptions are the key risks for the iron ore outlook
-Steel outlook in China could weigh on the stock
-Wodgina re-start in September quarter 2022 highly anticipated

By Eva Brocklehurst

The main negative implications for Mineral Resources ((MIN)) from a mixed quarterly production outcome were the provisional pricing adjustments and discounts for low-grade iron ore.

Yet brokers welcomed the announcement that Wodgina will re-start earlier than previously expected as this should mean the lithium business increases its contributions to earnings substantially from FY23.

The outlook for the business is highly dependent on variations in production volumes, cost assumptions and realised pricing for iron ore and lithium. A spot price scenario generates earnings that are -24% and -1% below Macquarie's estimates for FY22 and FY23, respectively, because of elevated low-grade discounts for iron ore amid high shipping rates.

Mineral Resources achieved an iron ore price of US$78/t in the September quarter which was 48% of the benchmark, affected by price volatility and volumes being weighted to the end of the quarter.

Market sentiment has been weak because of falling iron ore prices and Citi now assumes a first half average price realisation of 65%. **The company has maintained iron ore production and shipments guidance for FY22 at 21-22mt, irrespective of delays**.

Macquarie points out, as iron ore prices stabilised in September, the realised price did recover to 76% of benchmark and, while cutting assumptions for the remainder of FY22, retains a longer-term estimate of 80%.

Mineral Resources has undertaken plant upgrades at both Iron Valley and Wonmunna, which resulted in iron ore production of 2.4mt that was ahead of Macquarie's expectations. Iron ore in the Yilgarn was in-line, although shipments were -9% lower than anticipated. Yilgarn suffered from significant rainfall in July that affected the access to the open pit.

Movements in iron ore prices represent the most material risk to the broker's near-term earnings forecasts while variations in production and cost assumptions for key project are also risks.

Morgan Stanley's main concern centres on the significant expenditure required for low-grade iron ore projects. The company is continuing to progress Ashburton and asserts the project economics are compelling through all economic cycles.

Yet the broker's estimates suggest an internal rate of return of just 14% amid the impact of the addition of low-grade fines, as well as reflecting the carbon footprint. Mineral Resources remains ready to roll on Ashburton, as soon as final approvals are obtained, and is also confident in the development of South West Creek in the near future.

Ord Minnett suggests the weak outlook for steel in China could weigh on the stock, although flags the current share price is not factoring in much value for the iron ore division.

Citi reduces forecasts for operating earnings (EBITDA) by -28% for FY22 and -8% for FY23 to reflect weaker iron ore realisations that are partly offset by better spodumene prices.

Lithium

Spodumene sales from Mount Marion of 71,000t in the quarter were substantially impacted by delays to shipments. Again, rainfall in July affected access to higher grade ore. Guidance is retained at 450-475,000t per annum.

The company did not provide guidance for realised prices for Mount Marion. Yet, Macquarie asserts, with Orocobre's ((ORE)) Mount Cattlin now forecast to deliver a realised spodumene price of US$1650/t, there is significant upside potential for earnings forecasts for Mount Marion.

Nevertheless, the broker incorporates lower realisations for the remainder of FY22 and the first half of FY23 which translates to reductions for FY22 of -37% and -10% for FY23. Meanwhile, Kemerton commercial production is now expected by mid-2022 compared with the end of 2021.

Wodgina

Importantly, the Wodgina lithium mine is scheduled to re-start in the third quarter of 2022, which is a year earlier than Ord Minnett modelled. Mineral Resources and Albemarle have announced the re-start from one of the three trains which have a combined capacity of 750,000tpa of spodumene concentrate.

The company has signaled its interest in expanding downstream capacity into China and Ord Minnett expects there will be an announcement shortly in this regard, although it is not included in the broker's valuation. Longer-term, Macquarie incorporates a staged expansion of Wodgina with downstream conversion capacity in China.

FNArena's database has two Buy ratings, one Hold (Ord Minnett) and one Sell (Morgan Stanley). The consensus target is $53.75, signalling 36.6% upside to the last share price. Targets range from $41 (Morgan Stanley) to $72 (Macquarie).

AUSTRALIA

a2 Milk Pumps Up Growth Expectations

a2 Milk has outlined a bold 5-year strategy and revenue target which require a meaningful recovery in its infant formula sales

-Performance of higher-margin English label product key to FY22
-Significant downgrade to longer-term margin outlook
-Material expenditure on marketing now required by a2 Milk

By Eva Brocklehurst

While there was no substantial change to FY22 expectations at the company's investor briefing, a2 Milk ((A2M)) has set out a medium-term strategy that includes a $2bn five-year revenue target, while the margin outlook is now below most expectations.

Macquarie points out the revenue target assumes China label share doubles to 5% and half of the decline to date in English label revenue is recouped. It also anticipates growth in other dairy and nutritional products in China and further growth in Australasia and the US.

Still, Morgans believes the business is "through the worst of it" albeit earnings and regulatory uncertainty continues. All channels are running below the broker's expectations with the exception of the higher-margin English label product.

Pricing for English label has increased and further improvement is expected, and the performance of this higher-margin product will be a key determinant of the current year's performance.

What has not changed, Morgans asserts, is a strong brand that has significant opportunity to grow in China, although achieving targets will require significant investment.

In terms of English label sales, Credit Suisse believes there is a reasonable case for a recovery, given cross-border channels and daigou were shut down because of the pandemic.

The broker had been concerned that English label had lost its market position to domestic brands at similar prices, yet the company has assured investors that English label will soon benefit from a brand upgrade and innovations.

UBS observes a base is in place for a significant lift in store-based market share over the next five years amid brand strength, expansion of stores and higher marketing expenditure.

The broker also ascertains a meaningful recovery can occur in both daigou and CBEC infant formula sales over the next three years as well as market share gains in China label through the store roll-out.

In China, Macquarie notes the infant formula market has undergone premiumisation and intense competition and agrees this will place pressure on players to ramp up promotional activity.

Meanwhile, product innovation has been relatively limited and the company is still testing the brand's ability to move into new categories. Yet the broker observes company's "health" credentials in China are strong.

Despite the challenges of China's falling birth rate, a2 Milk has lifted its market share. UBS points out a2 Milk was the only major international brand for infant formula to gain market share in the mother and baby store channel during FY21.

Macquarie also acknowledges there are opportunities for a2 Milk to acquire capacity in China such as blending and canning and launch additional products while lowering its cost base. Online sales are also becoming a larger channel for first purchases and this continues to be a significant evolution in behaviour, the broker adds.

<u>Value?</u>

Credit Suisse upgrades to Neutral, noting the company is investing to recover lost English label sales and has gaps in its market share for China label that can be closed. The main catalysts for upgrades include proof that further market share can be obtained.

Jarden, not one of the seven stockbrokers monitored daily on the FNArena database, also upgrades to Neutral from Underweight with a target of NZ$6.60, on the back of evidence the business has retained its position in its key end market, China. The broker now envisages increased valuation support should offset the transition risk that exists in returning to growth.

UBS believes investors are being cautious and only a limited recovery is being priced into the stock. The broker continues to expect earnings will be back at pre-pandemic levels by FY25, which is about 20% ahead of market consensus and reflecting a stronger recovery in high-margin English label sales.

<u>US</u>

Macquarie points to the loss of a club channel customer in the US, which has meant first quarter volumes were down, and notes the distribution cost pressures in this market. As a result the path to profitability the US is being deferred again with a target now of FY25-26.

Based on expected revenue growth of $100m and an EBITDA margin of more than 10% the broker does not believe the US "prize" is material. Yet Jarden points out management is committed to the US growth option, although profitability does require further scale and optimised costs. Furthermore, brand awareness and household penetration metrics are improving.

<u>Margins</u>

As the company has set its target margins in the "teens" based on anticipated conditions and possibly the "low-to-mid twenties" longer term, Macquarie is hopeful this is the final material downgrade.

Nevertheless, the broker believes there is significant risk and uncertainty around a resumption of growth. The margin outlook is materially below consensus which had margin estimates of around 25% for the medium to longer term and a pre-pandemic outlook for 30% in operating earnings (EBITDA) margins.

Another dampener is the outlook for the Mataura Valley Milk business, with profitability now expected in FY26 rather than FY25 as previously disclosed.

Credit Suisse is now modelling $420m in EBITDA for FY26, on less ambitious sales, more ambitious margins and a 3.8% volume share in China, assuming a recovery in English label sales.

Morgans believes over the medium to longer term margins in the low to mid-20% region are possible if English label sales recover well. The company's margin peaked at 32.3% in FY19 yet the business has now changed amid a declining birth rate in China and increased competition.

The company needs now to increase marketing expenditure having previously relied on daigou and the underspend by competitors, the broker asserts. In addition, there are the losses of Mataura Valley Milk to contend with and the broker considers the valuation "full", downgrading to Hold from Add.

<u>FY22</u>

On a qualitative basis the company indicated English label sales will be weaker in the first half comparatively, albeit running ahead of expectations. On the positive side, UBS points to a material improvement in retail pricing and reseller margins. China label sales in the first quarter were down while distributor offtake and retail sales were up in double digits.

Australasian fresh milk sales were lower than Morgans expected in the quarter, largely stemming from adverse FX rates. The broker notes the company's trading update was noticeably weaker than peers.

US milk sales were lower mid distribution cost pressure and Mataura Valley Milk nutritional demand was weaker too, following a decline in third party volumes. As a result first half net profit is likely to be materially lower while the second half should be higher on a comparable basis, Morgans suggests.

The database has two Buy ratings, two Hold and one Sell (Macquarie). The consensus target is $6.94, signalling 15.1% upside to the last share price, and compares with $6.09 ahead of the update. Targets range from $5.20 (Macquarie) to $10.20 (UBS).

Find out why FNArena subscribers like the service so much: "[Your Feedback (Thank You)]" - Warning this story contains unashamedly positive feedback on the service provided.

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

AUSTRALIA

Humm Group Brimming With Confidence

Card and BNPL transactions are expected to surge as travel resumes and borders re-open thus Humm Group expects a more than doubling of volumes over the medium term

-BNPL expected to be the main driver of growth for Humm Group
-Margin pressure could be aggravated by the need to secure a base in highly competitive markets
-Exploring potential divestment of NZ commercial business

By Eva Brocklehurst

Humm Group ((HUM)) is increasingly confident that transaction volumes will improve as international and local borders reopen. Travel contributed $350m of the company's Australian card transactions annually before the pandemic hit.

Medium-term targets were disclosed in the first quarter update with Humm anticipating cash net profit of over $100m, a more than doubling of volumes and a reduction in the cost-to-income ratio to less than 40%. BNPL is expected to be the largest driver of growth supported by rebound in cards and expansion of commercial.

Macquarie believes these targets are just aspirations at this stage and the company will need to execute successfully, through both increased earnings and a higher multiple, in order to obtain material upside to the current share price.

The main disparities with the broker's forecasts appears to be in product yields, with **management expecting increased interchange and customer fees will drive yield expansion in BNPL**.

Yet Macquarie believes, given the competitive dynamics, this is an optimistic assumption or, alternatively, will be at the expense of growth. The broker assesses the risks stem from yield compression, a deterioration in credit quality and lack of success offshore.

The company has reiterated its focus on a blended BNPL revenue model amid a combination of consumer, merchant, affiliate and interchange fees. Australian revenues are currently split 70:30 between merchant:customer fees and Humm expects the international business will be closer to 60:40 initially and eventually move to 50:50.

UBS believes the main debate for investors is understanding the level of cost investment required in BNPL, particularly in the UK and Canada. Net profit targets were broadly in line with estimates for FY25 and the broker believes a commitment to targets should provide more comfort around the earnings visibility.

Credit Suisse expects lower BNPL volumes in FY22 and higher net losses for the short term, yet raises estimates for FY23-24 by 2-4% to reflect stronger momentum in the commercial and leasing business, and confidence in a recovery for cards.

The stock has value appeal but the broker believes margin pressure in BNPL could be aggravated by the need to secure a base in new highly competitive markets. There is also growing execution risk around international expansion.

Australian card volumes are depressed given ongoing travel restrictions yet, as many states announce their intentions to open borders, Credit Suisse is now more confident about a recovery in volumes throughout 2022. NZ card volumes were flat in the first quarter as business was affected by the recent restrictions.

UK/Canada

The building of new technology in the UK and Canada BNPL businesses is almost complete, with Credit Suisse noting the original Certegy system in Australia will be replaced soon and cost efficiency will, therefore, increase. Management has also flagged partnerships in BNPL and a mix of licensing and loyalty program opportunities.

Credit Suisse is cautious about BNPL net losses in the short term because of the rising contribution from short duration products that are likely to face higher net losses as there is minimal customer history available to assess credit worthiness.

Rising volumes from new markets in the UK and Canada present a challenge in making credit decisions around new customers and demographics. The broker asserts this is likely to lead to higher net losses in the initial stages of these markets.

Commercial

The commercial & leasing business is expected to double FY21 gross income and reach $1bn in volumes over the medium term with revenue margins of 9%. Commercial & leasing saw a second consecutive quarter of record volumes of $205m.

Sustained momentum signals success following a shift to broker originators in SME lending from vendor financing, Credit Suisse observes, as the business carves out its position in a market that is less dominated by the major banks. The broker highlights the commercial business has been driving volume growth in recent years, although New Zealand has experienced a decline.

Hence, the company is exploring a potential divestment of this business having ascertained increased interest from various parties. The division contributed $10.9m in normalised cash net profit in FY21. The commercial NZ business has a high exposure to the education and government sectors with a portfolio of mostly laptops, telecommunications and office equipment.

Macquarie finds it hard to estimate an appropriate multiple for the NZ business, with no historical growth information. Moreover, management was not willing to disclose any information about the potential use of the proceeds, given the balance sheet is robust and there is no corporate debt.

Humm Group is confident it can fund growth and not require a future equity raising. Moreover, the historical pay-out ratio of 30-40% will return from the first half. This implies, on UBS calculations, an FY22 dividend yield of 4%.

FNArena's database has two Buy ratings and one Hold (Macquarie). The consensus target is $1.22, signalling 35.2% upside to the last share price. The dividend yield on FY22 and FY23 forecasts is 4.3% and 5.9%, respectively.

COMMODITIES

Material Matters: Oil, Lithium, Magnesium, Coal

A glance through the latest expert views and predictions about commodities: oil & gas, lithium, nickel, magnesium, steel, and coal

-Current tight market suggests support for oil and gas stocks
-Lithium sector a hive of activity as UN climate change conference looms
-Tightness in the nickel market likely to persist
-Acute shortage of magnesium to have significant implications
-Jarden anticipates heightened demand for US steel as China curbs production
-China's coal market expected to become more balanced

By Eva Brocklehurst

Energy

Morningstar suspects the market is underestimating the demand for **oil** over the medium term. Tight supply and high prices should underpin oil because of an underperformance of the OPEC alliance compared with stated targets, combined with a recovery in demand as economies normalise.

A mid-cycle oil price forecast of US$55/bbl for West Texas Intermediate and US$60/bbl for Brent is maintained. Over time, the analysts believe the upward pressure on oil prices will ease.

This will occur as sanctions on Iranin exports are modified or lifted, while OPEC should be able to build production levels up over time. US producers also plan to grow at low single-digit rates, which will be enough to bring new supply onto the market and keep it balanced after 2022.

Meanwhile, **natural gas** prices in Europe are extremely high, which is the result of a combination of factors. Inventory in Europe had been replenished over the summer, although production remains affected by the pandemic.

Electricity producers are trying to purchase natural gas in order to make up a power deficit before winter arrives and, on the supply side, there is not a lot of excess natural gas available. Europe has to compete with Asian buyers such as China, which is making its first steps to rely less on **coal** for electricity generation and more on natural gas.

The analysts believe the transition in the electricity market to renewables is likely to lead to greater variability in power generation and, as intermittency remains an issue for renewables, generators are resorting to natural gas.

In summary, while there is a lot of negative sentiment around investing in oil companies, many oil stocks have surged and, based on long-term forecast for prices and demand, the analysts believe these are undervalued.

Lithium

Activity is heating up in the **lithium** sector and Bell Potter runs the ruler over the major transactions that have occurred since the start of 2021. The broker expects heightened news flow for the sector, given the UN climate change conference will be held shortly.

Specifically, in just over the last two months, there have been purchases of stakes such as the Lilac Solutions earn-in to 25% of the Kachi lithium brine project, owned by **Lake Resources** ((LKE)), **Sayona Mining**'s ((SYA)) acquisition of 60% of Moblan lithium project and the Zijin Mining takeover of Neo Lithium.

Pilbara Minerals ((PLS)) and POSCO have firmed the joint venture to develop a 43,000tpa lithium hydroxide plant in South Korea while **Mineral Resources** ((MIN)) and Albemarle will re-start the Wodgina lithium mine by the September quarter of 2022.

In other news, Suzhou CATH Energy has an agreement with **AVZ Minerals** ((AVZ)) to earn a 24% equity interest in the Manono lithium and **tin** project. And **Ioneer** ((INR)) has a 50-50 joint venture with Sibanye-Stillwater to progress the Rhyolite Ridge project.

Nickel

Morgan Stanley envisages persistent tightness in the **nickel** market. China may be curbing its **stainless steel** production yet supply disruptions and strong demand for electric vehicle **batteries** are overriding factors in determining the outlook for nickel.

The broker observes the current draw on nickel exchange inventory, at an average rate of 1000t/day since early September, has tightened the market and pushed the price to test a 10-year high of $21,000/t (last US$19985).

There has been a net reduction of -225,000t in nickel demand on an annualised basis from China, or 9% of global primary refined supply, the broker observes. Yet, these energy-driven cuts to stainless production are likely to be more temporary than the environmentally-related restrictions on **carbon steel**.

A healthy rebound in China's stainless output is also likely as power shortages ease after the winter. On the supply side, refined nickel supply is expected to improve once the rainy season in the Philippines has passed. Norilsk has also indicated its output was up 55% in the September quarter.

Morgan Stanley does not expect the nickel price will follow the lead of **iron ore** given a much tighter market. The broker also disregards the potential bearish view of Tesla's confirmation it will switch to nickel-free LFP battery chemistry in its standard-range models.

Magnesium

An acute shortage of **magnesiu**m has challenged several industries and Morgan Stanley suspects, without much of a buffer in the system, China's output restrictions are likely to weigh.

A shortage of magnesium could have widespread impact on the automotive, aerospace, beverage can and consumer goods sectors. China's smelters are facing strict controls and while there was some recovery in October, utilisation is capped at 40%. China makes up 87% of the world supply of magnesium.

Europe is considered the most challenged in obtaining magnesium as it has no supply of its own and relies on China. While the US has supply there are some risks to components coming from Canada and Mexico. Morgan Stanley also points out magnesium begins to oxidise after 3-6 months which means it is hard to store for a long period.

What will occur, in the broker's view, is that **aluminium** producers, being unable to secure enough magnesium to produce their major aluminium alloys, will instead switch to primary metal for delivery into LME warehouses.

The broker suggests the current shortage of magnesium is likely to mean end-users look for alternatives, and for in areas for which there are no alternatives it may not be possible for production, such as steering wheels, to recover completely.

Steel

Jarden considers the US steel market will experience growth in demand in 2022, albeit at a slower rate compared with 2021. The broker forecasts demand growth of 2.7% with potential upside stemming from infrastructure investment.

The swing factor could be automotive production, affected by semiconductor supply shortages, and China's curbs to steel production could mean steel prices are supported globally.

Jarden notes the global steel production utilisation rate has risen steadily to over 80%, which is high by historical standards. While the market is pricing in a mean reversion in the US steel price in 2022/23 the broker believes there is a risk for subsequent years as US steel production capacity expands.

Yet, as China restricts steel exports and cuts production capacity this should reduce the risk of the market being hit by oversupply. As a result, decarbonisation should mean rising demand for **scrap** metal and support ferrous scrap pricing.

Jarden has initiated coverage on **Sims** ((SGM)) with a Buy rating and **BlueScope Steel** ((BSL)) with an Overweight rating. The former has 6% of global market share of seaborne scrap that should benefit from rising scrap demand while expansion into e-cycling and repurposed data centre equipment should diversify earnings sources.

The broker forecasts BlueScope's North Star (US) FY23 pricing will be 58% above the average pricing since 2019, at around US$1173/t.

Coal

JPMorgan suspects, after an extremely volatile year for China's coal consumption, the worst of the shortage is probably behind the country, amid a change to the government's attitude towards domestic production.

New production should reach the market in November and growth in coal production will accelerate. Coal price momentum should therefore subside and lead to a de-rating of coal equities. Extreme coal volatility in China over 2021 was caused by both weather and government policy. **Hydro** production was extremely weak and increased the requirement to boost **thermal coal** power.

Tight import controls and mining restrictions also led to limited supply growth. A coal shortage has persisted over the past month which the broker suggests is because incremental supply could not cover the lack of Australian coal imports.

JPMorgan expects demand will moderate and lead to a normalisation of coal inventory. Supply tightness in the winter peak season is not expected to be as severe as summer given new domestic supply should enter the market.

FEATURE STORIES

Evergrande's Risk To The Australian Economy

The risk of China's largest property developer going into liquidation remains real, but even if Evergrande doesn't, there are clear risks ahead for the Australian economy.

-Evergrande's debt systemically significant
-Beijing orchestrating a property market slowdown
-Financial risk considered contained
-Risk to commodity demand is substantial

By Greg Peel

The collapse of Evergrande would not, analysts agree, spark a "Lehman moment", referring to the collapse of one of America's largest investment banks in 2008, which shifted the global "credit crunch" to that point into a Global Financial Crisis.

On the day it appeared Evergrande might well collapse, the Dow fell over -600 points and global markets followed suit. But analyst confidence that another GFC was not upon us swiftly relieved markets, at least until the Fed started to send more hawkish signals, exacerbating the September sell-down already in train.

Subsequently, Evergrande faded from the minds of investors, with news out of China not always overly forthcoming. However, the issue of Evergrande's future, if it has one, has by no means yet been resolved. To that end, while analysts may not foresee another GFC, they still believe the risk is substantial for the world's second largest economy, and that those risks flow on to the global economy.

And in particular, the Australian economy.

How did we get here?

Evergrande is a very significant Chinese property developer, notes Auscap Asset Management, with some 1.5 million dwellings under development, spread across 778 projects in 223 cities, in a country that produces approximately 15 million new dwellings a year. Property development is an enormous driver of economic growth within China.

Evergrande employs 200,000 people directly and reportedly creates 3.8 million jobs per annum indirectly in its construction and other businesses. The problem is that it has approximately US$300bn of liabilities, US$170bn of which is due within twelve months, and has only one tenth of that amount in cash on hand.

To put that into context, US$300bn was approximately the net debt of the Australian federal government prior to the pandemic, and is equivalent to 2% of China's GDP. These obligations are so large that many consider the business to be systemically important, and it is at risk of defaulting on its obligations. Evergrande has missed bond payments, is late in paying employees and has not paid due invoices from suppliers and other creditors.

One of those bond payments, an amount of US$83m, was due to be paid on October 23 and at the last minute, Evergrande made good. But the company is by no means out of the woods.

Ironically, one might suggest, Evergrande's problems have their roots in the GFC.

China's response to the GFC was one of massive fiscal stimulus, supporting the country's rapid urbanisation, and driving strong economic growth. This resulted in a property boom as demand for housing in the cities ran wild. Like with all booms, a stumble followed, in this case in 2014-15, leading to a sharp pullback. Beijing's response was to ease property policies, and to support the market by investing in "shanty town" renovation.

The growth in China's property market was a major element of strong economic growth, and substantial growth in debt. But economies cannot grow at such a rapid pace forever. Eventually they mature.

Housing demand in China, notes JPMorgan, is sourced from new family formation (marriages), urbanisation, public housing (renovated shanty towns) and investor demand. By 2017, China was experiencing lower birth rates, a decline in new marriages, the end of shanty town investment subsides from the government, a slowing in the pace of urbanisation, and a crackdown on speculative property development. This is when housing demand peaked.

JPMorgan estimates that demand fell from 20.2 million units in 2017 to 16.4 million in 2020, and will fall to 12.7 million by 2030. Note that immigration is another driver of housing demand, and that came to a halt in the pandemic, which in China is not over yet.

Beijing's response to the 2014-15 pullback was to support property development. By 2017, President Xi had changed his mind. "Housing is for living," he said, "not for speculation". This represented a fundamental shift in housing policy, JPMorgan notes.

Xi perceived a rapid increase in housing activity as undesirable because it can crowd out investment in desirable areas for the new Chinese economy, such as manufacturing upgrades, "green" sectors, small and medium enterprises and rural development. Rapid property development also increases financial vulnerabilities, given the high indebtedness of developers and the risk of a house price correction, and increases social dissatisfaction among the haves and have-nots.

The importance of a more equal distribution of wealth, as one might expect from a communist government, has come strikingly to the fore in 2021, as Beijing has been prepared to suffer a sharp share market pullback with clampdowns on carbon emissions, tech companies, education companies and, most importantly, property developers.

Concerned about the level of ever-growing property developer indebtedness, Beijing last year introduced a "three red lines" policy, creating three measures to be used to assess the rate of allowable growth in developer debt. The lines are (1) a liability to asset ratio of less than 70%, (2) a net gearing ratio of less than 100%, and (3), a cash to short term debt ratio of more than 100%.

If developers fail to meet one, two or all three measures, the regulator can cap their debt growth at 10%, 5% and 0% respectively. If all measures are achieved, growth is capped at 15%. Beijing has given developers until mid-2023 to comply.

Evergrande failed all three tests in August 2020.

<u>The Spiral</u>

Evergrande responded to this failure by immediately implementing a clearance sale, offering -30% off all properties. Despite this, China's property sector performed strongly in the first half of 2021, with value of sales increasing year on year across all months, UBS notes. But data in July and August were weak.

In June, regulators reportedly instructed major lenders to conduct fresh stress tests on their Evergrande exposures, Auscap notes. Later that month, several large banks started restricting credit to the developer. In July, both Standard Chartered and HSBC began declining loans to buyers of Evergrande properties. In August, the chairman of Evergrande's onshore real estate business resigned.

Two days later, the regulator summoned Evergrande executives and told them to reduce debt levels. By end-August, Evergrande's debt had hit US$300bn. Claiming lack of payments from the developer, many suppliers stopped deliveries. In September, Evergrande announced its sales in August had fallen -26%.

In September, Evergrande missed two interest payments to bondholders, bringing the company into the global spotlight and setting off stock market plunges. Earlier this month it missed a third.

But while Evergrande was an early driver of September stock market weakness, concerns over inflation and monetary policy pushed Evergrande aside, and now markets have recovered. The S&P500 has since regained its all-time high. Markets believe Evergrande will not spark a new GFC, and assume it is a problem Beijing will solve one way or the other, with little impact outside China.

But such an impact may not necessarily be contained.

Evergrande has made good on one September bond payment, after a one-month period of grace, but another is due on October 29.

<u>Contagion?</u>

According to UBS, in 2019 the largest 50 developers in China accounted for 60% of development activity. Of the country's 66 major developers, almost half passed the "three red lines" test in August 2020, up from just 14 six months earlier. Only four failed all three tests, Evergrande being one.

Evergrande and one other were the only two developers not to show any improvement between June and December 2020.

UBS estimates China's property sector could represent, directly and indirectly, 25% of China's GDP growth. Land sales account for around one third of local government budget revenue, which funds 15-20% of total funding of infrastructure investment.

Housing market value is the biggest contributor to Chinese household wealth at more than half, and as is the case in any country, perceived wealth through property ownership has a major impact on consumer spending. Property debt at the household level has picked up, notes UBS, but remains manageable given the high level of down-payment required for purchases.

UBS estimates China's banks have a total exposure to the property sector of 28-32% of total bank loans. The analysts see this, too, as largely manageable in the case of an Evergrande spillover.

JPMorgan puts that figure at 40%, but only 6% of that is loans to property developers. Mortgage loans, construction loans and loans collateralised by land account for 20-25%. On that basis, JPMorgan suggests that given small bank exposure to developers, even severe credit quality deterioration for property developers is unlikely to trigger systemic stress in the banking sector.

Mortgage loans represent a big chunk of Australian bank lending, but compared to Australia, China has stricter macro-prudential controls and more conservative loan-to-value ratio requirements. JPMorgan notes that over 1997-2004, Hong Kong house prices collapsed by -70%, but mortgage delinquencies peaked at only 1.43% of loans.

<u>What will Beijing do?</u>

It is widely assumed the Chinese government will not sit idly by and watch Evergrande go under, setting off a property market crash. It is also assumed Beijing did not walk blindly into implementing the "three red lines" policy without knowing full well what the ramifications could be.

There is a question as to whether the government will act now, and control the restructure of the company, or whether it will allow Evergrande to fail before stepping in to pick up the pieces thereafter.

While a restructure was the popular assumption back in September when Evergrande missed bond interest payments, subsequent attempts by the company to offload assets to other Chinese developers to raise cash have failed. At least two potential buyers have assessed the situation so far and both have withdrawn, likely deciding they'd rather pick up assets at little cost in a liquidation.

Simon Hunt Strategic Services, writing in late September, believed it was likely Beijing would allow Evergrande to fail. But the government would then step in, the analysts suggest, to support households which have part or wholly paid for apartments off the plan, and provide credit to supply chain companies out of pocket.

The assumption thus is that equity and bond holders would be left to take the hit. But there have since been some developments.

There was news out of China on October 20 that Evergrande had made some sort of payment, amount unclear, to domestic bondholders. On September 23, the company missed interest payments due on two bond issuances – one domestic (renminbi) and one foreign (US dollars). Under the rules, Evergrande had one month to make those payments or default would follow.

The company avoided default on October 22 by making good on the US dollar bond payment, but that's just one obligation. A default on any payment means secured creditors can place Evergrande into liquidation.

However, on October 20, the Chinese central bank said it will "fully respect and protect the legal rights of Evergrande Group's creditors and asset owners in line with repayment priorities laid out by the law". The spokesman also said "regulators should do their best to avoid risks from cash-strapped Evergrande spilling over into other property developers and the broader financial sector".

Several of Evergrande's property developer rivals have in recent weeks already defaulted on debts and have seen their credit ratings downgraded. Evergrande said it would continue to implement measures to ease its liquidity issues, cautioning that "there is no guarantee that the group will be able to meet its financial obligations," while applying for a resumption of trading after it was halted on the Hong Kong stock exchange.

<u>The Fallout?</u>

Evergrande resumed trading on the Hong Kong exchange on October 21 and closed down -10%, to a level equivalent with that of late September of around HK$2.67, where it has hovered since. The shares traded at HK$30.00 in 2017.

The signs are that Beijing will do its best to contain the situation, while allowing the heat to come out of the property market in a controlled manner.

UBS analysts' baseline forecast assumed Chinese property sales declining by -8% year on year and new starts falling by -8-10% in the second half 2021, with real estate fixed asset investment falling by -2-3%.

In a worst-case scenario, in which Evergrande's outcome leads to major spillover effects, UBS sees new property starts falling by as much as -20% or more in the next few months and real estate fixed asset investment falling by -10%, potentially dragging down China's GDP growth by -1-2 percentage points.

However, UBS is not alone in assuming the macro impact of a worst-case scenario would not be as significant as that experienced in 2014-15 (remember images of China's "ghost cities"?) given inventories remain low and excess capacity in upstream construction materials sectors has declined.

If things really get bad, it is assumed Beijing would step in with further fiscal and monetary support, and perhaps extend the deadline on property developers satisfying the "three red lines".

However, Auscap believes the Evergrande fallout could lead to a "very significant impact" on GDP.

Chinese property developers fund themselves through also offering retail investors "wealth management products". More than 80,000 Chinese bought Evergrande WMPs over the last five years, raising US$15.4bn. Some US$6.1bn of these investments remain outstanding (as at September).

Non-repayment, or even just the *risk* of non-repayment, of WMPs by a developer as large as Evergrande could have repercussions for future developers trying to raise funds this way. Then there's the likelihood potential property market bond investors will be scared off, materially increasing the cost of capital, and furthermore, materials suppliers to the sector may well be once bitten, twice shy.

Then there's the so-called "wealth effect". JPMorgan notes housing is the largest asset making up Chinese household wealth, accounting for 60% of household assets according to a 2019 PBoC survey, compared to 30% in the US. Home ownership is also very high at 90%. When house prices are strong, property-owners feel wealthy, and are more prepared to spend money.

JPMorgan's research suggests every -1 percentage point decline in house prices tends to drag consumption down by -0.2ppt. More importantly, the analysts suggest, given the high level of home ownership, a housing price collapse would create a much bigger socio-political problem than a house price spike.

<u>Impact on Australia</u>

The large negative side-effects associated with China's traditional growth model, attempts to reduce moral hazard in the financial system, and President Xi's focus on achieving "Common Prosperity" have conspired to see China more comfortable with lower growth, particularly in the real estate sector, observes Shaw & Partners.

Strong growth since the GFC has come at the expense of rising debt levels, and sharply higher house prices have exacerbated inequality.

China's average house price to disposable income ratio is currently 27.9x. This compares to Japan at 11.6x, India at 10.8x, the United Kingdom at 9.5x, Australia at 7.3x and the United States at 4.0x, notes Auscap.

In short, a reduction in property development would likely have second and third order consequences that would negatively affect economic growth within China and therefore globally, given China's position as the world's second largest economy

In a worst-case impact of the "three red lines" property developer policy, property investment could fall -10% in the second half of 2021, Shaw suggests, and mark an annual contraction in 2022. But the peak-to-trough change will likely be smaller than that in 2014-15. Residential inventories versus sales are relatively low compared to 2014, especially in lower-tier cities.

The spillover effect to upstream industries such as coal and steel would also likely be smaller given excess capacity has reduced significantly since 2015, as has industry leverage.

And it is expected by all observers that in the case of a dramatic downturn, the government will respond with monetary/fiscal support to ease down the market rather than watch it collapse.

On a longer term horizon, Oxford Economics believes urban housing sales and property investment will continue to grow at a reasonable pace, but a much slower pace than in the past. Ongoing urbanisation and a still-high savings rate (albeit declining due to an ageing population) will continue to support future real estate investment, Oxford suggests.

There are already signs of a slowdown in the Chinese property sector, with new construction starts contracting, and a sharp weakening would have significant effects on growth in overseas suppliers, given the vast quantity of inputs this sector "sucks in", Oxford warns.

The impact would also spread more widely due to negative effects on global commodity prices. So far, the broader commodity indices are holding up well, Oxford notes, but there have been visible effects on some China-sensitive commodities, most notably iron ore. There are also indications of a weakening trend in copper prices. These commodities are probably the most important global channel for Evergrande contagion in the near term and should be watched closely.

However, there are two conflicting forces in China currently impacting on copper and other metal prices. One is lower demand as property construction slows, while the other is lower supply due to government enforced power cuts for producers and subsequently falling inventories.

Beijing has been attempting to limit production anyway, so as to reduce carbon emissions generally but also to ensure clean air for the Winter Olympics in February which no one is allowed to attend, unless you're an athlete, official or Chinese.

Any reduction in bulk commodity demand from China will have an impact on global commodity prices and volumes, negatively affecting Australia's terms of trade and government receipts, Auscap notes. There are also potential flow-on implications for employment and consumption to consider.

Auscap remains cognisant of potential risks emanating from China as a result of the deleveraging process that is currently being undertaken in relation to domestic property developers. While there is a reasonable probability that the Chinese government successfully navigates this issue, Auscap suggests there is certainly a non-zero probability attached to the risk that there are material flow-on consequences that negatively impact China's economic growth.

While Auscap remains positively disposed to domestic and global economic growth as the world emerges from covid, an awareness of the potential implications of any fallout from a significant slowdown in the property sector in China is informing Auscap's approach to investing while these risks are present.

The look-through risk to demand for products that go into residential construction, including some of Australia's largest exports such as iron ore and coking coal, could be very material, the analysts warn. China produced 56.5% of the world's steel in 2020. If China's demand for steel goes backwards, the combined growth in consumption in the rest of the world is unlikely to be enough to offset the decline.

Evergrande's next bond payment is due on October 29.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 22-10-21

Weekly update on stockbroker recommendation, target price, and earnings forecast changes.

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday October 18 to Friday October 22, 2021
Total Upgrades: 14
Total Downgrades: 19
Net Ratings Breakdown: Buy 54.68%; Hold 38.54%; Sell 6.77%

For the week ending Friday October 22, there were fourteen upgrades and nineteen downgrades to ASX-listed companies covered by brokers in the FNArena database.

There was only one material change to forecast target prices. Aristocrat Leisure received the largest percentage upgrade by brokers after making an offer for UK online gaming software provider, Playtech. The transaction is worth $5bn, to be funded by cash, debt and equity.

Macquarie considers the potential acquisition highly complementary to the company's existing business and has upgraded its rating to Outperform from Hold. Morgans agrees and feels the transaction creates an opportunity to get to scale quickly in a market segment forecast to grow at a double digit rate over the next five years.

Meanwhile, Audinate Group had the largest percentage decrease in forecast earnings last week. This came after news of a supply shortage of silicon chips used in products that have historically accounted for 43% of Audinate's revenue. All three covering brokers in the FNArena database consider this situation to be transitory.

29Metals was next after the September quarter featured weak production at Golden Grove, offsetting a better result at Capricorn Copper, according to Macquarie. Management has nonetheless retained 2021 production guidance though the broker believes costs will be higher than guidance suggests.

More positively, the analyst believes grades at Golden Grove should lead to significant improvement in earnings and cash flow in the December quarter. Credit Suisse, likewise is upbeat, and suggests the company offers the best value copper play on the ASX.

Zip Co was next as first quarter revenue revealed a negative impact in the US from rebranding and Macquarie noted implied growth rates in September were well below those disclosed as part of FY21 results. Australasian growth is also considered to have moderated. Morgans is also cautious, and believes the FY22 consensus revenue forecast will be hard to achieve and downgrades both its FY22 and FY23 EPS forecasts.

By initiating coverage on Nickel Mines, Ord Minnett effectively lowered what is now a four-broker average forecast earnings figure derived from the FNArena database. The broker begins with an Accumulate rating and a $1.10 target price. The miner is considered a unique Indonesian nickel pig iron producer that is generating significant cash flow.

On the flipside, Coronado Global Resources had the largest percentage increase in forecast earnings last week. Commenting after soft September quarter coal sales, Macquarie noted buoyant prices continue to drive earnings and valuation upside, with current spot prices suggesting an 85% free cash flow yield. Credit Suisse expects future increases in US domestic contract pricing will increase earnings by as much as US$230m in 2022, and lifts its target price to $2.00 from $1.60.

Both Whitehaven Coal and New Hope Coal featured in the table for material rises in forecast earnings and it seems the common factor is Macquarie. The broker revisited the investment theses for coal miners after reports that China is studying intervention measures and price caps.

The broker is forecasting a retraction in coal prices though considers present upside is material and maintains a positive view on both companies, which are enjoying free cash flow yields of more than 20% on the analyst's forecasts.

In another positive for Whitehaven Coal, its September quarter production report suggests to Morgans there's upside risk to the broker's base-case FY22 price forecast.

Finally, brokers generally put aside the slightly disappointing third quarter results for Alumina Ltd, as alumina prices have climbed sharply after the end of the quarter to around US$480/t. This suggests to Citi that margins will be strong in the fourth quarter. Morgan Stanley agrees and notes that while third quarter costs were a 6% miss versus the broker's estimate, this was largely driven by production disruptions.

Total Buy recommendations take up 54.68 % of the total, versus 38.54% on Neutral/Hold, while Sell ratings account for the remaining 6.77%.

<u>Upgrade</u>

ARISTOCRAT LEISURE LIMITED ((ALL)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 6/1/0

Aristocrat Leisure has made an offer for the UK's Playtech, worth $5bn, to be funded cash, debt and equity. The acquisition will provide technology and scale in order to pursue the real money gaming (RMG) market, particularly North America where the company is yet to make its presence felt.

Macquarie considers the acquisition highly complementary to Aristocrat Leisure and notes many opportunities. The broker considers the valuation compelling and upgrades to Outperform from Neutral. Target is raised to $52.75 from $39.00.

ATLAS ARTERIA ((ALX)) Upgrade to Add from Hold by Morgans .B/H/S: 3/2/0

Morgans upgrades its rating to Add from Hold for Atlas Arteria on an attractive 12-month potential return and a 5-year equity internal rate of return of 8.6% per annum. The target price lifts to $6.61 from $6.44 on improved asset performance and valuation assumptions.

Had it not been for adverse exchange rate movements, the lift in target price would have been 21cps greater, explains the analyst. It's conceded there's still uncertainty over the shape of the traffic recovery.

BAPCOR LIMITED ((BAP)) Upgrade to Add from Hold by Morgans .B/H/S: 7/0/0

Bapcor managed to achieve flat year on year revenue growth in the September quarter, with growth in wholesale of 7% offsetting a -12% drop in retail with 70% of stores locked down. Some margin pressure was suffered due to higher costs, but should ease post-lockdowns.

Morgans suggests the quarter showed the resilience of revenues and the potential once normal operating conditions fully resume. With sufficient valuation upside having emerged, the broker upgrades to Add from Hold.

Target rises to $8.45 from $8.25.

BHP GROUP LIMITED ((BHP)) Upgrade to Add from Hold by Morgans .B/H/S: 2/2/0

Morgans remains cautious on the iron ore market, but has upgraded BHP to Add from Hold, citing three reasons, the fist being recent share price weakness which implies an iron ore price of US$61/t.

Otherwise, the value of the Petroleum demerger has increased on the back of Woodside Petroleum's ((WPL)) share price increase, on the back of rising oil prices, and furthermore, despite the plunge in the iron ore price BHP will still be able to pay a 10%-plus dividend yield.

Target rises to $46.05 from $45.20 despite a mixed September quarter, hampered by maintenance.

BLUESCOPE STEEL LIMITED ((BSL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/2/0

Bluescope Steel has increased first half earnings before tax guidance by $300m to $2.1-2.3bn, in a move that Credit Suisse notes was largely anticipated.

The broker noted around $160m of the earnings increase was driven by US North Star spreads, reportedly US$570 per tonne compared to a modeled US$420 per tonne. Credit Suisse expects current trends to continue into 2022, with strong demand already predicted.

An additional $120m of the earnings increase was attributed by the broker to higher volumes and improved margins in Australian Steel.

The rating is upgraded to Outperform and the target price increases to $28.30 from $26.00.

See also BSL downgrade.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/4/1

Domino's Pizza Enterprises reiterated its European long-term store target at the 2021 Europe Investor Day.

Macquarie expects store ramp-ups in December and June but says covid headwinds persist, including lack of tourism, labour shortages, inflation and social distancing restrictions.

The broker revises down EPS forecasts -2.5% for FY22, but raises FY23 and FY24 forecast 4.3% and 2.8% expecting covid headwinds to dissipate.

Target price rises to $132.50 from $113.00.

The broker upgrades to Neutral from Underperform, thanks to the recent share price retreat.

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

Morgan Stanley upgrades its rating for GPT Group to Equal-weight from Underweight and lifts its target price to $5.30 from $4.70. Industry view is In-Line. This comes as Sydney prime grade office reaches its first material quarter of positive net absorption.

Total absorption is the total new square footage leased by tenants. The analyst likes the portfolio re-balance in in the last 18 months away from retail. The current split is 38% Retail, 39% Office and 23% Industrial compared to the prior split of 43%, 41% and 16%, respectively.

The broker hasn't included a range of potential positive-catalyst deals in forecasts, which would provide additional impetus above and beyond factors involved in the current rating upgrade.

See also GPT downgrade.

HOME CONSORTIUM ((HMC)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 1/2/1

Home Consortium and HomeCo Daily Needs ((HDN)) plan to acquire Aventus Group ((AVN)) at $3.82 a share. Ord Minnett observes the acquisition will lift Home Consortium's funds under management towards $5bn, ahead of its December 2022 target.

The broker is optimistic about the transaction for the company's investors, given the material earnings accretion. Rating is upgraded to Hold from Lighten and the target raised to $7.50 from $6.40.

IGO LIMITED ((IGO)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/1/1

Credit Suisse upgrades to Outperform from Neutral, lifting its target multiple for the lithium business to 22x FY23.

The broker believes this multiple is warranted, given the exposure to a tier-1 lithium business, low cost profile and expansion opportunities. Target is raised to $10.70 from $9.20.

NANOSONICS LIMITED ((NAN)) Upgrade to Add from Hold by Morgans .B/H/S: 1/1/1

Morgans upgrades its rating for Nanosonics to Add from Hold as there is more than 15% upside to its target price, which has been lowered to $6.97 from $7.26. The lower target comes as the analyst realigns its cost base in-line with management guidance.

By increasing the cost-base forecast to $90m from $82.5m, the broker's profit forecast falls to $10.8m from $15.3m. A continued investment in R&D helps underpin the long-term growth prospects in the business, believes Morgans.

ORORA LIMITED ((ORA)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/6/0

Orora reiterated full year growth guidance at its AGM and announced a new $150m buyback.

First half earnings for Australian beverages are expected to decline due to the loss of Chinese wine sales. The company has done a good job of replacing that market, Macquarie notes, but the impact will take a while to flow though.

Solid demand and well managed costs should deliver growth in North America earnings.

The broker upgrades to Outperform from Hold on a forecast total shareholder return of 16% and a PE discount to market. Target unchanged at $3.60.

PANORAMIC RESOURCES LIMITED ((PAN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

Panoramic Resources has reported its first concentration milestone three weeks ahead of schedule and is on track for a December shipment, reports Macquarie.

The broker expects the miner will now turn its attention to exploration at Savannah.

Macquarie upgrades to Outperform from Neutral, given the risk profile is much lower.

Target price rises 22% to 28c from 23c.

TRANSURBAN GROUP LIMITED ((TCL)) Upgrade to Add from Hold by Morgans .B/H/S: 4/2/0

Morgans upgrades its rating to Add from Hold after adjusting its valuation approach to concession-based assets, which also lifts its target price to $14.82 from $13.99. Following the recent retail entitlement offer, it's thought there's a current opportunity to buy shares.

WORLEY LIMITED ((WOR)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/3/0

Worley offers leverage to a large increase in sustainable energy and decarbonisation investment, UBS asserts. The broker estimates a cumulative investment of US$115trn is required to achieve net zero emission targets by 2050.

Sustainability projects are small but fast growing and with sales of 14% of the portfolio this is up 24% on FY20 levels, and these projects make up 32% of the company's future bid pipeline.

UBS upgrades to Buy from Neutral and raises the target to $13.20 from $11.65. FY22-24 earnings estimates are upgraded by 1-5%.

Downgrade

ALUMINA LIMITED ((AWC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/4/0

A price spike in September did not translate to the September quarter margin from AWAC, given the one-month lag in alumina pricing. As the current price is US$482/t , Credit Suisse increases its December quarter price realisation estimate for Alumina Ltd to US$450/t.

The broker does not believe the current prices is sustainable as supply interruptions should be temporary, although alumina should not return to the low US$300 range.

Credit Suisse does not recommend chasing the stock at the current price and downgrades to Neutral from Outperform. Nevertheless, dividend yields on a 12-month view are expected to be close to 8% and support the current price. Target is $1.90.

BLUESCOPE STEEL LIMITED ((BSL)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 4/2/0

Morgan Stanley assesses US steel prices have peaked and finds it hard to see BlueScope Steel outperforming in an environment of declining prices. The broker lowers its rating to Equal-weight from Overweight and slashes its target price to $23.50 from $29.50.

According to the broker's US strategists, lead times in the US have declined and service center inventories are reading a point of inflexion.

Prices are likely to remain at historically favourable levels across FY22, which will be supportive for cash flows and potentially a continuation of capital management, believes the analyst.

See also BSL upgrade.

CAMPLIFY HOLDINGS LIMITED ((CHL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

After a first quarter update by Camplify Holdings, Morgans increases its target price to $4.20 from $1.99 though reduces its rating to Hold from Add, due to the share price tripling since IPO.

The analyst highlights continued growth in Australia led by Queensland and WA, while the UK and Spain are showing promising early momentum post covid restrictions. There's considered a prodigious growth opportunity and the analyst likes the business model.

CLASS LIMITED ((CL1)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/1/0

HUB24 ((HUB)) has launched a bid for Class through a scheme of arrangement on an implied price of $3.11 - a 72% premium to Class's last price prior to the offer.

Ord Minnett describes the offer as compelling, and notes the bid price offers little room for a rival bid although stranger things have been known to happen.

HUB24 says Class will continue to operate separately.

Target price rises to $3 from $2.40, the broker noting there is some time for the transaction to play out, and rating falls to Hold from Buy.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/5/0

Credit Suisse downgrades to Neutral from Outperform, given relative valuation. FY22 is expected to be weighted to the second half as the company incorporates the Kundana/EKJV assets. Cowal is also expected to provide softer production because of major maintenance in August.

The broker also makes changes to estimates for earnings per share to reflect a modest reduction in Ernest Henry production and the extension of the ramp up at Red Lake. Target is reduced to $3.80 from $4.30.

GPT GROUP ((GPT)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/5/0

GPT Group has confirmed its acquisition of the Ascot portfolio for -$681.7m, containing 24 assets. The transaction is expected to complete in November, and the company is guiding to it being earnings accretive within the first year.

While Credit Suisse estimates the acquisition to generate an additional $15m per annum, the broker notes there is uncertainty in GPT Group's earnings outlook.

The company has not acquired three office properties and one industrial property that were originally included in the portfolio, reducing the price from an initial $800m. Funds from operations forecasts increase 0.9%, 2.9% and 2.8% through to FY23.

The rating is downgraded to Neutral from Outperform and the target price increases to $5.26 from $5.02.

See also GPT upgrade.

IDP EDUCATION LIMITED ((IEL)) Downgrade to Hold from Add by Morgans .B/H/S: 3/1/0

IDP Educations' trading update indicated a mostly strong recovery in growth, with IELTS volumes up 84% year on year, of which 55% was organic. However this required 120% growth from the northern hemisphere to counter -24% in Australia.

Growth in the US/Canada was the highlight for Morgans, supporting longer term growth expectations. But while the broker remains attracted to IDP's market share opportunity through acquisitions, valuation has now become stretched.

Target rises to $38.20 from $31.25, downgrade to Hold from Add.

OZ MINERALS LIMITED ((OZL)) Downgrade to Neutral from Buy by Citi and Equal-weight by Morgan Stanley .B/H/S: 2/2/1

Oz Minerals' September-quarter production was robust and Citi raises net profit estimates for 2021 by 3%. Still, the share price is up 20% over two weeks so the broker downgrades to Neutral from Buy. Target is reduced to $27.00 from $27.50.

Growth projects are going forward with the expansion of the shaft mine at Prominent Hill's Wira commencing and the West Musgrave study progressing. September-quarter copper production rose 3% despite a lower contribution from Carrapateena.

Oz Minerals' third quarter update revealed higher-gold-grade stockpiles at Prominent Hill, which led to a guidance upgrade for gold production and group all-in sustaining costs (AISC).

Morgan Stanley points to lower copper grades at Carrapateena and lower mining grades and tonnages at Prominent Hill. Equal-weight rating is maintained. Target is steady at $23.50. Industry view: In-Line.

SUNRISE ENERGY METALS LIMITED ((SRL)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/1/0

Following a first quarter update, Macquarie lowers its rating to Neutral from Outperform over the uncertainty in securing a funding and development partner for the Sunrise Nickel-Cobalt project. The $2.10 target price is unchanged.

In the broker's base case, it's assumed the development is funded via US$1.4bn in debt, US$0.5bn in offtake finance and a US$0.5bn equity raising at $1.40. A short-term catalyst is envisaged when assay results from the Phoenix Platinum Zone arrive.

SUPER RETAIL GROUP LIMITED ((SUL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/3/0

Ord Minnett downgrades Super Retail Group's rating to Hold from Accumulate after assessing a full valuation and sees downside risk of up to -7% for consensus earnings forecasts. This comes despite like-for-like sales growth being thought resilient in the first 16 weeks of the first half.

The analyst believes gross margins have likely peaked at 48% in FY21 and expects them to moderate by -70bps per year over the next two years. The return of promotions and increased logistics costs are cited as the main causes. Target price rises to $14.20 from $14.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Neutral from Outperform by Credit Suisse and Downgrade to Hold from Add by Morgans and Downgrade to Neutral from Buy by Citi and Downgrade to Hold from Buy by Ord MinnettB/H/S: 0/5/0

POSCO has announced a $4.40 a share offer for Senex Energy and Credit Suisse expects a higher offer (of roughly $4.60) may be in the wings, which would take it closer to the more typical 30% takeover premium.

The broker says other suitors may enter the fray. Senex's September-quarter update met the broker and consensus estimates.

Target price rises to $4.47 from $3.52 but rating is downgraded to Neutral from Outperform to reflect low deal risks (broker's view) such as FIRB, government and due diligence surprises, on top of recent share-price strength.

Morgans remains bullish on oil fundamentals, thinks the oil cycle has a long way to go and expects Australian oil and gas stocks to gradually re-rate. The broker upgrades its forecasts across the sector to mark-to-market the recent oil price strength.

After a 64% share price rise over the last 12 months for Senex Energy, the broker reduces its rating to Hold from Add. This is due to valuation and as the company has received a potential takeover offer from Posco International. The target price rises to $4.30 from $4.20.

Citi has responded to the prospect of a full take-over by Posco through a downgrade to Neutral from Buy for target Senex Energy.

Target $4.32. Citi sees limites scop for suitor Posco to increase its $4.40 offer to Senex shareholders.

Senex Energy has been in discussions regarding a potential takeover by South Korea's POSCO. Ord Minnett believes the conditional offer price of $4.40 is fair and with no obvious reason for the transaction it appears opportunistic.

The broker is also unsure whether there could be a counter bid. The Foreign Investment Review Board could also be a significant obstacle as Senex Energy services 4% of east coast gas demand.

Ord Minnett raises the target to $4.40 from $4.10 and downgrades to Hold from Buy.

VIMY RESOURCES LIMITED ((VMY)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The definitive feasibility study of Vimy Resources' Mulga Rock project confirmed a robust operation, Morgans notes. Vimy's exemption from WA's ban on uranium mining requires commencement of Mulga Rock by December, assuming approvals.

With approvals now received and funding in place, early works have begun. Target rises to 25c from 17c but on the share price run-up from under 10c, driven by higher uranium prices, the broker pulls back to Hold from Add.

WEST AFRICAN RESOURCES LIMITED ((WAF)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/1/0

West African Resources reported in-line production levels for the third quarter, but better-than-expected all-in sustaining costs and gold sales beat Macquarie's forecasts by -9% and 16% respectively.

The company expects fourth quarter results to exceed the third quarter, implying a full year beat on production guidance. The broker increases earnings per share forecasts 2% in 2021.

Given recent strong share price performance, the rating is downgraded to Neutral from Outperform and the target price increases to $1.50 from $1.20.

WEBJET LIMITED ((WEB)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/5/0

Macquarie downgrades Webjet to Neutral from Outperform in response to recent share-price strength. Target price rises to $6.65 from $6.45.

Webjet's annual general meeting tells Macquarie that global uncertainty persists but signs of a strong and instant recovery have featured where borders have re-opened (international leisure bookings now outpace domestic bookings)

The broker pushes out the growth profile 6-9 months to reflect A&NZ border closures. Several countries are profitable or approaching break-even.

EPS forecasts rise 15% and 4% for FY22 to FY24.

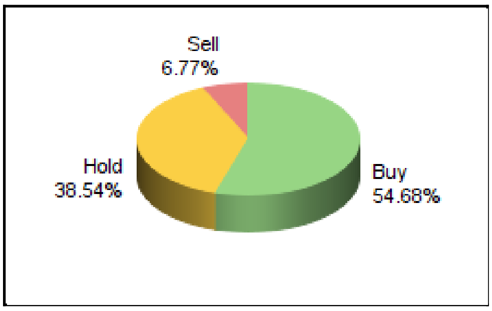
WOODSIDE PETROLEUM LIMITED ((WPL)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/2/0

Macquarie notes Woodside Petroleum is unlikely to capture current higher spot LNG pricing given weak production driven by impacts from the North West Shelf. The broker expects third quarter production levels to be the weakest reported since the second quarter in FY19.

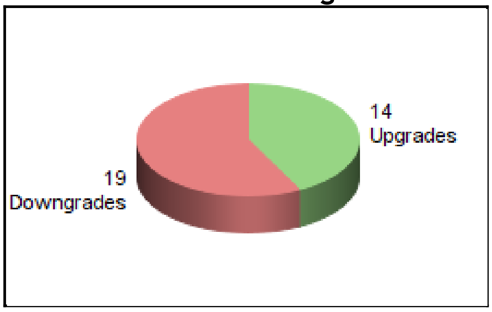
Earnings per share forecasts for FY21 are updated by -3.1% given lower output. Macquarie also noted Woodside Petroleum share price is up more than 30% since reported lows in August.

The rating is downgraded to Neutral from Outperform and the target price decreases to $27.15 from $27.25.

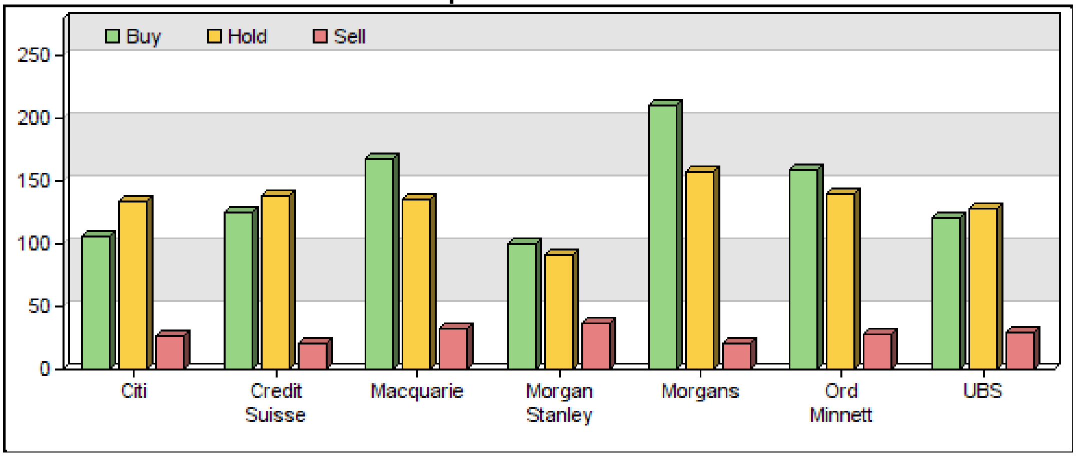
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ARISTOCRAT LEISURE LIMITED	Buy	Neutral	Macquarie
2	ATLAS ARTERIA	Buy	Neutral	Morgans
3	BAPCOR LIMITED	Buy	Neutral	Morgans
4	BHP GROUP LIMITED	Buy	Neutral	Morgans
5	BLUESCOPE STEEL LIMITED	Buy	Neutral	Credit Suisse
6	DOMINO'S PIZZA ENTERPRISES LIMITED	Neutral	Sell	Macquarie
7	GPT GROUP	Neutral	Sell	Morgan Stanley
8	HOME CONSORTIUM	Neutral	Sell	Ord Minnett
9	IGO LIMITED	Buy	Neutral	Credit Suisse
10	NANOSONICS LIMITED	Buy	Neutral	Morgans
11	ORORA LIMITED	Buy	Neutral	Macquarie
12	PANORAMIC RESOURCES LIMITED	Buy	Neutral	Macquarie
13	TRANSURBAN GROUP LIMITED	Buy	Neutral	Morgans
14	WORLEY LIMITED	Buy	Neutral	UBS
Downgrade				
15	ALUMINA LIMITED	Neutral	Buy	Credit Suisse
16	BLUESCOPE STEEL LIMITED	Neutral	Buy	Morgan Stanley
17	CAMPLIFY HOLDINGS LIMITED	Neutral	Buy	Morgans
18	CLASS LIMITED	Neutral	Buy	Ord Minnett
19	EVOLUTION MINING LIMITED	Neutral	Buy	Credit Suisse
20	GPT GROUP	Neutral	Buy	Credit Suisse
21	IDP EDUCATION LIMITED	Neutral	Buy	Morgans
22	OZ MINERALS LIMITED	Neutral	Buy	Morgan Stanley
23	OZ MINERALS LIMITED	Neutral	Buy	Citi
24	SENEX ENERGY LIMITED	Neutral	Buy	Citi
25	SENEX ENERGY LIMITED	Neutral	Buy	Credit Suisse
26	SENEX ENERGY LIMITED	Neutral	Buy	Morgans
27	SENEX ENERGY LIMITED	Neutral	Buy	Ord Minnett
28	SUNRISE ENERGY METALS LIMITED	Neutral	Buy	Macquarie
29	SUPER RETAIL GROUP LIMITED	Neutral	Buy	Ord Minnett
30	VIMY RESOURCES LIMITED	Neutral	Buy	Morgans
31	WEBJET LIMITED	Neutral	Buy	Macquarie
32	WEST AFRICAN RESOURCES LIMITED	Neutral	Buy	Macquarie
33	WOODSIDE PETROLEUM LIMITED	Neutral	Buy	Macquarie

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	BHP	BHP GROUP LIMITED	50.0%	25.0%	25.0%	4

2	IGO	IGO LIMITED	-13.0%	-38.0%	25.0%	4
3	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	-20.0%	-40.0%	20.0%	5
4	ALX	ATLAS ARTERIA	60.0%	40.0%	20.0%	5
5	WOR	WORLEY LIMITED	50.0%	33.0%	17.0%	6
6	ALL	ARISTOCRAT LEISURE LIMITED	79.0%	64.0%	15.0%	7
7	BAP	BAPCOR LIMITED	100.0%	86.0%	14.0%	7
8	TWE	TREASURY WINE ESTATES LIMITED	29.0%	17.0%	12.0%	7
9	TCL	TRANSURBAN GROUP LIMITED	67.0%	60.0%	7.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	OZL	OZ MINERALS LIMITED	8.0%	42.0%	-34.0%	6
2	IEL	IDP EDUCATION LIMITED	75.0%	100.0%	-25.0%	4
3	WPL	WOODSIDE PETROLEUM LIMITED	60.0%	80.0%	-20.0%	5
4	ILU	ILUKA RESOURCES LIMITED	20.0%	40.0%	-20.0%	5
5	APA	APA GROUP	40.0%	60.0%	-20.0%	5
6	HDN	HOMECO DAILY NEEDS REIT	33.0%	50.0%	-17.0%	3
7	EVN	EVOLUTION MINING LIMITED	8.0%	25.0%	-17.0%	6
8	IAG	INSURANCE AUSTRALIA GROUP LIMITED	64.0%	79.0%	-15.0%	7
9	WEB	WEBJET LIMITED	29.0%	43.0%	-14.0%	7
10	SUL	SUPER RETAIL GROUP LIMITED	57.0%	67.0%	-10.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	ALL	ARISTOCRAT LEISURE LIMITED	49.793	44.386	12.18%	7
2	IEL	IDP EDUCATION LIMITED	36.700	34.963	4.97%	4
3	IGO	IGO LIMITED	8.238	7.863	4.77%	4
4	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	131.896	127.996	3.05%	5
5	WOR	WORLEY LIMITED	11.788	11.530	2.24%	6
6	SUL	SUPER RETAIL GROUP LIMITED	14.071	13.765	2.22%	7
7	BAP	BAPCOR LIMITED	8.914	8.721	2.21%	7
8	OZL	OZ MINERALS LIMITED	24.875	24.550	1.32%	6
9	TWE	TREASURY WINE ESTATES LIMITED	12.337	12.212	1.02%	7
10	ALX	ATLAS ARTERIA	6.758	6.724	0.51%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	BHP	BHP GROUP LIMITED	44.263	47.300	-6.42%	4
2	APA	APA GROUP	9.774	10.058	-2.82%	5
3	HDN	HOMECO DAILY NEEDS REIT	1.620	1.650	-1.82%	3
4	EVN	EVOLUTION MINING LIMITED	3.975	4.042	-1.66%	6
5	ILU	ILUKA RESOURCES LIMITED	9.480	9.580	-1.04%	5
6	IAG	INSURANCE AUSTRALIA GROUP LIMITED	5.500	5.543	-0.78%	7
7	WPL	WOODSIDE PETROLEUM LIMITED	26.372	26.428	-0.21%	5

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	CRN	CORONADO GLOBAL RESOURCES INC	20.051	3.747	435.12%	3
2	WHC	WHITEHAVEN COAL LIMITED	93.650	58.862	59.10%	6
3	AWC	ALUMINA LIMITED	12.211	8.169	49.48%	5
4	NHC	NEW HOPE CORPORATION LIMITED	64.220	45.195	42.10%	4
5	S32	SOUTH32 LIMITED	56.568	46.731	21.05%	7
6	HLS	HEALIUS LIMITED	40.490	34.565	17.14%	6
7	SLC	SUPERLOOP LIMITED	-4.000	-4.667	14.29%	3
8	WSA	WESTERN AREAS LIMITED	6.217	5.508	12.87%	5
9	ILU	ILUKA RESOURCES LIMITED	74.302	66.276	12.11%	5

10	KAR	KAROON ENERGY LIMITED	8.387	7.553	11.04%	3

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	AD8	AUDINATE GROUP LIMITED	-8.233	-2.900	-183.90%	3
2	29M	29METALS LIMITED	5.720	9.520	-39.92%	3
3	Z1P	ZIP CO LIMITED	-18.840	-15.080	-24.93%	5
4	NIC	NICKEL MINES LIMITED	6.471	7.941	-18.51%	4
5	NXT	NEXTDC LIMITED	1.240	1.454	-14.72%	7
6	MIN	MINERAL RESOURCES LIMITED	453.500	518.333	-12.51%	4
7	BHP	BHP GROUP LIMITED	493.439	561.160	-12.07%	4
8	TCL	TRANSURBAN GROUP LIMITED	8.079	9.104	-11.26%	6
9	WPL	WOODSIDE PETROLEUM LIMITED	161.843	178.619	-9.39%	5
10	CWN	CROWN RESORTS LIMITED	-8.075	-7.400	-9.12%	3

Technical limitations

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

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

WEEKLY REPORTS

Uranium Week: COP26 Puts Nuclear In Focus

While the weekly spot uranium price rallied 4% last week, the focus now turns to the COP26 Net Zero Summit.

-Nuclear in focus as countries prepare for the United Nations' COP26 Conference
-ASX-listed Bannerman Energy receives renewed environmental clearance
-ASX-listed Deep Yellow intercepts significant mineralisation
-Uranium spot price rises 4% for the week

By Mark Woodruff

Announcements from a number of global leaders leading into the **Conference of the Parties to the United Nations Framework Convention on Climate Change** or the COP26 Net Zero Summit have acknowledged the material role that nuclear will have in assisting global decarbonisation efforts.

While the nuclear industry won't have a formal presence in the Green Zone at COP26, global wealth manager Canaccord Genuity sees substantial upside risk to its in-house uranium demand forecasts.

Media reports in **the UK** suggest the government is poised to unveil funding for a proposal to develop 16 new small modular reactors (SMRs) in conjunction with Rolls-Royce. Canaccord Genuity feels Prime Minister Boris Johnson is keen to rebuild the nation's nuclear energy commitment prior to COP26, particularly in light of the recent rise in power and gas prices.

Around 20% of the UK's electricity originates from nuclear, and half of the country's reactors will potentially be retired by 2025.

Meanwhile in **France**, where 70% of electricity is generated by nuclear power, President Macron recently announced a US$1.16bn investment directed toward the development of new SMRs. According to the Energy Information Administration (EIA) in the US "One kilowatt of energy you produce in France is six times less carbon intensive than the equivalent in Germany."

Speaking of **Germany**, a set of 25 leading public figures recently launched a campaign for the country to change course and reverse a plan to close all of its nuclear power stations. The group says Germany is in danger of missing its climate targets if the "2022 nuclear phase out plan" goes ahead.

Canaccord Genuity also notes **Japan**'s goal of reducing carbon emissions by -46% by 2030 assumes the restart of 30 nuclear reactors. These assumptions were outlined by Akira Amari, secretary-general of the Liberal Democratic Party. The party is also pushing for SMRs.

Company news

ASX-listed **Bannerman Energy** ((BMN)) last week received a renewal of Environmental Clearance for its proposed Etango uranium mine by the Namibian Ministry of Environment, Forestry and Tourism.

Managing Director and Chief Executive Officer Brandon Munro noted ongoing government support stems from high quality environmental and social assessments, broad community endorsement and a reputation for ESG leadership.

Again in Namibia, **ASX-listed uranium developer Deep Yellow** ((DYL)) recently completed the first phase of drilling at its Barking Gecko discovery, where 13 of 14 holes drilled intercepted significant primary U_3O_8 mineralisation. The Barking Gecko prospect is part of the Nova joint venture.

Uranium pricing

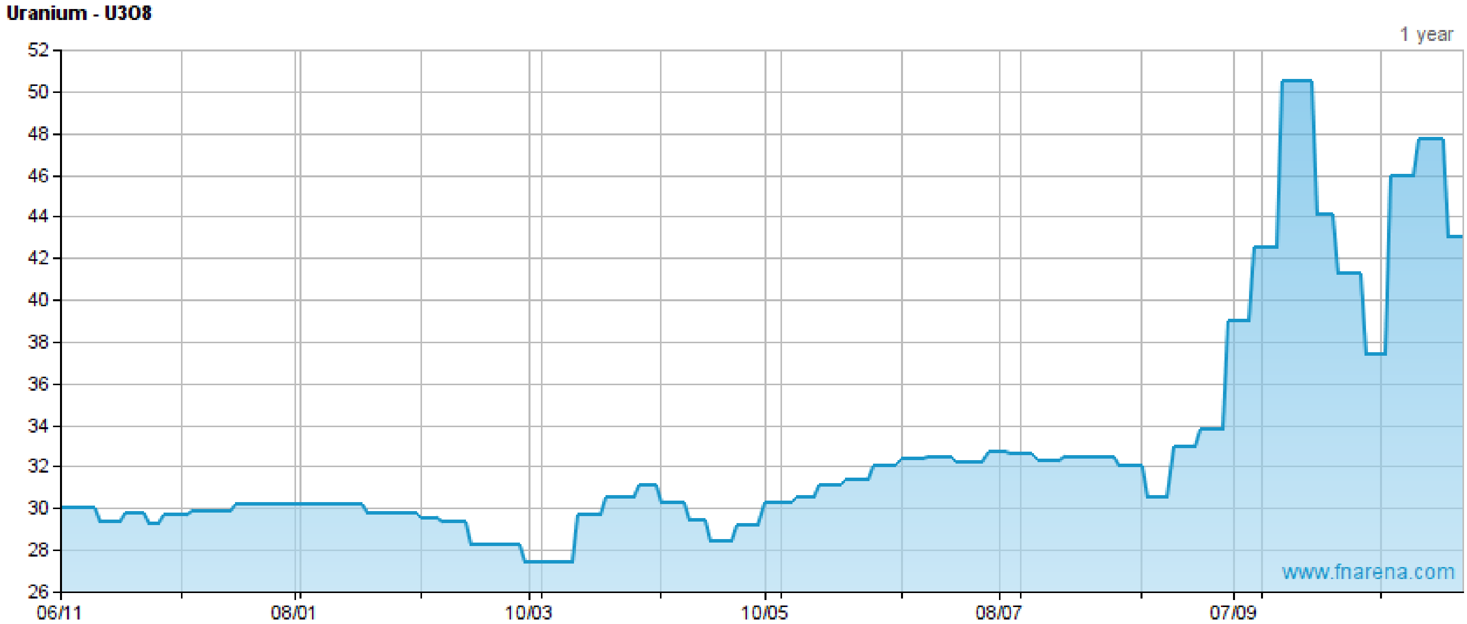
TradeTech's Weekly Spot Price Indicator ended last week at US$47.75/lb, up US$1.75/lb from the prior week. Taking into account this 4% increase, the weekly spot price has increased 27% in the last two weeks. Tradetech reported "a number of utilities are in the process of evaluating their current portfolios and are actively assessing opportunities in an effort to insulate and hedge against further price increases".

The Indicator is up 57% in 2021 and is 74% above the 2021 low point of US$27.40/lb. The average weekly spot price in 2021 is US$33.06/lb, US$3.35/lb above the 2020 average.

There were 2.7mlbs U3O8 traded last week, compared to 2.9mlbs in the prior week. According to TradeTech, investors and financial entities remain the primary buyers, although traders also participated last week and there is slow but steady buying interest from the end-user sector.

TradeTech's **term price** indicators are US$43.75/lb (mid) and US$45/lb (long).

No transactions were reported last week in the term uranium market.



Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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

WEEKLY REPORTS

The Short Report - 28 Oct 2021

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

Summary:

By Greg Peel

Week Ending October 21, 2021.

Last week saw saw the ASX200 run steadily upward until a last-day slip, when Evergrande recommenced trading in Hong Kong.

This from last week's report:

"The most notable aspect of last week is that there is currently no stock shorted on the ASX by 10% or more, with Flight Centre ((FLT)) dropping to 9.8% from 10.4%. This is rare, but not unprecedented. And following a weak quarterly update from the travel agent yesterday, next week's Report might be different."

Indeed. Last week Flight Centre shorts jumped back to 11.4% from 9.8%.

And after climbing bracket by bracket over the past weeks, Redbubble joined in too, rising to 10.2% from 9.3%. See below.

It was not long ago that the 10%-plus club persistently included Tassal Group ((TGR)), Zip Co ((Z1P)) and Kogan ((KGN)), at different times. It is notable that those three stocks have been quietly slipping down the table over past weeks.

The issue of environmentally damaging fish farming has faded from the news, and the BNPL non-believers have reassessed their theses. Amazon wannabe Kogan had a great run-up in October, the pinnacle of which came last week after the company declared it had overcome its excess inventory issues, but this week the stock has been on the slide again.

Otherwise, short positions remain relatively static.

Weekly short positions as a percentage of market cap:

10%+
FLT 11.4
RBL 10.2

In: FLT, RBL

9.0-9.9

WEB, KLA

In: KLA Out: FLT, RBL, KGN

8.0-8.9%

MSB, EOS, ING, KGN

In: KGN Out: Z1P

7.0-7.9%

Z1P, COE

In: Z1P Out: TGR

6.0-6.9%

BHP, TGR, A2M, PNV, MTS, TPW

In: TGR

5.0-5.9%

AMA, OBL, MND

Out: EML

Movers & Shakers

Redbubble is an online marketplace in which artisans and crafts people can offer their wares, similar to US-Based Etsy. The company has been listed since 2016 but did not hit the radar until last year, in which it enjoyed a 366% rise in share price from February to August.

While we can point to lockdowns driving a market-wide increase in online sales, and to arts and crafts activities being boosted by household imprisonment, the driving force for Redbubble in 2020 can be identified through its offerings of fashionable face masks.

The share price peaked out in January when we all thought covid was beaten, and by May Redbubble had more than halved in value. Delta arguably offered another opportunity, but the share price has done absolutely nothing for the past six months. Presumably fresh demand for masks was countered by the fact most of us already had one or more by then.

I say the share price has done absolutely nothing, but only on a six month basis. By contrast, the stock appears almost daily among either the top five index winners or losers on the day, often moving 5-6% in either direction for no apparent reason, which is why I have dubbed it a "meme stock".

Ironically, the US meme stock bubble kicked off in January as Robinhood's merry men and women went after heavily shorted stocks, loading up on call options. Over the past few weeks, Redbubble has moved steadily up the 5%-plus shorted table to now be the number two most shorted stock on the ASX.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.1	0.0	MQG	0.4	0.3
ANZ	0.6	0.6	NAB	0.6	0.7
APT	1.2	1.1	NCM	0.5	0.3
BHP	6.8	6.4	RIO	0.3	0.3
BXB	0.2	0.2	TCL	0.3	0.4
CBA	0.6	0.7	TLS	0.2	0.3
COL	0.7	0.7	WBC	0.8	0.7
CSL	0.2	0.2	WES	0.2	0.2
FMG	1.5	1.5	WOW	0.5	0.3
GMG	0.0	0.1	WPL	1.4	1.6

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

The above information is sourced from daily reports published by the Australian Investment & Securities Commission (ASIC) and is provided by FNArena unqualified as a service to subscribers. FNArena would like to make it very clear that immediate assumptions cannot be drawn from the numbers alone.

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

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

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

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

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

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

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

WEEKLY REPORTS

The Wrap: Top 10 Global Growth Risks, Packaging, Private Debt & BNPL

Weekly Broker Wrap: Top 10 global growth risks; packaging; private debt; and BNPL.

-Top 10 risk scenarios impacting upon global growth and inflation
-Is the de-rated packaging sector an opportunity?
-The swing towards private debt markets
-Will merchants add a surcharge to BNPL sales?

By Mark Woodruff

Top 10 risk scenarios impacting upon global growth and inflation

The post-pandemic recovery is expected to continue, with global GDP expanding by 4.1% in 2022, down from the 5.4% rate estimated for 2021.

However, *The Economist* is tracking ten scenarios that would see growth fall short of its forecasts.

Given recent media airtime, at least five of the risks will surprise no one. They are: a decoupling of the global economy due to **increased fallout in US-China relations**; **conflict between China and Taiwan**, forcing the US to intervene; **faster-than-expected monetary tightening** leading to a US stockmarket crash; **a property crash in China** leading to a sharp economic slowdown; and t**he emergence of new covid variants**.

There may also be **currency and/or debt crises in Emerging Markets** stemming from either the above-mentioned monetary tightening or a rise in commodity prices. This commodity risk is partially linked to a separate risk pertaining to **climate-change-induced droughts and/or famine**.

Social unrest was already a pre-pandemic feature for the Middle East, Africa and Latin America, and some countries within these regions underwent tough lockdowns and deep recessions. It's thought increasing unrest could lead to a government collapse, panicked investors and destabilising capital outflows. Mind you, *The Economist* also believes this same risk holds true for traditionally stable Western states and long-standing authoritarian regimes.

Under another scenario, **worsening relations between the EU and Chin**a could result in operational disruption for affected Chinese companies and leave EU companies operating in China vulnerable to retaliation.

When probability and impact are weighed for the ten risks, investors should be least worried about an **inter-state cyberwar crippling state infrastructure in major economies**. The equal top-ranked risks were the above-mentioned potential for worsening US-China relations, a Chinese property crash and the monetary-policy-induced US stock market crash.

Is the de-rated packaging sector an opportunity?

The recent **market de-rating of the Australian Packaging sector** has overshot fundamentals and underestimates the rate of organic earnings growth the industry can deliver in the wake of covid-19, believes Jarden.

The industry stands to gain, especially if increased 'At-Home' consumption patterns developed during lockdowns can stick over the mid-term. The pandemic was a hiatus for the decade-long structural shift to 'Out-of-Home' (cafes and restaurants) food & beverage consumption from 'At-Home' (grocery and specialty stores).

This of particular relevance for both **Amcor** ((AMC)) and **Pact Group** ((PGT)), which derive 68% and 48% of revenue from food & beverage, and the analysts believe consensus forecasts are yet to reflect any potential for higher revenue growth rates.

The broker initiates coverage of the sector with an Overweight stance and favours Amcor ahead of **Orora** ((ORA)) and Pact, and believes there's adequate risk/reward upside for investors at this early stage of the post-covid recovery. Amcor and Orora may benefit the most from expansions in return on invested capital (ROIC) based on current consensus estimates, note the analysts.

Additional upside may spring from the latent potential from prior M&A's and divestments, which are yet to fully deliver earnings upside.

Moreover, it should be remembered that contract structures allow the majority of any input cost increases to be passed on to customers. This, along with low though stable earnings growth, prompts Jarden to suggest **Australian packaging companies should be allocated to the defensive part of an investor's investment portfolio.**

The swing toward private debt markets

In the ongoing search for yield, it seems **investors have turned toward private debt markets**, which are expected to double by 2025. Returns can be up to three or four times what retail investors might get on conservative fixed income positions.

Non-bank lending has been at the forefront, which has recently inspired US fund management giant Apollo

Global Management to take a 50% stake in a local non-bank lender Max Cap.

While this is a global trend, **Australia's private capital market offers one of the most attractive risk/return profiles**. Assets under management rose steadily in 2020 to a record $77bn, points out Preqin, a company that provides financial data to alternative asset professionals.

The **commercial lending market** in particular values speed of execution and flexibility, as well as the capacity to deliver on terms outside where banks are able to trade, according to commercial broker, Stamford Capital.

SMSFs and super funds are turning more and more to private debt markets and a lot of private real estate deals are being funded this way, according to Matt McKenna at KPMG's Debt advisory Services.

Should merchants add a surcharge to BNPL sales?

Is a merchant willing to risk the loss of potential sales by adding a surcharge to BNPL sales?

Citi searches for an answer in the wake of the final report from the Reserve Bank of Australia on Payments Regulation, which now calls for the removal of no-surcharge clauses.

According to the broker, the amount of lost sales will likely be determined by the proportion of retailers deciding to add a surcharge. If adding a surcharge becomes the norm, then this reduces the potential impact to a retailer.

Moreover, the level of competitive intensity and consumer engagement are more likely to determine long-term BNPL merchant take-rates. Also, surcharging in an online context is quite rare (Amazon aside), which in the analyst's view reflects the risk of lost sales/cart abandonment. Citi analysis indicates that if over 7.5% of a retailer's BNPL's sales were to disappear due to surcharging, then that retailer is unlikely to add a surcharge.

It's felt **Zip Co ((Z1P)) is less exposed** given its average merchant fee of 2.5% to 3.0% in Australia is more in-line with the PayPal offering. The broker is currently research restricted on Afterpay ((APT)) due to Citi's role as a financial advisor on the Square transaction.

SMALL CAPS

Smartgroup Dashes Offer To Focus On Growth

The replacement of a stellar offer with a more circumspect price has caused Smartgroup to give the bidder the flick, and the focus is now on growing the business

-No reason provided why the initial price offered for Smartgroup was lowered
-Lockdowns have likely affected orders through August-October
-Potential for capital management in the absence of acquisitions

By Eva Brocklehurst

Smartgroup Corp ((SIQ)), which offers salary packaging, fleet management and novated leasing, is back to business after the consortium that raised an indicative proposal in September withdrew the price.

Originally, the consortium comprising TPG Global and Potentia Capital offered $10.35 a share. This offer has subsequently been withdrawn, with the consortium expressing an interest to proceed at $9.25 a share.

No reason was given as to why the initial proposal was revised lower, after the consortium took over 2.5 weeks of due diligence. The Smartgroup board declined to accept the lesser proposal and discussions have now ceased.

Ord Minnett finds the implications slightly negative but points out the initial bid was "indicative".

Morgan Stanley believes **the revised offer still reflected investor appreciation of the business model, such as the fact it is light on capital requirements and generates cash, amid low gearing** Further industry consolidation was also likely to be implicated in the assessment.

The broker assesses the mid-teen multiple of 16.6x 2022 price/earnings on the revised offer is more in line with recent history, versus an historically high multiple implied at the $10.35 offer.

Meanwhile, the company has signalled it is on track to provide a 2021 financial performance that is in line with consensus, which is around $68.5m in net profit and, Morgans ascertains, implies slight growth half on half.

Vehicle delivery was problematic in the first half and the broker suspects this has continued throughout the second half of 2021. The company signalled in August that orders from July were above pre-pandemic levels, although lockdowns likely affected orders throughout August to October.

Beyond that, Credit Suisse believes, **when new vehicle supply normalises, a recovery in earnings growth is on the cards**. The broker's valuation, now takeover discussions have ceased, reverts back to fundamentals and the rating is upgraded to Outperform from Neutral.

Macquarie has previously calculated that, as supply constraints normalise, demand could amount to 18,500 novated vehicles per year for 18 months from the second half of 2022.

Morgans, too, resumes an Add rating from Hold, noting earnings have been resilient and incremental growth should emerge from 2022. Net cash is expected by December 2021 which will allow for capital management in the absence of acquisitions.

A special dividend of 14.5c would top up the pay-out to 100%, equating to a 6.2% yield. The broker points out the recent salary packaging contract with the Queensland government has been tendered, with Smartgroup one of the incumbents. This top tier contract expires in March.

Still, contract renewal risk is perpetual, Morgans acknowledges, and there is a strong track record of Smartgroup retaining clients. The growth profile for the short term is relatively subdued but the broker notes the revenue position remains sustainable.

FNArena's database has three Buy ratings and two Hold for Smartgroup. The consensus target is $8.63, signalling 8.0% upside to the last share price. This compares with $9.23 ahead of the initial offer being withdrawn. The dividend yield on 2021 and 2022 forecasts is 5.0%.

RUDI'S VIEWS

Rudi's View: Australia's Share Market Sweet Spot

In this week's Weekly Insights:

-We Are All Worried
-Australia's Share Market Sweet Spot
-Conviction Calls
-What Works In Australia?

By Rudi Filapek-Vandyck, Editor FNArena

We Are All Worried

Confused? Well, you should be.

Investors, central bankers, business leaders, economists, politicians, and consumers, not to forget the many experts and market commentators on Twitter and elsewhere across social media; all are struggling to see what is really going on in a world full of contrasts and contradictions.

At its core lives a global economy that is far from 'normal' given the extraordinary context of a global pandemic and the re-opening of societies and country borders but still supported by extraordinary central bank largesse. Yet, central bankers are once again looking at winding down their accommodative policies at a time when global economic momentum is deflating.

Add share markets near all-time peak valuations and this process by definition will be a tricky one to pull off without triggering market anxiety, or worse; the threat of a good old fashioned asset market meltdown.

We've had a few of such moments in the recent past. September-December 2018 is most comparable to today's situation. In case anyone needs reminding: US indices tanked by -20% over those four months and only stopped falling once the Federal Reserve declared it understood the market's message, and stopped tightening through higher interest rates.

Today's central bankers' dilemma looks slightly different, because the focus is on 'inflation' -sticky or transitory- but other factors are eerily similar; asset valuations are high, economic growth is decelerating and central banks want to migrate to a less accommodative policy-setting.

The valuation gap inside equity markets is similar too. Growth and Quality are trading at a sizeable premium to cyclicals/Value, even as banks and energy stocks have performed strongly. Back in 2018, as the likes of Altium ((ALU)), CSL ((CSL)) and Afterpay ((APT)) started to sell off, the *schadenfreude* among your typical value-investors didn't last long with banks, miners and other laggards soon following suit.

The set-up three years later is equally as confusing: historically, when global growth slows noticeably markets are usually quick in pricing in the commensurate decline in demand for energy and commodities. This time around, however, inflation and higher bond yields are in focus and thus the general expectation is that energy producers and banks should take the lead in guiding indices higher.

At least widespread concerns about disappointing market updates from listed businesses, both domestically and in the USA, have thus far proved unfounded, or at the very least premature.

But earnings estimates are still falling, both in Australia and on Wall Street, providing an additional headwind for markets looking for answers and direction. Providing offset is the true avalanche in M&A deals that has descended upon the ASX (though, equally, this also involves a large number of failed attempts and aborted agreements).

Inflation Is The Concern

After more than a decade of subdued, benign inflation the possibility of a reversal in trend is now increasingly on investors' mind, and it scares many.

Look no further than this month's Global Fund Manager survey by Bank of America as back-up for that observation with the survey suggesting the overall mood among large institutional investors has not been this cautious since October last year, with average cash held jumping to the highest level in twelve months.

Portfolios have been rotating into energy and bank stocks in defiance of reduced optimism about growth next year, as general discomfort about the potential outlook for inflation has grown, and is probably still growing. Hence, overall allocation to bonds has slumped to an all-time low, while exposure to equities, US equities in particular, remains high by historical standards.

Banks are now the number one sector owned globally, followed by healthcare, with energy stocks third.

Observe The Gap

There are plenty of doom and gloom forecasters out there, alongside many (hyper)inflation fashionistas, but it's still worth pointing out this debate is far from settled (and it won't be for many more months). Of even more importance, I suggest, is the fact that implications from current market moves seem yet another case of too eager, too quick, too aggressive, and too soon.

Take the current situation in Australia, where government bonds have moved a lot quicker, and farther than comparables in the US (some say because of the first rate hike delivered by the RBNZ across the Tasman). This has now resulted in the local bond market essentially being priced for the first RBA rate hike by May next year, or approximately seven months from today.

In contrast, RBA messaging to markets has remained undeterred: no rate hikes before 2024.

Of course, markets will always try to test central bankers' confidence and speculate on a change in outlook, possibly forced by inflation deflating much slower than expected, but May next year, seriously?

The teams of economists producing forecasts at the Big Four banks in Australia are currently divided on the issue. ANZ Bank and National Australia Bank are still on par with the RBA's official forecast (2024, not sooner) while CBA and Westpac are projecting the first hike in the first half of 2023.

Most other forecasters sit somewhere in between. Citi, for example, sees the RBA in action from the third quarter of 2023 onwards. Virtually no one is on par with the local bond market. The situation is not that dissimilar in the US.

One should never try to be too clever in making predictions that are too far out still to be vindicated or proven inaccurate, but I think the current set-up once again smacks of fear and discomfort guiding market moves; government bonds most likely are priced too aggressively for what will plausibly unfold over the year(s) ahead.

As a matter of fact, I could easily string a story together that firmly suggests inflation already is losing strength as the impact from re-openings is evaporating against a downward trend in global economic momentum. All I would have to do is cherry-pick market signals and pieces of data, similar to what most inflation advocates are doing today.

My worry today is different from the media headlines and the many opinions and declarations on social media: my concern is this global fixation on never-ending inflation might be seducing central bankers into tightening prematurely, only to discover the economy is not half as healthy as projected.

Such an outcome, I believe, would be quite devastating for equities and commodities.

Meanwhile, the market is trying to figure out what scenarios are possible and which ones are the most viable. I know this sounds like the ultimate platitude but I think the sole certainty for the time being is there is none, and this usually means a lot more volatility is on the horizon.

Australia's Share Market Sweet Spot

The problem with an international best-seller such as James O'Shaughnessy's *What Works On Wall Street* is a reader in Australia can wrestle his/her way through the nearly 700 pages of fine print, charts and tables and still be left with that one crucial question: how much of all this actually works on the ASX?

Hence why my online presentation to members of the Ballarat chapter of the Australian Shareholders Association (ASA) last week was titled: What Works In Australia?

As per usual, slides of the presentation are available via the Special Reports section on the website, while the video is available via the website (FNArena Talks) and on YouTube (see also further below).

One of the key observations I highlighted is there is a sweet spot on the Australian share market, and it is situated in the second half of the ASX100; in other words: the group of stocks numbered 51-100 has traditionally crowned itself as the basket of outperformers on the ASX.

The presentation also made me realise it had been a long while since I reminded readers of Weekly Insights about this -research based- point of local knowledge, hereby corrected!

So which stocks are responsible for this segment to crown itself the best performing in Australia post-GFC?

My first suggestion would be ResMed ((RMD)). The stock has recently been elevated into the ASX50, but its steady climb through the ranks of Australia's sub-top in terms of market capitalisation automatically implies ResMed's relative outperformance has been a major contributor.

I remain of the view ResMed's longer-term growth story is far from finished, but, alas, further outperformance from here onwards will no longer be contributing to the overall performance of the ASX's sweet spot. There are, of course, fifty other stocks that still make up the best hunting ground on the stock exchange, and among these one finds plenty of growth and potential:

-Ansell ((ANN))
-Carsales ((CAR))
-Charter Hall ((CHC))
-Domino's Pizza ((DMP))
-Fisher & Paykel Healthcare ((FPH))
-IDP Education ((IEL))
-NextDC ((NXT))
-Orora ((ORA))
-Seek ((SEK))
-WiseTech Global ((WTC))

I haven't done the hard yakka in terms of data and total performance analysis, but I think we can safely assume the above mentioned 10 stocks, plus the likes of ResMed, Amcor ((AMC)) and Afterpay ((APT)) -who disappeared from this segment for the best reason possible- have made this segment the best performing on the ASX throughout the decade past.

Then we have those with a more cyclical bend:

-ALS Ltd ((ALQ))
-BlueScope Steel ((BSL))
-Downer EDI ((DOW))
-Harvey Norman ((HVN))
-Incitec Pivot ((IPL))
-JB Hi-Fi ((JBH))
-Orica ((ORI))
-Reece ((REH))
-Reliance Worldwide ((RWC))
-Washington H Soul Pattinson ((SOL))
-Worley ((WOR))

There is also the basket with question marks that need to be overcome:

-Altium ((ALU))
-Magellan Financial ((MFG))
-Nine Entertainment ((NEC))

For good measure, this particular basket of stocks also includes:

-AMP ((AMP))
-Challenger ((CGF))
-Crown Resorts ((CWN))
-Link Administration ((LNK))
-Star Entertainment ((SGR))

As per always: past performance is no guarantee for consistent returns in the future, but looking at the stocks mentioned above, I think this segment best remains on investors' radar.

<u>Conviction Calls</u>

Continuing on from some of the predictions made by peers elsewhere, **UBS** too has lined up its forecasts for the running **AGM season in Australia**.

Positive catalysts are expected from:

-Star Entertainment
-Premier Investments ((PMV))
-Medibank Private ((MPL))
-Steadfast Group ((SDF))
-Computershare ((CPU))
-Nine Entertainment
-Seven West Media ((SWM))
-Sims ((SGM))

Negative updates could be ahead for:

-JB Hi-Fi
-Harvey Norman
-Insurance Australia Group ((IAG))

****

From **Wilsons** latest strategy update:

"We think talk of stagflation is likely to be well wide of the mark. Inflation is high and may stay a bit high for

a bit longer but should moderate fairly significantly on 12-month view. Importantly, economic growth is likely to stay well above-trend.

"This reflationary backdrop should, on balance, be a decent environment for risk assets."

(See also my own take on this matter as per Weekly Insights last week and, for those who read newspapers, The Weekend Australian on the weekend past).

****

The Core Model Portfolio at **stockbroker Morgans** has sold out of Coles ((COL)) in order to top up on exposures to Endeavour Group ((EDV)) and Tabcorp Holdings ((TAH)).

The broker's Model Growth Portfolio trimmed its ownership of ResMed shares in order to buy more shares in BHP Group ((BHP)) while the portfolio weighting of ALS Ltd was also reduced in order to increase ownership of Hub24 ((HUB)).

<u>What Works In Australia?</u>

As mentioned above, the video of my presentation is now available:

-via the FNArena website:

https://www.fnarena.com/index.php/fnarena-talks/2021/10/25/what-works-in-australia/

-via YouTube:

https://youtu.be/diNBr7Zhc34

(This story was written on Monday 25th October, 2021. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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

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

****

<u>BONUS PUBLICATIONS FOR FNARENA SUBSCRIBERS</u>

Paid subscribers to FNArena (6 and 12 mnths) receive several bonus publications, at no extra cost, including:

- The AUD and the Australian Share Market (which stocks benefit from a weaker AUD, and which ones don't?)
- Make Risk Your Friend. Finding All-Weather Performers, January 2013 (The rationale behind investing in stocks that perform irrespective of the overall investment climate)
- Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection)
- Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
- Who's Afraid Of The Big Bad Bear? eBook and Book (print) available through Amazon and other channels. Your chance to relive 2016, and become a wiser investor along the way.

Subscriptions cost $450 (incl GST) for twelve months or $250 for six and can be purchased here (depending on your status, a subscription to FNArena might be tax deductible):
https://www.fnarena.com/index.php/sign-up/

TERMS AND CONDITIONS OF USE, AND DISCLAIMERS

These Terms and Conditions of Use, and Disclaimers constitutes your agreement with FNArena Ltd with respect to your use of its FNArena website, its weekday news periodical, Australian Broker Call, as well as any other publications (including articles) FNArena may publish on its website, or anywhere else, from time to time.

Please read the contents of this page carefully as it contains important legal information and disclaimers. By entering and perusing the website, reading the Australian Broker Call, or, if you are subscriber, by entering the password protected part of the website, you acknowledge that you have read, understood and accept this agreement.

By accepting this agreement you acknowledge, understand and accept the following:

1. Reference to “FN Arena” and “FNArena” means reference to FNArena Ltd, its journalists, directors, other employees, affiliates, agents, associates and subsidiaries.

2. FNArena Ltd is the owner of the FN Arena website and brand name.

3. Reference to “we” or “us” is reference to FNArena.

4. Reference to “this website” or the “FNArena website” means reference to www.fnarena.com, and includes reference to FNArena’s weekday news periodical, Australian Broker Call, as well as any other publications (including articles) FNArena may publish on this website, or anywhere else, from time to time.

5. Reference to “news periodicals” means reference to FNArena’s weekday periodical, Australian Broker Call, as well as any other periodicals FNArena may publish from time to time on this website, or anywhere else, from time to time.

6. Reference to “publications” in this agreement means any material, including articles, published or put in print on the FNArena website, or anywhere else, whatsoever, and includes FNArena’s weekday periodical, Australian Broker Call, and any other periodicals FNArena may publish from time to time.

7. Reference to a “visitor” means, you, a visitor to this website, and includes a subscriber to Australian Broker Call as well as any other publications or periodicals FNArena may, from time to time, publish through its website.

8. FNArena is a media company which employs financial journalists to report financial news. FNArena’s journalists perform the required research and collect the information that is, ultimately, each day, published on this website and in FNArena’s news periodicals. As is obvious, the process by which the information is collected and delivered to you is a purely journalistic one and, therefore, the comments, opinions and recommendations FNArena reports on this website are not the opinions of FNArena or any of its journalist or other employees. FNArena is ONLY and specifically a

matter-of-fact reporter of industry signals suggesting price direction probability of some shares. FNArena simply delivers the information – it does not create it.

9. Although FNArena obtains the information published herein from sources deemed to be reliable, and given and received in good faith, it cannot and does not guarantee its accuracy. FNArena does not take any responsibility either for the financial soundness or for the correctness of statement made or opinion expressed in the data or content reported by FNArena, and cannot and does not guarantee the reliability and accuracy of the opinions of the brokers whose opinions, recommendations and forecasts it reports.

10. FNArena publishes this website, all publications and its periodicals strictly for convenient personal, non-commercial, educational and informational purposes of its subscribers only. Our goal is to provide the subscribers with a convenient starting point of potentially useful, but not comprehensive, content that can educate or otherwise enhance a visitor's knowledge base and frame of reference.

11. FNArena is NOT a stock broker or financial or trading advisor, nor is it an advisory service of any kind, and no advice or recommendations on investments or trading are made nor implied on this website. Nothing contained in this website is intended to be, nor shall it be construed as, advice or recommendation. Any investment or other decisions made by you must be based solely on your own evaluation of the targeted subject for investment, and your financial circumstances and investment objectives, and FNArena will not be held liable for any such investments and decisions.

12. It is distinctly understood and accepted that the shares referred to in the FNArena website, FNArena's publications and/or periodicals have not been recommended by FNArena. The content and or any comments found of this website, including the content and/or comments published in any publication and/or periodicals published by FNArena, do not constitute a recommendation or endorsement by FNArena with respect to any company, security, share or investment or any financial or investment product.

13. This website makes no representations, and, to the extent allowed by the law, specifically disclaims all warranties, express, implied or statutory, regarding the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any material contained in the website.

14. Before making an investment decision, you must do your own research and rely on your own examination of the share, and the risk involved, and not on what you read on the FNArena website, or in any publication or periodical. The content of this website is provided strictly for convenient personal, non-commercial educational and informational purposes only and FNArena shall not be held liable for any investment decisions, sales or purchase decisions, which you may have made based on what you have read on this website or in the periodicals published by FNArena from time to time, or in any other publications FNArena may publish on its website, or anywhere else, from time to time. Anyone who makes investment decisions based on what they read on this website does so at their own risk, and agrees that they cannot hold FNArena responsible and/or liable for any loss whatsoever.

15. It is your responsibility to evaluate the completeness, accuracy and usefulness of any content made available on this website. If you are unsure, or in doubt about the meaning of any information, you should consult your financial advisor.

16. FNArena does not guarantee any returns on investments made in any share mentioned on this website by the visitors. As any investor well knows, any investment opportunity, strategy or concept involves a degree of risk and investors should not invest any funds unless they can afford to take the risk of losing their investment. FNArena strongly suggests that you consult your own financial advisors regarding the soundness of any intended investments, strategies or concepts, and discuss with such advisor your individual investment needs and goals. You may also wish to consult the broker who expressed the opinion we have reported on in the news periodicals we publish.

17. FNArena shall not be held liable to any visitor of the FN Arena website, or any reader of its periodicals and/or publications, or anyone else who may have relied on this website, directly or indirectly, for any inaccuracies in the printed material found on the FN Arena website, in the periodicals and/or other publications, any typing errors, omissions, interruptions, timeliness, completeness, deletions, defects, failure of performance, computer virus, communication line failures, alterations of, or use of any content herein, regardless of cause, for any loss or damage resulting therefrom.

18. Under no circumstances, including, but not limited to negligence, shall FNArena be liable for any direct, indirect, incidental, special or consequential damages that result from the use of, or the inability to use, the FNArena website, and any or the FNArena's publications and/or periodicals.

19. As a condition of use of the FNArena Website, FNArena's publications and periodicals, you agree to indemnify FNArena and all those affiliated with it from and against any and all liabilities, expenses (including legal costs) and damages arising out of claims resulting from your use of the FNArena website, FNArena's publications and periodicals. If you are uncertain about this agreement or the contents of the FNArena's website, or are dissatisfied in any shape or from, with the content of the FNArena website, or any of the publications or periodicals, or you do not agree with these terms and conditions, your sole and exclusive remedy is to discontinue using the FNArena website, FNArena's publications and periodicals.

20. FNArena may, from time to time, publish advice, opinions and statements of various third parties, other than the ten stock brokers, and various other information and content providers. FNArena does not represent or endorse the accuracy or reliability of any advice, opinion, statement or other information provided by these third parties. Reliance upon any such opinion, advice, statement, or other information is at your own risk.

21. The FNArena website may contain links and pointers to websites maintained by third parties. FNArena does not operate or control in any respect any information, products or services on such third-party websites. Third party links are included solely for the convenience of visitors, and do not constitute any endorsement by FNArena of any products or services provided by the third party link owners or operators. FNArena has no control over any websites that we might link to and does not

take responsibility for their quality, content or suitability.

22. FNArena is not responsible for claims made by advertisers on the FN Arena website or in any of its periodicals. Such advertisements are included solely for the convenience of visitors, and do not constitute any endorsement by FNArena of any products or services advertised. FNArena does not check the accuracy of the statements made by the advertisers. You assume sole responsibility for the access and use of third party links and pointers from the FN Arena website, as well as any purchases you may make from those third parties (including advertisers).

23. All the content, information and material made available on this website are provided to you "as is" and without warranty of any kind from FNArena whether express or implied, including, but not limited to, implied warranties of merchantability and fitness for a particular purpose, title, non-infringement, security or accuracy, nor does FNArena endorse or take any responsibility for the accuracy or reliability of any opinion, advise or statement made through the FN Arena website, its periodicals, or for making good all or part of any loss and/or damage that may have been caused by the visitor's reliance on any information, advise, product or service obtained from a linked website.

24. FNArena is not liable for any copyright infringements incurred by any outside content or information contributors, or by third parties who have links to this website, or advertise on this website.

25. FNArena reserves the right to make any and all changes to the FN Arena website, including the publications and periodicals, at its sole discretion without notice to you. FNArena reserves the right to deny access to this website or its information to anyone at any time.

26. This agreement shall be deemed to include all other notices, policies, disclaimers, and other terms contained in the FNArena website, provided, however, that in the event of a conflict between such other terms and the terms of this agreement, the terms of this agreement shall prevail.

27. FNArena shall have the right, at its discretion, to change, modify, add or remove terms of this agreement at any time. Changes shall be effective immediately. Notification of any such changes shall be made herein, therefore, you are strongly advised to read these terms each time you wish to access the FN Arena website or any periodical.

28. No permission is granted to copy, distribute, modify, post or frame any text, graphics, video, audio, software code, or viewer interface design or logos. The entire FNArena website, including the publications and periodicals, is subject to copyright with all rights
reserved. The information contained in the website, including the publications and periodicals, shall not be published, rewritten for broadcast or publication or redistributed in any medium, or for any other reason whatsoever, without prior written permission from FNArena.

29. All original content is the copyrighted property of FNArena.