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AUSTRALIA

Will Banks Recover With The Economy?

The next 12 months will test Australia's banks as the economy hits its nadir and then commences a recovery. How will they fare this time?

-Wide-ranging support to the economy allows for a more positive view
-Duration of dividend reductions will reflect the strength of recovery
-Loan losses could escalate later in 2020 as stimulus is unwound

By Eva Brocklehurst

An inescapable fact from an economic downturn is that any credit crisis will always favour large, established providers, but how are the banks placed for a recovery this time?

Morgan Stanley believes the next 12 months will be a test of the banks' resilience as the economy hits its nadir and then starts to recover, while Goldman Sachs economists take a slightly more optimistic view now, given the wide-ranging support provided by both Australia's government and the Reserve Bank.

The pandemic initially meant major bank share prices fell by an average of -38% and underperformed the ASX200, as investors became concerned about an emerging loan loss cycle and the need for more capital, as well as the impact of even lower cash rates on bank profitability.

Then there came a rebound of around 30% because of the strong fiscal and monetary policy responses as well as a better experience from the pandemic so far in Australia. Still, as Wilsons points out major bank share prices are -25% below pre-pandemic levels while the equity market overall is down -15% from its February peak.

The broker believes a sustained improvement in earnings is needed for the banks to re-rate, particularly given the low interest rate environment and is far from convinced about the relative strength of the Australian economy versus the rest of the world.

Morgan Stanley believes the performance of the major banks will largely be determined by the strength of the eventual recovery, which in turn will be reflected in the duration of the reductions in dividends.

Moreover, the size of earnings downgrades and the impact on capital remain sources of uncertainty because it is still early in the cycle. Once the full impact of the downturn is clearer, bank performance should be driven by margin management, the pace of rebuilding and the level of sustainable returns.

JPMorgan incorporates a return to a slightly more normal cost of equity into its estimates, driven by an improving economic backdrop and the controlled nature of the pandemic in Australia.

Still, a market risk premium of 6.5% is retained on the basis that the cost of equity will stay high as long as uncertainty persists. On margins, JPMorgan also envisages positive trends, with data suggesting term deposit spreads are improving.

Yet, Goldman Sachs points out banks have not been able to re-price their deposit products down in tandem with the cuts to the cash rate so far in 2020, although re-pricing has accelerated since May.

With significant amounts of surplus liquidity in the system the re-pricing trend is likely to continue throughout 2020. Citi emphasises the fact **the major banks retain superior deposit franchises and will benefit from excess liquidity.**

As government support recedes, Citi asserts this will favour the major banks. Major banks, too, will retain a structural advantage from wholesale funding over the longer term. The broker believes **Commonwealth Bank** ((CBA)) is best placed and **Westpac** ((WBC)) less likely to reap the benefits.

From a valuation perspective, the bank sector appears to be reflecting fair value, Wilsons assesses, and the deep value that existed in April and early May has been priced out.

Provisioning/Impairments

Morgan Stanley has concluded that **higher losses stemming from regulatory requirements will need a further increase in bank provisioning, while impairment charges will remain elevated.**

National Australia Bank ((NAB)) is expected to have the highest loss rate given its business mix and exposure to those industries most affected by the pandemic, and the broker downgrades the stock to Equal-Weight from Overweight.

Morgan Stanley, too, expects Commonwealth Bank to remain the leader on capital with Westpac lagging. Westpac is upgraded to Equal-Weight, given an improved margin outlook from lower funding costs amid less concern about loan losses.

Goldman Sachs agrees it likely the build-up in provisions has not yet come to an end, and assesses the sector is trading at what can sustainably earn a 10% return. **ANZ Bank** ((ANZ)) is downgraded to Neutral, as the broker calculates the stock only offers a 1% shareholder return and would become more constructive if cost targets can be achieved by FY22.

Bank of Queensland ((BOQ)) is upgraded to Buy as the broker is now more confident the bank can reach its target of a broadly flat net interest margin in the second half. The bank is expected to benefit from an improved deposit funding environment.

Wilsons speculates whether banks have taken too many provisions. The current bad debt cycle may turn out to be short, given the JobKeeper support package has turned out to be costing less than the government's initial estimates.

Provisions for bad debts were calculated in mid to late April and the broker points out this could mean banks have over-provisioned if the economy bounces back quicker than anticipated. This would then allow “deferred” dividends to be paid. Announcements regarding dividends are due in early August from both ANZ Bank and Westpac.

Morgan Stanley does not expect any more capital raisings from the banks, calculating that excess capital to the tune of $10bn puts the average CET1 ratios of the major banks ahead of the “unquestionably strong” target of 10.5% set by APRA.

While expecting each of the major banks will pay a final 2020 dividend the broker assumes the potential for more dividend deferrals, given the guidance from APRA. Dividends in 2022 are still likely to be around -25% below 2019, in Morgan Stanley's assessment.

In order for dividends to return to 2019 levels, the broker believes the average return on equity would need to recover to around 11% and pay-out ratios would need to be around 75%.

Credit Quality

Morgan Stanley expects a deterioration in credit quality will be more widespread than during the GFC because of the impact of the pandemic on employment and household incomes. Still, cumulative loss rates as a proportion of non-housing loans are anticipated to be lower than during the GFC and at less than half of the previous recessionary levels (1990-92).

Citi anticipates a second material credit event in the second half of 2020, as stimulus measures are unwound. Losses are typically higher amongst those loans that have originated in preceding years as less collateral has built up.

The broker expects two distinct phases in the fall-out from the pandemic. Firstly volume momentum will return to the majors, and feedback suggests this is starting to occur. Some such as **Macquarie Group** ((MQG)) are focusing on loan to value ratios of less than 60%, interpreted as a "practical withdrawal" from parts of the market.

In the second phase, as market intervention recedes and monetary conditions tighten, spreads are likely to widen and this could mean restricted access to funding for smaller lenders.

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AUSTRALIA

Healius Narrows Its Focus

Healius is simplifying its business, divesting medical centres, to enable a focus on pathology and imaging as restrictions related to the pandemic are gradually lifted.

-Profitability should improve in pathology
-Capital raising concerns removed
-Need to focus on reducing rental costs

By Eva Brocklehurst

Healius ((HLS)) is at a crossroads as it sells its medical centre business to focus on its pathology and imaging divisions. Management has also indicated that activity levels in June have started to return to normal. Firm growth has been recorded in the diagnostics business since mid April, in line with an easing of pandemic-related restrictions. Day hospitals are also improving as clinical restrictions are removed.

Credit Suisse can envisage a path to improved profitability in pathology. Historically, the broker notes the company's pathology department has operated at a lower earnings (EBIT) margin compared with rival Sonic Healthcare ((SHL)).

Healius is less profitable because of its larger collection centre footprint, higher rents and less complex mix of testing. Occupancy costs relative to sales have increased steadily over the past 10 years in contrast to Sonic Healthcare where they have fallen.

The transition to a specialist diagnostic and day hospital operator is far from complete, Morgans suggests. There is risk around GP referrals, while work on the cost base is required and growth initiatives are unclear.

Citi believes the divestment of a complex medical centre business will mean earnings are less volatile and less capital intensive and assumes normalised earnings in FY21. The broker does not make changes to forecasts yet, given the long settlement period of the transaction.

Balance Sheet

The company has divested the medical centre business to private equity firm BGH Capital for $500m, to be completed by the end of the year. No objection is expected from the Foreign Investment Review Board. The proceeds are being used to support growth initiatives and pay down debt.

The medical centre division comprises 62 dental clinics, 69 medical centres and 13 Health & Co practices. Healius will retain day hospitals, IVF, pathology and imaging. Citi considers this a positive move for shareholders, primarily because the level of gearing was uncomfortably high.

Moreover, the company has had a history of "one-off" costs that have reduced reported earnings and the broker now assumes this will cease and management can generate a profit at the underlying level.

Macquarie agrees the balance sheet should improve and the operating structure will be simpler as a result, while concerns about a capital raising have been removed. Revised forecasts imply FY21 gearing of 1.3x and, on the broker's calculation, there is around 15% upside to the current share price.

Costs

Credit Suisse concludes that the greatest opportunity to improve the profitability of pathology is through rationalising the cost base, particularly collection centres. Hence, reducing rental costs is a key area of focus. Healius has officially closed around 50 collection centres during FY20 and during the height of the pandemic up to 500 were temporarily closed to manage costs.

Credit Suisse does not believe this is temporary, rather it is a strategy the company will use to improve the profitability of the division. The broker expects, as this occurs, the pathology earnings margin will expand to 11.6% in FY22.

Driving margin expansion will be the laboratory information system, which is software aimed at increasing functionality and improving turnaround times. Credit Suisse expects an update on the strategy and investment plans at the full year results in August.

Morgans has downgraded to Hold from Add. The broker includes the divestment in estimates but believes it remains challenging to accurately forecast the impact from the pandemic. More work is required to be done before the platform will provide the benefits that will confidently support future growth.

FNArena's database has three Buy ratings and one Hold (Morgans). The consensus target is $3.28, suggesting 8.9% upside to the last share price.

AUSTRALIA

US Housing Underpins James Hardie

Once again James Hardie has provided a positive update, highlighting improvement in the first quarter, particularly in North America.

-Highly resilient and adaptable despite the downturn
-Stock still offers value despite the recent rally
-Underscores ability to grow US market volumes and retain margins

By Eva Brocklehurst

James Hardie ((JHX)) continues to provide positive surprises, with market volumes across all geographies improving in the first quarter. North America remains the highlight and the business appears to find areas to grow despite the lockdowns.

North American primary demand growth (PDG) is is tracking in excess of 7% and new housing construction has underpinned market strength, as the company benefits from the lagged effect of strong starts in January-March.

Management has noted that strength is emanating from new housing rather than renovations, and Citi considers this consistent with the feedback from the US homebuilders' data in April and May.

Professional renovation and DIY activity have also improved, but to a more moderate extent. However, UBS asserts **the disruption from the pandemic on activity and channels means that traditional calculations of PDG are less reliable right now**.

First quarter guidance for North American exterior volumes has turned around, to be up 0-2%, having been down -3% in April to mid-May. Australia is still flat, while the decline in Europe is better, now guided to be down -11-14% as opposed to down -16%. PDG should be supported by exterior remodelling work once restrictions ease further. Volumes in interiors have improved slightly but still remain down year-on-year.

<u>Resilience</u>

Morgan Stanley believes the update reflects the company's remarkable resilience. James Hardie traditionally operates on a one quarter lag from housing starts, which means that the September quarter could experience a greater impact on volumes from the downturn, yet commentary regarding the improved trajectory provides some confidence this may not be the case.

The first quarter may benefit from some abnormalities, such as upside surprise on volumes from a reduced cost base that was more geared towards a severe downturn but, Goldman Sachs asserts, it also means that management is adaptable, particularly in terms of the scale of its investment in PDG.

The broker also assesses the US housing market is structurally sound, given the under build and favourable mortgage rate environment as well as a robust customer base.

North American pricing is also in line with expectations, which suggests the market has remained rational despite the downturn. Management has reiterated it will not pay dividends until there is greater certainty on the outlook, although the liquidity position has strengthened.

Margin

Fibre cement earnings (EBIT) margin guidance is in the range of 27-29% for the first quarter, ahead of the range issued in May. Citi believes there is scope for further margin improvement should volume growth in the US be sustained.

Credit Suisse, too, envisages no material uncontrollable costs that could push margins back down in the remainder of the year, while a strong performance in the business justifies the outperformance in the stock.

With EBIT margins of 300 basis points, supported by better-than-expected volumes, savings and operating excellence, UBS agrees the stock offers value despite the recent rally. However, the broker suspects **pockets of the market may be wary of the recent outperformance, as this possibly signals downside relative to historical performance**.

The company has competently managed the disruptions to demand well but Ord Minnett warns a further impact from a second wave of the pandemic in the US needs to be acknowledged although, in the long-term, there is an opportunity to increase market share.

Goldman Sachs lauds the company's ability to grow market volumes in North America while retaining margins. The trading update has reinforced the view that management can manage margins to achieve targeted outcomes and the broker expects margins will return to around 25% in subsequent quarters.

Yet CLSA still envisages reinvestment is important and does not believe a 29% margin and 6% PDG can be achieved simultaneously. US EBIT margins are, therefore, expected to retrace to 26% by FY23, paired with a 5.5% PDG.

CLSA, not one of the seven stockbrokers monitored daily on the FNArena database, retains an Outperform rating with a $31.10 target, while Goldman Sachs, also not one of the seven, has a Buy rating and $34.38 target. The database has six Buy ratings. The consensus target is $31.42, suggesting 9.7% upside to the last share price.

See also, Resilient Start To FY21 For James Hardie on May 20, 2020.

AUSTRALIA

Momentum Improving For Metcash

Metcash has gained market share in grocery since the start of stockpiling in March and while an easing of restrictions may diminish gains going forward, some of the changed habits may stick.

-New customers generated from the pandemic restrictions
-Slowdown in comparable food sales growth likely in second half
-Hardware acquisitions consolidating Metcash's position in trade

By Eva Brocklehurst

Momentum is improving for Metcash ((MTS)) although the company's FY20 result reflected elevated operating costs towards the end, amid the recent stockpiling during the onset of the pandemic restrictions.

Credit Suisse suspects the result has probably missed more optimistic expectations but there was enough in the food division to support a solid outlook for FY21. The broker underestimated the additional costs required to meet the spike in demand, and profit leverage was therefore significantly lower than usual.

CLSA notes, while operating cash flow appeared very weak it was temporarily affected by significant investment in inventory in order to service the sales growth currently being achieved.

To date first half sales have accelerated, with grocery up 17%, liquor up 5.5% and hardware up 9.4%. The pandemic has provided new customers which, coupled with price investment, should improve medium term sales. More broadly, Ord Minnett points out **Metcash is benefiting from a food retail industry where inflation is occurring and competition, while aggressive, is not irrational.**

Metcash has gained market share in grocery since the start of stockpiling in March as shoppers favoured smaller stores, closer to home, that were outside of high-traffic shopping centres.

Credit Suisse believes the structural headwinds for IGA retailers will continue but also notes the potential for some permanence in localised shopping, which is of a strategic benefit to the independent grocery sector. Localisation, along with online expansion (of benefit to the large supermarket chains), are the two features of the current restrictions which are, presumably, going to continue to some extent.

However, Citi is more sceptical, believing the competitiveness and habitual nature of grocery shopping will mean shoppers return to their typical patterns over time and sales for Metcash will return to market levels.

UBS suspects Metcash is still facing a structural loss of share over the medium to longer term, although with a robust market backdrop and the independent grocers winning share this is more than priced in.

Morgan Stanley believes the stock warrants a higher multiple compared with history, given its diversification and balance sheet strength. The broker lifts FY21 estimates by 6% to reflect a modest increase in anticipated food earnings.

FY21

Under normal circumstances, Credit Suisse would assume a 6% earnings margin on incremental sales and estimates Metcash achieved 2.0% in the second half of FY20. While incremental margins were disappointing, management has indicated an improvement should occur as the profile is more predictable going forward compared with March and April.

Citi estimates sales growth was 25% in April before moderating to 17% over the past seven weeks. Some of the tailwinds are likely to dissipate over the rest of the first half of FY21 and the broker forecasts 5% underlying growth, in line with the market.

While expecting underlying food sales and earnings growth of 8% in the first half, Citi asserts this is more than offset by contract losses and will drive a headline -7% fall in first half food earnings. A further slowdown in growth in the second half, amid the challenge of cycling strong sales, should result in just 2% underlying growth on the broker's calculations.

Hardware

Hardware is showing some resilience in the face of slower trade demand, yet Credit Suisse expects trade will turn negative in the second half of FY21 as government housing stimulus moderates. Goldman Sachs observes **Metcash has taken advantage of the volatile conditions to consolidate a position in trade-focused hardware, through bolt-on acquisitions**.

The company completed two acquisitions, one in Victoria and one in South Australia, during FY20. This signals a strong move towards achieving significant scale in the segment, the broker adds.

The latest acquisition of 70% of Total Tools for $57m is an example, with the transaction yet to be completed. Total Tools is a franchise business in the trade market with more than $550m in sales and 81 stores.

Following both the equity raising and build in working capital, Metcash has options to increase its dividend and invest around $100m in bolt-on acquisitions, over and above the $140m already announced, Citi assesses.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $3.27 target while CLSA, also not one of the seven, reiterates a Buy rating with a $3.40 target. There are three Buy ratings on the database and three Hold. The consensus target is $3.12, suggesting 8.2% upside to the last share price.

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AUSTRALIA

Gatherings Lift Woolworths Food Sales Further

Woolworths has experienced an acceleration in food sales over recent weeks and is expected to exit the coronavirus crisis in a strong market position.

-Leverage is elusive because of cost growth
-Yet a substantial amount of costs likely to be temporary
-Return of capital unlikely until FY22

By Eva Brocklehurst

The ability of people to start gathering again has had a positive impact on supermarket food sales in recent weeks, Woolworths ((WOW)) asserts, while tobacco sales, or lack thereof, were a major drag. Liquor sales have benefited from ongoing restrictions on bars and clubs.

Woolworths expects FY20 underlying earnings (EBIT) to be $3.2-3.25bn. Sales were strong with the exception of hotels in the fourth quarter. Australian food sales rose 8.6%, NZ food sales 15.1%, Big W 27.8% and Endeavour Drinks 21.4%.

Shaw and Partners is positive on the outlook, believing the major supermarkets are better placed than most retailers in the current environment, with an effective market duopoly. Yet leverage is elusive, Morgan Stanley notes, given the cost growth. Specifically, earnings guidance implies broadly flat full-year earnings despite the strong growth in the first half.

Citi suggests sales are "excellent" although acknowledges operating leverage is relatively low, while UBS was also disappointed by the lack of operating leverage. Most of these costs should reverse through FY21, nevertheless, and the broker expects 7-9% earnings growth ex hotels.

UBS believes **Woolworths is well-placed to exit the pandemic as a higher-returning business**, assessing one or two quarters of heightened sales and costs are not material to valuing a listed grocer.

Moreover, there is an opportunity to expand the company's share of customer expenditure over the longer term. The broker concedes there is unlikely to be a significant re-rating story for Woolworths but there remains scope for an expansion of multiples.

Credit Suisse expects FY21 profit will be supported by above-trend growth in supermarket sales amid a normalising cost base and improvement in Big W and hotels. The broker suggests **Big W was an under-appreciated positive aspect of the update because of the increasing likelihood of profitability**, which will increase options for reinvestment and disposal.

A substantial amount of costs are expected to be temporary amid expectations that hygiene and social distancing costs will continue into July and then be progressively reduced as the health risks reduce.

Costs

Goldman Sachs notes guidance for an increase in pandemic-related operating costs has been maintained at $220-270m, albeit seen tracking at the higher end of this range. Management has indicated this guidance excludes team member bonuses, which the broker calculates at $125m.

Increased online transactions, particularly deliveries, along with losses in city-based metro stores have adversely affected Australian food earnings in FY20. As a result, underlying margins in the second half, in the broker's calculations, are likely to be down around -40 basis points for the Australian food and NZ supermarkets divisions and down -10 basis points for Endeavor Drinks.

Morgan Stanley now assumes a second half earnings margin of 4.37% in the Australian food business, down -34 basis points.

Macquarie anticipates recent losses of market share will unwind over the next year as conditions normalise. The broker points out shopping locally, which increased significantly during the height of the pandemic, has eased back.

Shaw expects Woolworths will maintain like-for-like sales growth above 3% and is better placed than its rival Coles ((COL)), given an ability to hold earnings margins at a higher level amid a significant packaging cost advantage and superior in-store execution.

Hotels have begun to reopen but around two thirds of the company's venues are in Victoria and Queensland where conditions are more restricted, particular for gambling. Management expects hotels to continue to be loss-making until more venues are operating with a full service.

Woolworths has advised separation of the hotels business is unlikely to take place before the first half of FY22 and Credit Suisse expects a return of capital is likely to wait until after that.

Distribution Centres

Woolworths will develop two automated distribution centres at Moorebank in NSW for an investment of $700-780m over four years. The investment will be funded through the existing capital expenditure framework. Construction is expected to be completed by the end of 2023 and initial benefits in FY25.

The facilities will replace the current centres in Minchinbury, Yennora and Mulgrave, although temperature-controlled fresh food distribution will continue out of Minchinbury. Qube Holdings ((QUB)) has committed $420-460m in warehouse construction at Moorebank.

UBS believes investment will result in significant direct and indirect benefits but wants more clarity on the return profile. Credit Suisse also wrestles with the limits implied by current capital allocations, assuming that Woolworths stays within an historical $1.8bn "envelope".

Goldman Sachs and Shaw and Partners, not among the seven stockbrokers monitored daily on the FNArena database have a Neutral rating and $35.90 target and a Buy rating and $42.50 target, respectively. The database has two Buy and three Hold ratings. The consensus target is $37.98, suggesting 5.1% upside to the last share price.

See also, Online Ordering Shaping Up For Woolworths on May 1 2020.

AUSTRALIA

Will Harvey Norman's Profit Growth Endure?

Increased Australian franchisee sales have generated exceptional profit growth for Harvey Norman in the latter stages of FY20 but will this heightened state endure?

-Profit drivers include increased Oz franchisee sales and lower tactical support
-Will exceptional profit growth be maintained after government stimulus fades?
-Housing outlook critical to the medium-term view

By Eva Brocklehurst

The Australian franchise business drove strong profits for Harvey Norman ((HVN)) which has signalled pre-tax profit in the 11 months of FY20 to date is up 20%, implying second half growth of more than 40%.

Ord Minnett notes the pandemic-induced sales process commenced with panic buying as restrictions were mooted, moving to entertainment and technology as people commenced working from home, and most recently to furniture and bedding. These are all categories that feature prominently in Harvey Norman stores.

Macquarie found the results commendable, given around 27% of the business was either closed or on restrictions for part of the second half. Almost all categories are in growth and margins appear to be the best in a long time. The broker observes consumers appear to be far less choosy when it comes to brands and willing to pay full ticket prices without promotions.

Margin expansion has been significant and operating leverage remains high, with the 20% profit growth, ex property, comparing with 7.4% sales growth. Yet both Ord Minnett and Citi suspect this substantial profit growth is unlikely to be maintained.

The company provided no further detail regarding the various divisions, having provided a sales update on June 10, but the drivers of profit, UBS asserts, are operating leverage from increased franchisee sales and lower tactical support as a result of the JobKeeper payments.

Goldman Sachs assesses Harvey Norman has benefited more significantly from operating leverage than previously anticipated. The broker also assumes there is a lower impact on profitability across international divisions.

Ord Minnett observes the external environment remains volatile and varied across the countries in which the business operates. Harvey Norman is considered one of the most exposed Australian retailers to the international scene.

Sales trends may be strong in the short term but brokers are cautious about the outlook as the stimulus fades after September and the housing market slows. Ord Minnett also points to rising unemployment as a risk to buoyant sales.

Still, UBS assesses risk/award in the stock remains attractive and Harvey Norman is benefiting from increased at-home consumption while the outlook for the housing downturn is less severe than previously anticipated.

Macquarie also suspects **travel restrictions could mean retail sales remain elevated even as the government stimulus unwinds**. Also, offshore markets are now re-opening and revealing better online sales traction than previously expected.

Assuming growth continues for the remainder of the financial year, guidance implies a pre-tax profit of around $605m, on UBS calculations. Yet the broker expects a significant decline into FY21, while FY22 should recover to pre-pandemic levels.

Credit Suisse finds the Australian housing outlook is most uncertain, particularly after temporary income support measures cease. The broker expects a flat FY21 although more certainty regarding the housing could potentially change its view.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, notes **the company's confidence when paying out the special dividend of $0.06 on June 10**, anticipating a stronger pay-out ratio of 82% in FY20 and a final dividend of $0.21.

The broker maintains a Buy rating with a $4.25 target. The database has three Buy ratings and three Hold. The consensus target is $3.98, suggesting 10.3% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.4% and 5.4% respectively.

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AUSTRALIA

Recovery Underway For Sonic Healthcare

The main issue confronting Sonic Healthcare is how quickly routine testing volumes recover, given temporary government support is underpinning COVID-19 volumes.

-Risk of price reductions for pathology testing has dissipated
-Cost savings and government support doing heavy lifting
-How quickly will routine work normalise?

By Eva Brocklehurst

Routine testing volumes are recovering for Sonic Healthcare ((SHL)) while there is also no sign COVID-19 testing is slowing down. The company is positioned well ahead of where brokers were expecting after the initial downturn in routine testing.

Sonic Healthcare now expects FY20 operating earnings will be similar to FY19, at around $1.08bn, having returned to pre-pandemic revenue in Australia and Germany although still below in the US. The base business has experienced positive trends with stabilisation emerging in late April ahead of a recovery in May. The company has also stated that "thousands of staff" are returning to work.

The update confirms improving activity levels, which combined with cost initiatives and government support schemes, have allowed for the better-than-expected earnings outcome.

UBS increases forecasts to allow for a more rapid return of routine work and improving operating margins. In addition, the broker suspects the risk of cuts to the price of pathology testing has dissipated in the US, Australia and Germany, based on the response by commercial pathology providers in meeting the needs of the populations.

If guidance is achieved, Goldman Sachs believes it would be significant, given the challenges. However, one consequence of the upgrade is that some of the volume assumptions are being brought forward from FY21.

Sonic Healthcare is a large player in a highly fragmented industry and acquisition opportunities could become more prevalent as a result of the economic challenges posed by the pandemic. Macquarie, too, expects, over the longer term, Sonic Healthcare's organic revenue growth will be supplemented by acquisitions, although reimbursement risk in key regions remains a feature.

Cost Savings

While the recovery in volumes is encouraging, Morgans assesses base revenue is subdued and, as the pandemic is far from over, this means cost savings and government support are doing the heavy lifting. Credit Suisse calculates a $300m incremental revenue benefit in the first half of FY21 from coronavirus testing, assuming reimbursement rates continue in Australia and the US until September.

However, **coronavirus testing reimbursement is a one-off benefit** and should unwind by the second half. Reimbursement policies were put in place to ensure pathology providers cover some of their fixed cost base as routine volumes fell.

On the other hand, while continuing to forecast volumes in most markets should be back to normal in FY21, Citi considers it likely that COVID-19 testing will be elevated in FY21 and this remains an upside risk.

In reality, the market has had no visibility on earnings since late March and it now appears that management has quickly adjusted the cost base to reflect what were -30-50% declines in revenue in some regions.

Morgans points out revenue in the US, UK, Ireland and Belgium is still below pre-pandemic levels and these regions represent around 35% of total sales. A recent uptick in Victorian cases also warrants close attention, in the broker's view.

In the US, which represents around 27% of total revenue, around 45% of laboratories are in the west and south-west, which are two areas that have seen a surge in cases. Hence, the broker considers the cost savings are the driver of the positive trend and remain finite, obscuring the outlook, and downgrades to Hold from Add.

Serology

A further opportunity lies in serology testing. The company has not disclosed its antibody testing capacity but Credit Suisse estimates there could be an additional 4-5% upside to earnings.

This is not factored in to the broker's estimates, as demand could be limited in most markets because of either low infection rates or reimbursement pressure. Moreover, many experts have been sceptical about the benefits of antibody testing, given the degree of false positives and limited actionable responses available.

Ord Minnett believes, if clinical results demonstrate antibodies can confer protection, then serology testing volumes could be substantial and a vaccine with relatively short-lived durability would only increase demand. Still, amid reports antibody testing growth has stalled the broker assumes only a modest contribution from this source for now.

Ord Minnett also envisages limited risk of a substantial second wave of the pandemic and expects routine work will continue to normalise, particularly where rates of community infection are low such as Germany and Australia. There is more risk in the US, given the recent growth in case numbers, but any drop in routine work could well be offset by higher COVID-19 testing.

Goldman Sachs acknowledges further outbreaks could set the recovery back to some extent but does not expect lockdowns to be as widely implemented in future as they were in March and April. The broker, not one of the seven monitored daily on the FNArena database, has a Buy rating and $34.50 target.

The database has three Buy ratings, three Hold and one Sell (UBS). The consensus target is $30.04, signalling -1.5% downside to the last share price targets range from $26.75 (UBS) to $34.00 (Citi).

AUSTRALIA

Significant Expansion Ahead For OZ Minerals

A block cave expansion at Carrapateena has been outlined, with potential to transform the long-term production outlook for OZ Minerals.

-Increased conceptual value from a transition to block caving at Carrapateena
-West Musgrave deal may signal OZ Minerals believes the project could be larger
-Brazilian assets provide no clear path to an acceptable return

By Eva Brocklehurst

Carrapateena is performing well for OZ Minerals ((OZL)) with the latest pre-feasibility study outlining potential for a block cave expansion and transforming the long-term production outlook for the company.

UBS asserts the vision and sequencing outlook delivered in the study are sensible. The broader province has prospects for satellite deposits and for the life of the mine to extend for decades beyond the current 20 years.

The expansion of Carrapateena drives increases of 50% to Macquarie's 2029-32 copper production forecasts and 30% to gold production forecasts. The expansion is expected to cost $1.25bn.

The inclusion of the larger scale development at Carrapateena leads to a 13% lift in Macquarie's price target, to $13.00 from $11.50. The broker expects OZ Minerals will be able to fund the project from operating cash flow and existing debt.

2020 guidance remains intact, supported by the mill at Carrapateena operating at rates above nameplate for six days of continuous operations. UBS considers OZ Minerals has several growth options that will be de-risked over time and drive outperformance in the share price. If the expansion is undertaken, production could grow to an average of 110-120,000tpa for 2026-37.

Citi believes the challenge for OZ Minerals will be choosing between spending US$1bn after FY22 on a block cave at Carrapateena or developing West Musgrave.

West Musgrave

OZ Minerals has announced a $73m scrip offer for Cassini Resources ((CZI)) in a move to acquire control of West Musgrave. However, management has signalled this should not be taken as an intention to develop the asset but rather as offering the potential to progress the project, perhaps to sale.

Ord Minnett envisages merit in the ownership structure being simplified ahead of the project financing. For Cassini Resources, the deal realises immediate value for shareholders rather than waiting for a longer-dated development.

The broker does point out that **OZ Minerals recently indicated it had reservations over increasing its exposure to nickel**, which is more than 50% of project revenue, which may indicate plans to reduce the commodity exposure or sell the project outright.

The deal may also be a sign that OZ Minerals is confident the project can become bigger, Citi asserts. Still, the broker considers the project ambitious with modest grade and limited options to push throughput higher.

Management has committed to providing more detailed asset and planning information once it secures ownership. Credit Suisse does not support the advancement of the project based on the current studies, which outline a sub-optimal risk/return profile based on high expenditure, modest grade, remote location as well as complex metallurgy.

It may be that ongoing drilling and improved understanding of the orebody could yield a project which improves the theoretical economic outcome but this is yet to be demonstrated.

The capital required to develop West Musgrave and Carrapateena's initial block cave expansion is material, although Credit Suisse acknowledges the conceptual timing around project development and transition could work out well.

Carrapateena Pre-feasibility

The Carrapateena pre-feasibility study has shown increased conceptual value from optimising a transition to block caving from sub-level caving. The first stage of the block cave development will be completed in 2021 while the current sub-level operation will be able to continue uninterrupted until 2023.

A final decision on the first block cave is expected in 2023, allowing for first production in 2026. A final investment decision on block cave 2 is expected in 2036.

The transition from sub-level caving at a point where grades are higher means mining will be in a sweet spot and drive production in the early years of the block cave to 140,000tpa of copper over 2028-32. This is expected to aid pay-back on the project and support de-leveraging. The main block cave will extend life until 2037, with the smaller one after that extending life to 2045.

Brazil

Credit Suisse also notes the Brazilian projects remain difficult as there is no clear path to an acceptable return on investment. The broker accepts that the move into Brazil came before the Vale dam disasters and the coronavirus pandemic but these factors have now simply increased the challenges for what is regarded as an inferior portfolio of assets.

FNArena's database has six Buy ratings and one Sell (Credit Suisse) for OZ Minerals. The consensus target is $11.18, suggesting 3.5% upside to the last share price.

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 - 19-06-20

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday June 15 to Friday June 19, 2020
Total Upgrades: 13
Total Downgrades: 20
Net Ratings Breakdown: Buy 49.71%; Hold 40.89%; Sell 9.40%

Today's dichotomy in the Australian share market is reflected in research updates released by stockbroking analysts.

On the one hand, underlying trends in earnings estimates and share price valuations and targets have turned positive.

On the other hand, the balance between recommendation upgrades and downgrades has turned in favour of more downgrades – often the same companies enjoying positive momentum in forecasts and price targets are the same ones receiving recommendation downgrades.

Today's dilemma for investors couldn't be made any clearer.

For the week ending Friday, 19th June 2020, FNArena registered thirteen upgrades versus twenty downgrades for individual ASX-listed stocks.

Only two of the upgrades didn't move past Neutral/Hold, whereas four of the downgrades sank to a fresh Sell.

Carsales and Megaport both received two downgrades, all four to Neutral, after stellar rallies in both share prices recently.

Fresh sell ratings were reserved for the ASX, InvoCare, Regis Resources, and Star Entertainment.

Negative changes to consensus price targets during the week are hardly worth paying attention to, but the positive side reveals plenty of fireworks, including for Viva Energy Group, Healius, and Premier Investments.

The situation is similar, though not quite as extreme, for the week's adjustments to earnings forecasts.

Heavy downward adjustments were made for Ardent Leisure, Sims Metal Management, and Crown Resorts but these are dwarfed by what is occurring on the positive side of the ledger.

Nine of the top ten largest increases to consensus forecasts all come in double digit percentage, with the week's top scorer -Oil Search- almost doubling the prior estimate.

Other big gainers include Viva Energy Group, Qantas, Nufarm, and Air New Zealand.

After a brief peek above the 50%, total percentage of Buy/Outperform ratings for the seven brokers covered has now fallen back to 49.71% - still very high by historical standards.

Total Neutral/Hold recommendations take up 40.89% of the total, while Sell ratings account for the remaining 9.40%.

Upgrade

COSTA GROUP HOLDINGS LIMITED ((CGC)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/2/0

Pandemic-related restrictions are being eased in Australia with sequential improvement in the food service sector. Meanwhile, Macquarie notes produce pricing remains solid and seasonal conditions robust.

Rating is upgraded to Neutral from Underperform. While Costa Group is at the higher end of the investment risk spectrum, Macquarie believes the bar is now set lower after a recent decline in the share price. Target is $2.87.

CROWN RESORTS LIMITED ((CWN)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 5/1/0

Morgan Stanley switches its preference to Crown Resorts and upgrades to Overweight from Equal-weight. Target is raised to $12.00 from $6.60. The broker believes there is now more reliance on the domestic market, given travel restrictions.

This will become a fight for market share and Crown Sydney, which opens in December, is expected to be the winner. With capacity restrictions, Morgan Stanley does not forecast a recovery until FY22. Industry view: Cautious.

FIRSTWAVE CLOUD TECHNOLOGY LIMITED ((FCT)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Firstwave Cloud Technology has completed a $15m capital raising, and on rising sales and tight cost control should reach cash flow breakeven by end-2022, Morgans estimates. With funding now settled, management can return focus to the business.

For Firstwave, the key to growing sales revenue is to continue adding distributors who pay to use the company's comprehensive cyber security offering, the broker suggests. Upgrade to Speculative Buy from Hold, target rises to 16.5c from 10.6c.

FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED ((FPH)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/3

In the US, Macquarie has research that indicates hospitalisation rates for the pandemic imply a high severity flu season. For the company, hospitalisation rates are a key driver of demand for consumables.

The broker assesses earnings momentum, combined with upside risk presented by second coronavirus wave, is compelling. Rating is upgraded to Outperform from Neutral. Target is raised to NZ$30.97 from NZ$25.02.

HEALIUS LIMITED ((HLS)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/1/0

Healius will sell its 69 medical centres, 13 Health & Co practices and 62 dental clinics for $500m. Proceeds of $470m are expected on completion. The sale to BGH Capital requires approval from the Foreign Investment Review Board and should be completed this year.

Meanwhile, trading conditions have improved in recent weeks with pathology revenue close to prior year levels and radiology revenue down in just single digits.

Credit Suisse raises FY20 earnings estimates by 20% and FY21 by 14%, expecting a stronger recovery from the pandemic.

Rating is upgraded to Outperform from Neutral, as the broker assesses the stock is trading in line with the multiple paid for medical centres, which is the least attractive and lowest-return business unit. Target is raised to $3.25 from $2.47.

See also HLS downgrade.

METCASH LIMITED ((MTS)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/3/0

Morgan Stanley anticipates a strong update for April and May. The broker believes Metcash merits a higher multiple, given its earnings diversification and balance sheet strength.

Industry feedback suggests the company's food business has taken share over the period of the lockdowns.

Morgan Stanley remains positive on the supermarket segment because of easing food deflation and discounters being less of a headwind.

Rating is upgraded to Overweight from Equal-weight and the target raised to $3.30 from $2.90. Cautious industry view.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/2/0

In light of recent online sales growth, Macquarie is of the view that the company's businesses are well-placed in terms of both brand and sales channels. Peter Alexander, Just Jeans and Portmans performed well over May.

The broker continues to assume some short-term rental relief and wage subsidies. Still, Macquarie is cautious about foot traffic, particularly in the UK. Rating is upgraded to Outperform from Neutral and the target raised to $20.11 from $12.62.

RELIANCE WORLDWIDE CORPORATION LIMITED ((RWC)) Upgrade to Outperform from Neutral by Credit Suisse.B/H/S: 4/2/0

Credit Suisse increases estimates for net profit by 53% in FY20 and 22% in FY21. The contractor outlook in the US has improved materially.

Reports are more mixed in the UK and sales are expected to be down -20-30% amid weakness in the renovation segment.

The broker is more confident Reliance Worldwide can outperform peers and upgrades to Outperform from Neutral. Target is raised to $3.25 from $2.70.

SEEK LIMITED ((SEK)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/1/1

UBS upgrades earnings expectations, anticipating most of the weakness in employment is behind us and job volumes are likely to be flat to slightly ahead from now on.

The broker also envisages potential for some of the new base costs to hold into FY21. Relative to Australian online classified peers, the broker assesses price upside for Seek and upgrades to Buy from Neutral. Target is raised to $23.00 from $15.25.

SUPER RETAIL GROUP LIMITED ((SUL)) Upgrade to Add from Hold by Morgans .B/H/S: 6/1/0

A sharp fall in Super Retail's sales in April was offset by an equivalent rebound in May, to a net -1.7% loss over the two months, Clearly the company has come out of the lockdowns relatively unscathed, Morgans notes, and it would have performed better but for more stringent restrictions in NZ. Success represents a balance of a big increase in online sales and a reduction in costs per unit.

Super Retail now wants to beef up its digital offering after paying down debt hence a $203m capital raising. While the raising is -6% dilutive to FY21 earnings, Morgans believes the resilience the business has shown over the period deserves a higher market rating. Target rises to $9.25 from $7.84. Upgrade to Add from Hold.

VIVA ENERGY GROUP LIMITED ((VEA)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/2/0

The first half update was ahead of Ord Minnett's forecasts. Costs and capital expenditure have been managed better than the broker expected.

The announcement of the Geelong energy hub provides an option but the broker has become more positive on the stock because of retail fuel margins, cost management and capital management.

Rating is upgraded to Accumulate from Hold. Target is raised to $2.00 from $1.40.

WESTPAC BANKING CORPORATION ((WBC)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 4/3/0

While Westpac has weak retail banking momentum and no plan for medium-term cost reductions, Morgan Stanley upgrades to Equal-weight from Underweight.

The upgrade stems from an improved margin outlook because of lower funding costs, amid less concern about loan losses and a reduced risk of a capital raising.

Target is raised to $18.10 from $15.00. Industry view: In Line.

WAGNERS HOLDING COMPANY LIMITED ((WGN)) Upgrade to Add from Hold by Morgans .B/H/S: 2/0/1

Australia's weak economic outlook will likely weigh on construction activity over the next 6-12 months, Morgans suggests, but government infrastructure spending will play an important role in the recovery.

Wagner's has contracts in place and a pipeline of tenders as of its first half result which should see the company well-positioned.

Leverage will peak as earnings trough in FY20, but Morgans believes the balance sheet can be managed and a debt facility extended, ahead of an earnings recovery in FY21.

On share price weakness, the broker upgrades to Add from Hold. Target unchanged at $1.20.

Downgrade

ANSELL LIMITED ((ANN)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/4/1

Ansell's CEO Magnus Nicolin has delayed retirement and will be staying until December 2021. This is due to the pandemic making it difficult to assess CEO candidates.

FY20 guidance remains unchanged with the company noting increased demand for products used by essential workers. Citi highlights the company is expanding its manufacturing and distribution capacity even as it tries to shift its focus away from pandemic-hit industries.

Ansell is also not increasing its prices except to compensate for increased costs, a strategy appreciated by the broker.

Citi downgrades to Neutral from Buy noting the stock reflects fair value currently. The target increases to $35 from $34.50.

ASX LIMITED ((ASX)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/2/4

Ord Minnett notes listing volumes and equity value traded are at high levels, although they have likely peaked and futures volumes may be under pressure.

The broker also expects capitalised costs will continue rising because of the delay in CHESS replacement.

Based on valuation, Ord Minnett considers ASX less attractive than other stocks under coverage and downgrades to Lighten from Hold. Target is reduced to $78 from $81.

CARSALES.COM LIMITED ((CAR)) Downgrade to Neutral from Outperform by Macquarie and Downgrade to Hold from Buy by Ord Minnett.B/H/S: 2/4/0

The company stated that lead volumes have grown strongly since late April, a surprise to Macquarie. The broker suspects part of this increase is cyclical, and one-off factors such as pent-up demand following the easing of social distancing restrictions as well as government stimulus have contributed.

On the basis the strength is cyclical this impact should normalise over time and have little bearing on long-term trends, in the broker's view.

Car ownership may be rising to some extent as a result of the pandemic, for which the implications are positive.

Following a 41% increase in the share price since late April Macquarie assesses value is better reflected at current levels and downgrades to Neutral from Outperform. Target rises to $18.00 from $15.30.

FY20 guidance for Carsales.com points towards operating income between $228-$232m which indicates a growth of 5-6% over FY19. Ord Minnett finds this impressive in the face of volume disruptions and a challenging new car market.

There is also a rebound in dealer activity with lead volumes growing strongly between April 22 and June 16. Public transport restrictions are also acting as a catalyst, notes the broker.

Ord Minnett considers the company to be fully valued and downgrades to Hold from Buy with the target price increasing to $17.06 from $15.72.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/4/1

Ord Minnett downgrades to Hold from Accumulate following a material outperformance of the share price.

The broker still envisages Fortescue Metals will offer strong yields but, given Brazilian iron ore exports are expected to recover in the second half of 2020, lower iron ore prices could weigh. Target is reduced to $14.60 from $15.10.

GALAXY RESOURCES LIMITED ((GXY)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/4/1

Ord Minnett downgrades to Hold from Accumulate because of recent appreciation in the share price. Target is steady at 90c.

HEALIUS LIMITED ((HLS)) Downgrade to Hold from Add by Morgans .B/H/S: 3/1/0

Healius has divested its medical centres business to BGH Capital for $500m with the transaction to be completed by end of 2020.

Morgans considers the transaction reasonably priced that will strengthen Healius's balance sheet and simplify operations across the main divisions. The company, as per a trading update, is seeing a recovery across its entire business.

The broker cautions the transition to a specialist diagnostic and day hospital operator is far from complete and highlights risks around GP referrals, optimisation of cost base and growth to drive market share gains.

The broker downgrades to Hold from Add on account of the divesture with target price reduced to $2.96 from $3.04.

See also HLS upgrade.

ILUKA RESOURCES LIMITED ((ILU)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/3/0

As there has been no update since the company withdrew guidance and reduced zircon production settings, Ord Minnett assesses there is plenty of risk around the outlook.

The main catalyst is a confirmation of the structure and timing of the spin-off of the royalty for the Mining Area C.

The broker also awaits further detail on the project pipeline to assess how this will benefit from the higher prices that are anticipated.

While remaining positive on the stock for the medium to longer term, Ord Minnett downgrades to Hold from Accumulate. Target is $8.90.

INVOCARE LIMITED ((IVC)) Downgrade to Underperform from Outperform by Macquarie .B/H/S: 2/3/1

Macquarie's analysis suggests the company continues to lose market share. Earnings risk is skewed to the downside. FY20 has been affected by lower case averages because of funeral restrictions.

There is also likely to be lower influenza-related deaths this winter because of physical distancing. Rating is downgraded to Underperform from Outperform and the target is lowered to $10.20 from $12.80.

MINERAL RESOURCES LIMITED ((MIN)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/1/0

Ord Minnett downgrades to Hold from Accumulate because of recent appreciation in the share price. Target is raised to $17.80 from $17.20.

MEGAPORT LIMITED ((MP1)) Downgrade to Hold from Add by Morgans and Downgrade to Neutral from Buy by UBS.B/H/S: 0/3/0

Demand for remote working and other cloud/collaboration solutions provided by cloud service providers has, unsurprisingly Morgans notes, been incredibly strong over the last six months. Megaport has now been included in the ASX200. The broker makes no changes to near term forecasts but lifts its target to $14.14 from $12.87 after rolling forward forecasts by 12 months.

The stock has rallied 122% year on year and shot up after the initial March sell-off. As the share price is now within 10% of target Morgans pulls back to Hold from Add.

UBS continues to like the business strategy but finds it hard to ignore the recent performance of the share price, which is up 13% since February and has outperformed the ASX small ordinaries by 29%.

The broker assesses there is upside in leveraging the platform to distribute complementary services but, without a business case, this is not factored in.

The short-term opportunity is reflected in the share price and UBS downgrades to Neutral from Buy. Target is raised to $14.05 from $11.90.

NATIONAL AUSTRALIA BANK LIMITED ((NAB)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 6/1/0

While National Australia Bank’s margin improvement is strong as is its credit quality, Morgan Stanley expects loss rates to be higher than peers due to exposure to businesses.

The broker points out the AUSTRAC issue has created uncertainty. All in all, the broker thinks the bank is more expensive than ANZ Bank and Westpac.

Morgan Stanley downgrades to Equal Weight from Overweight and increases its target to $18.50 from $16.70.

NOVONIX LIMITED ((NVX)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

Novonix has raised $5.7m from institutions and will add another $52-57m from the St Baker Energy Innovation Fund and other existing shareholders, Morgans reports.

The funds will be used to repay debt and expand synthetic graphite production capacity. The company's first graphite customer, Samsung SDI, has shown impressive sales growth.

Novonix has also filed another patent related to its Dry Particle Microgranulation technique which targets cathode production. All of which has led to a share price rally.

While the broker sees much potential, it's still early in the game and risks remain. Hence a pullback to Hold from Speculative Buy and a target cut to $1.09 from $1.39 on dilution.

OPTICOMM LTD ((OPC)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/0

Uniti Group ((UWL)), an emerging telecommunications company, is set to acquire fibre network operator OptiComm. The group has proposed a 5-option scheme of arrangement transaction to OptiComm shareholders involving scrip, cash and a combination of both.

The board of OptiComm will vote their combined circa 32% of shares in favour of the scheme and has recommended the shareholders do the same. The broker sees the chances of a third-party counter bid slim at this stage.

Ord Minnett reduces its rating to Hold from Buy with a target price of $5.42.

REGIS RESOURCES LIMITED ((RRL)) Downgrade to Sell from Hold by Ord Minnett .B/H/S: 3/3/1

Ord Minnett downgrades to Sell from Hold because of recent appreciation in the share price. Target is reduced to $4.10 from $4.20.

STOCKLAND ((SGP)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/3/1

Stockland has provided a positive update and Ord Minnett increases earnings estimates by 4% based on residential demand that is better than previously expected.

The stock sold off aggressively in February and March as the market priced in the potential impact of the pandemic but has since been the best performer among A-REITs.

As the stock is now trading broadly in line with the broker's target, the rating is downgraded to Hold from Accumulate. Target is raised to $3.50 from $3.10.

THE STAR ENTERTAINMENT GROUP LIMITED ((SGR)) Downgrade to Underweight from Overweight by Morgan Stanley .B/H/S: 4/2/1

Morgan Stanley believes Crown Sydney ((CWN)), which opens in December 2020, will be a winner in terms of the reliance on the domestic market and the ensuing fight for market share.

The broker does not believe this outlook and emphasis on domestic, has been factored into the share price for The Star.

The broker downgrades to Underweight from Overweight and acknowledges it is the sole underweight broker on the stock.

With capacity restrictions, a weaker domestic consumer and restrictions on international travel, the broker does not forecast a recovery in gambling stocks until FY22. Target is raised to $3.30 from $2.50. Industry view: Cautious.

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

Macquarie upgrades processing assumptions for Sanbrado as the performance to date has been strong.

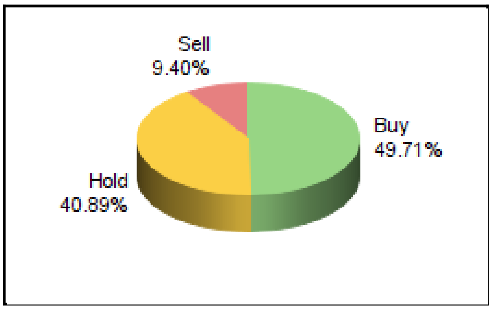
The broker now assumes throughput of 3.2mtpa from mid 2022 to mid 2021 and then reducing to nameplate capacity by mid 2022.

Rating is downgraded to Neutral from Outperform, given recent share price strength. Target is $0.90.

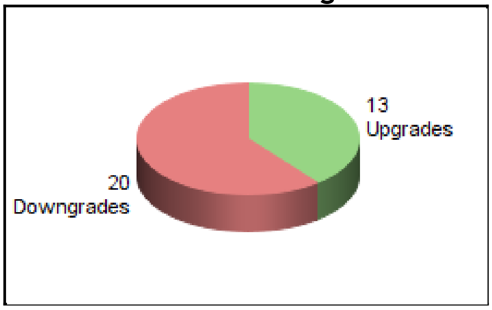
WESTERN AREAS NL ((WSA)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/3/0

Ord Minnett downgrades to Hold from Accumulate because of recent appreciation in the share price. Target is steady at $2.20.

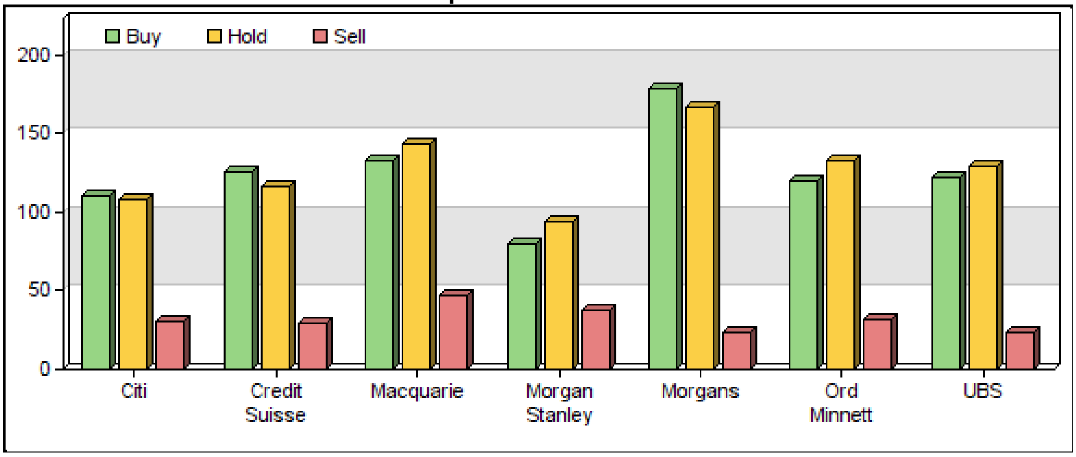
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	COSTA GROUP HOLDINGS LIMITED	Neutral	Sell	Macquarie
2	CROWN RESORTS LIMITED	Buy	Neutral	Morgan Stanley
3	FIRSTWAVE CLOUD TECHNOLOGY LIMITED	Buy	Neutral	Morgans
4	FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED	Buy	Neutral	Macquarie
5	HEALIUS LIMITED	Buy	Neutral	Credit Suisse
6	METCASH LIMITED	Buy	Neutral	Morgan Stanley
7	PREMIER INVESTMENTS LIMITED	Buy	Neutral	Macquarie
8	RELIANCE WORLDWIDE CORPORATION LIMITED	Buy	Neutral	Credit Suisse
9	SEEK LIMITED	Buy	Neutral	UBS
10	SUPER RETAIL GROUP LIMITED	Buy	Neutral	Morgans
11	VIVA ENERGY GROUP LIMITED	Buy	Neutral	Ord Minnett
12	WAGNERS HOLDING COMPANY LIMITED	Buy	Neutral	Morgans
13	WESTPAC BANKING CORPORATION	Neutral	Sell	Morgan Stanley
Downgrade				
14	ANSELL LIMITED	Neutral	Buy	Citi
15	ASX LIMITED	Sell	Neutral	Ord Minnett
16	CARSALES.COM LIMITED	Neutral	Buy	Macquarie
17	CARSALES.COM LIMITED	Neutral	Buy	Ord Minnett
18	FORTESCUE METALS GROUP LTD	Neutral	Buy	Ord Minnett
19	GALAXY RESOURCES LIMITED	Neutral	Buy	Ord Minnett
20	HEALIUS LIMITED	Neutral	Buy	Morgans
21	ILUKA RESOURCES LIMITED	Neutral	Buy	Ord Minnett
22	INVOCARE LIMITED	Sell	Buy	Macquarie

23	MEGAPORT LIMITED	Neutral	Buy	Morgans
24	MEGAPORT LIMITED	Neutral	Buy	UBS
25	MINERAL RESOURCES LIMITED	Neutral	Buy	Ord Minnett
26	NATIONAL AUSTRALIA BANK LIMITED	Neutral	Buy	Morgan Stanley
27	NOVONIX LIMITED	Neutral	Buy	Morgans
28	OPTICOMM LTD	Neutral	Buy	Ord Minnett
29	REGIS RESOURCES LIMITED	Sell	Neutral	Ord Minnett
30	STOCKLAND	Neutral	Buy	Ord Minnett
31	THE STAR ENTERTAINMENT GROUP LIMITED	Sell	Buy	Morgan Stanley
32	WEST AFRICAN RESOURCES LIMITED	Neutral	Buy	Macquarie
33	WESTERN AREAS NL	Neutral	Buy	Ord Minnett

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	FPH	FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED	-50.0%	-75.0%	25.0%	4
2	CGC	COSTA GROUP HOLDINGS LIMITED	60.0%	40.0%	20.0%	5
3	PMV	PREMIER INVESTMENTS LIMITED	60.0%	40.0%	20.0%	5
4	MTS	METCASH LIMITED	42.0%	25.0%	17.0%	6
5	SEK	SEEK LIMITED	42.0%	25.0%	17.0%	6
6	RWC	RELIANCE WORLDWIDE CORPORATION LIMITED	58.0%	42.0%	16.0%	6
7	CWN	CROWN RESORTS LIMITED	83.0%	67.0%	16.0%	6
8	IDX	INTEGRAL DIAGNOSTICS LIMITED	75.0%	60.0%	15.0%	4
9	SUL	SUPER RETAIL GROUP LIMITED	79.0%	64.0%	15.0%	7
10	WBC	WESTPAC BANKING CORPORATION	57.0%	43.0%	14.0%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	CAR	CARSALES.COM LIMITED	33.0%	67.0%	-34.0%	6
2	IVC	INVOCARE LIMITED	17.0%	50.0%	-33.0%	6
3	SGR	THE STAR ENTERTAINMENT GROUP LIMITED	43.0%	71.0%	-28.0%	7
4	WEB	WEBJET LIMITED	20.0%	40.0%	-20.0%	5
5	MIN	MINERAL RESOURCES LIMITED	67.0%	83.0%	-16.0%	3
6	ANN	ANSELL LIMITED	14.0%	29.0%	-15.0%	7
7	ABC	ADBRI LIMITED	-7.0%	7.0%	-14.0%	7
8	NAB	NATIONAL AUSTRALIA BANK LIMITED	79.0%	93.0%	-14.0%	7
9	RRL	REGIS RESOURCES LIMITED	29.0%	43.0%	-14.0%	7
10	ILU	ILUKA RESOURCES LIMITED	40.0%	50.0%	-10.0%	5

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	VEA	VIVA ENERGY GROUP LIMITED	2.077	1.778	16.82%	6
2	HLS	HEALIUS LIMITED	3.278	2.912	12.57%	4
3	PMV	PREMIER INVESTMENTS LIMITED	15.226	13.728	10.91%	5
4	CWN	CROWN RESORTS LIMITED	10.208	9.308	9.67%	6
5	JBH	JB HI-FI LIMITED	40.534	37.334	8.57%	7
6	SEK	SEEK LIMITED	20.050	18.758	6.89%	6
7	CAR	CARSALES.COM LIMITED	16.290	15.250	6.82%	6
8	IDX	INTEGRAL DIAGNOSTICS LIMITED	4.678	4.422	5.79%	4
9	SUL	SUPER RETAIL GROUP LIMITED	9.260	8.823	4.95%	7
10	WEB	WEBJET LIMITED	3.922	3.762	4.25%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	IVC	INVOCARE LIMITED	11.983	12.417	-3.50%	6

2	[ASX]	ASX LIMITED	74.231	74.660	-0.57%	7
3	[ILU]	ILUKA RESOURCES LIMITED	9.375	9.425	-0.53%	5
4	[RRL]	REGIS RESOURCES LIMITED	5.300	5.314	-0.26%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	OSH	OIL SEARCH LIMITED	4.417	2.269	94.67%	7
2	VEA	VIVA ENERGY GROUP LIMITED	2.967	1.598	85.67%	6
3	QAN	QANTAS AIRWAYS LIMITED	-6.028	-17.028	64.60%	5
4	NUF	NUFARM LIMITED	-1.710	-3.578	52.21%	7
5	AIZ	AIR NEW ZEALAND LIMITED	-7.154	-12.758	43.93%	3
6	JBH	JB HI-FI LIMITED	275.500	241.200	14.22%	7
7	STO	SANTOS LIMITED	22.779	20.015	13.81%	7
8	HLS	HEALIUS LIMITED	11.380	10.123	12.42%	4
9	URW	UNIBAIL-RODAMCO-WESTFIELD	54.697	49.095	11.41%	3
10	SXY	SENEX ENERGY LIMITED	0.217	0.200	8.50%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	ALG	ARDENT LEISURE GROUP	-9.600	-5.933	-61.81%	3
2	SGM	SIMS METAL MANAGEMENT LIMITED	-22.508	-20.130	-11.81%	6
3	CWN	CROWN RESORTS LIMITED	21.147	23.963	-11.75%	6
4	ILU	ILUKA RESOURCES LIMITED	56.005	58.005	-3.45%	5
5	SGP	STOCKLAND	32.683	33.517	-2.49%	6
6	Z1P	ZIP CO LIMITED	-10.267	-10.033	-2.33%	3
7	APX	APPEN LIMITED	64.316	65.745	-2.17%	5
8	IVC	INVOCARE LIMITED	37.183	37.867	-1.81%	6
9	HVN	HARVEY NORMAN HOLDINGS LIMITED	27.953	28.287	-1.18%	6
10	IPL	INCITEC PIVOT LIMITED	11.850	11.983	-1.11%	7

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: A Nuclear Recovery

The IEA has suggested nuclear energy plays a part in a post-virus global economic recovery, as the market remains fixated on more immediate matters.

-IEA supports nuclear power investment
-WNA points to job creation
-Uncertainty continues to weigh on uranium market

By Greg Peel

The Paris-based International Energy Agency last week put out a report titled *The World Energy Outlook Special Report on Sustainable Recovery*, outlining a set of policy actions and targeted investments in an energy-focused, post-virus economic recovery plan, put together with the International Monetary Fund.

While the report focuses mainly on energy efficiency and the expansion of renewables, it also supports nuclear power as an "important adjustment factor in reducing CO2 emissions", suggesting US$15bn should be invested in the maintenance and expansion of new nuclear power plants.

The report was not going to slip by the World Nuclear Association, which responded that for a sustained transition to a clean energy future, new nuclear plants must play a substantial role, industry consultant TradeTech notes. "The report underestimates the number of new nuclear power projects ready to start construction," the WNA declares, "as well as the thousands of supply chain jobs that would be created years before construction would begin on later reactor projects".

"In addition to construction, the operation phase of nuclear power plants, lasting 60 years or more, would create a large number of long-term high-skilled jobs that would particularly benefit local communities. This acceleration of nuclear new build would support long-term sustainable economic growth, and would make a major contribution to the global nuclear industry's Harmony goal, which targets 1000 GW of new nuclear capacity by 2050".

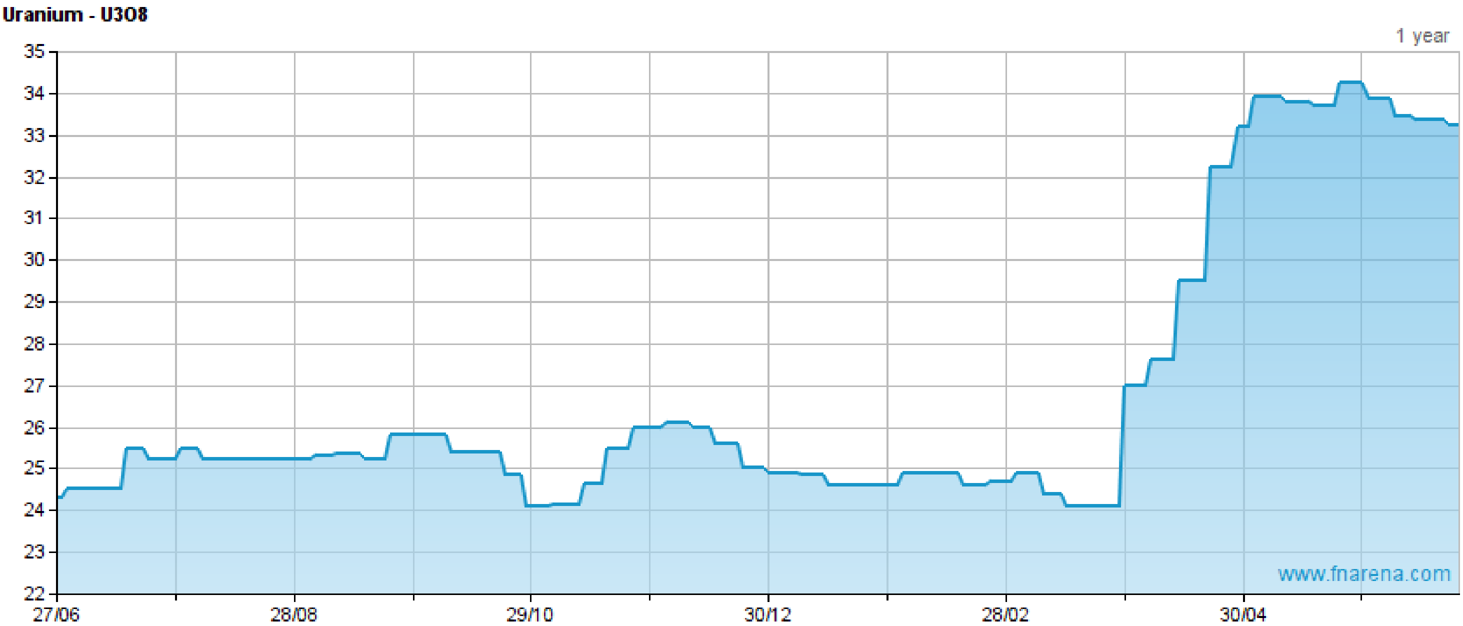
Back in the Now

That might be the future, but for now the nuclear power industry remains focused on the upcoming expiry of the Russian Suspension Agreement with the US. US Department of Commerce's International Trade Administration concluded last week the termination clause in the Agreement has signalled a free uranium market post-2020, and has thus allowed the prospect of "additional cheap and abundant Russian uranium products to overhang the market and impact pricing."

The DoC has established a schedule for comments from interested parties, which may submit case briefs on the Department's Preliminary Results and post-preliminary analysis no later than July 10. Clearly the process is set to drag on, ahead of the year-end expiry date, which means uncertainty in the uranium market will also drag on as utilities remain cautious about committing to long term supply contracts at current prices.

Which is why the uranium spot market remained muted, again, last week. TradeTech reports seven transactions completed for a total of 700,000lbs U3O8 equivalent. TradeTech's weekly spot price indicator continues to slip quietly away, after its pre-virus boost, falling another -US10c last week to US$33.25/lb.

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



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WEEKLY REPORTS

The Short Report - 25 Jun 2020

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

Summary:

Week ending June 18, 2020

Last week opened with the ASX200 tanking along with Wall Street as the US case-count climbed and the Fed warned of a weak economy. There followed a recovery of around half that loss, and until today the index tracked sideways.

I was right about one thing in last week's Report: Super Retail ((SUL)) shorts fell to 8.0% last week from 10.1% after a surprisingly positive trading update had the stock shooting up 10% on the day.

But I was wrong to assume this would only leave Myer ((MYR)) as over 10% shorted, given Perpetual ((PPT)) shorts rose to 10.3% from 8.2%. The fund manager has not performed well through the crisis, and the sharp market pullback at the beginning of the week would not have helped.

These were the only two short position changes of one percentage point or more last week, but we might note three stocks that were for *so long* stuck in the 10%-plus club continue to move further down the table, being lithium miners Galaxy Resources ((GXY)) and Orocobre ((ORE)) and stay-at-home beneficiary JB Hi-Fi ((JBH)).

We might also note that the prior steady trend of the number of stocks shorted by 5% or more reducing each week reversed last week, with a net three stocks being added.

The four stocks reappearing are all familiar faces in short table terms.

Weekly short positions as a percentage of market cap:

10%+
MYR 13.0
PPT 10.3

In: PPT Out: SUL

9.0-9.9

WEB, ING

No changes

8.0-8.9%

BOQ, NEA, CUV, SUL

In: SUL Out: PPT, JBH, GXY, ORE

7.0-7.9%

JBH, GXY, SXL, PLS, SEK, ORE, MTS

In: JBH, GXY, ORE, SXL, SEK

6.0-6.9%

NCZ, PGH, SGM, JIN, LOV, Z1P,

In: SEK, NCZ Out: SEK, SXL, LYC

5.0-5.9%

LYC, CLH, FLT, CSR, HUB, IVC, CTD, MYX, BEN, NEC, CLQ

In: LYC, FLT, CSR, IVC, BEN Out: BUB

Movers & Shakers

Movers & Shakers will return when things settle down.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	4.1	4.7	NCM	0.3	0.3
ANZ	1.0	1.1	RIO	2.2	2.3
BHP	4.4	4.4	SCG	0.7	0.4
BXB	0.3	0.2	SUN	0.7	1.6
CBA	0.5	0.6	TCL	0.8	0.4
CSL	0.2	0.2	TLS	0.2	0.2
GMG	0.5	0.4	WBC	0.8	0.8
IAG	0.6	0.7	WES	0.7	0.4
MQG	0.3	0.3	WOW	0.6	0.5
NAB	0.9	0.9	WPL	1.2	1.1

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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WEEKLY REPORTS

The Wrap: Wage Slowdown, Market Correction

Real wage growth could turn negative; a correction in the stock market; healthcare's permanent changes driven by the pandemic; and retail spending is expected to fall by 2020-end.

- Australia's nominal wage growth expected to slow
- Markets may be in for another round of correction
- Covid-19-led changes to healthcare involve more remote patient monitoring
- Retail spending is expected to fall in the quarter to December

By Angelique Thakur

Real wage growth may turn negative

ANZ Bank's research team forecasts Australia's nominal wage growth will slow down to 0.7% year-on-year (yoy) in the first half of 2021 from 2.1% (yoy) in the first quarter of 2020.

This forecast is underpinned by two developments. The first is an increase in underemployment, which has soared to more than 20%. More worrying is the unemployment rate, kept low artificially by JobKeeper.

ANZ expects it to be a long time before under-utilisation falls back to pre-pandemic levels, while unemployment is expected to reach 7.5% by the fourth quarter and remain high well into 2021.

The second development is an increase of 1.75% in the minimum wage by the Fair Work Commission on June 19. This will lead to an additional $13/week for full-time workers. The analysts note this is the smallest increase since the mid-1990s (except for the post-GFC freeze).

Also, as opposed to the usual date of July 1 for the new wages to come into force, it has been deferred for some workers till November 2020 (construction and manufacturing) and even till February 2021 (accommodation, aviation, retail and tourism). The analysts highlight some of the deferred sectors have been hit the hardest by the pandemic.

Nominal wage growth is predicted to improve to 1.2% (yoy) by mid-2022.

After adjusting for inflation, ANZ expects real wage growth could turn negative this year, continuing into 2021. This will reduce the living standards and purchasing power of households.

The fall in wage growth was also seen during the GFC with the US wage growth slowing to 1.4% (yoy) while New Zealand hit 1.5% (yoy). It took several years for wages to show any material improvement while Australia recovered quite quickly.

Right now, Australian wage growth is slower than the US or New Zealand and might even reduce to almost zero in some quarters, ANZ warns, while admitting to a lot of uncertainty around these forecasts and acknowledging an estimated 0.7% has upside risk.

Correction in the offing

Macquarie analysts anticipate a correction in equity markets and give three arguments to support their view.

Firstly, the analysts point towards rising covid-19 cases along with a second wave of shutdowns in some parts of the world. If this continues, the S&P 500 might undergo a -6-7% correction, which in turn will lead to a correction in the ASX.

The second reason is the shrinking Fed balance sheet led by reductions in repo and swaps. Since liquidity injected by the Fed has been crucial for equities, a continued contraction may add to the risk of a correction.

Here, the analysts highlight purchasing corporate bonds could offset the impact emanating from unwinding of the remaining repos and swaps.

Lastly, the analysts point out the forward price-earnings (PE) ratio for the ASX 200 is 19.3x, which is 3% above its pre-pandemic high. Such high valuations render the market vulnerable to negative surprises.

Offsetting all of the above, somewhat, may be improving earnings, with net earnings downgrades down to 15% on June 22 from nearly 80% on April 22. Macquarie analysts expect net revisions to continue to improve and be positive in August.

Macquarie prefers a defensive portfolio with exposure to commodities and resources over industrials. Stocks which have above-consensus earnings estimates and are rated Outperform include Rio Tinto ((RIO)), OZ Minerals ((OZL)), Oil Search ((OSH)), Santos ((STO)) and James Hardie Industries ((JHX)).

The new normal in healthcare

Covid-19 has changed our lives in many ways and while the pandemic itself may be temporary (hopefully), some of the changes it has prompted are expected to be far more enduring. The healthcare sector has experienced a shift in practices that Morgan Stanley feels may be permanent.

The government introduced new Telehealth codes for GP attendance which now make up about 35% of current consultations. Retaining this could increase convenience for patients and cost savings for both patients and medical centre operators. GP supply constraints could also ease up.

Morgan Stanley analysts estimate the total addressable market (TAM) for GP consultations to be about $6.5bn (in the 12 months to March) of which Telehealth could constitute $2.8bn.

Sonic Healthcare ((SHL)) and Healius ((HLS)), with a notable share of the GP attendance market, will benefit in terms of cost savings.

The Australian Health Ministry is currently assessing options pertaining to retaining Telehealth codes beyond September 30, 2020.

Cochlear’s ((COH)) Remote Check is an in-home testing tool which enables recipients to complete hearing tests. These tests are then sent to their clinician remotely for review. This solution was approved by the US FDA as a response to covid-19.

Since Cochlear is the only company offering this tool, Morgan Stanley expects this will drive market share gains and provide upside to earnings forecasts and price target.

The third shift, seen in April, relates to the US Centres for Medicare and Medicaid Services (CMS) releasing some reimbursement changes to increase access to remote care and remote patient monitoring. This was done to avoid exposure to covid-19. Morgan Stanley believes this will accelerate adoption of ResMed’s ((RMD)) Propeller Health.

Propeller Health is a digital health platform for managing asthma and chronic obstructive pulmonary disease (COPD) by tracking medication usage by patients and providing patient information to clinicians to optimize treatment.

The analysts expect more people to adopt this tool, boosted by US Medicare’s recent reimbursement changes and consider the company well positioned to benefit from sector growth.

Morgan Stanley estimates a 10% capture of the market will drive earnings upwards by around 3-4%. As a result of this sector research update, ResMed’s rating was upgraded to Overweight.

Regional Banks: A potential consolidation road map

Even excluding the impact of covid-19, regional banks continue to face challenging conditions due to their lack of scale. Bell Potter analysts believe the creation of a super-regional bank may make things easier. They advocate the merger of Bendigo & Adelaide Bank ((BEN)) with Suncorp Bank ((SUN)).

However, Suncorp Group wishes to retain its bank for the time being, prompting the analysts to look for another viable option. They point towards ME Bank and its merger with either Bendigo & Adelaide or Bank of Queensland ((BOQ)).

ME Bank was founded in 1994 by Australia’s superannuation funds industry. While it was founded to offer home loan products, it is a full-fledged bank today.

Due to its narrow focus, ME Bank’s growth profile and asset quality mirror those of smaller regional banks like Auswide Bank ((ABA)) and MyState Bank ((MYS)).

The bank’s industry fund ownership provides a stable source of funding -- its key strength according to Bell

Potter analysts, although this is somewhat marred by a lower net interest margin (NIM).

In terms of cost to income ratio, Bell potter notes ME Bank is at par with the larger regionals and ahead of Auswide and MyState.

The acquisition of ME bank by either Bendigo & Adelaide or Bank of Queensland will provide scale along with benefits like better credit rating and cost synergies. Bell Potter also expects the deal to be accretive in terms of earnings and return on equity.

The acquisition will benefit Bendigo & Adelaide more, given similarities in culture and operations.

Bell Potter analysts are bullish on Suncorp while maintaining a Hold rating for Bendigo & Adelaide Bank and Bank of Queensland.

Australian Retail: Artificially propped up

Retail sales were up 5% in May (yoy), as per ABS data, driven by at-home food retail and household goods. This is a jump from April which saw sales falling by -9% (yoy).

Citi analysts feel the current growth stems from the combined impact of factors like limited spending options outside retail along with government assistance. This is further supplemented by superannuation withdrawals with May recording -$12bn of super paid out to 1.6m members. Mortgage holidays have also boosted spending.

These factors are unlikely to persist, , and thus Citi expects retail spending to fall in the December quarter. Discretionary retail sales are expected to fall by -1-4%, even with stimulus measures amounting to $15-20bn.

Citi analysts are cautious about City Chic ((CCX)), Lovisa Holdings ((LOV)) and Wesfarmers ((WES)) due to elevated PE ratios.

AREITs: Distribution guidance throws light on operations

As most A-REITs had withdrawn guidance for the first half, Morgan Stanley analysts were keenly awaiting the June-half distribution forecasts.

Dividend forecasts by retail REITs like Shopping Centres Australasia Property Group ((SCP)) and Charter Hall Retail ((CQR)) point towards specialty tenant rent collection of only 30-50% for March- June. The analysts note rent collection may only be just starting, with rent relief measures being discussed.

A look at distribution estimates by Mirvac Group ((MGR)) and Stockland ((SGP)) implies both have lowered their payout ratios. The analysts think the two could be withholding some of their Trust earnings (used to pay dividends).

Morgan Stanley also highlights some companies may consider uncollected rent as revenue, implying there might be a huge difference between a company's reported earnings and cash actually received.

All REITs are funding distribution from cash rather than earnings, point out the analysts.

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SMALL CAPS

Adairs Positioned To Take Market Share

Adairs has experienced strong sales since its home furnishing stores re-opened and the online business is robust, standing the company in good stead despite the uncertain outlook.

-Elevated uncertainty likely to persist over the medium term
-Well-placed to take market share in both stores and online
-Main risk is a material slowdown after September

By Eva Brocklehurst

Home furnishings retailer Adairs ((ADH)) remains buoyant, experiencing strong sales since its stores have re-opened, while enjoying a robust online business.

Moreover, JobKeeper support and rent relief are underpinning the business, at least for the next few months. The main risk is a material slowdown after September but the business is considered well-placed for a potential downturn.

Sales guidance of $385-390m for FY20 signals both online and in-store sales have grown strongly. Online, Mocka (furniture) is up 52% and Adairs (soft furnishings) is up 93% in the year to date.

UBS assesses the market is rational and maintains a Buy rating and $2.55 target, but is cautious about the outlook. The company has also acknowledged elevated uncertainty exists and is likely to persist over the medium term.

Goldman Sachs believes the FY20 results are likely to be a catalyst for the market to further appreciate the extent of the online business. Online sales are expected to represent 27% of Adairs sales.

Morgans suspects additional sales have come at a little extra cost and upgrades forecasts by 20%. The broker, retaining an Add rating and $2.62 target, assumes no final dividend but anticipates the company can escape the pandemic without requiring new capital.

No commentary on costs was provided and the broker expects gross margins are within historical levels, while conditions are likely to remain robust for at least the remainder of 2020.

Management withdrew guidance at the onset of the pandemic but with wage subsidies enhancing profitability, Canaccord Genuity believes Adairs can at least meet the top end of its prior guidance range ($385-400m) for FY20.

Moreover, the broker does not believe the valuation is stretched and retains a Buy rating and $2.52 target. In sum, if faultless execution continues and FY21 turns out to be the trough in earnings, then the stock is worth owning at current levels.

FY21

A full year contribution from Mocka should add another $4-5m in earnings (EBIT) and it appears plausible to Canaccord Genuity that Adairs will continue to take share from department stores.

Recent data also indicates transaction values at specialty retailers remain elevated. Canaccord Genuity interprets this to mean **customers are being deliberate in their shopping choices, and this should favour specialty retailers over large format department stores**.

There was also significant new customer acquisitions for Adairs online when stores were closed. The company, therefore, appears well-placed to continue taking market share across either format.

Sales growth has been significantly stronger than Goldman Sachs expected, amid like-for-like sales growth of 5.3% in stores for the second half to date. The online offering is also strong, accounting for around 30% of pre-pandemic sales and there is an improving supply chain.

Goldman Sachs expects some additional expenses to emerge that reflect the faster ramping up of the store operations and forecasts zero sales growth, like-for-like, in the core stores and 10% online in FY21.

The broker assesses the stock is attractive at current levels and reiterates a Buy rating with a $2.80 target, upgrading estimates by 10-19% for FY20-22. The main risk is a material slowdown after September as JobKeeper and rental relief ends.

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SMSFUNDAMENTALS

SMSFundamentals: Australians Largely Uninformed About Their Super

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

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

Australians Largely Uninformed About Their Super

Australian super accounts have taken massive hits throughout the coronavirus pandemic highlighting the lack of knowledge the average Australian has about how their super fund works.

-Two-thirds of Australians assume super funds de-risk during a market downturn
-67% of Australians don't know how their super is invested
-The average growth super fund dropped -10% in the March 2020 quarter

By Danielle Austin

In a continuingly volatile market new research has shown that many Australians are unaware of how their superannuation funds act to protect their money during market cycles.

In a survey completed by Russell Investments in January, results showed that two-thirds of Australians believed their superannuation funds would automatically reallocate their investments during market downturns regardless of the portfolio they have opted into, while more than a third thought their superannuation investments were managed based on their personal circumstances even when they did not actively choose how their super was invested within their fund.

The results feed into a larger conversation around the lack of knowledge Australians have about how their superannuation funds are invested.

Knowledge is key when it comes to investment decisions, with appropriate asset allocation being one of the strongest factors to building an adequate retirement fund, but 67% of Australians do not know how their super is invested or simply opt into their fund's default approach to investment.

Russell Investments Research Highlights Lack Of Knowledge

According to Russell Investments' Managing Director Jodie Hampshire, more work needs to be done to ensure savers are aware of their options in managing their retirement funds.

"Our research shows choosing investments within super remains a minefield for many working Australians, leading to misinformed choices, or no choice at all," said Ms Hampshire.

Australia's retirement savings market already had a gap of -$1trn in required funds in 2015. That deficit is expected to grow to -$9trn by 2050, and research shows that savers who take a hands-off approach to their retirement savings are more likely to retire with insufficient funds.

According to the research, those who have made an active choice in how they invest their super are far more likely to have also set goals around the amount they want to save or spend in their retirement. By knowing when they can afford to take more risks with their investments, and when to make more conservative decisions, savers can significantly increase their funds.

Experts have suggested that personalised investment strategies for savers could be a better approach to bridge this gap.

The current defined contribution superannuation system leaves Australians exposed through market shifts. While almost half of Australians have set a goal for their super, almost 70% do not know if their super is on track or are aware that their super is behind where it needs to be.

Giving people the information to take a more individualised approach to their superannuation fund management and retirement plans could help them better weather inevitable market cycles, said Ms Hampshire.

"A key weakness of our current system is its inability to deliver investment strategies that address individual retirement goals. Super funds are serving up one-size-fits-many approaches to investing that might look sensible on average, but in the real world, nobody is average," said Ms Hampshire.

Experts have suggested the current approach to superfund investment is too generalised and that a personal, goals-based strategy for each customer, based on their retirement goals, would give better results.

<u>One-size-fits-all Doesn't Suit All</u>

According to Russell Investments' survey one in five Australians were unaware they could make choices about their super investments. Personalised super strategies could also go some way in educating savers on their choices and equalising retirement funds.

A shift to individualised superannuation investment based on customer needs would follow trends set by other industries such as the retail and health and wellness sectors, where technology is being applied to optimise results for individuals.

In the current one-size-fits-all approach to superannuation, where funds are defined for the taxpayer, assumptions are placed on what the average retirement experience looks like and how long the average retiree will require their lifestyles funded.

The reality is there is no average experience and the current approach fails to take into consideration that retirement is also tied to wider ambitions, such as a desire to spend more time with family or to pursue hobbies and passions, which should factor into retirement savings planning.

Currently, Australia operates on a compulsory superannuation system which requires employers to make regular super contributions of at least 9.5%.

Many argue this system is inequitable and leaves many more vulnerable groups, including women and lower income earners, without enough to retire with. Increased education on investment and retirement planning, particularly among these groups, could go some way to decrease this inequity.

<u>Target-Date Investing Strategy</u>

In Australia, balanced portfolios continue to be a popular investment option, but target-date investment strategies might be an attractive alternative for savers looking for that more personalised approach.

While allocation differs between funds, in a balanced investment portfolio around 70% of equity can be expected to be allocated to shares and property and the remaining 30% in fixed interest and cash.

A balanced fund expects reasonable returns with lower risk than a growth portfolio, making it feel like the safer middle-of-the-road option for many and is often the default choice for those who don't opt for a different portfolio.

However, growth or high growth portfolios may be a good option for growing retirement funds during years when investors can weather higher risk options.

A growth portfolio typically allocates around 85% of equity in shares and property and only 15% in fixed interest and cash. Growth funds are expected to accumulate higher returns over a long-term period, but the associated higher risk also indicates the portfolio will take a bigger hit in market downturns.

With a balanced investment fund asset allocation remains consistent throughout the working life of the saver, however market risk may be more or less important throughout the life of the saver.

For younger or middle-aged savers, for example, market volatility should be less of a consideration as they have a relatively longer time in the market than savers closer to retirement age.

A target-date superannuation fund adjusts asset allocation in line with the individual's retirement age goal. This strategy adjusts the risk level of the investment portfolio in line with the savers capacity to take risk; as the length of the investment period shortens, the riskiness of the asset allocation is reduced so that generally market exposure declines with age.

Target-age investment strategy encourages taking more risk with investments earlier when the distribution of earning ability is more flexible.

Although risk-averse savers may be opposed to taking risks, it is argued that the advantage of increasing funds at a young age outweighs the risks of market downturns, while savers are young enough to wait out market cycles.

While a target-age strategy is not completely personalised, it is a step in the right direction for client-based retirement planning. The downfall is that target-aged funds are still designed for groups of individuals rather than to achieve optimal retirement outcomes for each customer.

Compared to retirement fund systems around the world, Australia has a particularly high range of final retirement outcomes, meaning while some Australians retire with an adequate nest egg, many do not. A lack of personalisation in investment strategy could be one reason for this.

It has been further argued that Australia's retirement savings market could be strengthened by higher diversification, and particularly diversification into foreign investment markets. Geographical diversification could help superannuation funds weather market cycles isolated to one country.

While there is no one right way to manage your superannuation during a recession, a general review of your funds and retirement plan is always a good idea.

Ensure your super is consolidated into one account to reduce your fees and stick with a long-term plan rather than making quick decisions during a downturn.

RUDI'S VIEWS

Rudi's View: Price Targets Can Be Your Friend

<u>Dear time-poor investor:</u> stockbroker price targets can be a handy tool for investors, when treated with intelligence and experience

-Price Targets Can Be Your Friend
-BHP, CSL And CBA Versus Telstra
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<u>Price Targets Can Be Your Friend</u>

By Rudi Filapek-Vandyck, Editor FNArena

I haven't written about stockbroker price targets and consensus targets for a while, plus I received a number of questions about them recently. Time for an update.

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Let's assume I like a certain company and I would like to buy its shares and add to my investment portfolio.

I might have an idea about what this company does, and how it's positioned in an overall groovy looking industry.

There is a past record to pay attention to, and forecasts are available too. I might even look at a price chart to see how the share price has performed and how volatile it is.

But how much do I think the shares are worth?

It's an intriguing question and one that can potentially elicit endless discussions about Ben Graham's base principles and how much of an influence low inflation and bond yields near historical lows exert on a company's valuation in modern times.

There is also the added observation that an extremely low valuation is seldom an indication of a low risk, sustainable longer-term investment while an above-average Price-Earnings (PE) ratio is not necessarily a harbinger of a share price crash that hasn't yet happened.

In reality, many of the stocks trading on higher PE ratios have proven a much better investment than peers on low PEs, and this has been going on for many years now.

So why don't I leave this to the experts who are paid to follow and analyse stocks as a full-time occupation?

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Most stockbroking analysts these days are kind enough to not only calculate a valuation based on their modeling assumptions and forecasts; in most cases they provide a price target too – it's **where they think the share price should be in 6-12 months' time**, all else remaining equal.

Those four words at the end of that previous sentence give away the first and foremost mistake many investors make when focusing on stockbrokers' price targets. Theirs is not a static process, such as determining the distance between Brisbane and Melbourne.

In the share market, as well as in the real world (i.e. the day-to-day economy), circumstances and context remain seldom the same for very long. This clashes with our human desire to receive guidance that is set in stone, irrespective of what happens.

It's the same error investors make when basing decisions on PE ratios. Years ago, it was pointed out to me High PE stocks such as REA Group ((REA)) and Seek ((SEK)) usually saw their shares weaken around May-June each year.

Because that's when PE ratios elevate beyond historical averages. That is, if we continue to focus on the financial year that is about to end and which will be reported in August.

The crucial error investors selling out were making is that professional investors by now are already looking forward to FY21 and FY22.

Sure, we don't know yet what the exact numbers in August might look like, but if these growth companies continue to grow year after year, then this year's PE ratio has to look high by the time the calendar shows May-June.

It's either that or something's wrong with how fast these companies are growing.

Lesson number one is thus: financial indicators, whether they be targets or forecasts or a multiple derived from forecasts should never be treated as an inflexible, stand-alone, set-in-stone, never-to-change indicator.

Always keep in mind things can, and will, change.

This in particular applies for sectors and stocks that are impacted by many moving inputs, like commodity producers.

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Another complication is that when multiple experts look at the same company, they often end up drawing different conclusions.

UBS doesn't like Afterpay ((APT)). The broker currently has a price target of $14. At Ord Minnett the price target was recently raised to $64.70.

No guessing why UBS has a Sell rating on the stock, and Ord Minnett has a Buy.

Most analysts covering Afterpay have a price target closer to Ord Minnett's, but most are below today's share price.

So what's the ordinary investor to do with so much conflicting inputs?

Enter **consensus price targets**. Many years ago, I discovered consensus price targets, essentially the average of multiple targets published by stockbrokers covering the same company, can be used as a handy tool for assessing entry and exit decisions.

As a rough, plain vanilla concept, my interest is usually awoken when a share price weakens more than -10% below its consensus target.

Every time I try to establish what is likely the cause of this gap opening up. There is a big difference between market momentum switching out of, say, Coles ((COL)) and Woolworths ((WOW)) as a result of portfolio rotation by institutions into banks and commodity stocks and, say, Speedcast International issuing yet another profit warning, which forces management to renegotiate the company's survival with its lenders.

When things change, one has to remain flexible enough to accept that things have *really* changed, and not necessarily for the better.

In another scenario, when companies are on a winning streak, and operational momentum is so strong that it creates a string of positive upgrades -as has been the case with Afterpay this year- we should equally acknowledge that broker updates (with upgrades) happen at a delay, and the share price is not sticking around to see what the next upgraded target might look like.

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Broker targets are most reliable for companies and circumstances that are relatively steady.

We can all multiply the price of iron ore by projected volume minus costs, but not if AUD/USD swings around or when the price differential between high grade and lower grade opens up, and that's not even mentioning the price of iron ore itself, plus freight charges.

Some sectors are more stable than others most of times.

Banks in Australia used to be pretty straightforward, with relatively low unpredictability, but this too has changed since a few years.

Nevertheless, if anyone cares to check share prices of ANZ bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)) via **Stock Analysis** on the website, you'll find bank share prices are still among the most faithful in the market when it comes to consensus targets.

Their share price seldom remains above target for long. The exception is, of course, CommBank ((CBA)). CommBank shares are the complete opposite.

Being the premium brand in the sector domestically, CBA shares always trade at a premium versus the rest. This sees the stock trade seldom below consensus target, and most of times above it.

Thus, when it comes to the consensus target, CBA shares should be judged differently. The same applies to Cochlear ((COH)), for example.

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Making forecasts and modeling assumptions in the current market context comes with above average uncertainty for a guesstimated three quarters of ASX-listed companies.

What exactly will 2021 look like? We don't even know who'll win the US presidential election in November, or whether that dreadful second wave could ultimately dwarf the impact of the first one, or when Australia will open up its borders.

This variety in potential outcomes and scenarios is currently also reflected in a wider-than-usual gap in between forecasts and price targets for companies that are operating under extreme uncertainty.

Take Flight Centre ((FLT)), for example. UBS, being the high marker, has set a price target of $16.60. The low marker, Ord Minnett, refuses to go higher than $8.96.

The share price, believe it or not, has mostly traded in line with consensus, which is currently at $13.13.

Many investors find it a challenge to cope with such extreme non-conformities, it's too confusing. Years of market observation have taught me there is value in having outliers and opposing views. They show us, investors, what risk possibly looks like, in both directions.

My personal recommendation is to do your own research, form your own view, and if it is positive take guidance from the positive views. Keep paying attention to the others. If your view is negative, do things the other way around.

I still hold a positive view for CSL ((CSL)) shares, while acknowledging short-term risks have risen somewhat because of the stronger AUD and a potential dip in plasma collection. But the share price is only a smidgen above the low marker's price target, at $288, and Morgan Stanley has made it clear it doesn't want to overpay.

In that same healthcare sector, ResMed ((RMD)) has a larger number of detractors, but thus far taking guidance from the experts with a positive view has proven the most beneficial approach.

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The most confounding aspect of paying attention to stockbroker valuations and price targets is that the gap between target and share price can sometimes blow out to ginormous proportion.

This does not automatically imply here lays a bargain ready to be jumped upon.

FNArena's Icarus Signal includes an overview of the 50 stocks whose share price is trading the furthest from consensus target.

Investors new to this might be surprised to read the target for New Century Resources ((NCZ)) -loss-making zinc and lead- is currently trading some -177% below Credit Suisse's price target of 50c.

Ok, first up, Credit Suisse is the only broker in the FNArena universe that covers this stock. There is no consensus target as such.

Secondly, the company is engaged in negotiations with Vale for the potential purchase of the Goro nickel & cobalt mine in New Caledonia.

If an agreement can be reached, and that remains a big if, the details of the deal, and how it will be paid for, are crucial to the future of the share price.

This, I believe, is exemplary of why stocks such as New Century Resources trade at such a large gap to where the price potentially can be: lots of risk and uncertainties, and a lack of investors prepared to take it on.

For some market participants there is always the lure of what if? What if things do turn around positively?

MMA Offshore ((MRM)) shares are trading -157% below Morgan Stanley's price target of 18c. For shares in Cardno ((CDD)) the implied gap is -168%. For Cassini Resources ((CZI)) -nickel and copper, in JV with OZ Minerals ((OZL)), the gap is -87%.

Investors should always be mindful that valuations and price targets can move in both directions. In case of adverse development, they can equally come down like a feather tied to a giant rock.

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Broker forecasts and valuations/price targets can be an extra tool in support of portfolio construction and investment strategies, but they are not infallible, let alone the be all and end all for fundamentally oriented investors.

At times these targets are there to strengthen confidence, to show direction or to reveal market sentiment, but they can just as well be completely off the mark.

It’s the work of humans after all, and companies are organic creatures, not simply a mathematical model in an excel spread sheet.

As the founder/Editor of FNArena I am regularly asked what is the accuracy of all those broker recommendations? Years ago, I did some research into this topic and concluded it’s probably around 6/10.

Even then, it still very much depends on what the general trends and context are, and whether the broad trajectory is straight, or whether we see multiple changes and interruptions in between.

When using price targets set by stockbroking analysts, investors should apply the same principles.

It’s easier to predict the future when the road is wide and straight, plus market sentiment does not always follow the logic behind a valuation based on fundamentals.

I speak from personal experience when I say that using price targets, and consensus targets in particular (with added market intelligence), can add that extra insight that sometimes comes in handy.

As with every other tool and market indicator; nothing is flawless, nothing is perfect. Personal insights and experience are essential.

BHP, CSL And CBA Versus Telstra

I think I can safely claim my research from the past has inspired a recent comparison made between the differences in investment returns for shares in BHP Group ((BHP)), CSL, CommBank and Telstra ((TLS)).

I think you all know the answer which stock has performed best over the past twenty years or so, and which one the worst.

Here’s the story:

https://www.arrowsg.com.au/post/yield-or-growth-telstra-ipo-vs-csl-vs-cba-vs-bhp

FNArena Talks

My audio interview from last week:

https://www.youtube.com/watch?v=9reBXP8PBQM

(This story was written on Monday 22nd June, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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

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