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Friday, 4 June 2021

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AUSTRALIA

Iron Bridge Costs Up But Fortescue Is Forgiven

Stellar iron ore prices are supplying plenty of cash flow for Fortescue Metals so a modest lift in project costs has not induced panic

-Increase in costs reported across the WA mining jurisdiction
-Spot prices generating a sharply higher earnings outlook for Fortescue Metals
-Will low-grade discounts increase significantly?

By Eva Brocklehurst

As long as the iron ore price stays at heady heights Fortescue Metals ((FMG)) is forgiven for raising its assessment of the capital expenditure costs required at the Iron Bridge development.

Fortescue Metals has revised up capital expenditure at Iron Bridge to US$3.3-3.5bn from US$3bn, of which its share is now US$2.5-2.7bn. The revised budget is subject to approval by the joint venture and, in the event others choose not to contribute, this **may create an opportunity for the company to increase its effective stake**.

To date US$1.5bn in expenditure has been incurred and, while the increase in overall expenditure was largely anticipated, the 20% uplift to unit costs and sustaining capex (to US$5-7/t) surprised and disappointed Credit Suisse, given there is no change of scale in the project.

Nevertheless, the broker considers this can be justified because other mining companies in Western Australia have also reported wage inflation. Macquarie equally concludes the increase in capital expenditure reflects project-specific, end-market factors affecting materials and installation costs.

First production has been slightly delayed to a start in December 2021, yet the broker speeds up its forecasts for the ramping up of the project, offsetting the increase in life-of-mine cash costs.

Project planners have reverted back to the original 135km slurry pipeline having abandoned the option of railing magnetite to a port. New capital expenditure guidance includes constructing an offload facility at Lumsden Point, designed to ease logistics constraints.

Iron Bridge is expected to produce 22mtpa of high-grade 67% iron at a life-of-mine C1 cash cost of US$33-38/wmt, lifting the average product grade for Fortescue Metals.

Stellar Prices

The outcome for Credit Suisse is a moderating of the valuation of Fortescue Metal's 61% ownership of Iron Bridge, equating to around -$0.20 a share. Yet the iron ore price continues to hold up and the broker forecasts an iron ore price of US$170/t for the June quarter, noting spot prices have been averaging around US$190/t since the beginning of April.

Macquarie agrees the company is benefiting from buoyant prices, largely offsetting the increase in cost assumptions, and a current spot price scenario generates 8% higher earnings for FY21 and 104% in FY22.

Ord Minnett is also disappointed about the deteriorating metrics, reducing its value estimate for Fortescue Metals by -2%. Still, the project makes sense from a growth and product quality point of view, the broker adds.

Morgan Stanley is much more negative, believing the increases in both operating and sustaining capital will have further negative impact on the project valuation. The broker retains an Underweight rating, envisaging the risk to low-grade discounts increases significantly.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, has a Sell rating too, with a target of $18.20. The broker expects a strong June quarter result in terms of production and a record final dividend in August.

Yet the Sell rating is based on relative valuation and the widening of low-grade 58% product realisations along with the uncertainty surrounding the diversification into Fortescue Future Industries.

Goldman Sachs anticipates the iron ore market will move into balance by year's end on increased supply from Brazil along with steel curtailments in China, and this makes higher grade iron ore more favourable on a value-in-use basis.

Blending options and volumes will be based on market conditions and/or customer appetite when production starts. Fortescue Metals has full marketing rights and can sell Iron Bridge concentrate as a stand-alone product or blend to improve quality.

Ord Minnett highlights the dividend yield, strong market and the 25% potential upside to its discounted cash flow valuation, calculating Iron Bridge should generate almost US$600m in operating earnings (EBITDA) when ramped up.

The database has three Buy ratings, three Hold and one Sell (Morgan Stanley). The consensus target is $21.62, signalling -2.3% downside to the last share price. Targets range from $17.45 (Morgan Stanley) to $28.00 (Ord Minnett). The dividend yield at current FX values for FY21 and FY22 forecasts is 15.9% and 11.2%, respectively.

AUSTRALIA

Citrus Crop Critical To Costa Group In 2021

Agricultural conditions may be the best they have been for some time, yet Costa Group can only offer a modest improvement to its earnings outlook for 2021

-Labour shortages prolonging recovery in 2021
-Costa to benefit from growth in new plantings
-Are factors affecting guidance seasonal not structural?

By Eva Brocklehurst

Costa Group ((CGC)) has offered a disappointing outlook for the remainder of 2021, as the problems encountered in the agricultural industry throughout the pandemic come to a head. Namely, labour.

Labour shortages for mushroom production have been pronounced amid bumper supply-driven weakness in avocado prices. Favourable growing conditions may exist and Citi now forecasts avocado prices will decline by -18% in 2021.

Costa Group has managed to secure sufficient labour to cover its citrus requirements and main berry harvest at Corindi for the second half but mushroom production remains disrupted at Monarto.

Production is expected to recover once labour requirements are met although shortages are unlikely to be fully resolved until borders reopen. Reduced winter labour requirements (in Australia) may help in the second half.

Costa Group is an industry leader in each of its Australian produce categories and the international business outlook and execution remain strong. It is the domestic business where the uncertainty lies over the extent of a recovery in the second half. Hence, Morgans downgrades to Hold from Add.

The broker cites uncertainty surrounding the extent of an earnings recovery in produce and highlights the company is cycling a particularly easy first half domestic produce segment, having been affected by drought and bushfires.

Despite the clear evidence of a strong recovery in produce, the earnings guidance provided at the company's AGM now implies a contraction in that segment and **operating earnings are now expected to be only slightly ahead in 2021**.

The deterioration in profitability largely reflects weaker tomato and avocado prices and this spurs Morgans to raise questions regarding the extent of the "benefits" from elevated consumption experienced during the pandemic.

On the positive side, harvests in Morocco and China are progressing well and there has been strong pricing and demand over the season. Volumes in China are now finishing in line with expectations while Morocco has performed well despite increased costs.

The short-term pricing pressure on tomatoes because of increased field supply is abating. On the other hand, hail damage on citrus and fruit fly restrictions in South Australia have affected the first half performance.

Goldman Sachs envisages a positive earnings trajectory over the medium term largely because of the growth in volumes from new plantings. Challenges witnessed during the current half-year illustrate the leverage not only to agricultural conditions but also market conditions.

Regardless, the broker, not one of the seven stockbrokers monitored daily on the FNArena database, considers the negative share price reaction overdone and retains a Buy rating with a $4.85 target.

Furthermore, Goldman Sachs envisages a range of domestic growth opportunities, with the company actively pursuing a citrus acquisition program and planning for the development of a large-scale citrus packing facility. Commissioning of the 10ha tomato glasshouse at Guyra (NSW) is also on track for August and the roll-out of a high-density avocado program has also been approved.

Margins

Credit Suisse regards the factors affecting guidance are seasonal not structural. The main issue being what might be construed as a normal margin for domestic produce. Over a good year peak margins may be 14-15%, while in a bad year the company has experienced margins as low as 5-6%.

When agricultural conditions are favourable, Credit Suisse is inclined to judge "normal" margins as 11-12%. The broker upgrades to Outperform from Neutral, assessing agricultural conditions are improving and first half problems such as hail should not materially affect the second half.

Citrus

The first half also sustained cost impacts from the pandemic in Morocco and international profit was diminished because of currency movements, yet citrus yields should be higher in 2021 because of a biennial nature of the crop.

The main Australian berry season is in the second half and Credit Suisse assesses this should yield 25% more premium fruit. International earnings are weighted to the first half so the produce segment is the main second half contributor.

Morgans agrees **benefits should come from the "on-year" citrus crop, improvement in Monarto production and stronger tomato prices**, forecasting second half earnings of $92.1m, but requires greater visibility on the medium-term earnings potential in produce and the extent of the structural pressures that have emerged.

Citi also forecasts a larger harvest for citrus in 2021, although pricing will be uncertain until the main naval orange and mandarin seasons commence from July and this will be a key determinant of the second half performance. Currently, Citi assumes a -10% decline in citrus prices in the second half although persistent industry-wide labour shortage could mean upside risk emerges.

CLSA, also not one of the seven, considers the risk profile is elevated over the remainder of 2021 and reduces estimates for earnings per share by -28%. The broker, nevertheless, assesses the stock is now trading at a 24-month price/earnings discount of -14% and retains a Buy rating with a revised target of $4.40.

Bell Potter, while disappointed with the downgrade implied in guidance, retains a Buy rating and agrees the key driver the second half will be the direction citrus export pricing, noting early leads from the US season are encouraging.

The broker, not one of the seven, has a target of $4.60. The database has three Hold ratings and one Buy (Credit Suisse). The consensus target is $4.01, signalling 17.9% upside to the last share price.

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AUSTRALIA

California Drought Silver Lining For Select Harvests

Beyond the current price and earnings trough that led to Select Harvests' horrible, albeit unsurprising first half result, brokers remain confident a multi-year cyclical recovery in almond prices is just around the corner

-Management's pessimism over almond prices relates to increased Californian output
-Citi forecasts an average almond price of $7.05/kg in FY22
-Wilsons is forecasting Almond segment earnings declines of -7-45%

By Mark Story

Staring at the embers of what was arguably a dismal half year for Select Harvests, management for the fruit and nut grower attempted to put a brave face on the result by reassuring shareholders that tree health remains good with strong 2021 vegetative growth and high bud load.

Select Harvests operates a diversified portfolio of almond orchards, plus a state of the art processing facility in Carina, Victoria and value added processing in Thomastown, Victoria.

At face value Select's first half result was the tale of two diametrically different stories. First the good news story: In line with sustained underlying yield improvements over several years, the company's almond crop was up 21% for the six months to 31 March 2021, and this drove a total revenue increase of 37.4% to $84.8m.

Aided by sales delayed from the second half of 2020, operating cash flow of $4.7m also improved significantly on the previous period.

However, due to lower global almond prices – down -20% to $6.00/kg - and higher production costs, the company's net profit fell -93% from $17.4m to $1.3m. Almond earnings of $3.1m declined -89%, and were -74% below Wilsons' forecasts.

Within commentary that accompanied the first half result, management anticipates low levels of pricing for its main product, almonds, for the remainder of 2021.

Pricing & earnings trough

Much of management's pessimism over future almond prices relates to an expected increas in output from California which is largely responsible for setting the price. Following a record-breaking 2020 Californian crop, the USDA Subjective Almond Estimate indicates another large crop this year. As a result, US$ almond prices are forecast to drop -5% in FY21, and -4% in FY22.

Select anticipates the second half 2021 will be broadly consistent with first half 2021 based on an almond pool price of $6.00/Kg.

However, Wilsons notes a material deterioration in seasonal conditions, coupled with any negative news flow on the Californian crop could significantly alter almond price forecasts.

Beyond FY21, Citi continues to remain constructive on the outlook for almond prices. Much of the broker's multi-year cyclical recovery in global almond prices outlook is based on lower Californian supply.

Despite the USDA's expected increase in production this year, the broker remains aligned with the prevailing industry sentiment that California's worsening drought and water supply situation will impact crop yields. With 75% of the state now in extreme drought, and 26% in exceptional drought, the broker believes conditions are likely to impact yields for the 2021 crop.

Citi expects US almond prices to move higher on the lower supply, with continued strength in export demand observed during calendar year 2021 reaching US$2.32/lb or slightly below pre-covid levels.

However, Bell Potter reminds investors that in the last decade, the USDA's US crop estimates have had an average accuracy of 98%. The broker also notes, new plantings of 66,000 acres exceeded removals of 48,000 acres implying that there is still a tail of crop growth in outward years.

Meantime, the softer first half 2021 result and FY21 average almond price drives a $19m (-40%) reduction in Citi's FY21 earnings forecasts. But the broker is forecasting an average almond price of $7.05/kg for Select in FY22, which the broker in hindsight believes will mark FY21 as a trough in both pricing and earnings.

Citi notes, a $6.00/kg average almond price for FY21 – on the back of the record 3.1 billion lbs. US 2020 almond crop, plus covid market disruptions - will represent the lowest price since full year 2012.

Due to the lower than expected average almond price, and the resulting higher operating deleverage, Citi has downgrade FY21 earnings by -40%. Based on slightly lower almond pricing in FY22, plus a smaller water cost saving benefit, and a higher horticultural cost assumption, the broker is also expecting FY22 and FY23 earnings to fall by -17% and -5% respectively.

Robust results

Due largely to lower almond price assumptions in FY21 and FY22, along with slightly higher cost of production, Wilsons is also forecasting Almond segment earnings declines of -7-45%. But with improved Food earnings and lower depreciation and amortisation partly offsetting the lower Almond earnings, the broker is forecasting group earnings (EBIT) declines of 0-44%.

However, looking beyond the half year result, Wilsons is encouraged by an uplift in food segment earnings, which in the broker's view is evidence of the initial benefits from Select's strategic review. As a result, the broker continues to see the risk/reward equation as biased to the upside.

Aided by the reclassification of parts of the Food segment as a discontinued business, food earnings of $5.7m increased materially on the previous period, while corporate costs declined -26% due to reduced employee payments and discretionary spend.

The broker reminds investors, on key factors Select exerts some control over, including crop yield and cost of production, the company continues to deliver robust results, with the latter continuing to compare well to the past seven years.

Looking to the factors outside of Select's control, Wilsons is also encouraged by management's guidance for materially lower water costs in FY22.

Citi notes, a higher than anticipated carry-over of water allocations from full year 2020 has seen water cost savings largely deferred to FY22. While current southern connected Murray Darling Basin allocation prices at $100/ML are likely to persist through FY22 according to ABARES, the broker has tempered water cost savings with a new cost per kg assumption of $0.72/kg - previously $0.51/kg in FY22.

As a result, Citi expects lower water costs to drive a $5 million earnings benefit from FY20 to FY23.

Citi is the only broker in the FNArena database that covers Select Harvests. The broker notes the company's share price has historically been highly-correlated with spot almond prices, which Citi argues has priced the company's orchard assets at a discount to their potential market value.

Citi has a Buy rating on Select and a target price of $6.80, but also notes revaluing the company's orchards at the private benchmark implies a share price of $7.23/share, or 23% above the current share price.

By comparison, Wilsons retains an Overweight rating on the company and has a target price of $6.75, plus an earnings capitalisation FY23 PER 14.5x valuation.

But with US almond prices being the key near-term driver of Select, there is no change to Bell Potter's Hold rating, and target price of $6.00.

CSLA retains a positive thesis on Select Harvests while cutting its target price to $6.50 from $6.75.

AUSTRALIA

Nine Entertainment's Digital Deal Welcomed

A deal struck by Nine Entertainment with Facebook and Google in the wake of the stoush over sharing news content on digital sites has been welcomed

-Deal provides strong earnings contribution to Nine Entertainment
-Potential for extra sales from a video deal with Google
-Is the market underestimating the benefit of a cyclical recovery?

By Eva Brocklehurst

In a well-anticipated announcement after the Australian government enacted its News Media Bargaining Code, Nine Entertainment ((NEC)) has finalised commercial agreements with Facebook and Google.

The code, developed by the Australian Competition and Consumer Commission, requires large digital platforms which operate in Australia to pay news publishers such as Nine Entertainment for content that is made available or linked to their platforms.

The Facebook deal is over three years with flat fees per annum while the Google deal, minus YouTube, is five years and comprises a fixed annual fee with modest growth. The agreements with Facebook affect the supply of news video clips and access to digital news articles while news content will be supplied to Google for the News Showcase and other news products. Google will also expand its initiatives across the Nine Entertainment platforms.

While no financial terms were disclosed, Nine Entertainment expects its publishing business will grow operating earnings (EBITDA) by $30-40m in FY22. Given limited disclosure, Macquarie is reluctant to presume on the cash flow being received and, as a result, does not include the digital cash flows in FY22 estimates.

The broker does point out that, at the 2021 Macquarie conference in early May, Nine Entertainment indicated cash flows would be fixed over time with the level of indexation, and observes this indication is consistent with the latest announcement.

Macquarie calculates that $30m per annum additional cash flow would result in an extra $0.12 per share for Nine Entertainment or around a 3.5% tailwind to valuation. The broker also believes the market continues to underestimate the ability of Nine Entertainment to capture the cyclical recovery, reiterating an Outperform rating with a $3.60 target.

Outlook Enhanced

Guidance for publishing segment growth is consistent with expectations and Credit Suisse factors in a $35m benefit from the agreements, offset by slight declines in print circulation and advertising. The broker expects the increased certainty provided by the announcement will be welcomed across the market.

Morgan Stanley is one, increasingly convinced of the investment thesis for Nine Entertainment, and lifts estimates for earnings per share by 8.9% and 9.4% for FY22 and FY23, respectively.

UBS has factored in a $50m gross contribution in FY22 in its base case and anticipates potential upside in the future stemming from incremental sales from a video deal with Google, namely YouTube.

Goldman Sachs, too, welcomes the deal, given the strong earnings contribution and recurring nature of the payments. There are now a number of incremental earnings drivers which more than offset the broker's forecast for a decline in traditional TV revenue.

On the downside, **Goldman Sachs moderates its margin profile for Stan, as competition is increasing in SVOD** (subscription video on demand), and anticipates flat margins across FY21-23.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, reiterates a Buy rating and $3.40 target. The database has four Buy ratings and one Hold (UBS). The consensus target is $3.45, suggesting 15.4% upside to the last share price.

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AUSTRALIA

Inghams' Operational Efficiencies Save The Day

Inghams Group's strong expectant earnings recovery is wired to improving market conditions and a concerted attempt to improve operational efficiencies

-Earnings guidance is ahead of consensus
-Average chicken pricing increased 12% in 2H21
-Management identified 250-plus improvement opportunities
-More higher margin products planned

By Mark Story

The covid pandemic arguably brought mixed blessings for poultry processor Inghams Group ((ING)). While extra demand for its chicken, turkey and plant-based protein products came from people hoarding food, it was offset by restaurant restrictions and closures. As a result, management made no apologies in explaining that steering the company through a year of fickle and unpredictable demand has been tricky.

Following an improvement in trading conditions, as the impact of covid restrictions ease and operating efficiencies increase group margins, this week's maiden FY21 earnings guidance was ahead of consensus expectations. As a result, brokers believe Inghams' fundamentals are attractive, and have upgraded their forecasts to reflect strong earnings recovery.

While uncertainty around the current Victoria lockdown is not reflected in management's update, guidance suggests underlying earnings are expected to be $203-$213m, and underlying net profit is expected to be $96-103m.

While Inghams is broadening its customer relationships in wholesale, which accounts for 8% of revenue, management identified reduced international tourism as a lingering headwind. However Inghams also expects export volumes to grow slowly as overseas markets reopen.

Inghams had not previously provided FY21 guidance, but highlighted its typical earnings fist half/second half skew of 52/48%. The stronger relative first half reflects robust demand for poultry over the summer period, while turkey demand is skewed to the Christmas period.

Operational efficiencies

Macquarie believes Inghams' better guidance update reflects both the benefits derived from operational efficiencies implemented throughout the year, and improved general trading conditions as the impact of covid restrictions progressively decrease.

In early May Inghams noted that third quarter 2021 core poultry volumes were slightly lower versus the previous period due to cycling a period that benefitted from covid pantry filling. Management also noted slightly lower third quarter volumes had been offset by operational efficiencies and net feed cost improvement, which are positive for earnings margins.

Based on Inghams' guidance around efficiencies implemented throughout the year, Credit Suisse suspects they have not only driven further margin improvement, but are the main contributor to FY21 guidance that was ahead of consensus.

Due to increasing evidence of delivery on planned margin expansion, Credit Suisse believes demand trends remain positive, with input feed costs likely to provide a relative tailwind in FY22.

In Macquarie’s view, higher-margin channels are improving as covid restrictions ease. The broker notes average chicken pricing across the products track increased 12% in the second half of 2021 to date versus the previous period and up 5% sequentially versus first half 2021. Overall, Macquarie is forecasting FY21 net profit 5% up on the broker’s prior forecast.

Morgans also expects fourth quarter 2021 to have benefited from lower grain costs. The broker notes, the company has previously stated that FY22 will benefit from both a full year of lower grain prices and further efficiency benefits from recent growth initiatives, including new Victoria and WA hatcheries.

Inghams has previously highlighted how its continuous improvement program is securing cost savings with minimal capital required, and over 250 improvement opportunities have been identified.

Over time, the company is expected to expand its product offering to include higher margin products. With beef prices remaining at record highs, Morgans expect solid volume growth given that chicken is the affordable protein.

Resumption of normal trading & tax credits

While the impacts from international tourism restrictions in A&NZ were still being felt when Inghams last updated in May, management’s guidance suggests volume across the food service channel, which accounts for 8% of revenue, has now largely returned to pre-covid levels.

Two standouts were chicken nuggets and value enhanced products up 29% and 18% respectively on average in the second half of 2021 to date yer on year. While local lockdowns have had minimal impact on the retail channel, which accounts for 53% of revenue, Macquarie notes that consumer shopping behaviour continues to normalise.

Future earnings will also be aided by the expected receipt of an R&D tax credit and while this will lower

Inghams' tax rate, it is yet to be qualified.

Macquarie assumes it will be more material in FY21 given the need for management to disclose it in the company's update. Macquarie reduces effective tax rate assumptions to 27.6% in FY21 from prior 29.1%.

While the R&D tax credit has typically been $0.3-0.6m annually between FY17 and FY20, Morgans views the maximum benefit as being $8.5m.

Credit Suisse, Morgans, Macquarie and Cit -- four of the six brokers on the FNArena to cover the company -- all have Buy (or equivalent) recommendations on Inghams.

Post forecast changes, Morgans blended valuation has risen to $4.27 from $4.10. The broker expects key catalysts for the stock to include the FY21 result, further weakness in grain prices and resigning the Woolworths contracts (the company's largest customer) with no adverse impacts.

By comparison, Credit Suisse and Macquarie have a target price of $4.10 and $3.98 respectively.

Credit Suisse remains of the view that Inghams offers a positive growth trajectory against an undemanding valuation. Macquarie also notes, based on 13x FY21 earnings, Inghams trades at an attractive -27% discount to its peers.

The consensus target on Inghams is $3.97 which suggests 13.2% upside to the current price.

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AUSTRALIA

Worley Well Placed For A Sustainability World

Worley has emphasised the longer-term energy transition in its investor briefing and believes it can win a substantial portion of this new work

-Sustainability services are a growing proportion of the bid pipeline
-Parts of traditional business under structural pressure
-Cost savings, revenue growth likely to drive better H2

By Eva Brocklehurst

Sustainability has become a password to the future for Worley ((WOR)) which intends to take advantage of work encompassed in contracts involving decarbonisation, resource oversight, asset maintenance and environmental consulting.

In its investor briefing the company has emphasised a longer-term energy transition outlook, expecting $128-469bn of addressable expenditure per annum to 2030 across these sustainability segments.

While differing slightly regarding the areas of importance in terms of energy transition, most brokers agree expenditure will be material and ramp up significantly, and Worley can capture a large share.

Worley expects environmental consulting on its own will grow to a $60bn market, with 50-75% of this readily accessible to its workforce. UBS highlights a **track record in designing and delivering technically complex projects will stand the business in good stead**, as there is significant scale with a global workforce of over 48,000 engineers and project services staff.

Furthermore, while sustainability services are only a small component of the current revenue mix, this is a growing proportion of the bid pipeline and tends to have a higher margin than traditional services.

Traditional Business

What about the main part of the business? Momentum in the awarding of projects is improving and sector capital expenditure is expected to increase in 2021 across the company's three main branches of work, while operating expenditure should also improve gradually as activity normalises post the pandemic.

Worley estimates expenditure for legacy power plants will be $70bn per annum with $5bn of this addressable until 2026. The company observes global oil companies are becoming, more generally, energy companies and still require traditional operations to be serviced.

Meanwhile, chemical customers are experiencing improved profitability and anticipate a V-shaped recovery in investment and a successful roll-out of vaccines in the US means more personnel-intensive projects are recommencing.

Refinery revenue, currently 15% of total revenue, is expected to shrink going forward because of structural refining overcapacity and a shift to electric vehicles. Hence, Macquarie points to aspects of the traditional business that are under structural pressure and while new sustainability opportunities offer a substitute this could come at some cost to traditional business.

Management did not provide explicit guidance but reiterated expectations for growth half on half in 2021 while cost savings are on track for $350m by June 2022. Macquarie assesses cost savings and constant currency revenue growth rather than the mix of business are the likely drivers of a better second half compared with the first.

The business is still experiencing some impact from coronavirus delays, notably in Canada and Latin America. Citi takes the opportunity to revise growth projections for the energy segment in FY21-25 because of strong oil prices, noting the segment comprises around 47% of revenue and the backlog has increased to $14.1bn as of the end of March, up 4% since December.

While many of the company's large customers are adjusting expenditure plans for the energy transition, Morgan Stanley believes the main risk is activity not materialising quickly enough. Yet the broker acknowledges oil prices are rising and assumes some incremental capital expenditure will occur in traditional markets of oil & gas.

ESG

Decarbonisation is the largest segment being targeted and Worley estimates investment of US$1.5 trillion per annum with an associated addressable market up to US$225bn.

Sustainability work involves emissions control, materials used in the energy transition such as copper, energy efficiency, electrification, decarbonisation infrastructure and, of course, renewable energy construction.

Energy transition and circular economy opportunities represent 23% of total sales factored into the pipeline, up from 11% in November. There is also improvements likely in the average gross margin because of the mix of work.

By assuming Worley can achieve a 5% share of the sustainability market, Macquarie crunches some big numbers, estimating a revenue opportunity equivalent to around current annual revenue of $9bn.

The broker notes more than 35 new offshore wind projects were awarded to Worley over the past 14 months and the sales pipeline is more than 10x the sales achieved in FY20. The company also won 40 projects over the same period for hydrogen and envisages a US$200bn addressable market by 2040.

Macquarie assesses higher commodity prices and a recovery in the global economy will lead to more projects being sanctioned along with improved confidence in the customer base. After a downgrade in February the broker suspects the stock has decoupled from the oil price and improved earnings and more contract wins are required to close the gap.

Morgan Stanley estimates the stock is trading in line with long-term averages and **to justify higher multiples there needs to be a stronger outlook for the traditional business, or an indication that the energy transition is occurring quickly** and leading to more earnings in the next 1-3 years.

Ord Minnett agrees with this assessment, noting that near-term risks exist in that exploration & production companies are yet to commit to large-scale growth. Worley is not considering major acquisitions but will focus on selective areas where it can add skill to its base.

While a little cautious regarding the pace of demand growth Citi does not believe an overly optimistic view on operations is required to construct a bullish case for the stock.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $15.60 target while the database has two Buy and four Hold ratings. The consensus target is $11.29, signalling 0.9% upside to the last share price. The dividend yield on FY21 and FY22 forecasts is 3.9% and 4.0%, respectively.

See also, Recovery Still On Offer For Worley on February 2, 2021.

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AUSTRALIA

May In Review: Banks Rise, Technology Falls

During May net earnings revisions were positive for the ninth straight month, propelling the ASX200 2.3% higher, with the bank sector leading the way.

-The ASX200 climbed 2.3% during May
-Value outperformed growth and large caps outpaced small caps
-Banks were the best performing sector, Technology the worst
-Sector suggestions
-Stock picks for the Technology and REIT sectors

By Mark Woodruff

The ASX200 rose 2.3% in May, outperforming the 0.7% rise in the S&P500, while the Nasdaq fell -1.4%. The gains in the Australian market were driven by large caps, with the ASX50 outpacing the Small Ordinaries over the month.

The gap to pre-covid expectations continues to close with FY22 EPS levels now -3% below that high watermark. The Banks and Resources sectors continue to drive both the earnings pulse and index performance year-to-date.

Global Value outperformed Growth in May, driven by a rally in Energy and Financials. The largest move was in US Value, which outperformed its Growth counterpart by 422 basis points. **Australian Value outperformed Growth** by 101bps, while the EU was the only region to see Growth outpace Value.

Globally, since the end of October 2020, Value has outperformed by 14.0%, while Value in Australia has outperformed by 30% over the same period.

Banks were the best performing sector and Technology was the worst. In a tilt to quality, Healthcare returned to a positive contribution whilst Energy remains the clear laggard.

Emerging markets outperformed developed markets for the first time since January, with strong performances from India and Russia, rising by 6.4% and 7.9%, respectively.

Australian sector performance

Banks were the best performing sector, up by 7.3% overall, led by Commonwealth Bank of Australia ((CBA)), which rose by 12% and Westpac Bank ((WBC)) increased by 5.8%. All the major banks provided trading updates in May, with lower impairments driving earnings upgrades across the sector.

In fact, every bank in the ASX300 saw FY21 earnings upgraded in May, and rising earnings accounted for 70% of the sector's return last month.

In Morgan Stanley's view, major bank price earnings multiples can continue to trade above long-run averages given low interest rates, an ongoing earnings upgrade cycle, rising dividends, stronger capital ratios and a lower risk profile.

Technology was the worst performer falling by -9.9%, with a substantial fall for EML Payments ((EML)) of -41.9%, Afterpay ((APT)) -21.1% and Appen ((APX)) declining by -14.4%. On the flipside, Computershare ((CPU)) rose by 10.6%. This is a stock that normally outperforms when bond yields rise, notes Macquarie.

Utilities were also poor performers, with a -4.3% decline over the month. The falls in both the Technology and Utilities sectors were driven more by lower earnings than lower price earnings multiples, explains the broker.

Australian Value, with a rise of 3.7%, outperformed Growth which rose 2.2% in May, with the rise in inflation negatively impacting some long duration growth stocks (e.g. Technology).

While the RBA and the Federal Reserve are currently reluctant to talk about tapering, investors may be favouring Value on the expectation that stocks with shorter duration cash flows would outperform if bond yields spike after a tapering announcement. This occurred in 2013, notes Macquarie.

Where to now?

A continued bias higher in bond yields and the corollary of higher discount rates continues to pressure asset allocation away from growth trades and long-duration positioning.

So whilst the deep value opportunity has largely passed, a broader reflation exposure makes sense to Morgan Stanley. In Australia, this can continue to be played through **select Materials exposure, with a laggard opportunity in Energy.**

The broker also suggests fiscal policy beneficiaries will likely be supported, while Banks and Diversified Financials also retain Value credentials.

However, **a risk to earnings momentum is rising costs, supply chain friction and labour shortages.** This environment has been evidenced in global markets and is now a building theme in Australia. Morgan Stanley expects this to feature more prominently in FY21 results, with the breadth of cause, and magnitude of effect, yet to be fully priced-in.

Inflation Fears

While earnings changes were a key driver of returns, the outperformance of banks along with poor returns from Technology and Utilities is consistent with a market positioning for rising bond yields, explains Macquarie. This is despite the fact the bond yields fell slightly over the month.

The market appears to be reacting more to strong inflation data though there is ongoing debate as to the duration of inflation pressures.

The 10% rise in the gold sub-sector is consistent with rising inflation. While the broker believes bitcoin is a risk asset, there are some who believe it is "digital gold", and so, the -36% fall in bitcoin may have benefitted gold inflows.

Technology

So far a spike in treasury yields has seen a consolidation though not a decline in the Nasdaq.

US industry technology bellwethers still look solid as forward revenue estimates keep ticking up though multiples are flat. However, if the dotcom era is anything to go by, there appears a lag of rate hikes and stock market declines, notes Credit Suisse.

In Australia, technology share prices underperformed again in May, most clearly in the WAAAX's, led lower by Afterpay ((APT)). Three out of the five WAAAX stocks were down by more than -10% over the month.

The ASX technology index was down -7% versus the ASX100's rise of 2.2%. Within the technology index, Bravura Solutions ((BVS)) rose 22%, Praemium ((PPS)) 20% and Bigtincan Holdings ((BTH)) increased by 18%. Meanwhile, EML Payments ((EML)) fell by -42%, IOUpay ((IOU)) -36% and Nuix ((NXL)) declined by -33%.

After checking on WAAAX relative valuations, the broker feels Xero ((XRO)) looks pricey though subscriber growth and average revenue per user (ARPU) sets up well for FY22. The analyst is comfortable looking through the lower-than-expected FY21 margin and FY22 margin guidance, given top line strength.

Also, if Altium ((ALU)) returns to double-digit growth in the June half we could see convergence toward WiseTech Global's ((WTC)) higher price earnings ratio.

Within Credit Suisse's technology sector coverage the **order of preference among those with an Outperform rating are Xero, Life360 ((360)), Audinate ((AD8)), Altium, Iress ((IRE)) and Infomedia ((IFM)).**

While remaining Neutral on WiseTech Global and Appen ((APX)), the broker is skewed more positively towards WiseTech Global than Appen, about which it has more concerns.

Credit Suisse sees multiple companies under coverage with strong, multi-year compounding growth outlooks, which can continue to perform well. Within travel names the broker continues to see upside for Corporate Travel Management ((CTD)) and Webjet ((WEB)), as global travel resumes in late 2021 and into 2022.

REITs

REITs provided a total shareholder return of 1.69% in May, underperforming the ASX200 by -0.65%.

In news flow for the month, the May federal budget had limited obvious impact on the broader REIT sector, suggests Credit Suisse, though increased funding for childcare indirectly provided a boost for childcare landlords.

The Victorian seven day lockdown (since extended to 14 days) might delay the recovery in physical office occupancy and retail patronage in the Melbourne CBD. That said, the market did not appear to aggressively further discount those REITs with relatively high Victorian exposure, though it's felt it could impact their share price recoveries.

Also in Victoria, a key focus in the upcoming August reporting season may be the effect upon REITs of new stamp duty, land tax and windfall gains taxes.

The REIT sector is trading at an around 68.3% premium to net tangible assets (NTA) on a weighted average basis. Unsurprisingly for Credit Suisse, fund managers such as Charter Hall Group ((CHC)), Goodman Group ((GMG)), Centuria Capital Group ((CNI)) and Home Consortium ((HMC)) are all trading at meaningful premiums to NTA. Alternatively, regional mall-exposed names are still trading at relatively deep discounts.

The fund managers continue to trade on relatively higher funds from operations (FFO) multiples, with pure-play alternative and industrial sector-exposed stocks also trading above the sector average. This latter group includes Ingenia Communities Group ((INA)), Arena REIT ((ARF)), National Storage REIT ((NSR)) and Centuria Industrial REIT ((CIP)).

Also the retail-exposed BWP Trust ((BWP)) is trading at a relatively high multiple, potentially due to defensive and predictable earnings. The diversified Mirvac Group ((MGR)) is also trading on relatively high multiples, perhaps due to expectations of a recovery in its development business as the apartment pipeline is re-activated, suggests Credit Suisse.

Within the broker's coverage, the equities market is willing to pay a premium for pure-play childcare and industrial exposure, and to a lesser degree, residential exposure.

Outperformers for the month included Arena REIT, which rose 5.9%, Charter Hall Social Infrastructure REIT ((CQE)) 5.8%, Irongate Group ((IAP)) 5.8%, Ingenia Communities Group 5.7% and Hotel Property Investments ((HPI)) increasing by 5.2%.

Underperformers for the month were Home Consortium falling -5.2%, Lendlease Group ((LLC)) -3.3% and Charter Hall Long WALE REIT ((CLW)) declining by -2.0%.

Dividend yields and payout ratios vary across the sector, with those looking at "self-funding" models at the lower end of the payout ratio spectrum and thus, offering lower relative yields.

The Australian ten-year bond yield was fairly stable at around 1.655%, versus 1.69% one month ago.

Credit Suisse has a preference for Fund Managers and Industrial, with Goodman Group the preferred exposure. The broker is also attracted to the large cap diversified's as a basket, but prefers Dexus Property ((DXS)) and Mirvac Group.

Within retail, the broker prefers Charter Hall Retail REIT ((CQR)). While not a REIT, there's also considered long-term value in Lendlease Group for patient investors.

Bonds

US ten-year bond yields remained fairly flat declining by -3.3bps, with falling real yields being offset by rising breakeven inflation.

In the US, April consumer price index report posted a big upside surprise, with the core reading surging by 0.9%, its largest monthly gain since 1981. A large proportion (over half) of the rise was due to surges in prices for used vehicles, airfares and lodging.

Given the nature of these items, JPMorgan's US economists maintain that the move higher will prove transitory. This is because supply chain issues eventually will be resolved and travel-related prices will steady after getting closer to pre-pandemic levels.

Commodities

The persistence of negative real yields appears to have finally triggered a move higher in the most sensitive assets, being gold and silver, explains JPMorgan.

Through the month, gold gained 7.8%, which takes the cumulative gain over the past two months to over 11%.

Copper rose by 4.3, nickel climbed 2.4%, while iron ore rose by 14.5%, after retreating slightly from its peak.

Brent Crude rose 2.8% for the month and WTI Crude by 4.3%.

Currencies

The Australian dollar was flat over May gaining only 0.2%, while the US dollar index continued to slide. In the year-to-date, the Australian dollar has gained just 0.4%.

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.

COMMODITIES

Material Matters: Coal, Nickel And Aluminium

A glance through the latest expert views and predictions about commodities: coal; nickel; lithium; and aluminium

-China's import ban on Australian coal could last for some time
-Indonesia storming ahead with nickel production
-Upside potential in lithium carbonate prices
-Citi becomes bullish about aluminium

By Eva Brocklehurst

Coal

Australian **coal** companies suspect the Chinese import ban on Australian coal could last for some time. This is the view Goldman Sachs has formed after meeting with coal companies to discuss the outlook for the industry.

China has increased its **thermal** coal imports from Indonesia, Russia and Colombia and replaced Australian **metallurgical (coking)** coal by taking a hit to quality and increasing imports from Russia, the US, Canada and Mongolia.

Producers have signalled thermal demand is robust until at least August, based on order books, utility demand and no sign of any new 6000cal supply in the market. Spot prices are expected to stay above US$90/t for most of 2021.

Over the longer term demand remains robust with over 200GW in new coal power plants in the planning stages globally. The only new supply coming from Australia is the 5500cal 10mtpa Carmichael coal mine in the Galilee Basin, expected to produce its first coal in October.

Most producers believe the prospect of a new greenfield thermal mine in Australia is now very challenging to imagine, citing delays and legal challenges to government approvals. Goldman Sachs lifts 2022 estimates for 6000cal thermal coal pricing to US$80/t.

In metallurgical coal, producers are also upbeat about the fundamentals for 2021. Premium coal has typically been sold to China yet China has not revealed Australian coal import figures since November 2020. Goldman Sachs also highlights the fact it is currently cheaper for the European **steel** mills to buy coal from Australia rather than the US, based on freight rates and differentials.

The benchmark metallurgical coal price has rallied to US$155/t in recent weeks, with the broker noting major drivers include the Indian and Japanese markets as well as a particularly tight lower-ranked PCI market.

The coal producers suspect current benchmark methodology could change as it is inefficient and set by a small number of producers, and several customers would like to switch back to quarterly pricing.

<u>Nickel</u>

Indonesia has announced a very large new project for **nickel/cobalt** production to supply the rapidly growing battery market. PT Huayou Nickel Cobalt will build a high-pressure acid leach project at the Weda Bay Industrial Park to make 120,000tpa of nickel and 15,000tpa of cobalt.

No details were provided on the final product or timing. Macquarie assesses this is a massive project and "incredibly cheap" in terms of a capital cost at just US$2.08bn. The project will be a joint venture with a number of Chinese companies. This is in addition to planned additions to **nickel pig iron** capacity.

On review, the data suggests to Macquarie there is a major shift in production to value-added products and away from nickel ore. Indonesia has banned nickel ore exports since January 2020 in order to incentivise investment in value added production.

The broker notes the first ban in 2014 sparked minimal investment because of a downturn in global demand but the reinstated ban has had a profound impact amid major Chinese investment in nickel pig iron and **stainless steel** production in Indonesia.

Macquarie sounds a warning bell for nickel fundamentals for the second half, projecting output will reach around 935,000t and maybe even breach 1mt and calculating that, by 2028, Indonesian nickel production will exceed total 2020 production.

The broker emphasises such a high level of production is necessary, as global demand for nickel is set to rise by 2mt above 2020 levels by 2030 and more than half of that demand will come from the battery sector.

<u>Lithium</u>

Lithium carbonate prices have been relatively stable in the June quarter of 2021, Macquarie observes, and are expected to stay that way for the remainder of the quarter. Yet there is upside potential in the third quarter because of an increase in smelter activity in China and rising hydroxide prices, which have now pushed above carbonate prices.

The broker notes the raw material gap for downstream producers is significant with some buyers reportedly paying premiums to index prices in order to secure product prior to the expansions slated for the second half of the year.

Macquarie notes battery swaps are starting to be offered as well, yet finds it hard to believe that electric vehicle manufacturers will share the same swap stations given variabilities in battery/car design, and does not believe this will become a mainstream service.

The advantage in battery swaps is time and cheaper costs for the customer if cars are sold without the battery. Yet the ultimate goal for electric vehicle charging is to reduce the time to fuel up for a 500km range to less than 10 minutes. The broker suspects this could be achieved in 10 years with upgrades to charging standards/battery chemistry.

Macquarie evaluates the merger of **Orecobre** ((ORE)) and **Galaxy Resources** ((GXY)) will provide synergies for the Argentinian operations and a stronger base from which to fund downstream projects. Yet the broker prefers **Pilbara Minerals** ((PLS)) wich is assessing the potential to process spodumene into a mid-stream lithium product in a joint venture with Calix.

The broker's sector pick remains **Mineral Resources** ((MIN)) because of its diversified revenue stream.

<u>Aluminium</u>

Citi analysts are particularly bullish about **aluminium** even though, as they point out, there has been no supply constraints in this market, which means aluminium never provides leverage to global cycles in the way other commodities do.

China has become a driving force behind global smelting capacity additions and has brought enough supply along in a timely manner with low costs, adding to an oversupply issue.

Yet the outlook suggests to the broker a structural change is looming which could ultimately lead to higher incentive prices to obtain new aluminium project sanctions. China is now adding much less supply and, based on current project views, demand will overtake eventually.

In 2021 supply growth is projected at 5% while 2022 the pace is expected to drop back to 3%, and 2% thereafter. The broker points out structural change in the country's approach to energy intensive sectors will mean that growth in aluminium will be limited. Citi expects aluminium prices will rise to an average of around US$2750 in 2022.

COMMODITIES

Material Matters: Lithium, Gold And Potash

A glance through the latest expert views and predictions about commodities: lithium; gold; and potash

-Lithium outlook bright, front and centre of new battery technology
-Morgan Stanley favours gold stocks which can increase long-term production
-Potash projects increasingly important as arable land availability declines

By Eva Brocklehurst

Lithium

Wilsons expects electric vehicle technology will be one of the most disruptive over the next decade. **Lithium** is at the centre of this technology, being one of the lightest and most electro-conductive elements.

Today batteries account for around 35% of total lithium demand and by 2030 this is expected to be 85%. Moreover, grid-based storage will become increasingly important by 2030.

The broker notes almost all automotive manufacturers have committed to switching to electric vehicle sales as soon as possible. This has been predicated on tough emissions legislation, particularly in the EU.

Wilsons points out demand for lithium is expected to increase more than tenfold to 2030 against committed new supply growth of around 2.5x, which opens up a large potential deficit in supply/demand economics.

Hence upside to prices is likely over the medium term. Wilsons believes investors must by into the view of surging demand and constrained mine supply in order to go long on lithium yet notes miners and technologists could find new ways of feeding demand and this may create volatility over the longer term for lithium prices.

All four main Australian producers are in the front line of efforts to contribute to global supply. Battery-grade lithium is hard to extract and Australia is expected to be the largest supplier of "hard rock" lithium, suited to high-grade batteries.

In contrast, South American lithium is produced by brining and is less suited to batteries. The third extraction method, clay extraction, despite its relative abundance, is very expensive, Wilsons points out.

Yet the broker looks for better tactical entry points to Australian lithium producers and would prefer greater upside or margin of safety before considering putting the stocks in its Australian equity focus list.

Near-term earnings multiples are elevated and Wilsons notes both **Pilbara Minerals** ((PLS)) and **Orocobre** ((ORE))/**Galaxy Resources** ((GXY)) are at relatively early stages in their mining lives, with low levels of profitability and consuming capital. Nevertheless, for those willing to go long the broker believes these two pure lithium stocks remain the most prospective.

Gold

Morgan Stanley assesses the recent rally in the **gold** price was of benefit to those gold miners that have short-term earnings growth expectations. On the other hand, the broker expects headwinds for gold in the second half and anticipates a price of US$1670/oz in the fourth quarter compared with spot prices of US$1900/oz.

The broker has found that valuations of gold stocks are following their leveraged exposure to the gold price and, given a negative gold bias, favours those stocks that can increase long-term production.

The broker finds good value in **Newcrest Mining** ((NCM)), **Northern Star Resources** ((NST)), **Regis Resources** ((RRL)) and **St Barbara** ((SBM)). **Evolution Mining** ((EVN)) is the exception. Morgan Stanley does not have a price/value history for those recently initiated, such as **Silver Lake Resources** ((SLR)) or **Ramelius Resources** ((RMS)), although assesses these are showing reasonable value on this metric.

Potash

Shaw and Partners has a positive view on **potash** in Australia believing that as arable land per capita reduces over time, further investment will be required in this sector. Potash is a potassium-carrying fertiliser that is required for crop growth and there are no substitutes.

Sulphate of potash is a premium type of potash used for higher-value fruit and vegetable crops as it does not contain chlorine but rather the nutrient sulphur as well as potassium. Sulphate of potash offers a price premium versus muriate of potash, which accounts for 89% of global potash production and cannot be used on chloride-sensitive crops.

Primary sulphate of potash from brine is expected to account for a large share of supply as new projects come on line in the current decade. Brine is a lower cost than other sources of supply, Shaw notes.

The broker notes interest in the sector has increased significantly over recent years and the are now several ASX-listed companies with projects that are close to production. **Australian Potash** ((APC)) is preparing to start up its Lake Wells project in Western Australia. A 30-year operation is planned for a 170tpa sulphate of potash operation for a capital outlay of $300m. Shaw and Partners has a Buy rating with a $0.32 target for the stock.

Meanwhile, **Agrimin** ((AMN)), not covered, is developing the Mackay sulphate of potash project on the Northern Territory/WA border that is larger in scale and using a trenching network. Lake Mackay is the largest sulphate-of-potash salt lake in Australia.

This project has of capital expenditure requirement of $600m for a mine life of more than 40 years. The other stock of note is **BCI Minerals** ((BCI)), also not covered, which is developing the Mardie salt and potash project from seawater, located in the West Pilbara.

There has not been a new large salt project in Australia in the last 20 years and the company believes the project has potential to generate strong cash flow over a long life. BCI Mineral also receives a royalty from its Iron Valley iron ore mine, operated by **Mineral Resources** ((MIN)).

ESG FOCUS

ESG Focus: Forrest’s Green Steel Plan

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The Nuts and Bolts of Twiggy Forrest’s Green Steel Plan

-Andrew Forrest wants Australia to become a green hydrogen and green steel giant
-Fortescue Metals is working towards mass producing green hydrogen on an industrial-scale
-Forrest's green plan said to generate over 1,000 gigawatts of energy and create 40,000 new jobs

By Ed Kennedy

Billionaire Andrew ‘Twiggy’ Forrest has a high octane plan for the future of the Australian mining industry. A plan where it indeed has a future.

Yes, the idea that an industry which made $202bn in 2019-20 - a 10.4% share of the Australian economy during that year - could make a dive into the economic doldrums sounds unimaginable today. But the reality is there are numerous trends in play which indicate the decade ahead for the sector will be far more turbulent.

Enter Andrew Forrest: The founder of iron ore giant Fortescue Metals Group ((FMG)), the recipient of over $4.52bn in dividends since 2011, and a man on a mission to see green hydrogen and green steel boom downunder

It’s perhaps an eyebrow-raising notion that a former CEO of a company which exported 178.2m tonnes of iron ore in fiscal 2020 is pursuing with zest a new identity as an eco warrior. But a deeper examination of Forrest’s life and the industry which made him his fortune shows there’s rich potential behind this new push.

A Sustainable Interest in Green Pursuits

Although Andrew Forrest has made a fortune in iron ore, an interest in eco-friendly pursuits has been an enduring feature of his life. These days able to go by the title Dr Andrew Forrest, the completion of a PhD in marine science during 2019 is the latest chapter in what Forrest says is an ongoing love of the marine world, first starting when he was a child.

A passion for this field hasn't only been visible among university corridors, but also in the work of the Minderoo Foundation, the not-for-profit organisation led by Forrest and his wife Nicola. In 2018 the Foundation commenced an $100m 'Flourishing Oceans' initiative -- a venture created to track global fishing patterns, fund research into the oceanic effects of plastic pollution, and provide for the construction of a research facility in Exmouth, Western Australia.

These achievements notwithstanding, Forrest now wants to usher in a new era of green hydrogen and green steel production in Australia. If he does it, it could come to be seen as the most impactful step taken in a life abundant with pioneering steps.

Green Hydrogen and Green Steel Defined

For anyone yet to be familiar with the particulars of green hydrogen and green steel, a quick primer could be useful to understand the nuts and bolts of Forrest's plan. Green hydrogen is made via electrolysis from renewable energy sources. Fitting for its name, it's a cleaner version of hydrogen production than brown hydrogen made with fossil fuels, and blue hydrogen which pollutes less than brown, but is also inferior to green due to the emissions it produces.

Green steel is made using renewable energy that produces hydrogen, which then sees that hydrogen used instead of metallurgical coal to make the steel. The end-result of this process is water being the byproduct, instead of carbon dioxide.

Forrest, and fellow enthusiasts of this duo, contend that green hydrogen and green steel can help build the road to a cleaner and greener world, and generate immense rewards for those who help construct it.

Forrest's Green Plan

Forrest laid out the vision for growing Australia's green hydrogen and green steel industry during an ABC Boyer lecture in January. In a program entitled *Oil vs Water — Confessions of a carbon emitter*, he began with a self-aware acknowledgement of the unlikely background he holds for the task ahead.

"The iron ore company I founded 18 years ago, Fortescue, generates just over two million tonnes of greenhouse gas every year. Two million tonnes. That's more than the entire emissions of Bhutan and its 800,000 inhabitants."

But in detailing the push behind his new green agenda, Forrest noted his bold drive into this new arena is complemented by his prior ventures in mining.

"I'm used to fear, I feel it as much as anyone else. But my job is to persevere through it. Eighteen years ago, I was just a young upstart trying to set up Fortescue. Everyone told me I was crazy to take on BHP and Rio Tinto. That between them had a stranglehold on the Pilbara. Almost everyone I met in the industry said it was impossible. But we did it."

For Forrest the move towards green hydrogen is about optimising the use of existing resources. Essentially sustainability 101. As Forrest said *"...right now, what do we do with hydrogen? Well, we treat it as just an ingredient in various industrial processes, not as an energy source. And we make it from burning fossil fuels, quaintly calling it grey hydrogen to hide the fact it's a pollutant."*

Noting furthermore, "We're missing a colossal opportunity. The green hydrogen market could create revenues of US$12 trillion by 2050, way more than any industry that exists today. "

With Forrest and the Fortescue board deciding it would be a "first mover" in mass-producing green hydrogen, their plan boasts truly impressive numbers - ultimately seeking to generate or help generate over 1,000 gigawatts of zero emissions energy in the long term.

Forrest's plan also aspires to create Australia's first green steel project in the next few years. Located in the Pilbara, Forrest says its status as the world's largest iron ore province and the fact it's "perfect" for placing renewable energy installations make it the ideal locale. It's here the plan to scale green steel will begin -- one that could bring immense economic benefits if successful.

Forrest holds "if we do it, the immediate and multiply impact on the Australian economy will be nothing short of nation-building on a grand scale, capturing just 10% of the global steel market, which we could easily do as we produce 40% of all iron ore globally every year, it would create enough jobs to employ Australia's entire coal industry, some 40,000 jobs."

Ironing Out the Issues

There's no question Forrest's plan has potential, but also a number of hurdles that persist.

There are those who remain weary that all the hype surrounding green hydrogen's future could be a case of hot air. Others who retain concern that - in his own words - Forrest has "made an allowance for natural gas, as a critical stepping-stone" to seeing this plan brought into being.

Then, there are those who are sceptical of the speed in which Forrest's plan can be rolled out.

Forrest certainly has form in achieving rare feats given Fortescue's growth. Yet, analogous to tech titan Elon Musk and his ambitions for Mars, there is doubt whether this plan - and Fortescue's aspirations to meet the domestic target of reaching net zero emissions by 2030 - can really come off on its current timeline.

Ultimately, perhaps the greatest barrier to the green hydrogen and green steel industries growing nationally as Forrest expects is the current 'Canberra consensus'.

Both the Coalition government and Labor Party under Anthony Albanese's leadership back the ongoing role of Australian coal in coming decades. Forrest and Fortescue can blaze their own path, but it may be a narrow road for many years without greater support from Canberra.

What It Could Mean for Australian Mining

Any fair assessment of Forrest's plan must also occur with a wider context. Specifically, surrounding the current state and future of the Australian mining industry. There's no doubt the industry is going strong today, and that won't be changing overnight. Nonetheless, there are also a number of challenges emerging early in his new decade which suggests the years ahead will pose new threats to its current profitability.

Domestically, the industry would be cautious to regard the Rudd-Gillard era mining tax as gone.

Should Labor leader Anthony Albanese win the keys to The Lodge at the next federal election, the desire to revisit the tax introduced in 2012 - and ultimately rescinded by the Abbott government - could prove profoundly tempting.

This could be the case even if Albanese must walk a fine line as his current support for coal is seen as a 'lesson learned' following Labor's shock loss at the last election, where it saw its party vote plunge in coal heartlands of regional Queensland and the NSW Hunter Valley.

It's certainly clear former prime minister Kevin Rudd - a longtime close ally of Albanese - regards the taxation issue as unfinished business. The exact structure a future tax takes on may make concessions for green operations - but it also may not.

Yet, the greatest challenge for Australia's mining future ultimately resides offshore. Right now Australia provides around 60% of China's iron ore.

That's not going to change swiftly. But Beijing's present continuation of a 'deep freeze' in relations with Canberra, apparent frustration in the Chinese steel industry surrounding its dependence on Australia, and China's quest for access to untapped mineral resources in Africa to diversify its iron ore imports, all loom as significant problems in looking ahead.

The Need for Nerves of Steel

Andrew Forrest's plan is audacious. That's right on brand with his life and career. His ambition for Fortescue to turn Australia into a green steel superpower could provide the foundation to grow a very promising industry rapidly.

It could also serve as a hedge against economic downturn in the mining industry if the growth of the local industry pans out as he describes, and the problems on the horizon with Canberra and China do eventually deal some heavy hits.

Some scepticism will persist around Forrest and Co realising the potential of green hydrogen and green steel on the current timeline. But even if such critics feel his plan is unlikely, the same could be said for Forrest's startling ascent with Fortescue.

Forrest will surely be leaning into that history as he seeks to convince others to buy in his great green plan for Australia's future.

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ESG Focus: Copper Key To Energy Transition

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Copper key to climate change

Copper production is set to play a large role in the global transition to renewable energy over the next decade as governments ramp up production of solar and wind technology and electric vehicles to meet climate goals.

-As a key component to multiple green technologies, copper is essential to achieving climate change targets
-The 2020s are expected to be the strongest historical volume growth in copper demand
-Demand for copper could increase by as much as 900% by 2030 in the case of hyper adoption of green technologies

By Danielle Austin

A transition towards clean and renewable energy sources has become a key theme in global political and financial decisions in the last twelve months. Governments and policy makers, particularly the US, EU and China, have committed large investments into funding renewable energy sources and technologies as global energy consumption is predicted to rise by as much as 26% over the next 30 years.

Key to this transition is the continued production of copper. Without the use of copper, among other key metals, the substitution of renewables for oil will not happen. The metal is needed for a shift away from a production system based on oil and gas to a production system based on sustainable sources such as solar, wind and geothermal energies.

Copper is necessary in transforming and transmitting these sustainable energy sources to a useful final state.

Copper is a transition metal with a single valence election giving it ductility, electrical conductivity, thermal conductivity, and low reactivity. These properties make copper the most affordable option for a range of technologies key to sustainable energy, including cables, batteries, transistors and inverters.

Exponential growth rates predicted over the next decade

Currently, global annual supply of copper is around 25m tonnes, comprised of 21m tonnes of primary copper and 4m tonnes secondary, or scrap, copper. Forecasts show current levels of production and growth will not be sufficient to support a global economy shifting to renewable energy sources.

Goldman Sachs predicts that by 2030 copper demand could grow by as much as 900% in the case of strong adoption of green technologies, while more modest predictions still have demand up 600% in the next decade. Based on this, **the 2020s are expected to be the strongest historical volume growth in copper demand**, exceeding China-generated growth in the 2000s.

Copper prices bottomed out in 2016 after a growth period between 2001 and 2011 and remained relatively steady over the following five years, but following a period of growth in the last year, current prices are more than double that of 2016 lows and copper equities have risen over 200%.

While current global supply of copper is around 25m tonnes per year, Goldman Sachs' modelling attributes only 3% of global copper in 2020 to 'green' copper usage. Further, since 2000 global copper growth supply has increased on average only 2.7% per year.

Comparatively, the broker predicts green copper could account for 9% of global copper demand by 2025, and as much as 16% of global copper demand by 2030, equating to an overall increase of as much as 14.5m tonnes by 2030.

Substitutions and scrap trends

As copper production tightens due to increased demand, attention may turn to alternative metals. Aluminium is often considered an alternative for copper, being around a quarter of the price, but offers around only 60% of the electrical and thermal conductivity of copper. While it is likely some aluminium will be implemented to maximise profits, it is unlikely to provide a sufficient substitution in many cases and is not expected to significantly impact copper demand.

Copper scrap may also be used to fill supply gaps. Secondary copper, or copper scrap, is sourced from recycling copper-containing products at the end of their lifecycle and retaining the useful metal. Some brokers cite China's rapid-growth copper consumption in the 2000s as a likely source of secondary copper to assist in filling supply gaps over the next decade.

According to Goldman Sachs, however, China's copper usage accelerated as copper usage in other countries decelerated. The overall affect is global copper usage was largely unaffected, and as such the broker expects secondary copper levels to remain steady.

Despite this, a secondary copper destocking cycle is expected driven by increased prices over the next decade. Goldman Sachs forecasts that for every US$1000/tonne price increase for copper the scrap trend will see an additional 4% growth in secondary copper supply.

Where you'll see copper in next generation clean tech

Demand for renewable, green energies is set to be the primary driver of the tightening in the copper industry in coming years. The metal is set to play a huge role in the production and operation of next generation clean technology, with the electric vehicle, and solar and wind power sectors all claiming large portions of the global copper demand.

Copper is used in the production of cables, batteries and motors for electric vehicles, as well as necessary charging stations. Electric vehicles have more than five times the copper of an internal combustion engine vehicle. By 2030 electric vehicles are forecast to account for 40% of the green copper demand.

Goldman Sachs predicts over 31m electric vehicles will be sold each year by 2030, compared to the slightly more than 5m expected to be sold in 2021. According to the broker, this would equate to an annual demand increase in copper production of 2.4m tonnes, as well as an additional 153,000 tonnes to establish charging stations.

Longview Economics takes a slightly more bullish forecast, assuming copper production will need to increase by more than 12m tonnes by 2030 to meet global electric vehicle targets. These expectations have copper production growing 31-34% year-on-year over the next decade.

Copper will also play a large role in the transition to renewable energy sources, with 4-6 times more copper required per gigawatt by a renewable energy power plant than a conventional power plant. Given its higher conductivity per price compared to silver or gold, and its durability giving technology a 25-30-year lifespan, copper is crucial to the production of solar panels.

Goldman Sachs' predicts the growth of solar demand rising at a rate of 15% per year over the next decade, with the Middle East expected to account for a large share of growth as the region transitions from oil to renewables. The broker predicts global demand of copper for solar energy technology to reach 1.6m tonnes by 2030, if not more.

Wind energy is predicted to account for as much as 20% of green copper demand, with the metal used for the cables and generators in turbines. Goldman Sachs' expects wind-related copper demand to reach 1.3m tonnes per year by 2030, growing at a rate of 12.4% per year over the next decade. Wind and solar technologies combined will require total additional production of 2.5m tonnes copper by 2030.

Copper will clearly be key to meeting climate change goals in the next decade, but this increased demand will put pressure on an unprepared market.

This is the first in a series of two on the future of copper and copper mining. Part two will zoom in on changing dynamics for the miners globally.

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

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FEATURE STORIES

Bitcoin Versus Gold

Can bitcoin replace gold as a store of wealth in the face of inflation and times of uncertainty?

-Gold's history as inflation hedge
-Gold's history as a safe haven
-Bitcoin's short history
-Arguments for and against cryptos

By Greg Peel

This is the second in FNArena's series examining crypto-currencies. A link to Part 1 is provided near the bottom.

Since ancient times, gold has been seen as indicative of wealth and power. The first currencies were coins made of gold and silver – their value determined by their actual metal content.

The key to precious metals being used as currency is their rarity. They were a store of wealth because they were difficult and costly to find and mine.

Eventually, coins made of precious metals were replaced by coins made of lesser metals and banknotes, which were backed by the issuer's holdings of those metals. Gold was the primary store of wealth, and a currency's value reflected the extent of gold holdings.

In recent centuries, as economies developed across the world, gold-backing of a currency was an on again, off again affair. At the end of World War II America and its allies convened at a meeting at Bretton Woods at which it was agreed currencies would indeed be backed by gold. At the time, the US held two-thirds of the world's gold. The US dollar became the global reserve currency.

At the time, gold was US$35/oz.

With economic growth came economic cycles, and with each recession came fiscal spending, funded by money printing. Given currencies were backed by gold, money printing led to outflows of gold to other economies. The US became the most powerful economy on earth after World War II, but by the 1960s and 70s the defeated powers of Germany and Japan had swiftly begun to catch up.

The tipping point came in 1971 when, amidst other hefty spending programs, the US was bleeding money to fund the Vietnam War. Then President Nixon made the unilateral decision to end the Bretton Woods agreement. From then on, the reserve currency would be backed only by the US economy, and currency would effectively become a "promissory note" from the US government. Other countries had no choice but to follow suit.

The decoupling of currencies from gold sowed the seed for today's crypto currencies. It just required the growth of digital technology in the meantime.

Gold as a hedge against inflation

Printing money adds to the supply of that money and thus devalues that currency. It stands to reason, mathematically, that the more a currency is devalued the more of it is needed to buy the same pint of milk, the same family car and the same ounce of gold. The more money consumers require to buy the same items, the more wages must increase to cover that loss of spending power.

In the 1970s, central banks had no mandate to control inflation.

The post-war US economic boom meant a greater demand for oil, which made the US reliant on imports from Arab oil producers. Printing money devalued the dollars received by oil producers. Not happy with the situation, in 1973 those oil producers (OPEC) placed an embargo on exports to the US and other countries. If inflation was not already becoming an issue, it certainly was now. The price of oil skyrocketed as domestic supply could not meet demand.

The inflation shock also sent the US dollar gold price skyrocketing. OPEC ended its oil embargo in 1974, but without central bank control, inflation is a difficult beast to restrain once it’s let out of the cage.

Source: Kitco

The US dollar gold price surged accordingly.

Just when it looked as though things couldn't get any worse, the Iranian Revolution of 1979 shut down the world's biggest oil producer. The price of oil again shot up, and the price of gold again responded accordingly. Having gone "parabolic" in the late seventies, the US dollar gold price hit US$850/oz, up from US$180/oz only five years earlier.

The US inflation rate surged into double digits (as was also the case in Australia).

At the time, the US Federal Reserve's funds rate was 13% (compared to effective zero today). To cap the upward spiral of inflation and the resultant recession, then Fed chair Paul Volker raised the funds rate to 20%. The US CPI peaked in March 1980 at 14.8%. Three years later it was back at 2.6%.

Markets that go "parabolic" tend to end with a blow-off top. At the same time Volker was intervening to curb inflation, the Hunt brothers attempted to corner the silver market. They failed. The price of silver collapsed. The price of gold now had plenty of reason to collapse as well.

Source: Kitco

Clearly there were plenty of buyers of gold burned in 1980. But at the very least we could say gold did indeed play its role as a hedge against inflation, if only briefly.

Not so brief was the period 2009 to 2013. In the wake of the GFC, the Fed announced in late 2008, having cut its funds rate to near zero, it would further loosen monetary policy by implementing quantitative easing, which is money printing by any other name. Coincidentally, at the end of 2008 gold was trading around US$850/oz.

US money printing devalues the US dollar, which again implies inflation. But QE1 was not enough. The Fed was to follow with QE2, QE2.5 and QE3. In 2011, gold hit US$1900/oz.

Driving the rush into gold was an assumption QE could only lead to inflation, and even hyperinflation. Comparisons were even drawn with Germany's Weimar Republic, which in order to make good on World War I reparations, simply printed money.

But a funny thing happened. Despite the Fed feeling it necessary to continually top up monetary support for a slowly recovering economy, the resultant level of inflation feared never materialised. To explain this we might point to everything from automation of the workforce and an ageing population to the US dollar still being seen as the safest bet when there was nowhere much else to go.

The gold price wallowed around for a year up to late 2012, when finally the Fed decided it was time to wind back monetary support – to "taper". At the end of 2013 gold was trading at US$1200/oz.

This period of history supports the argument that gold does indeed act as a hedge against inflation.

But let's look at more recent movements.

In 2019, the US posted headline CPI inflation of 2.3%. In 2020, that figure was 1.4%. At the end of 2019, gold was trading at US$1500/oz. In August of 2020, the price traded over US$2000/oz.

What happened in 2020 to upend gold's inflation hedge equation?

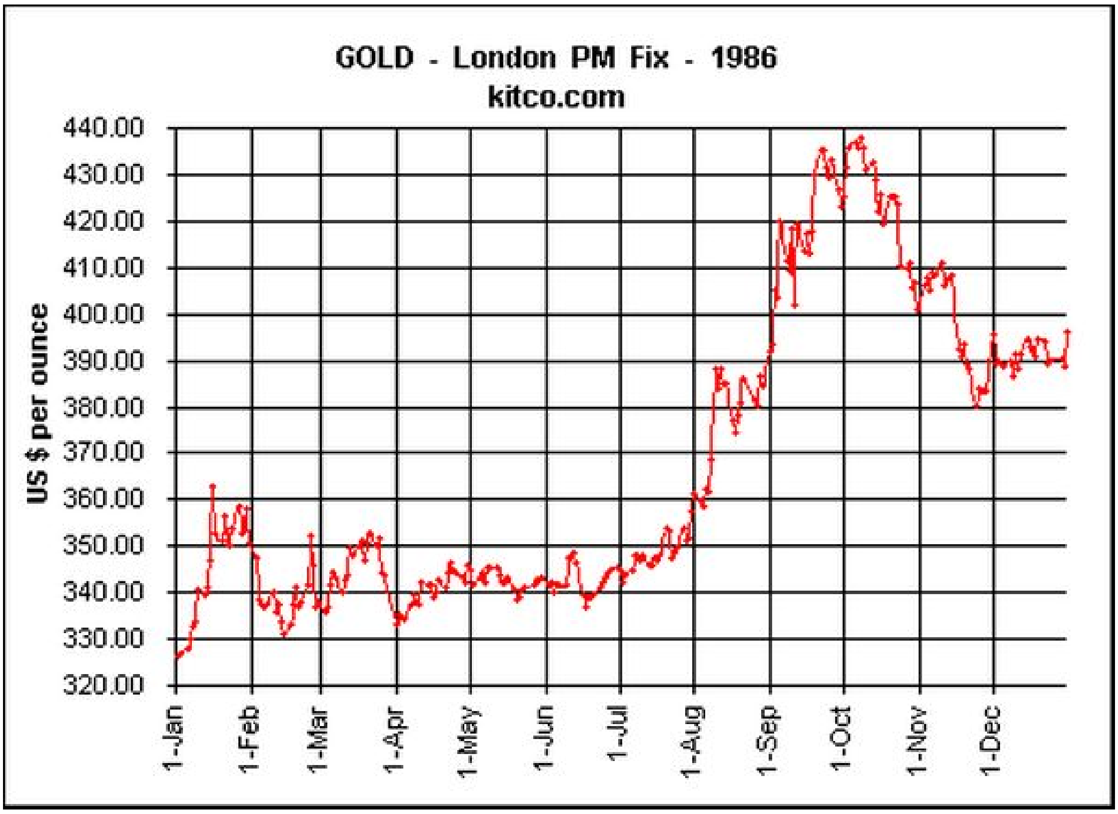
<u>Gold as a Safe Haven</u>

As a store of value, gold wears two hats. The discussion above reflects gold's status as a hedge against inflation and currency debasement. But gold also acts as a store of wealth in times of uncertainty. The two do not necessarily correlate.

We recall that the 1973 OPEC oil embargo and the 1980 Iranian Revolution and subsequent shutdown of Iranian oil production had sent the gold price soaring by the beginning of 1980. This was a reflection of real inflation, as the oil price (WTI) ran from US$21/bbl in 1973 to US$120/bbl by August 1980.

Five years later, with Iran back on line, oil fell to back to US$75/bbl. In the first three months of 1986, it fell to US$25/bbl. This was because having been united in imposing the oil embargo of 1973, by 1986 OPEC members could no longer agree to control the production levels required to maintain prices where they wanted them.

In 1985, the US CPI was 3.8%. In 1987, it was 4.4%. In between, in 1985, it fell to 1.1%. But this is what the gold price did:



Source: Kitco

In April 1986, the Chernobyl reactor blew up.

Ten years later, US hedge fund Long Term Capital Management, having taken bets on Asian currencies (Asian Currency Crisis 1997) and Russian debt (Russian default 1998), went under, owing an estimated US$6bn.

When we put this figure up against the sort of money being thrown around by governments today, and in the GFC, and even this year private hedge fund Archegos going under owing $10bn but causing barely a ripple, US$6bn seems trivial. But in 1996, it was sufficient to threaten the entire global financial market.

If ever there was a time to rush to the safe haven of gold, with the LTCM crash followed by the Asian Currency Crisis in '97 and Russian debt default in '98, this was it. But:

Source: Kitco

We could point to US inflation dropping from 3.3% in 1996 to 1.7% in 1997 and 1.6% in 1998, but the major influence on gold over the period was an agreement by the world's major economies to sell large amounts of their sovereign gold holdings to prop up global financial markets in such a time of turmoil.

Turmoil requires a safe haven, and gold wasn't it. With currencies collapsing in Asia and Russia, the rush was on to buy the reserve currency instead. The US dollar index rallied 25% over the period.

The Global Financial Crisis began in 2007 when two US hedge funds failed to find buyers for their sub-prime mortgage funds, and culminated in 2008 with the collapse of Lehman Bros. Initially, gold played its role as both safe haven and inflation hedge, with US CPI at 2.5% in 2006 and 4.4% in 2007. Gold rallied from US$650/oz at the beginning of 2007 to over US$1000/oz in March 2008.

Lehman collapsed in September 2008, but by October gold was at US$700/oz.

Again we can point to inflation, or lack thereof, given the US CPI was a mere 0.1% in 2008. But again we can say: surely if ever there was a need for a safe haven it was at the depths of the GFC?

The problem this time was the amount of leverage in US financial markets – not just the holders of mortgage instruments but the holders of stock. When Wall Street took its final and most pronounced dive post Lehman, leveraged stock investors had to sell something – anything – to cover their margin calls. They chose gold.

And again the US dollar became a global safe haven.

Fast forward to now and again we are witnessing inflation fears brought on by a rapid recovery out of covid and stubborn Fed monetary support.

From January to August 2020, gold rallied from around US$1500/oz to over US$2050/oz as the Fed responded to covid with immediate rate cutting and QE. By early this year, a rapid US recovery sparked inflation fears, as evidenced in US bond yields spiking in February.

Inflation fears? Gold fell to under US$1700/oz in March.

Here we see another battle of the safe havens. Longer dated US government bonds are another safe haven, but the difference in bonds and gold is one pays interest and the other doesn't. Thus if the interest rate available on bonds becomes more attractive (bonds sold on inflation fears), gold loses.

Most recently, with US bond yields stabilising, gold has begun to rally again.

So, what's the conclusion?

The conclusion is that gold is most often a hedge against inflation, but not always, and a safe haven, but not always, and can be influenced by a wider spectrum of factors than just inflation and global uncertainty. Gold can also suffer from bouts of volatility.

Nothing in financial markets is a given.

Bitcoin v. Gold

Bitcoin was born from the GFC. There's no point in comparing bitcoin's (highly volatile) early years, as it was a while before anyone outside of a specific few had even heard of it, and a longer time before anyone much understood it.

Arguably that's still the case, but either way bitcoin hit the headlines in 2017 when it rallied from US$1000 to US$19,000. Two years later it was back at US$4000.

From September 2020 to April 2021, bitcoin rallied from US$10,000 to US$60,000, before correcting -50%.

The 2017 rally was driven by millennials, who live in the world in which bitcoin exists. It was a classic, "fear of missing out", momentum-driven bubble that eventually burst. The established financial world scoffed.

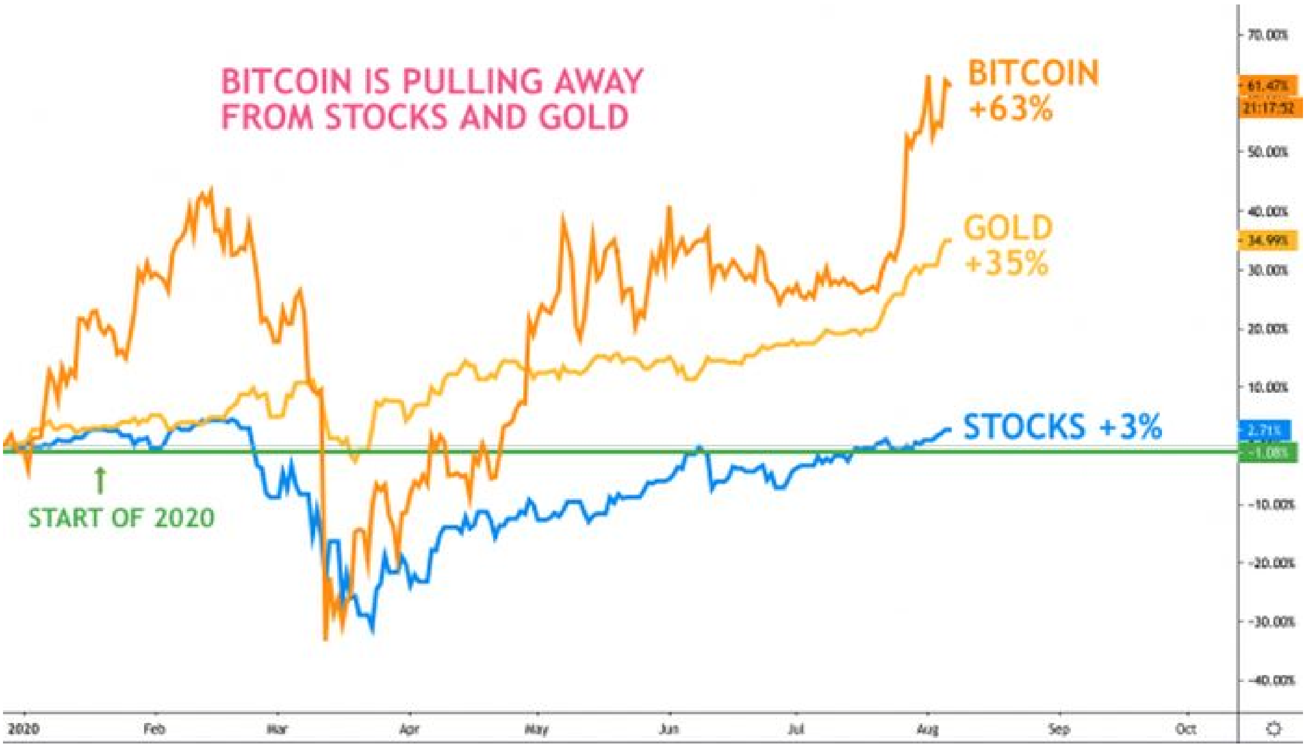
But by last year the established financial world had to admit bitcoin was likely not just a one-day wonder. Having fielded so many enquiries from investors, large fund managers and banks began offering crypto allocations to clients. Previously burned millennials were less present this time, institutions were the main drivers.

Millennials nevertheless paid attention when their hero, Elon Musk, announced Tesla had bought a large bitcoin holding and one could now buy a Tesla with bitcoin. But Musk went from millennial hero to villain recently when he completely about-faced, denouncing crypto as "bad for the environment" – a reference to the enormous amounts of energy required for crypto mining.

It is this energy requirement that may yet spell the death of crypto, or at least render it insignificant.

We have noted gold is not without its bouts of volatility, but so far these pale into insignificance compared to bitcoin. This renders bitcoin questionable as a store of wealth, a hedge against inflation or a safe haven in uncertain times.

Note the following chart:



Source: Coinbase (published with permission)

This chart, courtesy of Coinbase, covers the period from the beginning of 2020 to August of that year. It captures covid crash and initial recovery.

Bitcoin may well have been the "winner" over the period in percentage terms, but how did it fare as a "safe haven"? Not too well.

Gold – the recognised safe haven – did dip at the time as well, which we can attribute once more to forced selling to pay margin calls, as was the case aforementioned in late 2008. Otherwise, gold, by comparison, performed its role rather well.

The Argument Against

“When we examine Bitcoin,” note analysts at asset manager Bridgewater Associates, “we believe it shares some but not yet all of the qualities we would consider necessary to act as a storehold of wealth. Certainly, Bitcoin has merit: similar to gold, it cannot be devalued by central bank printing and its total supply is limited. Further, it is easily portable and exchangeable globally, especially for individuals. It also has the potential to provide diversification, though to date this is more theoretical than realized”.

But:

Bitcoin remains an extremely volatile asset. Compared to traditional stores of wealth, such as gold, real estate or “safe haven” fiat currencies, bitcoin faces a much greater range of outcomes as to its future value, suggests Bridgewater.

Bitcoin still faces meaningful regulatory risk. While greater regulation might help bitcoin gain broader institutional acceptance, it could also trigger selling by some of its largest existing owners who prioritise a lack of public oversight of the asset.

And, while there have been improvements, current levels of liquidity still constitute real structural challenges to holding bitcoin for large traditional institutions such as Bridgewater and its clients, the analysts warn.

Then there’s the matter of turnover.

Turnover as a percent of total outstanding is tiny for gold in comparison to bitcoin, in part as central banks around the world hold a large share of total gold supply as a long-term store of value in their reserves. By contrast, bitcoin volumes have exploded in recent years, due to the emergence of high-frequency traders, a booming derivatives market, and a surge of new coins that trade against bitcoin.

This, warns Bridgewater, combined with questionable volume data reported by unregulated exchanges, creates the illusion of increased liquidity. In reality, this liquidity is much more representative of high churn and speculative trading rather than longer-term risk taking.

Another issue for cryptos relates to their very raison d’etre of being “outside” the global banking system and offering anonymity. As ECB President Christine Lagarde noted recently:

“It’s a highly speculative asset, which has conducted some funny business and some interesting and totally reprehensible money laundering activity…There has to be regulations…It’s a matter that needs to be agreed at a global level, because if there is an escape, that escape will be used.”

US Treasury Secretary Janet Yellen had previously raised similar concerns:

“We really need to examine ways in which we can curtail [crypto] *use and make sure that money laundering doesn’t occur through those channels.”*

But the wheels of regulation turn slowly. And just this past couple of weeks, from the time of writing, bitcoin has suffered two significant plunges and rebounds. Respected fund manager and CNBC “personality” Jim Cramer puts this down simply to too much leverage being on offer in a market regulators do not control.

“That's why it is imperative that either Treasury Secretary Janet Yellen or SEC Chairman Gary Gensler simply come out and say they are uncomfortable with all of the leverage they are seeing in the crypto markets. Today we saw Treasury opine on shifting income tax-free via cryptocurrencies, and that's all well and good, but it has nothing to do with what really matters: stopping a train wreck before it happens.”

Cramer’s point is that when it comes to financial markets, words can speak louder than actions. Markets adjust immediately to words, well ahead of actual actions.

<u>The Argument For</u>

“We believe Bitcoin is creating the possibility of a global monetary system controlled not by nation-states but by individuals. By eliminating the need for a trust-based model, Bitcoin is calling into question the current foundation of economic organizations and is paving the way for a more predictable financial system.

Bitcoin presents investors with a unique opportunity. While many investors question its merit, in our view bitcoin is the most compelling monetary asset to emerge since gold.”

Yassine Elmandjra is the blockchain/crypto analyst for ARK Invest. ARK Invest sponsors a wide variety of exchange-traded funds, and even EFTs of ETFs, with the one underlying theme of “innovation”. ARK initially caught the attention of investors in being an outspoken champion of Tesla, setting price targets that had Wall Street in disbelief.

Eyebrows were raised when Tesla did indeed surge in value, either side of covid. More recently, ARK has become known for being the leading supporter of crypto.

Elmandjra in particular elicited a lot of eye rolling when recently he suggested crypto mining is actually *good* for the environment, as it will encourage more renewable energy investment. Shortly afterward, the other great champion of crypto, Elon Musk, completely about-faced on his support for crypto, declaring it "bad" for the environment, given the extent of energy required for crypto mining. In so doing, Musk set off the most recent bitcoin rout.

Elmandjra again:

"We believe its rapid growth has positioned bitcoin to earn an allocation in well diversified investment portfolios. Bitcoin offers one of the most compelling risk-reward profiles among assets, as our analysis suggests it should scale from roughly $200 billion today to $1-5 trillion network capitalization during the next five to ten years. In our view, capital allocators must consider the opportunity cost that will be associated with ignoring bitcoin as a new asset class."

Supporters of bitcoin shrug off its volatile history to date. Indeed, ARK Invest founder Cathie Woods, when confronted on CNBC about plunges in both bitcoin and Tesla shares, responded "I *love* this set-up".

Throughout history, longer term investors in any asset class – the stock market in particular – have *loved* sharp corrections of a market that has become too frothy, and thus overvalued. They serve to shake out the fly-by-night speculators and restore valuations to a more measured assessment of risk/reward, thus providing a more attractive buying opportunity. Cathie Woods is no exception.

Crypto fans are not concerned about bitcoin volatility, seeing it more as a sign of growing pains in a new asset that will increasingly gain acceptance as time goes on, at which point volatility will ease off.

Conclusion?

Having studied the bitcoin assessments of his own analysts, Bridgewater founder and respected investor Ray Dalio concludes:

"Bitcoin looks like a long-duration option on a highly unknown future that I could put an amount of money in that I wouldn't mind losing about 80% of."

In other words, Dalio is not prepared to dismiss bitcoin with a wave of a hand, rather he is prepared to acknowledge its merits. However, with the future of crypto highly uncertain, Dalio sees it as a potential opportunity, but one of significant risk.

The Competition

This article has looked specifically at the bitcoin versus gold debate, but bitcoin is not the only kid on the crypto block. Most recently, blockchain fans have acknowledged Ethereum as a far more useful blockchain platform, and hence the prospects of its underlying "ether" currency as potentially more plausible than those of bitcoin.

Remember that scepticism and criticism of bitcoin does not imply the same for blockchain technology. In fact the opposite is true.

The third article in this series will examine the Bitcoin versus Ethereum debate, and its implications.

See also:

Part 1, *Bitcoin: What's That All About?* (https://www.fnarena.com/index.php/2021/04/30/bitcoin-whats-that-all-about/)

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 - 28-05-21

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

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday May 24 to Friday May 28, 2021
Total Upgrades: 9
Total Downgrades: 8
Net Ratings Breakdown: Buy 54.81%; Hold 38.67%; Sell 6.52%

For the week ending Friday 28 May, there were nine upgrades and eight downgrades to ASX-listed companies by brokers in the FNArena database.

After ALS Ltd posted an underlying FY21 profit 4.5% ahead of consensus last week, two brokers in the FNArena database downgraded the company rating due to a strong recent share price. Morgans attributed the result to astute management of costs and capacity, while Morgan Stanley was impressed by momentum in the Commodities segment, but notes the risk with cost inflation.

The final dividend of 14.6 cents was well ahead of expectations, underpinned by strong cash conversion and debt reduction.

ALS also achieved the weekly double by appearing atop the tables for the largest positive percentage change to broker's forecast target prices and earnings.

This was the only material adjustment to forecast target prices though there were several material upgrades to forecast earnings, including the second-placed Insurance Australia Group.

Following the release of APRA's quarterly general insurance performance statistics for March, Macquarie estimated industry price rises remain strong. However, the broker also concluded covid-19 benefits, particularly in Home and Commercial lines, are dissipating for IAG.

Next up was Nufarm, after Citi assessed the earnings trajectory looks positive through to FY23. The company offers leverage to strong agricultural fundamentals across key markets on top of continued execution on cost-out initiatives, explains the broker. In the short term, the one negative is a higher tax rate outlook in the second half, which had the analyst lowering the FY21 profit forecast by -9%.

Finally, Costa Group Holdings was next in terms of earnings downgrades last week. The more limited visibility for the earnings potential of the domestic Produce business, and uncertainty remaining over the extent of the second half earnings recovery, prompted Morgans to lower the rating to Hold from Add. Conversely, Credit Suisse upgraded to Outperform from Neutral while lowering the target price dropping to $4.15 from $4.70.

While management guidance was below market expectations it resulted from factors the broker considers are seasonal and not structural. Meanwhile, the company expects the June half performance to be marginally ahead of the last year.

Total Buy recommendations take up 54.81% of the total, versus 38.67% on Neutral/Hold, while Sell ratings account for the remaining 6.52%.

Upgrade

COSTA GROUP HOLDINGS LIMITED ((CGC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/3/0

Credit Suisse upgrades to Outperform from Neutral with the target price dropping to $4.15 from $4.70.

Costa Group Holdings expects the June half performance to be marginally ahead of the last year. This guidance was below market expectations and a result of factors that Credit Suisse considers seasonal and not structural.

The broker finds it difficult to ascertain a normal margin for the group's domestic product since in a 12-month period, the group's peak margins have been about 14%-15% while in a bad year, margins have been as low as 5%-6%.

The 2021 operating income forecast has been reduced by -7.5%.

See also CGC downgrade.

CHAMPION IRON LIMITED ((CIA)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/1/0

Citi upgrades to Neutral from Sell with the target price rising to $7.10 from $6.40.

Champion Iron delivered a record quarterly revenue, observes Citi, with strong price momentum in iron ore. Net profit for FY21 was slightly below Citi's forecast at $477m but more than doubled over FY20.

In the broker's view, the company is well-positioned to capitalise on a global de-carbonisation theme and expansion upside via Phase II delivery and potential Phase III expansion post Kami acquisition.

CORPORATE TRAVEL MANAGEMENT LIMITED ((CTD)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 6/0/0

There are signs of a strong FY22 domestic recovery in North America and Australasia and Macquarie notes these regions now comprise more than 70% of group revenue. The broker points to recent updates from Qantas ((QAN)), Serko ((SKO)) and corporate activity data.

Macquarie upgrades to Outperform from Neutral, noting the main risk is that the pandemic restrictions persist and delay recovery of domestic and international travel. Target is raised to $20.75 from $20.05.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/4/1

Citi upgrades Domino’s Pizza Enterprises to Neutral from Sell with the target rising to $104.2 from $72.40.

Citi sees potential for Domino’s Pizza Enterprises to enter a number of new countries in Europe like Italy, Spain and Poland. The broker estimates these markets could represent a network opportunity of 2,506 stores, potentially contributing an operating income of $263m.

81 net new stores were opened in Europe to date, suggesting the company needs to roll out at least 53 stores if it plans to rollout 2,850 stores by 2028-33. Citi highlights rollouts have been skewed towards the second and fourth quarters.

Looking at the opportunities to expand into new countries, the scope for store acquisitions in existing markets and the improving rollout pace in Europe, Citi remains optimistic.

MIRVAC GROUP ((MGR)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/2/0

Morgan Stanley notes Australian dwelling prices have been pacing at 2-3% per month for most of 2021 and believes housing affordability will become a key issue in the physical as well as the equities market.

After completing a deep dive into the affordability of 72 residential projects by Mirvac Group and Stockland Corp ((SGP)), Morgan Stanley concludes the group's land product is more affordable than Stockland's core products.

Analysing Mirvac Group's 31 active projects, the broker suggests 79% of the lots look affordable. The broker is positive on the group's prospects and has increased its FY22 residential forecast to 2.6k from 2.3k while modelling in more apartment settlements in FY23-25.

Morgan Stanley upgrades to Overweight from Equal Weight rating with the target price rising to $3.15 from $2.60. Industry view is In-Line.

NEW HOPE CORPORATION LIMITED ((NHC)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/2/0

Citi updates coal prices to allow for marking-to-market adjustments and the recent rally in thermal coal. This results in material earnings upgrades for New Hope and the rating is upgraded to Buy from Neutral.

The broker notes risk appetite is low but argues the stock is now trading on 3x enterprise value/EBITDA for FY22 and the balance sheet is moving to a net cash position in FY23. Target is raised to $1.75 from $1.55.

See also NHC downgrade.

OZ MINERALS LIMITED ((OZL)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/2/1

Copper has eased back from highs of US10,700/t to US$9900/t, yet Citi expects this to be a temporary pullback before prices rebound. The broker envisages another 20% upside to spot prices over the next six months and forecasts copper will hit US$12,200/t.

The broker understands investors are hesitant about buying a stock that has rallied around 50% in the past six months but still expects it will trade higher and upgrades to Buy from Neutral. Target is $27.

RESMED INC ((RMD)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/3/0

Ord Minnett reviews forecasts and takes a more optimistic view of the potential boost from the launch of the AirSense 11 flow generator platform.

The new device is also expected to support gross margins as manufacturing volumes ramp up. In the interim, sales are expected to stagnate as customers await the new device, which may exacerbate already tough comparables.

Ord Minnett upgrades to Accumulate from Hold, envisaging potential upside to consensus numbers. Target is raised to $28.50 from $26.50.

SYNLAIT MILK LIMITED ((SM1)) Upgrade to Hold from Reduce by Morgans .B/H/S: 1/2/0

Despite FY21 guidance being lowered to a loss of -NZ$20-30m from March's breakeven expectation, Morgans believes issues will be largely confined to FY21. The rating rises to Hold from Reduce and the target price falls to $2.55 from $2.58.

The broker explains lower guidance was due to ongoing shipping delays and lower-than-expected ingredient sales prices due to sales phasing impacts and volume pressure. Also, there's a more conservative approach to year-end inventory volumes and valuations.

The analyst feels investors could start to look through existing issues if the company can start to rebuild confidence in a FY22 earnings recovery at the FY21 result. The broker continues to believe gearing is too high though management states a raising is not in prospect.

Downgrade

ARISTOCRAT LEISURE LIMITED ((ALL)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 5/2/0

Aristocrat Leisure added 886 machines to the North American installed base during the first half, ahead of Morgan Stanley's expected 600.

The broker notes the company continues to reinvest ahead of peers, with design and development spend up 2% versus the NYSE listed International Game Technology PLC's -23%. In the broker's view, this leaves it well placed to add machines and gain market share.

IDFA changes were implemented in late April and the impact on Aristocrat Leisure has been limited so far, highlights the broker while warning it is too early to tell.

Morgan Stanley believes the results support the thesis that the company will emerge from covid in a better position with considerable balance sheet optionality.

Noting the company outperformed the ASX200 by almost 30% and looks fairly valued, Morgan Stanley downgrades to Equal-Weight from Overweight with the price target lifting to $41 from $38. There is no industry rating.

ALS LTD ((ALQ)) Downgrade to Hold from Add by Morgans and Downgrade to Equal-weight from Overweight

by Morgan Stanley .B/H/S: 2/4/0

Morgans downgrades the rating for ALS to Hold from Add after a strong share price rise. It's considered astute management of costs and capacity drove underlying FY21 profit 4.5% ahead of consensus.

The broker lifts FY22-24 EPS forecasts by 4-11% due mainly to a lift in assumed Commodities margins close to 30%, to reflect the sector outlook. The target rises to $11.56 from $10.35.

ALS Ltd provided a strong FY21 result, in Morgan Stanley's view. Commodities momentum impressed amid higher volumes which lead to higher earnings margins. Still, cost inflation is a risk. In life sciences there was modest margin compression, the broker notes.

Morgan Stanley upgrades estimates by 8% and 3% for FY22 and FY23, respectively, noting that the stock has performed well and while there may be further upside the magnitude is likely to be lower.

Morgan Stanley downgrades to Equal-weight from Overweight. Target is raised to $12.90 from $10.70. Industry view: In-line.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Downgrade to Hold from Add by Morgans .B/H/S: 1/3/0

Morgans downgrades Costa Group to Hold from Add, after first half guidance was for marginal growth. Also, from the guidance, there was considered implicit contraction in Produce segment that is materially weaker than expected.

The broker lowers FY21-23 underlying earnings (EBITDA-S) forecasts by -10%, -5% and -5%, respectively. Also, increased D&A guidance and operating deleverage has seen material downgrades at the profit (NPAT-S) level.

Overal, the more limited visibility on the earnings potential of the domestic Produce business and uncertainty remaining over the extent of the second half earnings recovery, prompts the analyst to lower the rating. The target price falls to $3.54 from $5.03.

See also CGC upgrade.

FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED ((FPH)) Downgrade to Neutral from Outperform by Credit Suisse.B/H/S: 1/1/2

Credit Suisse downgrades Fisher & Paykel Healthcare Corp to Neutral from Outperform with the target dropping to $30 from $34.

Post the FY21 result, Credit Suisse has lowered its earnings estimates for FY22-23. Earnings uncertainty is expected to persist over the next six months and the broker does not see a short-term catalyst for the stock to outperform.

Management conceded there is too much uncertainty in the monthly and quarterly earnings to provide any guidance or be confident that the current trends will continue.

The broker notes demand is tracking covid-related hospitalisations and in countries where hospitalisations have fallen, there has not been evidence of sustained strong utilisation of the installed base outside of covid patients.

NEW HOPE CORPORATION LIMITED ((NHC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/2/0

Total coal sales for the March quarter were softer than Credit Suisse had expected, as were the Bengalla realised prices. The company rating is lowered to Neutral from Outperform after a recent rally in the share price. The price target of $1.30 is unchanged.

With earnings continuing to concentrate to Bengalla, the broker believes the company will likely need the successful approval and execution of the Acland extension to trigger a re-rate.

See also NHC upgrade.

UNITI GROUP LIMITED ((UWL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/1/0

Ord Minnett reviews the outlook for Uniti Group in light of a strong housing backdrop and stability in the wholesale broadband price.

The March quarter dwelling numbers highlight another quarter of above-trend growth, observes the broker, supported by positive sales and pricing from greenfield property developers in 2021.

The broker expects FY21 operating income of $84.4m and operating cash flow of $71m after-tax but prior to re-investment in new fibre construction. Ord Minnett also highlights lower integration risks with the recent OptiComm acquisition.

Ord Minnett downgrades to a Hold recommendation from Accumulate with the target rising to $2.90 from $2.23.

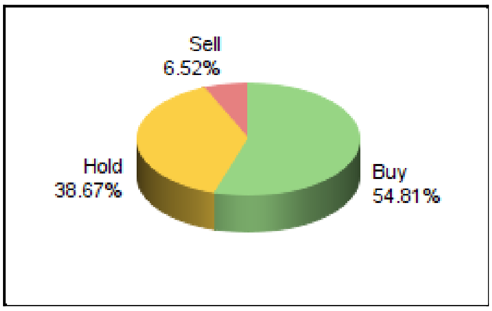
XERO LIMITED ((XRO)) Neutral by Citi .B/H/S: 2/2/1

While noting there isn't a lot to read-through for Xero from Intuit's third quarter, Citi sees Intuit's commentary on the use of online accounting and associated services as positive for Xero.

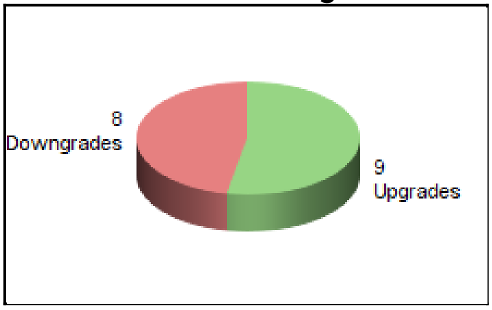
In the broker's view, the results from both companies point to home markets outperforming the International markets although going by Intuit's comments, it looks to the broker Xero could be outperforming Quickbooks in the UK.

Neutral rating with a target price of $136.

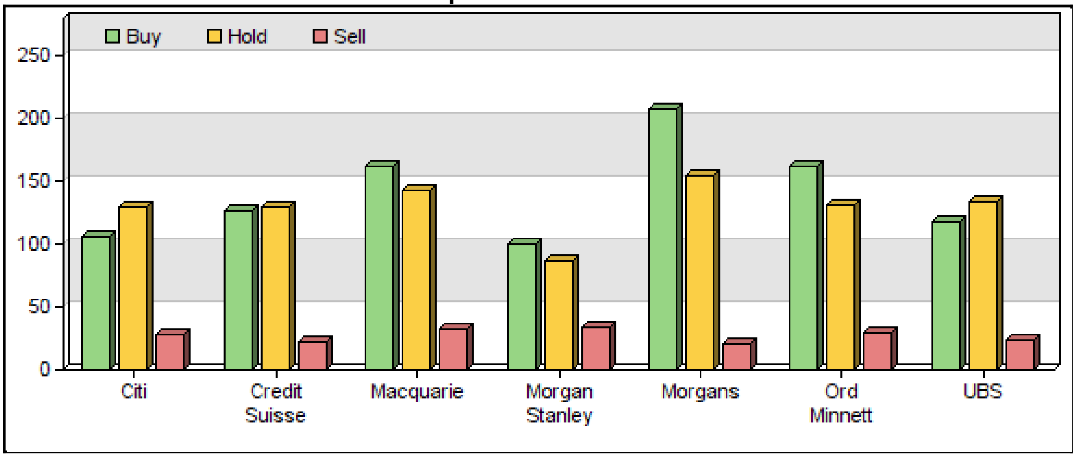
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	CHAMPION IRON LIMITED	Neutral	Neutral	Citi
2	CORPORATE TRAVEL MANAGEMENT LIMITED	Buy	Neutral	Macquarie
3	COSTA GROUP HOLDINGS LIMITED	Buy	Neutral	Credit Suisse
4	DOMINO'S PIZZA ENTERPRISES LIMITED	Neutral	Sell	Citi
5	MIRVAC GROUP	Buy	Neutral	Morgan Stanley
6	NEW HOPE CORPORATION LIMITED	Buy	Neutral	Citi
7	OZ MINERALS LIMITED	Buy	Neutral	Citi
8	RESMED INC	Buy	Neutral	Ord Minnett
9	SYNLAIT MILK LIMITED	Neutral	Sell	Morgans
Downgrade				
10	ALS LTD	Neutral	Buy	Morgans
11	ALS LTD	Neutral	Buy	Morgan Stanley
12	ARISTOCRAT LEISURE LIMITED	Neutral	Buy	Morgan Stanley
13	COSTA GROUP HOLDINGS LIMITED	Neutral	Buy	Morgans
14	FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED	Neutral	Buy	Credit Suisse
15	NEW HOPE CORPORATION LIMITED	Neutral	Buy	Credit Suisse

16	UNITI GROUP LIMITED	Neutral	Buy	Ord Minnett
17	XERO LIMITED	Neutral	Neutral	Citi

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	RHC	RAMSAY HEALTH CARE LIMITED	25.0%	7.0%	18.0%	6
2	MGR	MIRVAC GROUP	67.0%	50.0%	17.0%	6
3	CTD	CORPORATE TRAVEL MANAGEMENT LIMITED	100.0%	83.0%	17.0%	6
4	OZL	OZ MINERALS LIMITED	21.0%	7.0%	14.0%	7
5	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	7.0%	-7.0%	14.0%	7
6	RMD	RESMED INC	42.0%	33.0%	9.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	ALQ	ALS LTD	33.0%	67.0%	-34.0%	6
2	SKC	SKY CITY ENTERTAINMENT GROUP LIMITED	67.0%	100.0%	-33.0%	3
3	ALL	ARISTOCRAT LEISURE LIMITED	64.0%	79.0%	-15.0%	7
4	NUF	NUFARM LIMITED	57.0%	71.0%	-14.0%	7
5	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	25.0%	33.0%	-8.0%	4

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	ALQ	ALS LTD	12.510	10.283	21.66%	6
2	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	97.973	93.430	4.86%	7
3	MGR	MIRVAC GROUP	2.773	2.665	4.05%	6
4	ALL	ARISTOCRAT LEISURE LIMITED	42.280	40.651	4.01%	7
5	NUF	NUFARM LIMITED	5.679	5.493	3.39%	7
6	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	5.525	5.383	2.64%	4
7	RHC	RAMSAY HEALTH CARE LIMITED	70.132	68.970	1.68%	6
8	RMD	RESMED INC	28.340	28.007	1.19%	6
9	CTD	CORPORATE TRAVEL MANAGEMENT LIMITED	21.650	21.533	0.54%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	ALQ	ALS LTD	48.287	37.220	29.73%	6
2	IAG	INSURANCE AUSTRALIA GROUP LIMITED	25.814	21.100	22.34%	7
3	NUF	NUFARM LIMITED	17.328	14.379	20.51%	7
4	NHC	NEW HOPE CORPORATION LIMITED	11.568	9.978	15.94%	4
5	AD8	AUDINATE GROUP LIMITED	-3.600	-3.933	8.47%	3
6	FBU	FLETCHER BUILDING LIMITED	40.443	38.078	6.21%	5
7	FMG	FORTESCUE METALS GROUP LTD	427.419	410.482	4.13%	7
8	RIO	RIO TINTO LIMITED	1751.588	1683.106	4.07%	7
9	BHP	BHP GROUP	446.643	438.939	1.76%	7
10	ALL	ARISTOCRAT LEISURE LIMITED	124.129	122.157	1.61%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	WEB	WEBJET LIMITED	-5.044	1.096	-560.22%	5
2	CGC	COSTA GROUP HOLDINGS LIMITED	16.356	20.478	-20.13%	4
3	XRO	XERO LIMITED	22.289	25.370	-12.14%	6

4	NEA	NEARMAP LTD	-4.833	-4.500	-7.40%	3
5	APX	APPEN LIMITED	49.443	53.268	-7.18%	5
6	SKC	SKY CITY ENTERTAINMENT GROUP LIMITED	9.280	9.730	-4.62%	3
7	TNE	TECHNOLOGYONE LIMITED	22.118	22.683	-2.49%	4
8	CTD	CORPORATE TRAVEL MANAGEMENT LIMITED	-25.815	-25.215	-2.38%	6
9	DRR	DETERRA ROYALTIES LIMITED	14.453	14.678	-1.53%	4
10	NHF	NIB HOLDINGS LIMITED	36.057	36.300	-0.67%	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: Investment Vehicle Concludes Raising

As the uranium spot price continues a four-week winning streak, Uranium Participation Corp concludes an equity raising to fund future purchases of uranium

-Uranium Participation Corp raises C$80m
-Exelon seeks nuclear plant reprieve
-Uranium spot price rises by 0.8% for the week and 10% for May

By Mark Woodruff

In a good sign for interest in the uranium sector, Canadian-listed **Uranium Participation Corp** has closed its capital raising with proceeds of approximately C$80.5m/US$66.8 million. The original raising announced 3 May was for C$50m and it was upsized the next day to C$70m.

The company invests nearly all of its assets in uranium, in the form of uranium oxide or uranium hexafluoride, with the primary objective of achieving capital appreciation. Consequently, net proceeds of the offering will be used by the company to fund such future purchases as well as an allocation toward general corporate purposes. After deducting fees, that should give the company enough cash to acquire circa 2mlbs U3O8 at current prices.

For further details on the backstory for recent significant developments for Uranium Participation Corp please refer to last month's article: https://www.fnarena.com/index.php/2021/05/04/uranium-week-new-uranium-investment-vehicle/

Legislative news

US press reports over the long weekend suggested an impasse in negotiations between bargaining parties over the threatened closure of nuclear power plants in Illinois.

The CEO of America's leading energy provider, Exelon Corp, stated earlier last month that the company will go ahead with the closure of the Byron and Dresden nuclear plants later this year if the state of Illinois does not pass policy reforms to support their continued operation before the end of the current session.

The Climate Union Jobs Act (CUJA) is one of several clean energy bills currently under consideration by the Illinois General Assembly. Along with other initiatives, it would create 74m megawatt-hours of carbon mitigation credits for facilities including Exelon's Braidwood, LaSalle, Bryon and Dresden nuclear plants.

Byron's two pressurised water reactors are licensed to operate for another 20 years but would shut in December, while Dresden's two boiling water reactors would shut in November despite having a decade of their operating licence remaining.

Meanwhile, there was a proposal at the Federal level by US senators last week to introduce a production tax credit for existing nuclear power facilities. This energy tax reform bill is supported by the Biden administration, in an effort to reduce carbon emissions.

Company news

Last week, ASX-listed **Peninsula Energy** ((PEN)) agreed to purchase 300,000lbs of uranium at a price of US$31.35/lb. This will be fully funded by a share placement at 15 cents.

The company is currently focused on transitioning the Lance Uranium project in the US state of Wyoming to low-pH in-situ recovery from an alkaline operation. The company recently updated on the low pH demonstration work and expects completion by the first half of FY22. Shaw and Partners stockbrokers expect the commencement of a revised Feasibility Study in the first half of 2022, incorporating the field demonstration trial.

Settlement is due in June 2021, and the uranium will be stored at the Cameco Facility located in Ontario, Canada.

The company noted “Adding physical uranium to our balance sheet provides significant flexibilities and potential upside as we move towards the restart of operations. Importantly, holding uncommitted uranium inventories at a time when there is a strong and continued push by the US Government to support nuclear power generation and the domestic production of critical minerals like uranium, enhances our ability to successfully participate in expanding market opportunities,” said Managing Director and CEO Wayne Heil.

This week, ASX-listed **DevEx Resources** ((DEV)) has received firm commitments to raise just under $8 million via a placement. The funds are to be applied to expanded exploration work at its WA, NSW and Northern Territory projects.

The company has flagged using some of the funds on renewed field exploration at the Nabarlek Uranium and Gold-Copper Project.

Investors were offered shares at 32 cents. The company now has a total cash balance of around $17.6 million.

Also this week, ASX-listed **Vimy Resources** ((VMY)) announced the completion of the Alligator River project acquisition from Cameco Australia. The company is also close to finalising the acquisition of Rio Tinto Exploration’s 21% interest in the King-River-Wellington Range joint venture, part of the Alligator River project. At completion, Vimy Resources will hold 100% of the project.

Uranium pricing during the week

TradeTech’s **Weekly Spot Price** Indicator is US$31.40/lb, up US$0.25 from last week’s Indicator. It has risen over 10% so far in the month of May. The Indicator is up 3.3% since the beginning of 2021.

Uranium Pricing-During the month

Market activity was quiet on the last day of the month, as the US celebrates its Memorial Day holiday. As a result, TradeTech's **Monthly Spot Price** closed at US$31.40/lb at the end of May, a rise of US$2.25 from the end of April, and unchanged from the May 28 Weekly Spot Price Indicator.

TradeTech's Daily Spot Price Indicator averaged a 0.4% interday change in May, while the Weekly Spot Price Indicator increased at an average of 1.5% per week through the month. The monthly uranium spot price has increased nearly 6% so far in 2021.

The current price currently sits 4% above the 2020 average of US$30.15/lb. The average value for 2021 is US$29.86/lb.

A total of 4.6mlbs U3O8 equivalent was traded in the spot delivery window during May. Prices during the first half of the month remained below US$31/lb. However, TradeTech reports that by the third week of the month, prices began to inch up steadily, reaching US$31.15/lb, where the price remained until the last few days of the month. Friday, May 28, saw 300,000lbs trade at successively higher prices to close out the week at US$31.40/lb.

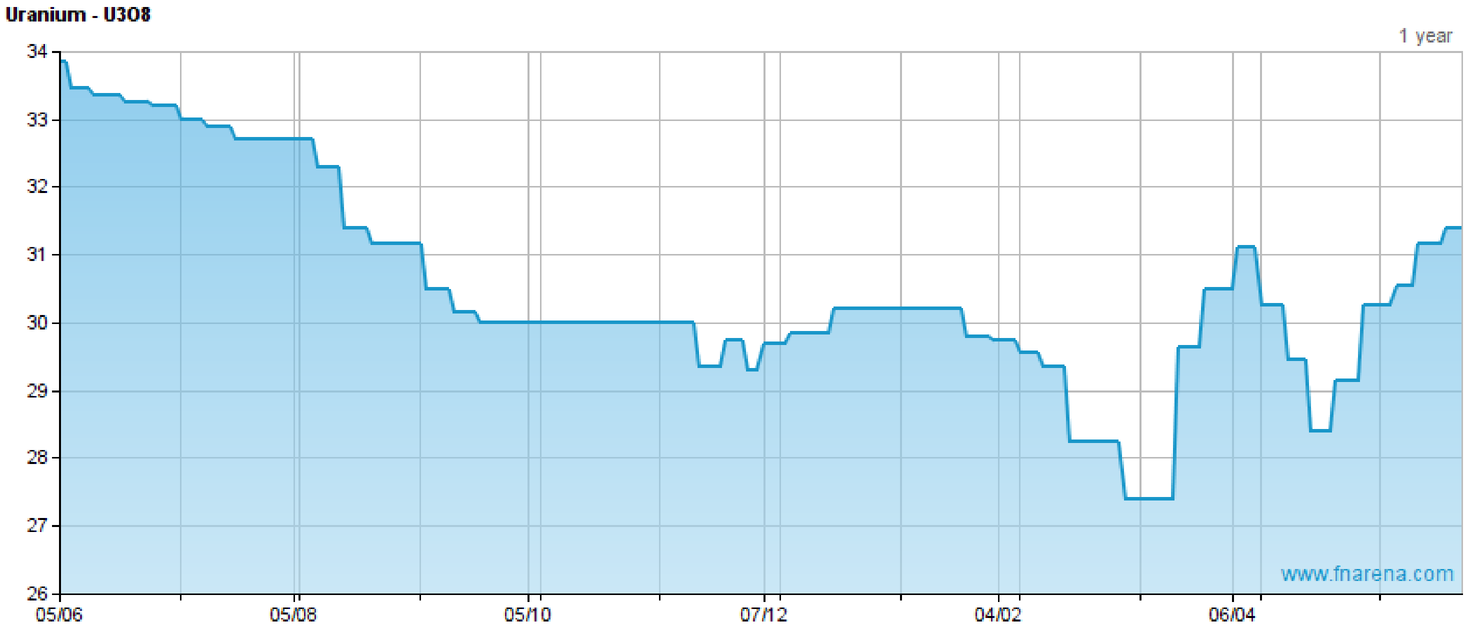
TradeTech notes that while spot supply is currently sufficient to meet demand, excess material has been largely absorbed from the market and sellers are less willing to part with their material at previously reported prices as new demand emerges.

TradeTech's **mid term price** indicator for May 31 rose to US$31.50 from US$3.000 at the end of April, while the **long term price** indicator remains unchanged at US$35.00/lb.

Three transactions involving delivery of over 900,000lbs U3O8 in the mid-term delivery window were reported this month. One transaction involved a utility buyer while financial entities acted as buyers in the other two transactions.

Term uranium sellers continue to exhibit a willingness to compete aggressively for utility business in the mid-term space, according to TradeTech. Utilities are consistently commanding multiple offers that are below the published price indicators due to the relatively small quantities and early delivery period, which allows for a variety of entities to compete for the business.

One of the factors contributing to the flat price curve in the mid term is access to exceptionally low interest rates by several non-primary sellers.



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WEEKLY REPORTS

The Short Report - 03 Jun 2021

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

Summary:

By Greg Peel

Week Ending May 27, 2021.

Last week saw the ASX200 bottom out below 7000 before commencing a sharp rally back through 7100 and now 7200 this week, with just a brief profit-taking blip at end-month.

In terms of short position movements, as the table below suggests, there was very little going on last week. All the action was at the top.

There has been no new news out of Kogan ((KGN)) of late, but last week shorts increased to 12.6% from 9.9%. Having quantified its March quarter issues in late May, reflecting unmoved inventories, Kogan has since recovered the losses of that time.

Clearly the shorters see an opportunity.

Otherwise, Victoria went back into lockdown last week and the lockdown will now continue in Melbourne for another week, which has shorters fiddling around with their travel agent shorts. Webjet jumped back up to 10.4% shorted from 9.9%, while Flight Centre ((FLT)) fell to 9.3% from 10.4%.

No Movers & Shakers this week, but rather this is replaced with a warning out from ASIC with regard activist short selling. See below.

Weekly short positions as a percentage of market cap:

10%+

KGN 12.6
WEB 10.4
RSG 10.3

In: KGN, WEB Out: FLT

9.0-9.9

TPW, TGR, FLT

In: FLT Out: KGN, WEB

8.0-8.9%

EOS, MP1, ING

No changes

7.0-7.9%

Z1P, JBH, MTS

No changes

6.0-6.9%

IVC, BVS, MSB, ALK, A2M

In: A2M

5.0-5.9%

BGL, OBL, PNV, NEA

In: COE   Out: A2M, AMP, NEA

Movers & Shakers

See above.

ASIC Warning

"To protect the integrity of Australia's securities markets, activist short sellers, target entities, market operators and market participants should apply the better practices outlined in INFO 255.

These include, for activist short sellers, releasing short reports outside normal trading hours; drawing on reliable information and avoiding overly emotive language. Target entities should seek a temporary trading halt to provide time to digest and comprehensively respond to the claims of activist short sellers.

ASIC also reminds market participants of their obligations to report suspicious short selling activity under the market integrity rules, and for market operators to maintain a fair, orderly and transparent market."

The key here is separate "activist" short sellers from your common or garden short sellers.

Typically short sellers fall into two camps: those who genuinely believe a stock is overvalued and thus take on a "naked" short position in the expectation of a fall in share price; and those who hold an offsetting long position on the other side, such as another stock or options position, or ahead of a capital raising.

All of which is explained in detail in the **Guide** below.

An "activist" short seller is one who takes a short position in a stock, then informs the market of why it has done so – perhaps accusations of dodgy accounting or unrealistic projections or similar – setting off a run on the stock from which said short seller can buy back at a profit.

It is the reverse of the old "pump and dump" buy-side tactic popular last century, in which stock pickers of questionable repute would buy a stock, typically a little known small cap, espouse its virtues in a weekly Tip Sheet, and then take profits when the faithful rush in to buy.

ASIC calls the reports activist short sellers publish post selling the stock "short reports". Please do not confuse this with FNArena's weekly Short Report you are currently reading.

In recent times we've seen activist short sellers move in on the likes of TechnologyOne ((TNE)), Nearmap ((NEA)) and Tyro Payments ((TYR)).

Clearly any investor with some clout, such as a hedge fund, can undertake spurious activity via a "get set then tell everybody" strategy featuring a publicly published report on either sell *or* buy-side. ASIC is tasked with identifying these strategies as unlawful, in a similar vein to insider trading (being privy to non-public information and taking advantage).

It is notable that all funds in the US open to public investment must, following the end of each quarter, disclose all the stocks they bought and sold in that period and what they now hold. The most anticipated is that of Berkshire Hathaway, which always triggers a reaction in noted stocks.

Even though Buffett's trades could be by now months old.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.2	0.3	MQG	0.2	0.3
ANZ	1.0	0.9	NAB	0.9	1.0
APT	1.9	1.9	NCM	0.1	0.3
BHP	4.2	4.2	RIO	0.3	0.3
BXB	0.5	0.5	TCL	0.6	0.7
CBA	0.6	0.6	TLS	0.2	0.2

COL	0.6	0.6	WBC	0.9	0.9
CSL	0.2	0.2	WES	0.3	0.3
FMG	0.6	0.5	WOW	0.3	0.3
GMG	0.2	0.3	WPL	1.0	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: Jobs, Savings Rates, Banks, Travel

Weekly Broker Wrap: Labour shortages, savings rates in double-digits, banks beat the market, travel winners & losers

-Upward pressure on construction/mining wages
-RBA likely to hike ahead of 2024 guidance
-Major global spend of accumulated savings predicted
-Bank outperformance the market by 18% year-to-date
-Travel stocks not all equal

By Mark Story

Labour shortages: Mounting wage pressure

Assuming international borders remain closed until mid-22, Jarden expects unemployment to fall to 4.5% by the end of 2021 and 4% by the end of 2022. However, Jarden believes a lack of skilled labour presents downside risks which could see hiring slow below the broker's modest 1.5% year-on-year forecast.

Driven by strong demand and lack of foreign arrivals, Jarden analysis suggests labour shortages are most pronounced in agriculture, construction, hospitality and mining. But the broker notes there are also reports of skills shortages in finance/professional services, technology, retail, and transport/logistics.

Jarden is witnessing upward pressure on construction and mining wages, with some channel checks suggesting professional and mining services are seeing cases of wage rises of up to 10%-plus. The broker also expects wage increases to eventually emerge in a number of sectors, including hospitality and agriculture, if seasonal workers don't return.

While these four sectors only represent 20% of employment, Jarden expects skills shortages to put upward pressure on wages across the economy. Given that 36% of the CPI basket is 'labour sensitive', the broker suspects this wage pressure will eventually flow through to higher inflation outcomes and see the Reserve Bank hike ahead of 2024 guidance.

While UBS doesn't forecast wages to jump above 3% year-on-year, the broker has upgraded forecasts to 2.5% from 2.3% by the end of 2022, which would be the fastest since 2014.

Due to the lag in the real economy, and weak public wages, UBS does not see materially stronger year-on-year wage growth until the second half of 2022. Adding to the broker's conclusion is the Fair Work Commission annual wage review which is expected to remain low at around 2%.

To see wages increase 3%-plus year-on-year by the end of 2022, UBS thinks private sector wages would need to do the heavy lifting given they comprise 77% of the wage price index.

However, the broker concedes, the rapid pace at which the labour market is forecast to keep tightening is another reason why wages might surprise higher. The underutilisation rate dropped in April to 13.3%, the lowest since February 2019, and UBS expects it to fall -4.2 percentage points in the 2 years to December 2022.

Overall, the broker thinks the RBA is likely to wait for outcomes of wages and inflation, and is unlikely to quickly follow the RBNZ signal to hike the cash rate based on forecasts.

UBS still sees the cash rate unchanged over the forecast profile until at least the end of 2022. However, the broker also sees a risk of the RBA abandoning their yield target in 2022, which would enable them to hike in 2023.

Savings rates: Spending sprees pending

Covid-induced lockdowns, fear of catching the virus, coupled with concerns about becoming unemployed or being unable to work by default resulted in savings rates across the world reaching exceptional levels.

According to Shaw and Partners June Infocus update, various US government support programs, which boosted personal disposable income, led to a surge in the personal saving rate to over 30% in April last year.

Personal savings rates also remained well above 10% during the rest of the year.

It was a similar savings story in other countries too. Within the eurozone and the UK, consumption and income growth both fell in the second quarter of 2020, despite government programs to support the economy.

Given that much of the unprecedented savings experienced globally were 'forced savings, Shaw's Infocus update suggests households will want to spend all the saved funds quickly once they are able to do so. But rather than focusing on whether the increase in savings occurred because households were unable to spend or not, the broker thinks it's better to think of these savings in terms of their wealth effects.

The wealth effect, adds Shaw, also suggests households will want to increase future spending, hence are unlikely to spend all their current savings. Given that households are likely to want to reduce their indebtedness, Shaw doubts consumption will rise one-for-one with household savings.

What's clear to Shaw from the research is there will be clear winners and losers when to it comes to how consumers splash their savings. For example, while an increase in wealth leads to a temporary surge of purchases of durable goods, Shaw suggests the purchases of non-durable goods, such as food, are unlikely to rise sharply.

While it's unlikely that all the savings will be spent quickly, Shaw suspects as vaccination campaigns across the world lead economies to reopen, consumers will respond by spending some of their accumulated savings. As a result, saving rates will reduce closer to their normal levels.

Given that it is a large part of GDP, Shaw expects the pending boost in consumption spending to boost to the global economic recovery.

Oz banks beat the broader market

Banks outperformed the broader market by 5% in May, bringing their year-to-date outperformance to 18%.

Macquarie notes the positive thematic around improving credit quality, volume growth and capital management appears to be well understood. As a result, the broker doesn't expect these thematics to drive further significant share price re-rating.

However, while the "easy money" has been made, tenable relative valuations and an absence of negative catalysts suggests to Macquarie that's it is too early to go underweight on the bank sector. The broker retains a neutral sector view with a **preference for the regionals over the majors**.

While banks have started to talk about early green shoots in business credit, Macquarie notes that the growth rates remain subdued. In this context, the broker continues to expect housing credit to drive balance sheet growth in FY21, with the regionals continuing to benefit from this thematic as they grow share well ahead of the majors.

Macquarie believes the majors should continue to benefit from deposit mix changes, with the overall impact on margins from liability pricing likely to diminish in the second half of 2021. However, the broker's analysis suggests the benefits for the regionals is ongoing, and expects more supportive margin trends in their upcoming results.

When looking specifically at the Big Four, the broker observes that Commbank's ((CBA)) mortgage franchise continues to outperform major bank peers. ANZ Bank's ((ANZ)) performance continues to disappoint after a strong first quarter 2021.

Anecdotal evidence suggests less attractive pricing and processing issues are at the centre of ANZ's issues while National Australia Bank ((NAB)) and Westpac ((WBC)) continued to improve, growing at 0.7x and 0.8x system, respectively. Macquarie understands both banks relied on competitive pricing to drive an uplift, which is likely to impact future mortgage margins.

Meantime, the regionals continued to take share with Bendigo & Adelaide Bank ((BEN)) and Bank of Queensland ((BOQ)) growing at 2.5x and 2.0x, respectively, which, when coupled with favourable deposit tailwinds, the broker believes bodes well for their earnings in FY21.

Travel: Early post-covid winners & losers

Citi expects the nuances associated with the business models of travel stocks to produce materially different profit recovery times. Having concluded that they're earlier beneficiaries of the recovery cycle, and after assessing how much of the recovery is already priced into each stock, the broker's favoured travel companies are Corporate Travel Management ((CTD)) and Qantas ((QAN)).

Citi has initiated coverage on Corporate Travel as a Buy and views it as having the fewest headwinds, a net cash balance sheet and an attractive relative valuation (target price $23.65). The broker expects Corporate Travel's earnings to come back the quickest, as it's automated booking fee business model suits the current environment.

Additionally, the broker notes the company has used the crisis to make an accretive acquisition in the US, which is one of the fastest recovering geographic regions globally.

Given that Qantas' domestic business has strong economics which should be profitable near term, the broker also has a Buy on the airline (target price $5.89). With the competition's product offering dropping away, Citi has already seen market share gains.

Given that the leisure business relies on complex multi-destination trips to increase ancillary sales, Citi expects uncertainty around borders and the resumption of international travel to directly impact Flight Centre ((FLT)). With the recent sell-off capturing Flight Centre's issues in the valuation, Citi retains a Neutral rating on the stock (target price $16.55).

Having analysed each travel stocks underlying global exposure, the broker determines Webjet ((WEB)) has the least favourable exposure on a relative basis. Despite Webjet's heavy domestic focus and the tailwinds of increased adoption in e-commerce, Citi expect WebBeds to be slower to recover.

The broker believes Webjet's exposure to middle income/less developed economies and long lead time, plus low cancellation rate travel bookings to be out of favour within the current environment.

Citi is High Risk rated on Webjet given this large section of the business is still burning cash. However Citi has a Neutral recommendation (target price $5.27) as the broker has seen management's strong track record of pivoting a business quickly, and believes the company has adequate liquidity.

SMALL CAPS

Peter Warren On Track For Sustainable Growth

Peter Warren Automotive is on track for sustainable growth and a further re-rating of the stock is likely from industry consolidation

-Highly-fragmented automotive industry ready for consolidation
-Property ownership reflected in strong margins relative to peers
-Will Peter Warren Automotive be impacted by the push to an agency model?

By Eva Brocklehurst

Consolidation opportunities are likely to abound in the automotive industry over 2021 and Peter Warren Automotive Holdings ((PWR)) is well-positioned for that eventuality. The integrated network operates at scale in NSW and Queensland and has long-standing relationships with original equipment manufacturers (OEM), providing access to capital.

Morgan Stanley expects sustainable growth will be driven by cyclical tailwinds amid continued execution across the company's multiple strategic initiatives. The business has around 2% share of new vehicle volumes which compares with the top operator's 11% share and national presence.

The broker finds upside potential and a further re-rating highly likely from industry consolidation, comparing the opportunity in M&A to that of Eagers Automotive ((APE)), which scaled up to more than $120m in pre-tax profit in 2015 from just $40m in 2010.

Were this to occur for Peter Warren, the broker estimates consolidating the family-owned Toyota assets could add around 12% to pre-tax profit, and having Toyota representation would enable much broader M&A.

Jarden also believes the highly-fragmented automotive dealership network in Australia is primed for consolidation. The broker estimates **a theoretical, fully debt-funded acquisition of $20m could potentially add an incremental 5-8% to FY21 pre-tax profit**, assuming a 4-6x acquisition multiple.

Peter Warren Automotive has 27 OEMs under its belt and owns two properties including the flagship Warwick Farm site in western Sydney and this is a key consideration for valuation, in the broker's view. Jarden believes property ownership is reflected in the strong margins relative to peers.

Morgans envisages Victoria as a natural market for expansion, anticipating the industry could consolidate at a fast pace over the next five years. In this way, Peter Warren, being well capitalised, can take advantage. Debt facilities are likely to be easily obtainable, given the strong asset backing, and scrip could also be an attractive option for vendors.

While its FY21-23 forecasts signal a relatively steady growth pattern the broker does not factor in the likely M&A potential. Morgans would prefer a greater discount in the stock's multiples compared with Eagers Automotive yet believes industry conditions will favour the business and initiates coverage with an Add rating and $4.05 target.

<u>Margins</u>

Prior to the pandemic, the Australian new car sales industry was in the midst of a downturn and this was then exacerbated by the onset of the pandemic. November 2020 was the first positive month for new car sales growth since March 2018.

From that point monthly growth has continued to accelerate and Morgans suspects the recent surge in demand could last for some time. Production cuts by OEMs have been compounded by chip shortages but in April deliveries were at record levels, which signalled plenty of stock is arriving. Thus, Morgans believes **demand will be the main driver of the strength in margins**.

The broker points out most industry participants expect chip shortages will last into 2022, implying car supply is likely to remain constrained and there is an increasing likelihood OEMs will keep supply closely matched demand going forward.

Jarden has initiated coverage with a Buy rating and $4.12 target, calculating pre-tax profit margins of 3.5% for FY21. The broker believes earnings drivers over the medium term will include macro economic strength and housing, as vehicle sales strongly correlated with house price growth.

Leading indicators are signalling 20% upside in house prices and Jarden notes the recovery in automotive sales is already evident, estimating a six-month lag in new vehicle volumes versus housing price gains.

The stock is not trading at peak earnings, Morgan Stanley adds, despite the recent trading update lifting FY21 guidance above the prospectus forecasts. The main concern is the elevated margins but these can remain elevated for longer amid a structural changes in the supply dynamics.

Small improvements in growth or margin can also be material for earnings, the broker points out and initiates coverage with an Overweight rating and $4.40 target.

Peter Warren has a licence to operate the Honda agency model and could be a Mercedes-Benz agent as well. Morgan Stanley flags the implementation of the dealer code by the federal government as providing an additional layer of earnings protection for dealerships.

<u>Risks</u>

The main downside, in the broker's view, is if gross margins revert back to pre-pandemic levels faster than previously anticipated. There is also the prospect that demand has been pulled forward and the company is unable to participate in M&A at attractive valuations.

Global production shortages have led to demand outstripping supply and consequently higher margins per vehicle sold. Yet, as Australia is a right-hand drive market it is likely to experience supply constraints for longer, as left-hand drive and large-volume markets are prioritised.

The main risk, in Jarden's view, is the cyclical industry in which the company operates, changes in consumer sentiment as well as macro factors that constrain discretionary expenditure.

Also, dealerships are operated under franchise agreements with manufacturers and changes in these relationships can lead to a reduction in earnings. Morgans points out, in its favour, Peter Warren Automotive has operated for 60 years, providing a full service model across industry. Therefore, it is too early to tell if it will be better or worse off financially under an agency model.

The agency model involves OEMs retaining ownership of the car ex factory until it is sold to a consumer as

opposed to selling the stock to a dealer. The model removes any requirement for price haggling, as prices will be set by the OEM on a national basis.

Morgans notes a push towards an agency model ensues from the significant amount of change affecting the industry over the next decade, such as electric vehicles and autonomous vehicles. With a flat commission structure the broker expects dealer gross profit margins will be lower but inventory carrying costs will also be removed, smoothing the overall earnings position.

RUDI'S VIEWS

Rudi's View: How To Protect Against Inflation

In this week's Weekly Insights:

-How To Protect Against Inflation
-Tech Might Require More Patience
-S&P June Index Rebalancing
-Conviction Calls
-Research To Download
-Morgans Strategy: Catalyst Stocks

By Rudi Filapek-Vandyck, Editor FNArena

How To Protect Against Inflation

It is a question that has regularly landed in my inbox this year: *I am worried about inflation. How do I protect my investment portfolio?*

Let me start with the observation that, on my assessment, still less than half of all investment experts is predicting a fundamental change in the outlook for inflation, and many of those expert voices have an agenda, a built-in bias or a history of proclaiming the end is nigh or the system is approaching its ultimate day of reckoning.

Think: the always-buy-gold bugs (alongside silver). Today's true believers in crypto. Your old fashioned, true blue cheap-value-is-everything investor, many of whom also believe risk assets are in a bubble and the Fed's QE policy alone is responsible for the outperformance of growth stocks pre-November last year.

Having said so, it cannot be denied many more expert voices and market participants are paying attention this year, if only because most portfolios and strategies were not prepared for potentially higher inflation, plus one can never be 100% certain about these matters; it's thus best to hedge and to re-align so that one unforeseen event doesn't destroy all the good work done previously.

As one prescient expert put it recently: **inflation might prove transitory, but a lot of damage can be done in the meantime**.

Judging from the emails and messages I have received since the beginning of the year, I am certain many an investor agrees with that assessment. Share prices for some of last year's share market champions are down by -50% and more. This whole market re-set has been nothing but brutal for particular pockets and corners, impacting on portfolios, returns and strategies.

Ironically, it is also my observation a new stream of expert voices seems to be rising to the surface; one that is looking beyond the current supply-chain bottlenecks and production shortages, questioning the sustainability and the severity of this year's economic recovery. What if next year brings disinflation, if not deflation, rather than run-away inflation?

Needless to say, this year's Grand Debate among experts and investors worldwide is to remain inconclusive for a while longer. My take on it from two weeks ago:
https://www.fnarena.com/index.php/2021/05/20/rudis-view-collins-foods-rio-tinto-and-aurizon/

Irrespective of one's own views, bias or portfolio positioning, it does make sense to re-align portfolios and strategies, even after the adjustments that have occurred already since November last year. Because if inflation does decide to stick around for much longer, global re-positioning in financial assets will have a lot longer and farther to run still.

Basic rules of inflation

Let's not make this subject too complicated. **Higher inflation weighs on asset valuations**, hence why investors have been selling equities trading on high PE multiples (in a general sense) and buying into laggards and lower priced equities instead. This has been factor number one underpinning the switch from Growth and Quality into Value and Cyclicals.

Another factor is that if higher inflation translates into higher bond yields, in particular at the longer end (further out) then most financials stand to benefit.

Hence why Australian banks have made such a forceful comeback. However, all else remaining equal, this should equally have benefited insurance companies and other financials, but we only have to look briefly at share prices for the likes of Challenger ((CGF)) and Insurance Australia Group ((IAG)) to find out that other factors still have a say as well.

Inflation and bond yields are but one factor. They are not the only driver for share prices.

Inflation also favours real assets above financial assets. Think bricks and mortar properties, but also so-called "hard" assets like oil, gold, metals, and even agricultural products, not just timber and wood chips.

Again, since January the share price of Woodside Petroleum ((WPL)) has gone from $27-plus to below $22 today. Santos' ((STO)) share price shows a much flatter trajectory, while Senex Energy ((SXY)) has simply continued trending upwards.

A highly simplified way of looking at inflation is that most industrial companies buy in commodities and other input materials, meaning their margins are coming under pressure unless they have strong pricing power.

In a simplified set-up, this pits the likes of Amcor ((AMC)), Ansell ((ANN)) and Incitec Pivot ((IPL)) against the producers of basic materials, such as BlueScope Steel ((BSL)), Oil Search ((OSH)) and BHP Group ((BHP)). Yet again, if inflation really takes off, those producers will start feeling the squeeze themselves from rising inputs and slowing demand.

As an investor, one should always be careful what to wish for. We might just get it in spades, and not fully realising the potential consequences. Today's doom and gloom scenarios, or at least one, of them involves persistently higher inflation which forces central banks to turn less accommodative, with devastating impact on assets, economies and government finances.

Inflation and bond yields are one factor, but seldom the sole defining driver. Which is why formulating an answer to what appears a simple and straightforward question is more complicated than one might think, especially now that bond yields have calmed down and a large re-adjustment between opposing parts of the share market has already occurred.

The case for real assets

Wilsons last week explained **the case for increased exposure to real assets** during times of inflation outbreak uncertainty. Such hard assets tend to preserve real value in an inflationary environment, in addition to truly acting as a portfolio diversifier and often offering lower correlation with equities and bond markets.

Wilsons also suggests hard assets reduce portfolio volatility, but that would be the topic of fierce debate. Just like gold doesn't always retain its momentum in the face of inflation, and iron ore prices will sink if China stops buying, regardless.

Wilsons also advocates investors looking to diversify because of inflation concerns should broaden their spectrum and include **real estate and infrastructure**. Most infrastructure assets have an explicit link to inflation through regulation, concession agreements or customer contracts, explain the analysts. This means they can increase prices at least in line with inflation, and without impacting on demand.

Gold has a history of generating strong returns during times of high run-away inflation, while Wilsons also includes **exposure to farmland**.

UBS's and JPMorgan's global macro strategies

Making matters a little more complicated, there is a difference between nominal bond yields moving higher and the direction in real bond yields -adjusted for inflation- global strategists at UBS once again explained last week. Nominal bond yields did surge earlier in the year, but real, inflation adjusted yields are still near an all-time low in the US.

UBS predicts real bond yields will start trending upwards later in 2021. This eventually turns into a negative as rising real yields slow down economic activity. However, this should not become an issue anytime soon, and central banks are keeping an eye out as well (insofar they can retain control).

Assuming UBS's scenario plays out, Value stocks should outperform, as well as US small cap stocks vis a vis the large and Megacaps.

Strategists at JP Morgan have started advocating for a more nuanced approach in the Value versus Growth debate. In their view, certain segments in the Value basket no longer automatically represent opportunity, while the trend among Growth stocks is turning favourably towards GARP - Growth at a Reasonable Valuation.

Maybe JP Morgan's assessment is the most valuable among all now that market momentum has turned, and that initial, large re-adjustment between Winners and Laggards has taken place.

Find those companies that are able to grow profits and create shareholder value next year and in subsequent periods. Don't own them at too high a valuation.

Tech Might Require More Patience

Investors must be scratching their heads after several **Australian tech stocks** tumbled in 2021, comment **analysts at Wilsons** in their latest review of the sector. After such a remarkable run in 2020, what could have changed in such a short space of time?

The relative underperformance of the domestic technology sector over the first five months of 2021 has exceeded -20% and this applies both against the ASX200 as well as vis a vis the Nasdaq. Time for an explanation.

Wilsons points out the overall performance of Australian tech stocks in 2020 had been exceptionally strong, and this has to be taken into account when measuring this year's relative performance, which has been poor on everybody's assessment.

A few additional points to include in this year's sector performance assessment:

-Australian technology companies often have no profits but do trade on elevated multiples which makes them ultra-vulnerable to rising bond yields and an increase in inflation forecasts. Wilsons makes the observation this was in particular apparent during February and March, the most intense phase of bond markets adjusting to the changing inflation outlook this year;

-because of the exceptional performance in 2020, the starting point of highly elevated valuations left the sector extremely vulnerable to any market switch out of last year's winners and into the market laggards. This switch accelerated in the opening months of 2021;

-the global cyclical recovery unfolding is much stronger than expected and favours cyclicals and cheaper alternatives with higher economic leverage instead of growth stocks, even if they are merely trading on reasonable multiples;

-earnings momentum for Australian technology companies has been trending negatively since January in direct opposition to the firm positive trend for financials and commodity producers in Australia. In contrast, Wilsons points out, US Tech has been in upgrade mode since July 2020

For the sector to resume its prior outperformance, Wilsons suggests two things need to change:

-earnings momentum for the sector needs to revert back to a positive trend - investors should watch trading updates pre-August and financial results and guidances in August, Wilsons suggests;
-investors need to feel more comfortable with the level and direction of bond yields

Regarding the second factor, it is Wilsons' view that bond yields can still rise to a higher level and who could possibly argue with that?

None of the above has stopped Wilsons from retaining a few technology stocks in its selected list of High Conviction Buys; see further below.

For my own take on the local technology and growth stocks, see last week's Weekly Insights:

https://www.fnarena.com/index.php/2021/05/27/rudis-view-investing-in-quality-growth-a-journey/

S&P June Index Rebalancing

As Standard and Poor's is expected to announce the next batch of index inclusions and exclusions in Australia on Friday June 11th, analysts at **Wilsons** expect no changes for the ASX20 or ASX100, but the ASX50 and ASX200 are unlikely to retain their current compositions.

Two weeks ago I explained the potential short-term importance of index changes, and forecasts made by **Morgan Stanley** in this regard:

https://www.fnarena.com/index.php/2021/05/20/rudis-view-collins-foods-rio-tinto-and-aurizon/

Wilsons is anticipating a whole lot fewer changes will be announced on the above-mentioned Friday morning. Appen ((APX)) might lose its ASX100 spot to Harvey Norman ((HVN)), but this scenario might depend on respective trading volumes this week, say the analysts.

More probable are fresh ASX200 inclusions for Orocobre ((ORE)), Chalice Mining ((CHN)) and Uniti Group ((UWL)), respectively replacing Resolute Mining ((RSG)), Austal ((ASB)) and Perenti Global ((PRN)).

Wilsons also thinks Orica ((ORI)) is likely to lose its ASX50 inclusion to Northern Star Resources ((NST)).

All shall be revealed on June 11 with announced index changes put in practice after the market's close on June 18th, the following Friday.

Conviction Calls

Investors still looking for exposure to oil and gas companies might take some guidance from **RBC Capital**'s initiation of coverage of Senex Energy ((SXY)).

Generally speaking, the share price has gradually made its way to $3 from $2 around the release of FY20 financials in August last year, but most stockbroking analysts covering the sector still regard the share price as too low, and certainly RBC Capital backs up that assessment.

Monday's initiation contains a maiden Outperform rating alongside a price target of $4, which beats all other targets in the FNArena database with exception of the $4.20 set by stockbroker Morgans.

The reason as to why RBC Capital and others remain positive on Senex's outlook is related to the company's substantial reserves that are located near its existing operations and which underpin the potential to double current production level in the years ahead, which -if successful- should translate into strong revenue growth and a tasty dividend yield (think more like 4% instead of the current 2%-plus).

It is RBC Capital's assessment that delivering future production growth is relatively low risk and low cost for Senex management, also because the GLNG Project is to become increasingly reliant on third party gas supply volumes, which is seen as de-risking Senex's expansion plans.

Meanwhile, Senex's Atlas project delivers gas to high quality customers including Alinta, Origin Energy, Orora, CleanCo and CSR via fixed-price, CPI linked contracts.

Outside of RBC Capital, five of the six stockbrokers monitored daily by FNArena rate the shares a Buy (or equivalent) with a consensus target of $3.77. Loyal shareholders received an interim dividend of 1c in March, but there should be a lot more to follow in the years ahead, as also indicated by the fresh research update by RBC Capital.

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JPMorgan's mid-year sector updates have generated a Top Pick nominattion for NextDC ((NXT)) in the local technology sector, while platform operator Hub24 ((HUB)) is now Least Preferred.

On observation the NextDC share price has found the going a lot tougher thus far in 2021, JP Morgan suspects short-termism is to blame for the relative underperformance of Australia's leading cloud centres operator. There still is a large pipeline of large developments and the company remains well-funded.

As far as Hub24 is concerned; JP Morgan is worried margin pressure is to reveal itself over the near-term due to increased commodification of the local financial platforms industry. This would make current growth momentum unsustainable with potentially serious consequences for Hub24's valuation.

Elsewhere, the same mid-yearly sector revision for the oil and gas industry has elevated Beach Energy ((BPT)) as JPMorgan's Top Pick for the sector, with Worley ((WOR)) now Least Preferred.

A similar exercise by analysts at the REITs desk has triggered a forecast that strong operational momentum for Goodman Group ((GMG)) is likely to persist for the next 3-4 years.

Moreover, JPMorgan sees little risk to Goodman's earnings growth being delivered over the period ahead. More positive commentary refers to Stockland Group ((SGP)), while Waypoint REIT ((WPR)) is expected to announce capital management initiatives with the release of interim financials in August.

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Analysts at **Wilsons** have conducted a deeper-dive into this year's misfortunes for local technology stocks, as mentioned earlier, and their conviction in the ongoing growth potential for Afterpay ((APT)) and Xero ((XRO)) has remained intact.

Both remain on Wilsons' Focus List and in both cases "the long-term growth outlook continues to look bright, driven by the global opportunity set, transformative customer proposition, and network effect that both businesses have".

EML Payments ((EML)) is also one of the analysts' favourites among local technology stocks. Wilsons is of the opinion the share price has fallen way too much in response to an investigation by the central bank of Ireland into EML's Irish subsidiary.

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Property analysts at Moelis highlighted while large shopping centres are battling with declining rents and assets under valuation pressure, sector peers owning smaller formats are currently seen offering an attractive investment alternative.

On Moelis' assessment, rents and yields have been relatively consistent through the pandemic, while retail sales remain elevated, and long term structural risk remains relatively low.

Hence, for yield/income investors looking for an alternative for your traditional Unibail-Rodamco-Westfield or Scentre Group, Moelis recommends Shopping Centres Australasia ((SCP)) and Charter Hall Retail REIT ((CQR)) instead.

Both are Buy rated (of course) with price targets of $2.64 and $3.87, respectively, with respective forecast dividend yields of 6.1% and 6.9%.

Research To Download

RaaS on that (potentially) transformational deal for Betmakers Technology Group ((BET)):

https://www.fnarena.com/downloadfile.php?p=w&n=87C22027-C0C6-DE79-525E43A93DF4AD71

Morgans Strategy: Catalyst Stocks

It remains the view of stockbroker Morgans that current investor fears about a sustainable outbreak in inflation will -ultimately- prove unfounded. In the meantime, of course, this won't stop share market volatility spiking higher whenever economic data suggest otherwise.

One of the strategies to deal with this environment, suggests Morgans, is to concentrate on positive catalysts. Share prices tend to respond favourably to positive catalysts, irrespective of the overall risk climate.

Within this framework, Morgans prefers Sonic Healthcare ((SHL)), Sydney Airport ((SYD)), APA Group ((APA)), Tyro Payments ((TYR)), Eagers Automotive ((APE)), Lovisa Holdings ((LOV)), Acrow Formwork and Construction Services ((ACF)), and Alliance Aviation ((AQZ)).

Identified catalysts range from anticipated positive trading updates, to new contract wins, expected acquisitions and a strong forward pipeline of projects.

Other companies mentioned include Link Administration ((LNK)), Afterpay, Atlas Arteria ((ALX)), DBI Infrastructure ((DBI)), Micro-X ((MX1)), ImpediMed ((IPD)), and Antisense Therapeutics ((ANP)).

Morgans has identified five companies potentially awaiting negative catalysts, mostly related to anticipation of disappointing company guidances in August: AGL Energy ((AGL)), Origin Energy ((ORG)), CSL ((CSL)), Cochlear ((COH)), and Ramsay Health Care ((RHC)).

The latter has by now announced a large acquisition in the UK.

(This story was written on Monday 31st May, 2021. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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