

# STORIES TO READ FROM FN Arena

Friday, 9 December 2022



[November In Review: Shares Up, Yields Down](#)



[ESG Focus: Takeaways From COP27](#)



[2023 Outlook: Global](#)

## CONTENTS

### AUSTRALIA

1. [The Year Of Hydrogen](#)
2. [November In Review: Shares Up, Yields Down](#)
3. [Metcash: Strong Hardware, Weak Cashflow](#)
4. [Peak Expenditure to Impact Woodside Returns](#)
5. [Longer Term Outperformance For Pexa Group?](#)

### ESG FOCUS

6. [ESG Focus: Takeaways From COP27](#)
7. [ESG Focus: The Clean Hydrogen Prospect \(Part 1\)](#)

### FEATURE STORIES

8. [2023 Outlook: Global](#)

### WEEKLY REPORTS

9. [Weekly Ratings, Targets, Forecast Changes - 02-12-22](#)
10. [Uranium Week: Video Killed The Radio Star](#)
11. [The Short Report - 08 Dec 2022](#)
12. [In Brief: Insurers, Healthcare, Contractors, Classifieds, Retail](#)

**AUSTRALIA**

# The Year Of Hydrogen

2022 has seen a sudden burst of listed hydrogen pure-plays, largely out of nowhere. Tim Boreham investigates.

- Hydrogen can be harnessed in many ways
- Sudden burst of listed stocks
- Energy intensity the key

By Tim Boreham

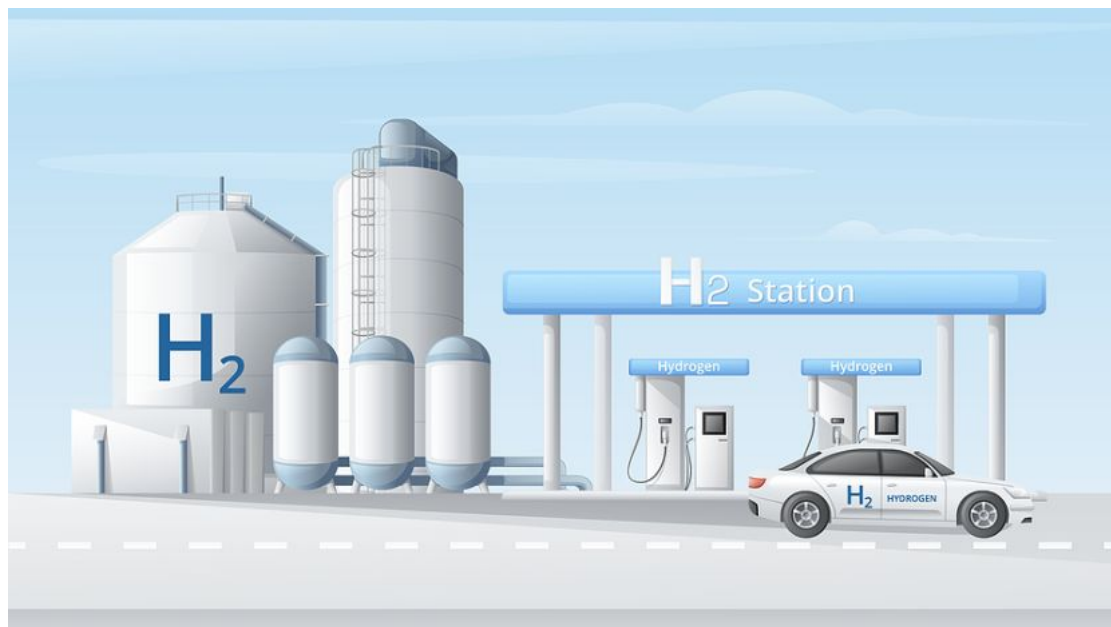
Whether in grey, blue, green and even turquoise form, hydrogen this year emerged as a compelling investment theme and 2023 looks to be no different for the first element on the periodic table.

Having been bereft of pure-play ASX-listed hydrogen exposures, investors are becoming spoilt for choice as more ventures seek to list.

To date, the emphasis has been on 'green' hydrogen, which refers to producing the gas by splitting water atoms with electrolysis, using renewable energy.

Some hydrogen developers have turned to solving the knock-on issues of renewables adoption including storage and transportation, battery materials recycling and improved battery performance.

One missing element (excuse the pun) of the hydrogen debate is the prospect of tapping naturally-produced hydrogen to obviate the need for any energy-intensive extraction and separation.



Your columnist professes to be worldly-wise, but had no idea that hydrogen occurred in natural form until he read about Gold Hydrogen's upcoming IPO plans.

Chaired by former federal pollie Alexander Downer - and no hot air jokes please - **Gold Hydrogen** is mulling a \$20 million raising and ASX listing to support its quest to explore for naturally-occurring hydrogen in South Australia.

Inspired by historical records showing incidence of the gas, Gold Hydrogen has 7820 square kilometres of granted ground on the York Peninsula and Kangaroo Island and has applied for another 67,512 sqkm.

The company has "independently and conservatively assessed" a potential 1.3 billion kilograms of the stuff.

So, with an estimated production price of \$1 a kilogram relative to a current global price of around \$17/kg, Golden Hydrogen could be cooking with, er, gas.

The company plans to list in mid-January with an indicative market cap of \$70 million.

The science of electrolysis might be proven, but commercialisation challenges include transporting and storing the volatile gas. There's a dearth of hydrogen pipelines, while compressed hydrogen is hard to handle and has low energy density.

Rio Tinto's ((RIO)) chief scientist Nigel Steward this week asserted that hydrogen remained "prohibitively expensive" and it didn't make much sense to ship it (both cost and carbon emissions wise).

For IPO candidate **Electriq Global**, the solution lies with a powdered form of hydrogen which - like laundry powder - can be stored in a box until required with an indefinite 'shelf life'.

According to the Israel-based Electriq, hydrogen powder is inert (there's no risk of an explosion) and has an energy density more than two times that of liquid organic hydrogen and around five times that of compressed hydrogen.

"Hydrogen is well known in compressed or liquefied form, however when migrating hydrogen into fuel there are new challenges," says Electriq executive chairman Baruch Halpert.

Electriq's patented generation process involves bonding hydrogen with another material.

The hydrogen is produced in situ from a generator about the size of washing machine. On usage, half of the hydrogen drives from the powder and the other half from released water.

"That means when you deliver one kilogram of our powder, you actually get two kilograms," Baruch says. "It's literally a solution in a box."

Electriq has released the world's first generator run on powdered hydrogen, called Joshua. With an 80-kilowatt hour capacity, the unit is powering cranes on a Dutch construction site.

Baruch envisages the powder as a replacement for diesel generators at remote sites (such as mines) with marine applications as well (including submarines).

"Just as fossil fuels come in different forms, hydrogen will be the same," he says.

The rush to develop upstream hydrogen facilities has also overshadowed the need to ship the material safely and economically.

Renamed from Global Energy Ventures, the ASX-listed **Provaris Energy ((PV1))** initially pursued natural gas shipping but is now eyeing the development of two bespoke hydrogen gas vessels (called GH2 carriers).

With a capacity of 26,000 and 120,000 cubic metres, the ships have been approved by the American Bureau of Shipping, with construction slated for mid-2023.

Provaris's patented method involves integrating two 130-metre-long tanks into the vessels, built with high-carbon steel to avoid the risk of the highly compressed gas leaking.

Provaris managing director Martin Carolan notes the common shipping method is by way of ammonia or liquefaction (similar to LNG). But the gas needs to be cooled to ultra-low temperatures and then reconverted to gas on arrival.

"There's a lot of energy and capital being spent to convert the product into a much higher density liquid, purely to get the shipping costs down," Carolan says.

The proposed fleet is part of a broader joint venture project based on the Tiwi Islands, which would integrate a 2.8-gigawatt solar farm and with a 30-kilometre transmission line to an existing port, where an electrolyser would be built.

A prefeasibility (design and concept) study has costed the venture at \$US4.5-5.2bn based on 100,000 tonnes per annum of green hydrogen exports.

Carolan notes that only two per cent of the gas would be lost in the compression, storage and export stages, compared with up to 35 per cent if the hydrogen is transported in the form of ammonia under current methods.

"It's a simply way of delivering a pure gaseous product and in the molecule the customers typically want," he says.

Carolan says the ships initially could be used for other third-party hydrogen ventures, ahead of the Tiwi Islands

project.

While a more efficient shipping method would help, producing 'green' hydrogen still requires intense energy input.

To ameliorate this age-old problem, the Adelaide based, ASX-listed **Sparc Technologies ((SPN))** is furthering a novel technology to produce hydrogen from an electricity-free process called photocatalytic water splitting (PWS).

The work is by way of the Sparc Hydrogen joint venture, with Sparc Technologies in partnership with the University of Adelaide and Andrew Forrest's Fortescue Future Industries.

Known about for five decades but eluding commercialisation, PWS uses the sun's radiation and a highly-engineered photocatalyst material to split water into hydrogen and oxygen.

Because it obviates the need for electrolyzers - an expensive component of conventional green hydrogen production - the output is expected to be very competitively priced.

The tech is based on a solar reactor developed by the University of Adelaide and Flinders University.

The bourse's original hydrogen pure-play, **Hazer ((HZR))** is beavering away on its plans to produce clean hydrogen and graphitic carbon from methane.

Normally, methane-derived hydrogen is expensive to produce, with high carbon emissions. That's why it's known as 'grey' methane.

Hazer's 'turquoise' iteration, methane pyrolysis, adds iron ore as a catalyst to produce the high-value graphitic carbon, rather than carbon in its feared planet-warming gaseous form.

Hazer has two pilot projects on the go, in Sydney and Perth's Kwinana and plans to start a 100 tonnes per annum, biogas powered commercial demo plant in Perth in 2023

Beyond that, Hazer has a memorandum of understanding (MOU) with Canadian energy giants Suncor Energy and Fortis Inc to build a 2500 tpa plant in Canada's British Colombia province.

Hazer also inked a vague but promising MOU with Japan's Mitsui & Co to explore potential markets for the company's tech.

Hazer chief Glenn Corrie envisages a leveraged business model by which the company out-licenses its patented to know-how to other parties.

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**AUSTRALIA**

# November In Review: Shares Up, Yields Down

The ASX200 gained 6.6% in November, buoyed by the ongoing decline in 10-year bond yields and a strong materials sector.

- The ASX200 gained 6.6% (total return) during November
- Value outperformed Growth, while large caps shone
- Materials contributed over half the market return
- Australian 10-year bond yield fell by -23bps to 3.53%
- The Australian dollar jumped to US\$67.87 from US\$63.97

By Mark Woodruff

The ASX200 gained 6.6% (including dividends) in November as investors responded to a more dovish than expected 25 basis point interest rate increase by the Reserve Bank of Australia and easing interest rate concerns in the US.

This monthly gain boosted the calendar year-to-date return into positive territory at 2.2%.

The Australian 10-year yield moved down by -23bps to 3.53%, less than the -38bps fall to 3.70% for US 10-year yields, as the Australian dovish pivot occurred in the prior month, explains Macquarie. Australian 10-year yields fell by -13bps to 3.76% in October.

Hopes for a re-opening in China also buoyed ASX shares, which also led to a 22% outperformance by Chinese shares relative to global equities.

Shares performed strongly internationally following comments from the US Federal Reserve indicating a potential slowing of rate hikes. The MSCI Developed Markets Index rose by 5.7% and the S&P500 in the US gained 5.6% in local currency terms.

Asia Pacific ex-Japan was the best performing region in a month when Emerging Markets gained 9.8% and outperformed Developing Markets.

In Australia, **Materials contributed over half of the total market return in November**, points out Morgan Stanley, driven largely by large-cap miners. The Utilities sector gained 20.8%, boosted by the takeover offer for Origin Energy ((ORG)), while Materials posted a 16.3% gain and Healthcare also rose by 6%.

The worst relative performers were Communication Services, Financials and Energy, which gained 2.1%, 2.5% and 2.7%, respectively.

**Value outperformed Growth** by 4.8% in November, extending its year-to-date lead to 13.8%, while globally Value has also maintained style leadership, most notably in the US, observes Morgan Stanley.

**Large caps outperformed** their mid-and small-cap brethren as the ASX50 gained 7% versus 5% for the MidCap50 and 4.9% for the Small Ordinaries.

Commodity prices displayed mixed trends, notes UBS, with iron ore rising by nearly 26% on news of government support for the China property market and reopening expectations, while Brent crude oil prices slipped around -10% on increasing doubts about a production cut at the next OPEC meeting.

Macquarie feels increasing concerns of a US recession also contributed to the falling oil price. By contrast, the Japan/Korea Marker (JKM) liquefied natural gas (LNG) price rallied by 31% in November.

The gold price rose strongly on speculation the US Federal Reserve is closer to the end of the hiking cycle, according to UBS.

The broker now expects the RBA to raise rates to 3.35% from the current 2.85%.



The Australian dollar jumped to US\$67.87 from US\$63.97, supported by optimism regarding a China re-opening, explains Macquarie. A lower US dollar also contributed.

UBS predicts a sub-trend pace of growth through 2023, with only a 4% increase in the ASX200 by the end of 2023, from the broker's end-of-2022 target of 7,000, held since June. The index closed November at 7,284. This outcome is predicated on an easing of 2022 headwinds from input/energy costs, supply chain pressures and labour shortages.

Macquarie, on the other hand expects earnings downgrades on the ASX over 2023, based on the lagged impact of all the rate rises by global central banks in 2022. It's felt Australian equities are currently closer to the top of a bear market rally. A stronger outperformance by cyclicals and small caps would be expected if the ASX was experiencing a bull market.

This broker sees the Federal Reserve easing interest rates in a US recession, which will drive a sustainable low for equities by mid-2023.



#### ASX100 Best and Worst Performers of the month

Company	Change	Company	Change
ORG - ORIGIN ENERGY LIMITED	41.11%	JHX - JAMES HARDIE INDUSTRIES PLC	-14.12%
FMG - FORTESCUE METALS GROUP LIMITED	31.84%	LLC - LENDLEASE GROUP	-12.43%
EVN - EVOLUTION MINING LIMITED	29.33%	PLS - PILBARA MINERALS LIMITED	-8.45%
VUK - VIRGIN MONEY UK PLC	25.62%	XRO - XERO LIMITED	-7.84%
RIO - RIO TINTO LIMITED	24.29%	SGR - STAR ENTERTAINMENT GROUP LIMITED	-7.82%

#### ASX200 Best and Worst Performers of the month

Company	Change	Company	Change
SFR - SANDFIRE RESOURCES LIMITED	44.09%	ELD - ELDERS LIMITED	-20.62%
ORG - ORIGIN ENERGY LIMITED	41.11%	CKF - COLLINS FOODS LIMITED	-18.62%
CIA - CHAMPION IRON LIMITED	35.90%	NVX - NOVONIX LIMITED	-16.42%
NIC - NICKEL INDUSTRIES LIMITED	33.56%	HLS - HEALIUS LIMITED	-15.16%
FMG - FORTESCUE METALS GROUP LIMITED	31.84%	JHX - JAMES HARDIE INDUSTRIES PLC	-14.12%

#### ASX300 Best and Worst Performers of the month

Company	Change	Company	Change
EML - EML PAYMENTS LIMITED	59.26%	CCX - CITY CHIC COLLECTIVE LIMITED	-39.08%
ARU - ARAFURA RARE EARTHS LIMITED	54.24%	BVS - BRAVURA SOLUTIONS LIMITED	-35.25%
BGL - BELLEVUE GOLD LIMITED	48.65%	PGH - PACT GROUP HOLDINGS LIMITED	-26.13%
AMI - AURELIA METALS LIMITED	47.62%	5EA - 5E ADVANCED MATERIALS INC	-22.64%
SFR - SANDFIRE RESOURCES LIMITED	44.09%	JRV - JERVOIS GLOBAL LIMITED	-21.43%

#### ALL-TECH Best and Worst Performers of the month

Company	Change	Company	Change
EML - EML PAYMENTS LIMITED	59.26%	BVS - BRAVURA SOLUTIONS LIMITED	-35.25%

SPT - SPLITIT PAYMENTS LIMITED	35.25%	4DX - 4DMEDICAL LIMITED	-25.58%
IRI - INTEGRATED RESEARCH LIMITED	29.73%	MMM - MARLEY SPOON AG	-25.00%
JAN - JANISON EDUCATION GROUP LIMITED	26.88%	TNT - TESSERENT LIMITED	-20.87%
NXL - NUIX LIMITED	22.81%	NVX - NOVONIX LIMITED	-16.42%

### Australian Banks

A total shareholder return by the major banks of just 1% trailed the 6.6% ASX200 gain in November.

All the banks underperformed as follows: CommBank ((CBA)) 3%, Westpac ((WBC)) 1.5%, National Australia Bank ((NAB)) flat, ANZ Bank ((ANZ)) -0.5%, Bendigo & Adelaide Bank ((BEN)) 1.5% and Bank of Queensland ((BOQ)) lost -2.5%.

Morgan Stanley points out since the start of the current RBA tightening cycle, the major banks' share prices have fallen by an average of around 2% and price earnings multiples (PE) have de-rated by an average of circa 2.2 times.

Relative to the other major banks, CommBank is trading on a P/E premium of 55% (end-November), while ANZ is trading on a discount of -25%.

On yields the ASX Industrials ex Banks, Morgan Stanley believes the major banks are slightly cheap relative to the average since 2010.

### REITs

Despite a November performance by REITs just shy of the ASX200 gain and the second consecutive month of positive gains, Credit Suisse believes it is not the end of macro-driven volatility.

Feedback from a range of investors suggests to the broker concerns remain on a number of fronts, including Office sector operating conditions and asset valuations, and the impact on Retail REITs from potentially lower consumer spending.

In addition, Credit Suisse notes investor uncertainty over the "right" multiple to apply to Fund Managers and impacts on the FY24 outlook for Residential due to affordability pressures and potentially lower demand for new dwellings.

The analyst feels much of the uncertainty relating to the issues noted above will continue into the second half of FY23.

Regarding November, fund managers like Goodman Group ((GMG)) and Centuria Capital Group ((CNI)) were relative outperformers, as were small cap names such as HealthCo Healthcare & Wellness REIT ((HCW)), Dexu Industria REIT ((DXI)) and Ingenia Communities Group ((INA)).

Underperformers included REITs with exposure to storage such as National Storage REIT ((NSR)) and Abacus property Group ((ABP)), and smaller market cap names with Office exposure including Growthpoint Properties Australia ((GOZ)) and GDI Property Group ((GDI)).

After recent outperformance, Retail REITs paused during November, while Residential names such as Mirvac Group ((MGR)) and Stockland ((SGP)) gained, notes Credit Suisse.

The broker's preferences among REITs are for Goodman Group, Mirvac Group, Stockland, Charter Hall Retail REIT ((CQR)) and Region Group ((RGN)).

### Commodities

The CRB Commodity Index rose by 2.1% to 280 in November.

Brent crude oil fell by -9.9% to US\$85.4/bbl.

The iron ore price rose by 25.9% to \$US102/t.

The gold price increased by 8.2% to US\$1,768.3/oz.

Hard coking coal prices fell by -14.9%, while thermal coal rose by 11.8% during November.

### Foreign exchange

The US dollar Index (DXY), a measure of the value of the US dollar relative to a basket of foreign currencies, declined by -5% to 105.99.

The Australian dollar moved higher to US\$67.87 from US\$63.97.

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## AUSTRALIA

# Metcash: Strong Hardware, Weak Cashflow

While Metcash delivered first half results ahead of expectations, brokers also weigh the impact of lower cash flows.

- First half results for Metcash exceed expectations
- Strong performances by Hardware and Liquor
- Strong earnings for Total Tools
- Cash flow slumps on higher working capital investment
- The impact of inflation on the company's business

Mark Woodruff

Wholesale distribution and marketing company Metcash ([MTS](#)) has delivered first half earnings ahead of consensus expectation.

The main discordant note related to disappointing cash flow, according to brokers, as stronger growth led to greater investment in working capital.

Overall, the average 12-month target price of five brokers in the FN Arena database rose slightly to \$4.61 from \$4.59, suggesting 7.8% upside to the latest share price.

Outside of the database, Goldman Sachs and Jarden raise their targets to \$4.20 and \$4.40 from \$4.10 and \$4.20, respectively.

The company specialises in grocery, fresh food, liquor, automotive parts & accessories and has a trade-focused hardware business.

In late 2020, the Hardware division (Mitre 10) was expanded when the group acquired 70% of the shares of Total Tools, a franchisor to the largest tool retail network in Australia. This stake was later increased to 85%.

Group revenue for the first half rose by 7.8% and underlying profit increased by 9.1% on the previous corresponding period.

Outperform-rated Macquarie points out **the Hardware and Liquor divisions were the key drivers of the result**, with an increase in earnings (EBIT) of 15.6% and 10.8%, respectively.

**Total Tools was a standout**, with earnings climbing by \$14m to \$47m, on an earnings margin of 15.8%, which compares to the 4.9% achieved by the company's Independent Hardware Group (IHG).

Group sales also climbed by 6.2% for the first four weeks of the second half of FY23, compared the previous corresponding period. The trading update revealed Liquor and Food sales rose by 8.9% and 4%, respectively.

The rise in Food sales is suggestive of market share gains, according to Overweight-rated Jarden, and is consistent with independent data on supermarket foot-fall.

It may not be all plain sailing, however, as management suggested all divisions remain at risk to supply chain challenges, despite a recent easing in pressures.

Also, while Macquarie notes strong ongoing demand for both IHG and Total Tools, Goldman Sachs (Neutral) sees first signs of softening in the Hardware division, with (trading update) sales decelerating to 8% due to inclement weather impacts.

Citi (Neutral) also sees potential obstacles from easing inflation, an unwind of local shopping and impacts from a housing slowdown, which may offset earnings growth from the Total Tools rollout.

A fully franked interim dividend of 11.5cps was declared, a 9.5% increase on the first half of FY22, and ahead of the consensus forecast for 9.6cps.



### The effect of inflation

Ord Minnett (Buy) points out Metcash is typically considered the largest beneficiary of inflation, given its wholesaling model and fixed cost base.

A bounce-back in food sales in the latter part of the first half, which continued into the trading update period, was partly due to rising wholesale inflation, according to UBS (Buy).

Despite the inflationary backdrop, the company delivered flat margins and no underlying earnings growth, partly due to elevated supply chain costs, explains Ord Minnett. The company is also considered to be placing a priority on price competitiveness.

### Cash realisation ratio

Neutral-rated Credit Suisse stresses the importance of cash conversion via its relevance to the medium-term dividend payout. The latter is considered an important factor in the company's positioning in income-oriented funds. It's felt the strong interim dividend payment provides some comfort.

The broker attributes a fall in the company's cash realisation ratio (to 36.5% from 91.6% in the previous corresponding period) to inflation (due to typically higher payables than inventory) and growth in the Hardware business. **For now, it's felt the 70% payout ratio can be sustained.**

**UBS (Buy) expects cash realisation will improve in the second half to 72% and will normalise back to around 90% in time** as inflation moderates and growth slows. It's noted the Hardware is the most working-capital intensive and the fastest-growing division.

### Outlook

Management remains confident on the volume growth trend for supermarkets and doesn't believe the company is ceding share from local shopping behaviour gained during covid.

Jarden expects the market perception (and valuation) of Metcash as a structurally challenged food wholesaler will change.

This is expected to occur as the company establishes a growing market share in Food and as the higher-multiple Hardware business becomes a larger contributor to group earnings.

Of the five brokers in the FNArena database, three continue with a Buy (or equivalent rating), while two remain Neutral.

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**AUSTRALIA**

# Peak Expenditure to Impact Woodside Returns

Woodside Energy warns of constrained near-term cash flow as it approaches peak capital expenditure for growth plans, and outlines intention to increase gas exposure to ensure longer-term growth.

- Woodside Energy disappointed with near-term guidance for low production and high expenditure
- The company intends to increase gas exposure as oil-linked contracts expire
- A domestic production decline is expected from 2024, but international production to peak in 2025

By Danielle Austin

Woodside Energy ((WDS)) has treated its recent investor day as an opportunity to update on its growth projects and capital management over coming years as it approaches a peak in its capital expenditure.

The company intends to increase its long-term exposure to gas hub pricing as oil-linked contracts expire, but near-term growth remains heavily dependent on oil assets. The company intends to lift its gas hub exposure to 30-35% of produced natural gas, from a current 20-25%, from 2027.

A longer-term production profile through to 2027 has Australian production flat through 2023, ahead of an expected decline in 2024-2026, and international production peaking in 2025. The company anticipates generating free cash flow of US\$7-9bn over the next five years, and capital expenditure of \$6.0-6.5bn in 2023, which it expects to moderate near \$4.0bn in 2024.

The company is targeting a final investment decision on its Trion oil asset in the coming year, and analysts highlighted approval for the project would imply additional upside to capital expenditure.



Incremental capital returns unlikely until free cash flow profile improves

Analysts largely found near-term production guidance low and capital expenditure high, compared to

expectations, while the free cash flow profile was reduced. Morgans (Hold, target price \$34.50) found 2023 production guidance disappointing, attributing the miss to lower natural gas, pipeline gas and oil volumes, and delays in the start-up of the Sangomar project. The broker also found the “less informative” update to be a step from the company towards being less transparent.

Ord Minnett (Hold, target price \$36.20) noted Woodside Energy’s free cash flow forecast of US\$7-9bn was below its expectations, given higher than anticipated capital expenditure and lower than anticipated production. While the broker considers the balance sheet to remain in a strong position to fund growth projects, it warns investors who were banking on incremental capital returns may be disappointed. Further, management suggested this will be a trend until capital expenditure begins to decline.

On fresh guidance, Ord Minnett downgraded its earnings forecasts -10% each year through to 2024, leaving its estimates at a -16-17% miss to consensus. Citi (Buy, target price \$38.50) similarly downgraded its earnings per share forecasts -23% and -12% through to 2024. Macquarie (Neutral, target price \$39.00), meanwhile, lifted its earnings per share forecasts 9% in 2023, accounting for increased natural gas trading and a production mix-shift.

Morgan Stanley (Overweight, target price \$41.00) expects Woodside Energy’s weighting to gas production underpins its appeal to investors, and within its industry coverage finds the stock’s positioning preferable to peers.

Outside of daily coverage, Jarden (Neutral, target price \$33.00) found Woodside Energy provided a clear and disciplined growth strategy to maintain production through to 2027. Further, this broker found capital expenditure guidance lower and production guidance higher than it had forecast between 2025 and 2027, driving the broker to lift its target price.

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AUSTRALIA

# Longer Term Outperformance For Pexa Group?

Recent research indicates brokers are generally positive on the longer-term outlook for Pexa Group, while also holding some nearer-term concerns.

- Since listing, Pexa Group shares are trading down around -20%
- The average target in the FN Arena database is materially higher
- Morgan Stanley anticipates long-term outperformance
- Shorter-term property market concerns weigh
- Growth avenues for the PEXA Exchange platform and PEXA Insights

By Mark Woodruff

Pexa Group ((PXA)) began life on the ASX in July 2021, after being spun-out from Link Administration ((LNK)), and closed out its first day of trading at \$17.00, down from the \$17.13 IPO price.

After peaking at \$20.81 early this year, the share price has drifted down to \$13.75, yet the average 12-month target price in the FN Arena database is around 29% higher at \$17.75.

While some doubts are creeping in, brokers have retained positive ratings in recent months, except for Jarden (outside the database), which is sticking with its Underweight assessment.

The company operates the leading digital property settlements platform in Australia and is pursuing growth options both domestically and internationally.

**The PEXA Exchange platform** connects financial institutions, practitioner firms, the Reserve Bank of Australia, Land Titles Offices and State Revenue Offices to facilitate a range of essential functions in the conveyancing process.

There's also a **PEXA Insights initiative**, which aims to develop products and services that leverage the company's property data, together with third party data, to generate property, dare I say, insights.

Back in late October, Morgan Stanley was effusive in its praise for Pexa and initiated coverage with an Overweight rating. In a broad analysis of the Technology, Media and Telecom sector, **the broker felt Pexa was one of few stocks that possessed attributes sufficient to qualify as a potential long-term outperformer.**

The business is profitable, has a sustainable first-mover advantage and is meaningfully free cash flow positive with a 45% earnings (EBITDA) margin, pointed out the analysts.

The company handles 80-90% of property transactions settled, and Morgan Stanley expects this leadership position will result in greater investment in R&D, as a percentage of sales, to maintain its leadership position.

On the flipside, the broker noted upcoming transaction volumes for FY23-25 may be worse than expected, given falling house prices/listings. However, the business is regarded as only a "shallow cyclical", with transaction volumes varying with the activity levels of the broader property cycle. **Longer-term, the total number of transactions in Australia is expected to grow broadly in-line with population growth.**

The analyst also observed running a digital exchange is a highly regulated industry, with attendant risks of change.

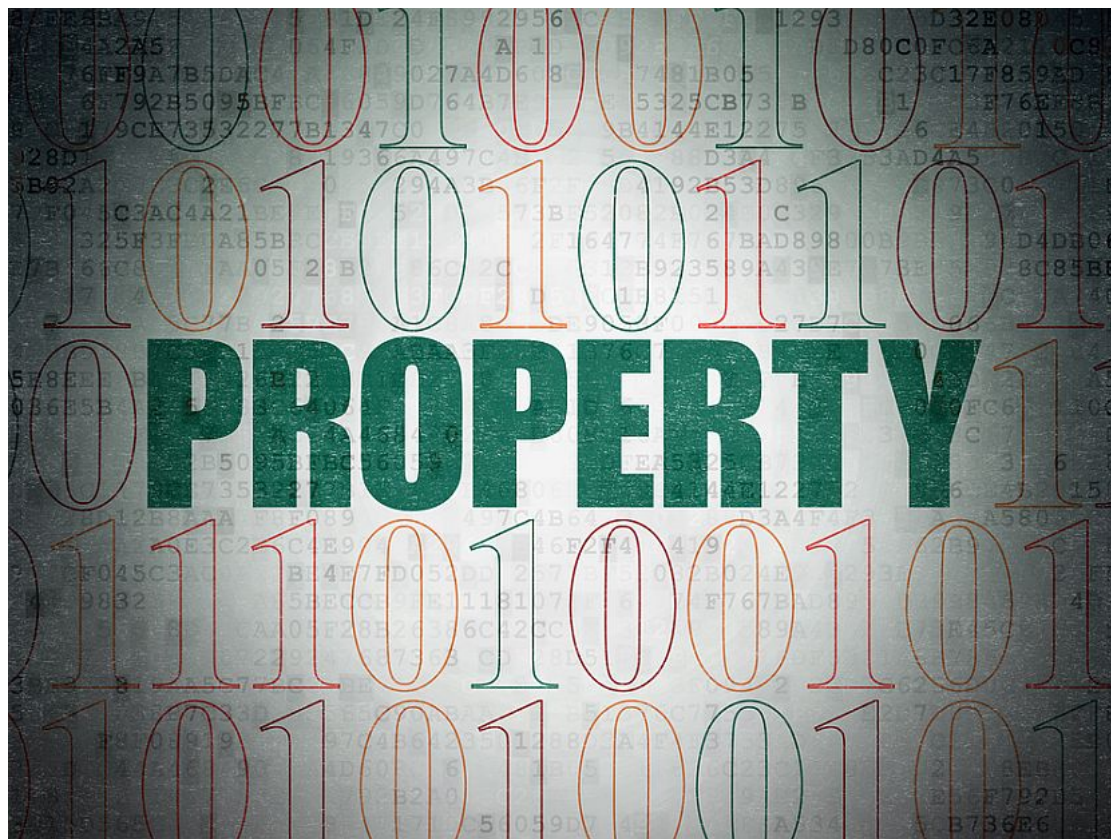
At its late-November AGM, Pexa reported "encouraging" first quarter transaction volumes of 963,000 and raised first half guidance to 1.9m.

This guidance was in excess of Macquarie's forecasts though the broker remained under research restriction and didn't provide a target price or rating (previously Outperform). Macquarie anticipated refinance volumes would remain in line with recently elevated levels before normalising in 2024, while transfer volumes would likely

continue moderating, before recovering in 2024.

In a circumstance that benefits Pexa, the analyst noted banks were utilising margin benefits from higher rates to compete for new mortgage customers.

More recently, Jarden observed settlement activity in NSW and Queensland continues to show weakness, while Buy-rated UBS noted from industry data that second quarter volumes appear to be materially lower.



Jarden expects near-term pressure on refinancing activity though expects a recovery by the second half of 2023. A wave of mortgage expiries, along with an ongoing shift to external refinancing is expected to provide near-term support.

The broker's Underweight rating is driven by its outlook for the property market, with downside risks to FY23 consensus forecasts expected.

NSW and Queensland settlement activity fell by -16% in November compared to the previous corresponding period, while transfers compressed by -25% in NSW and -27% in Queensland.

Refinancing activity also fell in NSW and Queensland by -11% and -10%, respectively. Despite this data, Jarden's target rose to \$12.70 from \$12.35 on a higher market multiple.

In research released yesterday, UBS lowered its target to \$19 from \$20 after updating for the latest industry data on domestic activity and the company's expansion targets.

For refinancing activity, the broker noted CoreLogic data suggest ongoing buoyancy, while transfers are -23% lower for the quarter so far.

#### Growth avenues for the PEXA Exchange platform and PEXA Insights

Via PEXA Insights, the company is targeting \$50m of revenue by FY25, which would make this segment a larger revenue contributor than Refinancing.

Management continues to work towards a land information total addressable market (TAM) estimated at over \$1.1bn by 2027.

UBS prefers to only incorporate revenues of less than \$20m into its forecasts until there is execution, M&A progress, and the required spending on development becomes clearer.

Regarding the PEXA Exchange platform, Morgan Stanley sees expansion opportunities into a few international markets, such as the UK, which has a TAM two-three times that of Australia.



The broker points out significant localisation is required for the platform in each new market it hopes to address. As a result, Pexa Group is not considered scalable in the same way as other global software companies.

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**ESG FOCUS**

# ESG Focus: Takeaways From COP27

*FN Arena'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:*

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## ESG Focus: Upshots From COP27

FN Arena summarises the key developments at COP27 and Macquarie checks out their implications for Australian stocks.

- Loss and damage fund for vulnerable countries
- Successful oil and gas lobbying
- Transforming the financial system
- Crackdown on greenwashing
- Private sector eyes US\$2trn opportunity in developing countries
- Macquarie checks out implications for Australian stocks

By Sarah Mills

It would be fair to say that COP27 ended with a whimper rather than a bang, and that was pretty much to be expected.

However, there were a few developments worthy of note, and a few regressions.

The main big-ticket item was the estimation that decarbonizing developing countries will require US\$4trn to US\$6trn a year prior to 2030.

Estimates suggest current investment falls about 30% short of this figure, and it is an investment opportunity many corporations and governments appeared keen to support.

The Energy Transitions Commission identified six critical areas going forward: energy efficiency, deforestation, methane, power, road transport and heavy industry.

It outlined 25 actions to accelerate decarbonisation in hydrogen, road transport, steel, power and agriculture in 2023 and expected building and cement sectors would be added to this list by COP28.

A US\$410m green hydrogen investment in Egypt was also announced as part of a World Bank plan for a US\$1.6bn green hydrogen global program.

On the regressions front, The Ukraine conflict may well have strengthened the suit of oil and gas producers.

Environment Analyst reports that the producers and their 636 industry lobbyists may have won this COP, noting language on phasing out oil and gas was removed from the Glasgow Climate Pact, which was agreed at COP26.

The Indian government, backed by 80 member states led a proposal for the text “unabated coal” to be expanded to include all fossil fuels but this fizzled.

Although to some extent, this is a moot point given big capital is driving the decarbonisation regardless of COP27 commitments.

Progress on international carbon markets also fizzled, with Article 6 being watered down and no consensus was reached.

Other key points included:

## Loss And Damage Fund For Developing Countries

The establishment of a loss and damage for developing countries went hand-in-hand with an agreement to let

developed countries off the legal hook for climate change damage.

The terms of the fund are poorly articulated, and it doesn't appear to be a giveaway, but rather will likely be distributed in the form of loans, so one suspects that, pending terms, the agreement is more hot air than substance.

An Adaptation Fund also garnered \$230m in new pledges, chicken feed in the broader scheme of things.



### Methane Pledge Gains Momentum

The battle against methane emissions did make some headway, the Pledge gaining 50 new signatories committing to cut methane emissions by 2030.

US President Biden signaled domestic methane regulation of oil and gas producers, aimed at cutting leaks by 87% on 2005 levels. This would cost the industry \$20bn, depending on government support, and would ensure producers cap high-volume leaks.

Macquarie expects the methane pledge will, in the future, have repercussions for Beach Petroleum ((BPT)), Cooper Energy ((COE)), Woodside Energy ((WDS)), Santos ((STO)), Karoon Energy ((KAR)), Strike Energy ((STX)), a2 Milk Company ((A2M)), and Cleanaway Waste Management ((CWY)).

### Alliances, Programs and Partnerships

Dollar-commitments and regulations were thin on the ground but decarbonisation alliances, programs and partnerships were abundant.

One of the major partnerships, and one with some financial heft albeit widely expected, was a \$20bn JustEnergy Transition Partnership to phase out coal signed between Indonesia and the US, as well as the UK, Denmark and Italy. Bankers Citi, Macquarie, HSBC and Deutsche Bank were also signatories.

The Asian Clean Energy Coalition, Global Renewables Alliance, Global Offshore Wind Alliance, African Green Hydrogen Alliance and African Cities Water Adaptation Fund, were among the other initiatives.

### Transforming The Financial System

One of the potentially more impactful developments was the Sharm el-Shiekh Implementation Plan's call to transform the global financial system (Sharm el-Shiekh being the location of the meeting in Egypt).

The gist is that multilateral development banks and international financial institutions will soon be called upon to reform their lending practices and align them to climate policy.

Macquarie expects this will have impacts for Australia's four major banks: Commonwealth Bank ((CBA)), ANZ Bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)).

### Crackdown On Greenwashing

The other was the United Nations' signaling of its intent to crackdown on greenwashing with tougher reporting standards and verification.

The UN called for corporations to include interim emissions target (2025, 2030 and 2035) to give investors a clearer indication of the progress of their investments' transition prospects.

The other big call was for corporations to include emissions from their entire value chain - Scope 1, Scope 2 and Scope 3 emissions, although there were no hard dates set. Already, ASX300 companies are starting to add Scope 3 emissions into their reporting.

Also, corporations will not be able to claim to be net zero as long as they build or invest in new fossil fuel supply.

Already, greenwashing is shaping up as a new challenge for ASX-listed stocks, ASIC issuing its first greenwashing fine of \$53,000 fine to Tlou Energy in October, and the ACCR slapping a greenwashing lawsuit on Santos ((STO)) in Australia's Federal Court.

Macquarie expects the crackdown may have implications for Commonwealth Bank and Santos.

### Deforestation And Biodiversity

Deforestation and biodiversity also featured prominently, COP27 linking biodiversity to climate change for the first time.

Brazil President-elect Lula da Silva committed to ending deforestation in the Amazon, but this appears slightly toothless given the strong incentive for landowners to clear forest prior to the introduction of biodiversity measures.

The Ocean Economy Report announced its Ambition Loop and Roadmaps and Partnerships were announced for the Mangrove Breakthrough.

Macquarie says that deforestation and sustainable agriculture commitments may have implications for food-system companies such as a2 Milk, Coles ((COL)), Woolworths ((WOW)), Endeavour Group ((EDV)), Genex Power ((GNX)), Inghams Group ((ING)), Treasury Wine Estates ((TWE)) and United Malt Group ((UMG)).

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**ESG FOCUS**

# ESG Focus: The Clean Hydrogen Prospect (Part 1)

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## The Clean Hydrogen Prospect (Part 1)

As green hydrogen hits a tipping point, investors are turning their focus to the broader clean hydrogen prospect, and this article examines the nuts-n-bolts of the hydrogen market and its related technologies.

- The economics of green hydrogen
- The clean hydrogen rainbow
- Applications: grids, fertiliser, aviation and heavy industry
- Electrolyser market
- Hydrogen carbon-capture plays
- Storage, Transport And Infrastructure

By Sarah Mills

Clean hydrogen is shaping up as the biggest green prospect since renewables and in 2022, an energy-hungry world pivoted sharply towards the fuel, and the International Energy Agency basically gave the fuel its imprimatur.

This article (Part 1 in a series on the subject) discusses the mechanics of clean hydrogen production and its applications and challenges.

We follow up with a review of the clean hydrogen prospect - its markets and key developments domestically and overseas in Part 2.

Part 3 checks out the Australian hydrogen prospect and examines specific ASX-listed stocks, including its best-known local advocate Fortescue Metals Group ((FMG)).

A reminder to investors, this ESG column takes the long view. It does not discount positive or negative price movements in existing energy sources in the near term.

## The Economics Of Clean Hydrogen

Clean hydrogen is a subset of the clean technology sector.

Clean technology reduces the use of non-renewable materials cutting waste; energy; pollution; emissions; and many issues associated with mismanagement.

In these respects, clean hydrogen is competitive if not superior to conventional counterparts on the global ESG stage, but it is yet to prove economically competitive.

Clean hydrogen, including green hydrogen (powered by renewables), are unlikely to ever compete with renewables, short of massive improvements in catalytic technologies.

So clean hydrogen's main competitors are fossil fuels and battery technologies.

The price of green hydrogen needs to fall to between US\$0.70/kg and US\$1.60/kg to be competitive with natural gas by 2050.

That compares with an average of US\$3.80/kg to US\$5.80/kg prior to the Ukraine conflict, according to Reuters. (Prices have temporarily skyrocketed due to high energy costs).

But assuming fossil-fuel prices remain elevated, observers expect the fuel to reach cost parity by 2025 as carbon markets, methane pledges, tariffs and the redirection of subsidies from fossil fuels kick in.



### Green Hydrogen Is Uncompetitive Without A Price On Carbon

Unlike the rest of the world, Australia has no price on carbon, which means clean hydrogen is likely to continue to prove an unviable investment in this country for the next few years, particularly in a rising interest rate environment, in which the market is focused on risk, and prizes value over growth.

Director Climate Energy Finance Tim Buckley notes that clean hydrogen as an investment is unviable without a regulatory impost.

“There is no such thing as clean hydrogen without a price on carbon,” says Buckley.

Such imposts and subsidies are already in place in countries such as the US and Europe (we discuss this below), but Buckley expects Australia will lag for at least three years, until the government’s hand is forced by global competition.

In the meantime, advocates point out that green hydrogen costs have fallen by a factor of three in 20 years, that it took solar four decades to achieve the same result, and expect costs will fall precipitously from here (particularly from post 2025) meaning the subsidy threshold could tighten if not evaporate.

But clean hydrogen’s challenges are more than just financial, all of which we discuss below.

### Not All Clean Hydrogens Are Created Equal

Clean hydrogen is a catch-all term for a range of hydrogen technologies that do not release carbon dioxide (CO<sub>2</sub>) into the air, or that release substantially lower levels of CO<sub>2</sub> into the air.

To qualify for the EU green taxonomy, a technology must have a low carbon/hydrogen footprint of less than 36.4g CO<sub>2</sub> equivalent per megajoule.

There are several forms of clean hydrogen being produced globally, all with varying prospectivity.

These include a range of processes from green hydrogen (derived through electrolysis and catalysts), to bio-mass produced hydrogen, and methanol (waste to energy) hydrogen.

For ease of description, pundits have colour-coded the hydrogen market.

- Green hydrogen is derived from electrolysis using renewable energy such as wind, solar and hydro;
- Yellow hydrogen is like green hydrogen but is powered purely by solar rather than renewables generally (such as wind for example).
- Pink hydrogen is derived from nuclear energy;



- Turquoise hydrogen includes technologies that use methane pyrolysis to produce hydrogen and solid carbon, in processes powered by renewable energy and stored carbon;
- Blue hydrogen uses carbon capture, utilisation & storage and technically scrapes into the category but given the expense of CCUS is an unlikely contender.

Green and yellow hydrogen currently occupy pole position as long-term investment prospects; while blue hydrogen languishes at the bottom, and in many instances qualifies as greenwashing.

There are other “approaches” being promoted such as mixing liquid natural gas with green hydrogen (Hydrogen 2) to be used in western power plants’ existing LNG infrastructure as a near-term decarbonisation measure.

Hydrogen can be used in existing gas infrastructure by using up to 15% hydrogen in the mix, say observers.

The US HyGrid Project is one of the nation’s first clean hydrogen blending projects, aimed at increasing the recovery rate of H<sub>2</sub> from methane, again pointing to the prospects of green methane in the hydrogen market.

Even further down the list given the bleak forecasts for coal production are catalysts that increase the heat from hydrogen or gas and can be retrofitted to coal and gas plants, allowing the use of existing infrastructure (a form of carbon capture technology which we discuss below).

Biomass-produced hydrogen (using anything other than waste) is also a less environmentally positive prospect.

#### Four Types Of Electrolysers

The electrolyser market is likely to be one of the first beneficiaries of the next wave of green hydrogen investment.

There are four main types of electrolysers, the two main types being:

- Polymer Electrolyte Membrane (PEM) electrolysers, which use an ionically conductive solid polymer, which best suited for large-scale hydrogen production. Examples include HyLyzer and Rincircle.
- Alkaline Electrolysers use a liquid electrolyte and are better suited to small-to-medium-scale hydrogen production. Examples include HyStat, Ragain and Australia's experimental Hysata (a capillary fed electrolyser).

Both PEM and Alkaline electrolysers provide onsite, on-demand hydrogen, which is 99.999% carbon free.

Anion electrolysers combine elements of PEM and Alkaline batteries using water electrolysis.

Anion electrolysers are potentially a low-cost option given water electrolysis allows the replacement of conventional noble metal electrocatalysts with low-cost transition metal catalysts.

Anion technology is not yet stable, but its introduction would prove a game-changer in the electrolysis market.

Solid Oxide Electrolysers use solid ceramic material as the electrolyte which operate at much higher temperatures, but which have the potential to become more efficient.

#### Applications and competitors

Hydrogen has many and varied applications in an ESG world.

Renewables remain the kingpin in the green-energy production universe given even green hydrogen must be powered by renewable energy.

First off the bat, it can compete with grey hydrogen (produced from natural gas) in traditional hydrogen markets.

These include:

- glass purification
- aerospace
- semiconductor manufacturing
- pharmaceuticals
- fertilisers
- welding and annealing and heat-treating metals
- coolants in power plants
- petroleum refining (not for too much longer);
- and the hydrogenation of unsaturated fatty acids

But the first green application mooted for green hydrogen is that of providing stability to an electricity grid powered by renewables.

While green hydrogen is being pitched as the energy-of-choice to provide grid stability, this is by no means a done deal.

Renewables advocates would argue that it would be easier and cheaper to just increase renewables infrastructure to the point of excess, meaning even on cloudy or still days, enough energy could be extracted from the system to provide grid stability. They would also advocate investment in batteries to provide further stability.

But there is a problem with batteries: they are polluting and expensive, and until dramatic innovation takes place, hardly qualify as environmentally positive.

“Acceptable” nuclear energy (as yet poorly defined) could also prove a formidable rival, but at this stage, that technology (technology that would make nuclear energy acceptable in a green world) is not available, and green hydrogen is.

Green methane pyrolysis allows the production of basic chemicals such as ammonia and methanol throughout the chemical industry, as well as offering a turquoise hydrogen option using “clean” fuel. The resulting carbon can be reprocessed into plastic and rubber products such as car tyres and mats.

(There are even more experimental uses of carbon, which we discuss below).

In this sense, green methane does count as circularity and vertical integration play.

There are some who advocate for a methanol economy in which green methanol replaces fossil fuels in transportation, energy storage and fuel cell technology given it is relatively more easily retrofittable to existing infrastructure.

But given big capital appears to be committed to green hydrogen and solar, methanol’s most likely manifestation is that of a transition fuel.

Outside of grid stability, the main applications for green hydrogen are expected to be for decarbonising heavy industries requiring intense heat or explosive energy, such as cement and steel.

Hydrogen can be used in many industries, including power to gas; the production of green chemicals such as methanol and fertilisers (ammonia); and other liquid fuels.

Pending developments in fuel cells, green hydrogen is also being pressed as a source of aviation fuel and long-haul fuel.

At the moment, batteries are not only heavy and expensive, but do not even rate as a rival for efficiency in the air.

Theoretically, renewables could function well in this environment (flying car prototypes currently use electricity but flight times are short) and battery technology remains renewables’ Achilles’ heel.

Battery materials are increasingly expensive and the longer big capital seeks to maximise its investment in these commodities, the greater the threat green hydrogen poses to the renewables industry’s ambitions.

It is not a big leap to move from success in hydrogen fuel cells in the air, to success on the ground, although by that time, perhaps all cars will be airborne.

For now though, battery-powered vehicles have the support of big capital, even over more efficient vehicles such as Lightyear One and Lightyear2 - the world’s first solar electric, most aerodynamic and efficient cars created in the Netherlands (I want one - the One). Lightyear includes a battery but rarely needs to use it unless garaged or travelling long distances at night.

(I digress, but to give car-lovers a feel for this market, the Lightyear One doubled in price just one year after its introduction, and appears to have a similar lustre and potential cult-status to Tesla’s Roadster, despite not boasting quite as svelte an interior.)

But the appeal of the Lightyear further reveals the threat to battery-materials markets from improvements in solar-cell design in electric vehicles, as well as solar-cell technology’s growing threat to the economics of green hydrogen.

Some hydrogen advocates also press green hydrogen as a substitute for gas in building heating, arguing that it would allow the use of existing LNG infrastructure, but this is not as simple a task as it is made out to be, and we discuss this below in the section on challenges.

This argument appears to be one of the many red herrings floating around in the hydrogen market.

## Experimental Hydrogen-related CCUS Technologies

There are a myriad of alternative grey/blue hydrogen technologies in development outside of the conventional clean-tech market described above - too many to list, but we examine some of the most interesting here.

One of the more common technologies involves heating gas hydrocarbons to a point where carbon separates from the hydrogen in solid form (a type of carbon capture), allowing the use of continuing infrastructure.

From an energy perspective, it is less attractive than other clean-hydrogen tech given it is heavily reliant on carbon-capture subsidies, and is never likely to be "economic" on its own merits.

However, if carbon-fibre technologies suddenly advanced, could open a market for recycled solid carbon backed by circularity incentives, given current solid carbon products such as graphite and diamonds are expensive. This could also prove a market for green methane (which would have the jump on gas regardless) and other hydrogen technologies.

At the moment, the quality of solid carbon derived from such processes is low, and could be used as low-cost moat filters around polluting industrial plants, etc, but if affordable technologies upgrading solid-carbon waste became available, it could prove a game-changer.

The development of carbon nano-materials is one potential use for high-quality solid carbon (if obtainable from these processes - big ifs).

Nanotubes, a subclass of Fullerenes, share many features with polymers because of their thin diameter and elongated shape and can for self-supporting macroscopic materials.

Their prices range from US\$2,000/kg to US\$100,000/kg so the development would fit neatly into the plastic recycling play as well.

ResearchGate says carbon nanomaterials could be synthesised by splitting hydrocarbons and that these materials could displace steel, aluminium and cement while providing lightweight solutions, all of which would fit neatly into a long term recycling and energy-reduction plan.

At extremely high temperatures (4,000 degrees Celsius), solid carbon can be converted to graphite.

A price of US\$20 to \$30/kg could enable penetration in most of the copper aluminium and stainless steel markets.

At \$10/kg they could replace steel components in vehicles.

Below US\$3/kg the product is feasible in large infrastructure such as bridges, buildings and houses.

The development of multi-walled carbon nanotubes to rival graphite anodes in conventional alkaline water electrolysis cells is another proposed technology that fits on this spectrum.

Amoltek, for example, claims it can cut the use of rare and expensive noble metals by 50% to 70% using carbon nanofibres, while double or tripling the active surface area of the proton exchange membrane (PEM) or anion exchange membrane (AEM) used in membrane electrode assembly.

Fuel cell technology powered by solid carbon is another technology given carbon nanotubes can store hydrogen, even at room temperature. This could have implications for the transport and storage of hydrogen generally.

Science Daily notes that carbon nanotubes increase up to tenfold the amount of power a battery's electrodes can produce compared to a conventional lithium-ion battery.

The reporter notes these could be used in small devices and maybe eventually in big batteries. They excel where short bursts of energy are required.

Scientists are even attempting to use solid carbons and CO<sub>2</sub> to build organometals and in various catalytic processes for transforming CO<sub>2</sub> and incorporating it into synthetic organic molecules. The mind boggles.

All these are experimental not commercial technologies, but we mention them because there are a plethora hitting the market, only a handful of which may prove fruitful, and it's a matter of buyer beware.

But they would certainly explain the willingness of big capital to back carbon-capture over other more economically viable and environmentally friendly approaches, and so cannot be discounted.

But in the investment market of today, such hydrocarbon splitting technologies are about as close to greenwashing as you can get, short of largely economically unfeasible direct-air carbon capture, and most are purely aimed at catching rather generous US carbon-capture subsidies of between US\$60 a tonne and US\$85 a

tonne.

The US is offering US\$180 a tonne for direct-air carbon capture, and what Climate Energy Finance's Tim Buckley describes as a phenomenally generous price on methane emissions of US\$1500 a tonne.

Environmental advocates would decry these technologies as a diversion of valuable resources away from investment in clean energy.

But much depends on the intent of big capital, technology and the rise of circularity.

### Green Hydrogen Challenges - Transport, Storage And Infrastructure

There are many good reasons why many doubt the ability of green hydrogen to replace battery materials or prove a substitute for natural gas and other fossil fuels in existing fossil-fuel storage infrastructure.

It is lighter than natural gas (requiring larger infrastructure) and more difficult and dangerous to store and transport (requiring significant moderations).

People talk of using existing pipeline infrastructure to transport hydrogen but this is fraught (a bullet to a pipeline, for example, or even a small leak could prove much more expensive and problematic than a gas leak) and at this stage little more than a pipe dream (pun intended).

Hydrogen is highly flammable and much of its future will depend on the strength and integrity of materials used to contain it - and so the environmental plunder continues, in a similar manner to batteries.

At the moment, the only viable storage and shipping method for green hydrogen is green ammonia. This is an extremely prospective market for hydrogen.

But technology is snowballing. Already the Swedes are delivering green steel, previously considered an intractable problem. Once this problem is solved and green steel is fully commercial, one assumes many storage and transport issues will be solved simultaneously (given blast furnaces are probably among the most dangerous environments for applying hydrogen).

The other major challenge is rising interest rates, which is hindering impact investment but the tightening cycle is expected to end next year and investors are preparing to place their bets.

This article has highlighted both the conventional, safer green hydrogen plays and some of the riskier more dubious concepts doing the market rounds, which combined provide a broad big-picture scenario of the market and its potential.

In our next article, we move from the nuts and bolts of hydrogen technologies (many of which are experimental) to the broader tangible green hydrogen prospect from a global financial perspective.

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## FEATURE STORIES

# 2023 Outlook: Global

## 2023 Outlook: Global

Is a global recession afoot? If so, how should investors position themselves for 2023?

- What is a recession really?
- Slow going for global economy
- Structural elements of inflation
- The new (old) normal
- Ongoing bear market

By Greg Peel

The problem with recessions is that you don't know whether you're in one until you have been. Today in Australia we'll learn the result for the September quarter GDP - two weeks before the end of the December quarter.

The Australian economy grew 0.9% in the June quarter so there is no risk of recession, nor is a negative growth quarter expected in September. But had June seen GDP contraction and September proved to show further contraction, then the media would have a field day:

"It's official: Australia In Recession!"

Or at least it was. If you accept the technical definition of two consecutive negative quarters. But nearly three months after the end of the second of those quarters, are we still in a recession? We could well be rocketing back out.

That's what happened in 2020. The June lockdown quarter brought -7.0% GDP contraction, after a slight contraction of -0.2% in the March quarter which just caught the beginning of the lockdown. For the first time in 26 years, we were "in recession". Then in the September quarter the economy grew 3.5%.

Delta lockdowns brought -1.8% contraction in the September quarter 2021, but the December quarter saw a swift 3.9% rebound. Inflation and RBA rate hikes have slowed the economy to a crawl in 2022, but not into contraction. Yet.

Of course, many scoff at the two-quarter technical definition anyway. The US economy contracted by -1.4% in the March quarter this year and -0.6% in June, and no one said "recession". September saw a rebound of 2.9%.

In the US a recession is "officially" called by the National Bureau of Economic Research.

Officially, the NBER defines a recession as "a significant decline in economic activity that is spread across the economy and lasts more than a few months." The bureau's economists, in fact, profess not even to use GDP, the broadest measure of activity, as a primary barometer.

And they're not exactly a bunch of Usain Bolts. The NBER declared the 2020 recession in July 2021.

Thanks Scoop.

So forget definitions. Probably the simplest definition of a recession is that if you feel like you're in one, you are. And if people keep telling you a recession is coming, and you respond accordingly, it will.

And the two-quarter definition implies two sole GDP measures to decide the country is in recession. In the 2010s Australia did not see a recession, but we did see a "two-speed economy" - miners versus everybody else. For everybody else it "felt" like a recession, which basically means for everybody else, it was.

Another thing about recessions is they are typically not so predictable. Covid came right out of the blue, the GFC was slower moving but followed an unforeseen (by most) US property crash, the long seventies recession was led by unforeseen Arab oil shocks. Maybe the nineties recession was more predictable, given Volker had

been trying his best to invoke one, hence it was “a recession we had to have”, but if the world, the US or Australia hits a recession in 2023, I think it would be the most pre-warned recession in modern history.

Which could mean one of two things.

There is a market adage that if everyone has the same view at the same time, the opposite will happen. That's why, for example, market analysts place so much faith in “contrarian” indicators. On that basis maybe recession will be avoided.

But I just said the best way to cause a recession is to assume one is coming. Batten down the hatches dear, things might get tough. Stop spending now.

So we'll probably see one next year. At this stage it's the US, more probable, and for Australia, possible.

The world economy is set to slow, with Europe bound for an energy crisis-led recession, China to remain slow if it continues with zero-covid (but late indications suggest it won't), and the US somewhat of a swing factor.

Recession(s) will be experienced because central banks will make them happen, just as Volker did, as the only means of combating inflation. If we have it, it will be another recession we had to have.

So with that in mind...



### Slow Going

Morgan Stanley forecasts global growth to have slowed to around 3% in 2022, down from 6.2% in 2021, and fall to 2.2% in 2023. Growth will be uneven, with developed markets to be in or near recession, while emerging market economies should recover modestly.

Globally, inflation should peak in this December quarter, Morgan Stanley believes, before disinflation takes hold in 2023. Headline inflation will ease on general stability in oil prices and an improved global supply of food. Core inflation will see the effects of slowing demand and an easing of supply chain constraints, leading to lower consumer goods inflation, and slower growth, weaker demand and more normalised labour markets impacting on services inflation.

Developed market central banks will continue to tighten policy into restrictive territory and then stay there, plateauing throughout 2023, with the Fed holding on the longest. China and Japan are not worried nor overly impacted by inflation and will retain an accommodative stance.

Morgan Stanley notes however that there are risks to such a view. Another wave of commodity price shocks would lead to another temporary upside inflation surprise. A further increase of geopolitical tensions may again disrupt supply chains. Central banks may have to hike further.

The broker places some faith in China providing demand support after reopening from zero-covid restrictions in the northern spring of 2023. “Recent comments from policymakers in China to minimise economic disruptions and the fine-tuning of aspects of covid policy suggest to us the direction of travel is toward reopening”.



Morgan Stanley published its 2023 outlook reports around mid-November. At the time, the world was indeed excited over news Beijing had formed a committee to assess reopening, and the *Wall Street Journal* had us convinced this was indeed the plan. Beijing's response was swift and definitive.

Rubbish.

Beijing doubled down on zero-covid, citing "science-based evidence", at least until there were riots in the streets. Xi was left with two choices: send in the tanks or shift away from zero-covid, providing a simple, science-based excuse as to why.

Suddenly the government believes covid is not actually as bad as first thought. Hence it now looks like a much-feared ongoing slowdown in China's economy in 2023 may not come to pass after all.

Morgan Stanley may thus be right about China's reopening, but warns:

*"A delayed reopening in China could have non-linear impact on China's growth trajectory, with adverse spill-over implications for the rest of the region."*

### Taming the Beast

Oxford Economics agrees China (and Russia) remain sources of uncertainty when it comes to inflation trajectory predictions. Otherwise there is now greater scope for supply-side developments to push down core inflation, particularly in the goods sector where easing bottlenecks, inventory unwind and lower commodity prices should all weaken pipeline price pressures.

Oxford expects food and energy inflation to fall sharply from here, but the rate of fall in 2023 is uncertain, and unlikely to be as swift as was the case in the GFC.

Over 2008-09, above-target inflation quickly morphed into deflation, the economists note. The best cure for high prices is high prices. But they would be cautious in concluding inflation will fall far below target in 2023-24.

Oxford notes supply-side factors have been important in leading inflation, hence there should be a substantial fall in eurozone core inflation. But a more gradual easing is likely in the US given demand-side forces have played a larger role.

Fidelity International believes inflation is likely to remain elevated in 2023, increasing the risk that over-tightening by central banks will trigger a sharp recession.

For most of the second half of 2022 to date, two words have dominated financial market anticipation: "pivot" and "pause".

"Pause" is sufficiently straightforward, implying a central bank will lift its cash rate to a certain level and then stop lifting it. "Pivot" is a little more vague. It means to change policy direction, which would be to start cutting rates again. But then a pause would also be a change in direction, and thus a pivot, at least in some minds.

Assuming pivot means cutting rates, the Fed has made it abundantly clear this is simply not going to happen in the foreseeable future. FOMC members have most recently suggested a pause will soon be appropriate, but not until the cash rate is well into restrictive territory, which at last count is 5% or higher.

The current rate is 3.75-4.00%, with another 0.50% expected at the December meeting.

Fed chair Jerome Powell has all but confirmed the 50 point hike this month, as the lag effect on the economy suggests a moderation of the pace of hikes is now appropriate, but also warned rates would remain higher for longer.

Once at an appropriate level, the cash rate will stay there until inflation is back in the 2-3% zone (core PCE).

Of course, the Fed is unlikely to endorse any possibility of a pivot back to cutting rates, as this would imply they got it wrong in not hiking soon enough and wrong again in hiking too far. The driver of the market's pivot expectations is exactly that - the Fed will go too far and send the US economy into a "hard landing" recession, forcing a swift switch to policy easing.

In Fidelity International's view, a hard landing for the US economy remains the most likely outcome in 2023.

*"Until markets absorb this fully, we could see sharp rallies on the back of expected action by the Fed, only for them to reverse when it doesn't materialise in the way they expect. Rates should eventually plateau, but if inflation remains sticky above 2 per cent, they are unlikely to reduce quickly."*

A key swing factor, Fidelity notes, is the US dollar. The strong dollar in 2022 has proven a “wrecking ball” for other economies, both developed and emerging.

Developed economies have imported inflation via high-dollar costs of goods. Emerging economies have suffered crippling US dollar debt repayments. In Australia, imported inflation has been balanced by exported inflation - extremely strong AUD commodity prices. US dollar strength has reflected the Fed’s lead in raising interest rates ahead of and further (among developed economies) than everyone else.

If the dollar continues higher, recession risk is greater outside the US. If it is weaker, the world will be relieved, and overall liquidity should increase.

### The New (Old) Normal

It is oft pointed out that given it’s been 14 years since the GFC, a whole generation of youngsters joining the financial markets in that time have up until this year never known anything other than zero cash rates, or close enough to zero. For them, life is now very strange, and far from normal.

For anyone who’s been around the traps a bit longer, while today’s cash rates seem unusually high, they’re only at levels familiar in the past, and indeed still lower than most grew up with.

Thus today’s policy settings are a New Normal that’s really an Old Normal.

There have been other strange occurrences. Higher interest rates now mean fixed income investment is actually becoming a viable alternative to equity (or property) investment, after over a decade of TINA for equity markets. And while Dad always said the best portfolio is one that balances equity and fixed income allocations, as they move in opposite directions, in 2022 both equity and bond prices have moved down in tandem.

This is not unprecedented, but irrespective of one’s age, it’s unusual.

Following such a dislocation, Allianz Global Investors suggests investors might expect a recovery ahead. But much will depend on the path of inflation and interest rates and the severity of any global recession. Caution is warranted, says Allianz, but there could likely be opportunities for investors during the year as the global economy adjusts to more “normal” conditions.

Neither the pandemic nor the war were expected at first to last as long as they have, hence one then the other led central bankers, including the Fed and RBA, to assume inflation would be “transitory”. But while these external factors have clearly had an impact, Allianz has long argued structural factors are also to blame.

It took a long time for excessive monetary stimulus rolled out after the GFC to be wound back, sowing the seeds of inflation. Then followed excessive monetary and fiscal stimulus to counter the pandemic. Meanwhile, several structural factors are now contributing to a longer term inflation environment: deglobalisation, which is putting supply security above the search for the cheapest manufacturing destination; stronger wage dynamics (tied in to deglobalisation); and the fight against climate change, which is driving money to be invested in projects it would otherwise not be on a return on investment basis.

Hence while the scale and speed of central bank tightening in 2022 has surprised markets, Allianz still believes the market is underestimating where rates will end up, and for how long they’ll stay there.

The Fed will likely need to rebalance well above the “neutral” rate and into restrictive territory, Allianz warns, which would imply 5% or above. Since the Allianz outlook was published, US futures markets have moved to pricing in 5%. Last week Fed Chair Jerome Powell warned that while the pace of rate hikes will likely now slow, the time spent at the ultimate peak rate will be longer.

While inflation is set to fall in 2023, Allianz does not believe it will fall by enough to prevent further central bank tightening. There may have to be a pause if economies fall into a recession, but that then introduces the risk of more government fiscal stimulus, which will have to be met by further monetary tightening in order to prevent another inflation breakout.

We are already seeing the signs in Australia. The government has managed to pass a new industrial relations policy that will lead to higher real wages after a decade of intended stagnation - most urgent now following the surge in the cost of living. But the easiest way to fire up inflation is to raise wages.

The RBA has slowed its pace of rate hikes, and there are even suggestions it may now pause, but not if a wage-price spiral becomes a threat.

Will economies fall into recession?

It’s a “yes” from Allianz in the case of the US. A strong labour market has shielded the economy so far, but the

higher cost of finance and declining real incomes due to cost of living increases will drag. Corporate earnings growth will slow, leading to a suppression of corporate investment. All add up to a downturn.

It's a "yes" for Europe as well, probably from this December quarter, given the energy crisis.

For China it's matter of providing ongoing monetary and fiscal stimulus to counter property market headwinds and zero-covid. But as noted, zero-covid has since potentially been given an end-date.

A global recession, or at least recessions in parts of the globe, is a major headwind for the price of risk assets, Allianz notes. But if the past is any guide, markets start looking out the other side to beyond recession about half way through the recession, and that's when longer term investment opportunities arise.

So, how long is a recession? Yes, well, that's the slight flaw in the plan. No one blows a whistle at half-time.

More likely there will be a first-half overshoot of weakness, which soon lures the first bold buyers, who then lure others. Typically the nadir occurs when investors simply could not be any more pessimistic.

In the "new old normal" we are now moving into, Allianz is seeing potential ideas in fixed income assets, starting with government bonds, and moving eventually into investment-grade credit.

While markets will remain volatile heading into 2023, it could be the time to position portfolios for the long term, focused on high-conviction thematic such as national security, climate resilience and innovation, and sustainability.

### Darkest Before the Dawn

*In a rare occurrence, stock and bond markets have collapsed simultaneously this year, leaving investors with few safe havens. Historically, after stock market sell-offs of this year's magnitude, equity returns have been quite robust looking ahead a year or more."*

Clearly T. Rowe Price is on the same page as Allianz Global Investors.

Central banks will remain resolute in containing inflation in 2023, T. Rowe believes, but they tread a difficult line with the global economy slowing and possibly entering a recession. The Fed is between a rock and hard place. Its key challenge is how to navigate a soft landing without appearing to be dovish on inflation.

Equities markets are likely to remain volatile until the virulence of inflation becomes clear. The severity of any recession will be a key driver of market performance next year.

T. Rowe Price also agrees with Allianz on the structural inflation front. Longer term, interest rates and inflation are likely to remain higher than levels we have seen over the past decade, the analysts suggest, as deglobalisation, "on-shoring", and increasing geopolitical risks create structural changes in the global economy.

"On-shoring" - bringing manufacturing back to the country of residence - is a catch-cry that largely began with Trump, became more prevalent following covid supply chain crunches, and even more so since the war has exposed sovereign vulnerabilities. Supply chain security is one thing - national security is another.

More recently another new, rather clumsy expression has cropped up - "friend-shoring". If it's too expensive/time consuming to on-shore, the next best thing is to shift supply reliance on to trusted allies.

The next decade of equity market leadership, following the last ten years of dominance by growth companies, is likely to be broader, T. Rowe Price suggests, and may favour companies with "shorter-duration cash flows", including value stocks.

Since the GFC, equity markets, particularly the dominant US equity market, have been dominated by "growth" companies. Arguably this began earlier out of the embers of the 2000 Tech Wreck, which only the strongest survived - such as Microsoft and Amazon.

An exponential trajectory in innovation has driven the rise and rise of growth stocks this century, bringing us online shopping, smart phones, social media, software-as-a-service, the cloud, the lithium battery, electric vehicles, electric everything, the Internet of Things, machine learning, artificial intelligence... Some are even putting faith in something called the "metaverse".

The common theme amongst these companies as they set out on their early paths is growth in revenues, with ongoing reinvestment assuring earnings may still be some time away. In other words, cash flows are "longer-duration" - somewhere out in the future.

Short-duration cash flows are reserved for the dinosaurs of yesteryear - familiar industries that existed in the twenty century but are still alive today, from banks to miners, supermarkets to manufacturing. These stocks are typically boring plodders offering gradual capital appreciation and low but stable returns through reliable

dividends. Yet-to-profit growth stocks don't pay dividends.

These companies offer short-duration cash flows and, assuming they're not about to be relegated to history, "value", if they have been overlooked by investors.

We could make the case that many of this century's runaway growth stock success stories would not have been success stories if money wasn't as good as free, and if future cash flow forecasts were not able to be discounted back to today's dollars at the lowest of risk-free rates. Hence in 2022, as money once again bears a cost, the music has stopped for the growth sector.

While even the mighty have suffered falls of -25%, -30% or more, some have copped -80%, -90% or more. Complete lifetimes of corporate existence all but wiped out.

Value companies have also suffered in the general bear market, but they've seen the ebbs and flows of interest rates over time and are still here to tell the tale. Their lower, but more reliable future returns are discounted at the same risk-free rate, but have far less impact on overall valuation.

Value has spent two decades waiting in the shadows for a renewed moment in the sun.

Not that T. Rowe Price recommends abandoning growth altogether. The asset manager is underweight stocks in general, remaining cautious on the environment for equities given still-aggressive central bank tightening and a weakening outlook for growth and earnings.

But within equities, T. Rowe is "nearly balanced" between value and growth. The slowing economic growth backdrop is unfavourable for cyclicals, while higher rates weigh on growth-oriented equities.

As the November rally has shown, growth stocks can come flying back on the slightest hint of light at the end of the rate hike tunnel. Growth is not dead (just pining for the fjords).

#### Follow the Leader

We recall that Morgan Stanley believes developed market economies will be "in or near" recession in 2023. For the US specifically, the broker believes the economy will "barely skirt" a recession, but the landing "doesn't feel soft", which harks back to my opening regarding "feeling like" it's a recession.

Morgan Stanley expects the Fed will maintain a restrictive policy stance for nearly all of 2023, and the lagged impact of the policy will keep GDP growth below the "potential" rate of 1.5% in 2024. The result will be two "very weak" years.

Only in the back half of 2024 will the Fed return (cut) the policy rate toward a neutral level by year-end.

The broker forecasts GDP growth of 0.3% in 2023 and 1.4% in 2024.

That said, Morgan Stanley believes we will now enter the final stages of the US equity bear market, in which "two-way risk" must be respected. At the beginning of November the broker switched to a "tactically" bullish view (correctly as it turns out) but did not suggest the bear market was over.

The "pause before the cut" of policy is typically good for stocks, once the end-game for rates is understood.

Morgan Stanley forecasts a year-end level for the S&P500 of 3900 (it was last at 3941) but sees more volatility through December. Consensus earnings forecasts for 2023 are still "materially" too high in the broker's view, and is forecasting S&P net earnings to fall -11% year on year. This earnings risk will be acknowledged by the market sometime in the March quarter, sending the S&P down into the 3000-3300 range.

The 2022 low to date is 3491.

The broker then suggests, as is historically typical, the index will trough ahead of the actual earnings trough, and there will follow a sharp rebound to end-2023. Back to 3900.

Might as well have a year off.

Morgan Stanley remains defensively positioned in equities.

Morgan Stanley is not Robinson Crusoe. While there are some on Wall Street who believe the bottom of this bear market has now been seen, the majority continues to write off recent gains as no more than just another, traditional, bear market rally.

Note: *2023 Outlook: Global* will shortly be followed by *2023 Outlook: Australia*.

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*contains unashamedly positive feedback on the service provided.*

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## WEEKLY REPORTS

# Weekly Ratings, Targets, Forecast Changes - 02-12-22

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

By Mark Woodruff

### Guide:

*The FN Arena 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 November 28 to Friday December 2, 2022*

*Total Upgrades: 1*

*Total Downgrades: 11*

*Net Ratings Breakdown: Buy 55.18%; Hold 37.22%; Sell 7.60%*

For the week ending Friday December 2 there was one upgrade and eleven downgrades to ASX-listed companies covered by brokers in the FN Arena database.

It was a disappointing week for City Chic Collective with ratings downgrades by three separate brokers after the company reported a -2.0% fall in sales across the first 20 weeks of FY23, compared to the previous corresponding period.

Ord Minnett doesn't expect margin contraction from weaker demand (particularly in the northern hemisphere) to abate anytime soon and downgraded its rating to Hold from Buy. The broker noted the impact on operating margins from elevated fulfillment costs, and falling gross profit margins.

Macquarie, which downgraded its rating to Neutral from Outperform, observed growing macroeconomic pressure and online competition, while higher product returns and promotional spend also hit margins. Even though the A&NZ region proved more resilient than Morgan Stanley had anticipated, results from North America and the EMEA region dragged on performance, resulting in a downgrade to Equal-weight from Overweight.

Five brokers' new outlooks combined to lower the company's average FN Arena database target price to \$1.23 from \$2.45, which was the largest (and only material) percentage adjustment for the week across all companies.

City Chic also received the second largest percentage downgrade to forecast earnings in the database, behind 29Metals.

Brokers lowered earnings forecasts after 29Metals announced its latest results for a feasibility study performed at Gossan Valley, as well as a pre-feasibility study for Cervantes. These two parts comprise one greater extension for the company's Golden Grove project.

While the studies suggest Gossan Valley offers a marginal short-term return and Cervantes remains in an early stage, Credit Suisse noted the potential for a third mining front at Golden Grove.

This broker felt the Gossan Valley study showed marginal economics and adopted a downsized approach to



reduce upfront capital expenditure by, for example, excluding a mill expansion. Cervantes is considered a better source of value. Production is expected to commence there in late 2025.

In the Healthcare sector, brokers also lowered earnings forecasts for Healius and Ebos Group last week.

Morgans assessed a poor performance from a trading update by Healius for the financial year up to the end of October, largely due to an -85% decline in covid testing. Credit Suisse also noted fewer patients entering at the GP level is the biggest issue facing the company, combined with GP shortages and a decline in bulk billing rates.

Citi attributed what will likely be a significant first half earnings margin miss (versus consensus) to wider operating de-leverage faced by the pathology industry from lower covid revenues, as well as a delay in recovery of business-as-usual volumes.

Regarding Ebos Group, Outperform-rated Macquarie reviewed industry data for October and observed mixed trends, with neurosurgical and plastics/reconstructive turnover outpacing orthopaedic (below trend) and spinal business.

Industry surgical trends suggest to the broker an uplift for the group's Institutional Healthcare division and a medium term catch-up for orthopaedic volumes will act as a medium-term tailwind, as the surgical waitlist normalises.

On the flipside, Imdex received the largest percentage increase in forecast earnings. The company provides products and services to drilling contractors and resource companies globally.

While UBS and Macquarie already research the company, it was an initiation of coverage by Citi last week which raised the average earnings expectations in the database.

This broker foresees a continuation in strong commodity prices and expects the company will be able to grow revenue without increasing its work force. This is expected to cushion the company against labour shortages, given its operations are less labour-intensive than many peers.

The analysts observed the company's extensive offering relative to peers and commenced coverage with a Buy rating and \$2.70 target price.

Total Buy recommendations comprise 55.18% of the total, versus 37.22% on Neutral/Hold, while Sell ratings account for the remaining 7.60%.

### **Upgrade**

**NEW HOPE CORPORATION LIMITED ((NHC)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/1/0**

Following a -19% share price fall in the last month, Citi upgrades its rating for New Hope to Neutral from Sell.

October quarter run-of-mine (ROM) and saleable coal production fell by -10% and -15%, respectively, on inclement weather impacts.

Management expects Qld coal production will be close to 5mtpa of saleable coal in FY25.

An on market buy-back of ordinary shares for up to \$300m was announced on November 3 to commence on or after 17 November this year.

After the broker incorporates into its forecasts the New Acland Stage 3 (assumed capex of -\$400m) and the 12-month \$300m buyback, along with FY23 guidance, the target falls to \$4.50 from \$4.60.

### **Downgrade**

**AUSTRALIAN FINANCE GROUP LIMITED ((AFG)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/1/0**

Australian Finance Group's total residential lending volumes fell sharply in the September quarter (-10.7%), downward momentum accelerating into October (-24%) and November (-16%), as lending competition intensified.

Margins also took a hit and Macquarie cuts net interest margin and securitisation settlement forecasts accordingly.

EPS forecasts fall -12.7% in FY23; -6.9% in FY24; and -6% in FY25.

Macquarie downgrades its rating to Neutral from Outperform. Target price falls to \$1.81 from \$2.09.

**BANK OF QUEENSLAND LIMITED ((BOQ)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/5/0**

Bank of Queensland has surprised the market with the announcement of the immediate departure of its CEO, with the bank's board feeling different leadership is required to build a stronger and more resilient bank.

Credit Suisse noted that the bank did not disclose an earnings update alongside its announcement. The broker reads this news as a strategic pivot away from growth and towards strengthened financial resilience through increased investment.

The rating is downgraded to Neutral from Outperform and the target price decreases to \$7.50 from \$10.00.

**BUBS AUSTRALIA LIMITED ((BUB)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/1/0**

While remaining supportive of Bubs Australia's journey to become a more diversified and sustainable business, and despite recent momentum improvement in key markets, Citi has downgraded on the stock following a weaker than anticipated first half.

The broker attributed first half performance to slower-than-expected US consumer offtake and a new model in China. The broker lowers its full year net profit forecast to -\$8.3m from \$2.7m, factoring in first half performance as well as expected increased costs.

The rating is downgraded to Neutral from buy and the target price decreases to \$0.32 from \$0.68.

**CITY CHIC COLLECTIVE LIMITED ((CCX)) Downgrade to Equal-weight from Overweight by Morgan Stanley and Downgrade to Neutral from Outperform by Macquarie and Downgrade to Hold from Buy by Ord Minnett .B/H/S: 1/4/0**

City Chic Collective's first half update has come in below Morgan Stanley's expectations, as softer demand, higher promotions and cost headwinds impacted. The retailer reported a -2% year-on-year revenue decline in the first twenty weeks of the year.

While Australia New Zealand proved more resilient than Morgan Stanley had anticipated, results from North America and Europe Middle East dragged on the group. The company did highlight improving demand moving into peak trading periods.

The rating is downgraded to Equal-weight from Overweight and the target price decreases to \$1.20 from \$2.85. Industry view: In-Line.

City Chic Collective's AGM trading update reveals growing macro pressure and online competition, while higher product returns and promotional spend have hit margins, observes Macquarie.

The broker adds that the sales outlook is deteriorating (not to mention recession and inflation threats) and this should result in operating deleveraging.

EPS forecasts fall -89.5% in FY23 to reflect the percentage fall in gross margins; and -56.9% in FY24 (partly reflecting fulfilment inefficiencies).

Macquarie spies no likelihood of recovery to its mid-teen margin "sweet spot" out to FY25.

Rating downgraded to Neutral from Outperform. Target price slumps to \$1 from \$2.60.

Ord Minnett doesn't expect margin contraction for City Chic Collective from weaker demand (particularly in the northern hemisphere) to abate anytime soon. Elevated fulfilment costs and falling gross profit margins impacted on operating margins.

The company reported sales for the first 20 weeks of FY23 fell by -2% compared to the previous corresponding period, amid volatile demand.

The Americas experienced a -12% decline in sales as customer and competitor behaviour were impacted by the macroeconomic backdrop, explains the analyst.

The broker lowers its rating to Hold from Buy and slashes its target to \$1.10 from \$2.90.

**DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 4/2/1**

Collins Food's ((CKF)) December-half result revealed continued rising costs for restaurant operators and Macquarie observes menu price rises are not outpacing cost inflation.

While the broker observes Domino's Pizza Enterprises with its franchise model is better positioned to manage

inflation, falling franchisee profitability will affect store expansions, one of the company's main profit drivers.

EPS forecasts are cut -9% for FY23; -3% for FY24; and -3% for FY25.

Rating downgraded to Underperform from Neutral. Target price falls to \$60 from \$61.90.

#### **FORTESCUE METALS GROUP LIMITED ((FMG)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/2/5**

Citi downgrades its rating for Fortescue Metals to Sell from Neutral on valuation and because of high initial opex costs for Iron Bridge when global steel output is declining.

First magnetite production for Iron Bridge is set for the March quarter 2023. The broker points out opex will likely exceed guidance and potentially spook investors during the ramp-up phase.

The \$16.70 target is unchanged.

#### **IDP EDUCATION LIMITED ((IEL)) Downgrade to Hold from Add by Morgans .B/H/S: 4/1/0**

Following September quarter student visa approvals data, Morgans awaits a pullback in the IDP Education share price to provide another buying opportunity. For the moment the rating is downgraded to Hold from Add on valuation.

Approvals were strong, according to the analyst, across the company's markets of Australia, the UK and Canada.

The analyst notes International study demand from India remains strong for all destinations. A slight tempering of Canadian demand is expected with that country's immigration introducing a new English proficiency test provider to its panel.

The target price falls to \$30.75 from \$31.10.

#### **OBJECTIVE CORPORATION LIMITED ((OCL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0**

Morgans expects a normalisation of growth in FY24 for Objective after management announced softening revenue growth and margin expectations for FY23.

The broker lowers its rating to Hold from Add though suggests long-term investors accumulate on potential share price weakness.

The lower growth expectations come as the company phases out Perpetual Right To Use (PRTU) licensing and some adjacent services revenue relating to the enterprise content management (ECM) offering, explains the analyst.

In short, the broker's growth expectations have been deferred by a year. The PRTU licensing effect is seen as a final step to a transition to the SaaS subscription model for the entire product suite.

The target price falls to \$15.20 from \$17.30 on earnings revisions and a higher weighted average cost of capital (WACC) assumption.

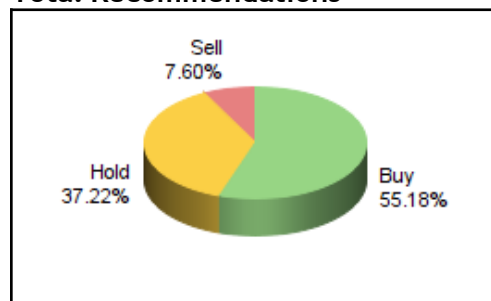
#### **RIO TINTO LIMITED ((RIO)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/4/0**

While Rio Tinto's full year Pilbara iron ore production guidance of 320-335m tonnes per annum was marginally lower than Citi had expected, the broker notes the company has reinstated its mid-term production target of 345-360m tonnes per annum.

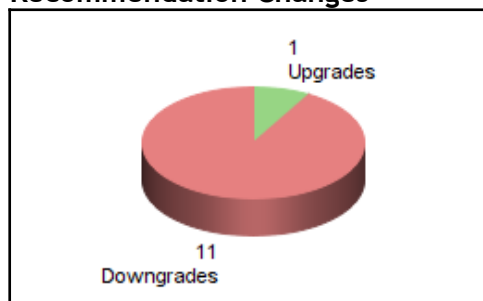
Citi highlights ramp up at Rio Tinto's Gudai Darri asset, alongside completion of a number of mine developments in coming years, is crucial to the company meeting its target.

The rating is downgraded to Neutral and the target price of \$115.00 is retained.

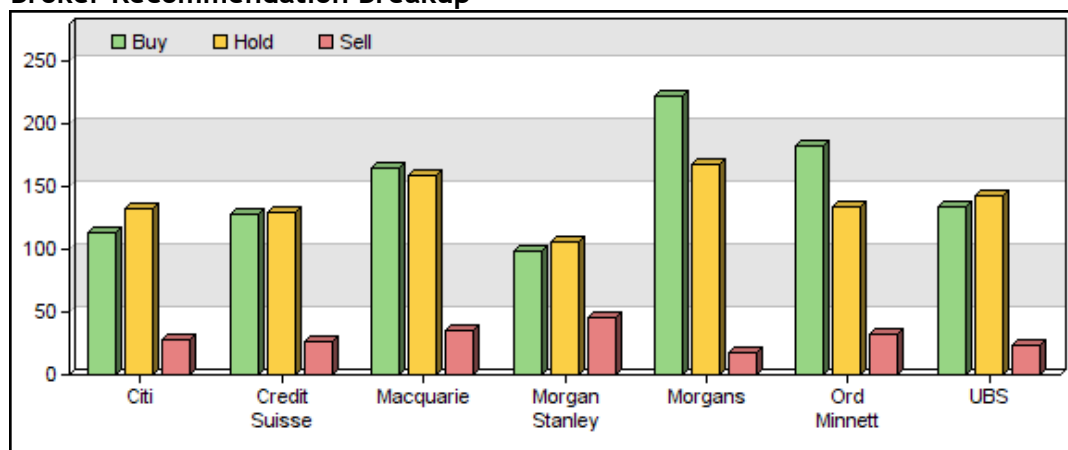
#### **Total Recommendations**



#### **Recommendation Changes**



## Broker Recommendation Breakup



## Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	<a href="#">NEW HOPE CORPORATION LIMITED</a>	Neutral	Sell	Citi
Downgrade				
2	<a href="#">AUSTRALIAN FINANCE GROUP LIMITED</a>	Neutral	Buy	Macquarie
3	<a href="#">BANK OF QUEENSLAND LIMITED</a>	Neutral	Buy	Credit Suisse
4	<a href="#">BUBS AUSTRALIA LIMITED</a>	Neutral	Buy	Citi
5	<a href="#">CITY CHIC COLLECTIVE LIMITED</a>	Neutral	Buy	Ord Minnett
6	<a href="#">CITY CHIC COLLECTIVE LIMITED</a>	Neutral	Buy	Morgan Stanley
7	<a href="#">CITY CHIC COLLECTIVE LIMITED</a>	Neutral	Buy	Macquarie
8	<a href="#">DOMINO'S PIZZA ENTERPRISES LIMITED</a>	Sell	Neutral	Macquarie
9	<a href="#">FORTESCUE METALS GROUP LIMITED</a>	Sell	Neutral	Citi
10	<a href="#">IDP EDUCATION LIMITED</a>	Neutral	Neutral	Morgans
11	<a href="#">OBJECTIVE CORPORATION LIMITED</a>	Neutral	Buy	Morgans
12	<a href="#">RIO TINTO LIMITED</a>	Neutral	Buy	Citi

## Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	<a href="#">IMD</a>	IMDEX LIMITED	2.610	2.565	1.75%	3
2	<a href="#">UMG</a>	UNITED MALT GROUP LIMITED	3.830	3.787	1.14%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	<a href="#">CCX</a>	CITY CHIC COLLECTIVE LIMITED	1.228	2.448	-49.84%	5
2	<a href="#">BOQ</a>	BANK OF QUEENSLAND LIMITED	7.858	8.425	-6.73%	6
3	<a href="#">MND</a>	MONADELPHOUS GROUP LIMITED	13.916	14.308	-2.74%	5
4	<a href="#">NHC</a>	NEW HOPE CORPORATION LIMITED	6.375	6.450	-1.16%	4
5	<a href="#">DMP</a>	DOMINO'S PIZZA ENTERPRISES LIMITED	74.746	75.501	-1.00%	7
6	<a href="#">FMG</a>	FORTESCUE METALS GROUP LIMITED	15.179	15.250	-0.47%	7
7	<a href="#">RIO</a>	RIO TINTO LIMITED	104.429	104.571	-0.14%	7

## Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	<a href="#">IMD</a>	IMDEX LIMITED	16.567	14.600	13.47%	3
2	<a href="#">BEN</a>	BENDIGO & ADELAIDE BANK LIMITED	86.250	81.033	6.44%	6
3	<a href="#">FPH</a>	FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED	32.574	31.330	3.97%	4

4	<a href="#">WDS</a>	WOODSIDE ENERGY GROUP LIMITED	552.385	536.971	2.87%	7
5	<a href="#">AKE</a>	ALLKEM LIMITED	137.067	134.316	2.05%	7
6	<a href="#">HVN</a>	HARVEY NORMAN HOLDINGS LIMITED	40.548	39.748	2.01%	5
7	<a href="#">NWH</a>	NRW HOLDINGS LIMITED	24.567	24.250	1.31%	3
8	<a href="#">WBC</a>	WESTPAC BANKING CORPORATION	211.286	209.086	1.05%	6
9	<a href="#">ANZ</a>	AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED	242.729	240.800	0.80%	7
10	<a href="#">CBA</a>	COMMONWEALTH BANK OF AUSTRALIA	609.700	605.714	0.66%	7

**Negative Change Covered by > 2 Brokers**

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	<a href="#">29M</a>	29METALS LIMITED	0.098	1.498	-93.46%	5
2	<a href="#">CCX</a>	CITY CHIC COLLECTIVE LIMITED	6.080	12.220	-50.25%	5
3	<a href="#">HLS</a>	HEALIUS LIMITED	11.365	15.683	-27.53%	6
4	<a href="#">EBO</a>	EBOS GROUP LIMITED	121.284	150.616	-19.47%	5
5	<a href="#">AWC</a>	ALUMINA LIMITED	4.668	5.522	-15.47%	5
6	<a href="#">PGH</a>	PACT GROUP HOLDINGS LIMITED	15.907	17.567	-9.45%	3
7	<a href="#">XRO</a>	XERO LIMITED	21.823	23.923	-8.78%	6
8	<a href="#">CKF</a>	COLLINS FOODS LIMITED	43.767	47.000	-6.88%	3
9	<a href="#">DOW</a>	DOWNER EDI LIMITED	35.298	36.638	-3.66%	4
10	<a href="#">NHC</a>	NEW HOPE CORPORATION LIMITED	229.725	237.475	-3.26%	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.*

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**WEEKLY REPORTS**

# Uranium Week: Video Killed The Radio Star

Interest in the uranium spot market is waning, as interest in uranium term markets heats up.

- Interest fading in spot uranium market
- Term markets remain active
- Global demand continues to grow
- Supply doesn't

By Greg Peel

A total of 12 transactions involving 1.2mlbs U3O8 equivalent were recorded in the uranium spot market in November, industry consultant TradeTech reports, compared to 4.5mlbs in October. The majority of this activity occurred during the first half of the month, before activity stalled as the US Thanksgiving holiday approached, which is not unusual.

TradeTech's spot price indicator closed out the month at US\$49.75/lb, down from US\$52.25/lb at end-October.

Sellers re-entered the market following the Thanksgiving weekend, but buyers didn't. By last Friday, after sellers continued to drop prices, one transaction had been reported for 200,000lbs at US\$48.00/lb, down -US2.00/lb week on week.

This price movement runs counter to activity occurring in the term uranium markets. Multiple US and non-US utilities, along with other buyers, are actively engaged in formal and informal discussions with potential suppliers regarding purchases of uranium under multi-year delivery arrangements, TradeTech reports.

One problem is the lack of recent buying by the Sprott Physical Uranium Trust, investment in which by speculators appears to have reached somewhat of a saturation point. The SPUT has accumulated some 59.3mlbs U3O8 since launching in July last year.

The SPUT wasn't the first kid on the speculative uranium investment block, but since its launch has become the most dominant. The result was the spot uranium market became quickly connected with financial market volatility in general, rather than uranium demand/supply in particular.

This is one reason actual end-users - utilities - have abandoned the spot market in 2022. It has been a very volatile year in financial markets, and to date, a net negative one, scaring investors out of risk assets.

## When Climate Change Meets War

The other factor is Russia's war, which has led to utilities moving to secure future supply from anywhere outside Russia, despite no official sanctions on Russian exports to date. This is likely because the war is already creating an oil & gas supply crisis, sending global electricity price soaring, so take nuclear out of the equation as well and things would only be worse.

Not only have utilities left the spot market behind, they have shifted their supply horizons further out in time, beyond the mid-term and into the longer term, to be more secure ahead of who-knows-what might happen next.

Utilities shied away from the spot market when spot price weakness failed to reflect actual uranium supply/demand when asset prices were falling, and since asset prices have been rebounding, largely on hopes the Fed is nearing the end of its policy tightening cycle, the spot market has not responded with similar strength.

Rumours of the death of the spot market may yet be exaggerated, but before a backdrop of growing global awareness of the need to tackle climate change, and the need to shift into non-fossil fuel energy alternatives to isolate Russia, the action is all in the term markets.

That said, TradeTech's monthly mid-term price indicator has dropped back by end-November to US\$51.00/lb, down from US\$53.00/lb. The long term indicator, where more of the action is being recorded, remains at

US\$53.00/lb.

### Growing Demand

The trajectory nevertheless remains to the upside, TradeTech suggests, given the extent of interest suggested by utility enquiries going forward, and by a growing shift towards nuclear energy.

Fukushima was over eleven years ago. Last week the Netherlands said it would consider building two new reactors, and would knock the US out of the World Cup. The UK confirmed its investment in a new plant, and Canada moved forward with its plan to build the country's first modular reactor plant.

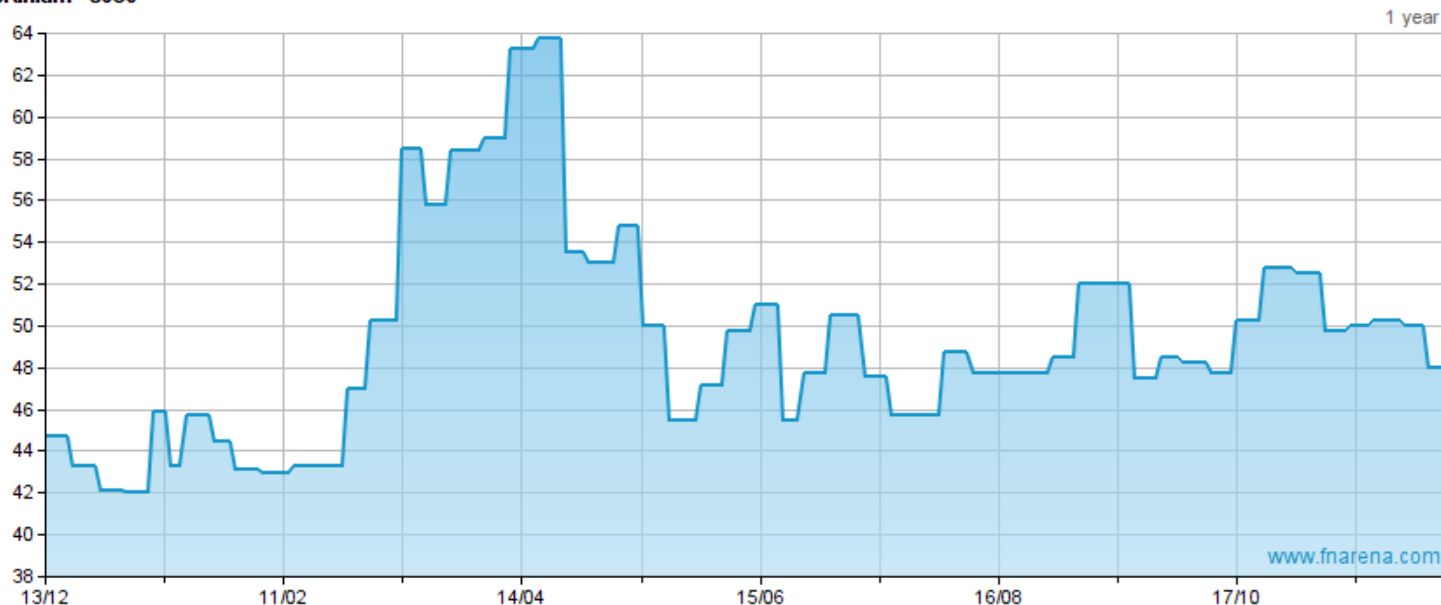
As demand grows, supply remains constrained. TradeTech's estimated production cost indicator, is at an all-time high since April 2020 introduction of US\$56.20/lb. The indicator has not once taken a back step in that time, and is 30% higher year on year, thanks to inflation.

The indicator is considered the cost of incentivising new supply, which is currently not enticing when term price levels are lower.

### Uranium companies listed on the ASX:

ASX CODE	DATE	LAST PRICE	WEEKLY % MOVE	52WK HIGH	52WK LOW	P/E	CONSENSUS TARGET	UPSIDE/DOWNSIDE
AGE	02/12/2022	0.0400	▼- 2.27%	\$0.12	\$0.04			
BKY	02/12/2022	0.3200	▼- 3.03%	\$0.64	\$0.14			
BMN	02/12/2022	1.8100	▼- 3.47%	\$2.49	\$0.15			
BOE	02/12/2022	2.3900	▲ 0.41%	\$3.10	\$0.31		\$3.300	▲38.1%
DYL	02/12/2022	0.7200	▲ 5.93%	\$1.25	\$0.55			
ERA	02/12/2022	0.2300	▲ 9.30%	\$0.42	\$0.16			
LOT	02/12/2022	0.2100	▲ 7.50%	\$0.46	\$0.19			
NXG	02/12/2022	7.0800	▲ 4.42%	\$8.99	\$0.00			
PDN	02/12/2022	0.8000	▲ 2.55%	\$0.97	\$0.53	-139.6	\$1.100	▲37.5%
PEN	02/12/2022	0.1300	0.00%	\$0.28	\$0.13			
SLX	02/12/2022	2.6200	▼- 6.97%	\$4.14	\$0.99			

Uranium - U3O8



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## WEEKLY REPORTS

# The Short Report - 08 Dec 2022

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

### Summary:

By Greg Peel

Week Ending December 1, 2022.

Last week brought a surprise drop in Australia's CPI and confirmation from Jerome Powell the Fed will now ease the pace of rate hikes, sending the ASX200 soaring to its highest level since May.

It's been all downhill since.

In the week before last short activity was minimal. Last week all hell broke loose.

There was a lot of action at the bottom of the table, as has been the case lately, but last week suddenly the top of table got in on the action as well.

Last week Betmakers Technology ((BET)) shares fell -15% and profit-taking took shorts down to 13.3% from 14.7%, moving Flight Centre ((FLT)) back into its longstanding top of the table position. Betmakers then rallied 20% to a peak on Monday, but has come off again since.

Moves to regulate the BNPL sector have weighed on Block ((SQ2)), shorts in which fell to 11.3% from 12.5% last week.

A capital raise from Domino's Pizza ((DMP)) had shorters snapping up discounted stock. Shorts fell to 7.7% from 11.4%.

Perpetual ((PPT)) moved up to 11.2% shorted from 9.4%, with the company currently involved in a messy two-way takeover play.

Shares in perennially troubled gold miner St Barbara ((SBM)) fell modestly last week but the stock has dropped out of the 5%-plus shorted table from 8.3%. I'll reserve judgement on that one, in case it's an ASIC data blip.

In a tale of two discretionary retailers, Temple & Webster ((TPW)) posted a positive trading update last week which sent that stock higher and shorts down to 6.9% from 8.1% on short-covering, while City Chic Collective ((CCX)) posted a rather negative trading update and lost half its value. Profit-taking saw shorts fall to below 5% from 6.1%.

### Weekly short positions as a percentage of market cap:

#### 10%+

FLT	14.3
BET	13.3
SQ2	11.3
PPT	11.2
MP1	10.6

In: **PPT**      Out: **DMP**

#### 9.0-9.9

SYA

Out: **PPT**, **NAN**

### 8.0-8.9%

LKE, NAN, ZIP, BRG

In: **NAN, ZIP** Out: **SBM, TPW**

### 7.0-7.9%

DMP

In: **DMP** Out: **ZIP**

### 6.0-6.9%

TPW, BRN, NXT, ABB, VUL, BGL

In: **TPW, ABB** Out: **AWC, JBH, CCX, CUV**

### 5.0-5.9%

CUV, JBH, AWC, ING, NIC, PBH, ARB, IEL, BOQ, CHN, GOR, BLD, CGC, CXO, SHV, PME, PDN

In: **CUV, JBH, AWC, CXO, SHV, PDN**

Out: **ABB, KGN, JHG, EVN, APX, MFG, PNV, PNI, ADH**

### Movers & Shakers

All covered above.

### ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.2	0.4	NAB	0.7	0.8
ANZ	0.5	0.6	NCM	0.6	0.6
BHP	0.3	0.3	RIO	0.5	0.6
CBA	1.5	1.6	STO	0.3	0.5
COL	0.2	0.3	TCL	0.9	0.9
CSL	0.4	0.5	TLS	0.2	0.2
FMG	1.8	2.1	WBC	1.5	1.7
GMG	1.1	0.9	WDS	1.2	1.5
JHX	1.1	1.1	WES	1.4	1.7
MQG	0.5	0.6	WOW	0.5	0.7

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**

# In Brief: Insurers, Healthcare, Contractors, Classifieds, Retail

Weekly broker wrap: insurers more resilient, healthcare picks, contractors remain labour-reliant, classifieds look resilient, retail braces for decline.

- Climate resilience supports domestic insurance outlook
- Wilsons lists healthcare sector picks
- Contractors less reliant on labour force to deliver guidance upside
- Classifieds look to hold strong in an uncertain year
- Household retail valuations appear to have largely accounted for a decline in house pricing, but downside risk exists

By Danielle Austin

## Outlook looks up for domestic insurers amid increased climate investment

Morgan Stanley is taking a more constructive outlook on domestic insurers into 2023 as the industry appears to improve its climate resilience. Rising catastrophe and associated reinsurance costs have weighed on the industry in recent years, but action from both insurers and government should improve the situation.

While investment should go some way in improving industry resilience, given years of under-investment Morgan Stanley expects it could take up to a decade for investment to have meaningful impact. The federal government has allocated \$200m annually to resilience in levees, sea walls, cyclone shelters, evacuation centres and fire breaks, and to explore ways to reduce the cost of insurance.

Further underpinning a better industry outlook is surging premiums, rising investment yields and cheap trading multiples. Morgan Stanley prefers insurers QBE Insurance ((QBE)) and Suncorp Group ((SUN)), which have more self-help options, to further buffer against earnings volatility moving forward.

The broker does anticipate ongoing weather-related catastrophe severity will drive up insurance premiums, and warns investors may be concerned about the affordability of higher premiums for consumers. Of concern is the 10% of Australian households already reporting experiencing extreme home insurance affordability pressures.

## CSL tops broker's healthcare picks ahead of the new year

Wilsons expects critical trial results and regulatory approvals to be pivotal for share price movement across healthcare stocks in the coming year, and that stocks which have performed strongly through recent difficult periods (namely Pro Medius ((PME)) and Aroa Biosurgery ((ARX))) are primed to be rewarded as appetites for equities return.

The brokers top six picks for the industry are CSL ((CSL)), Pro Medicus, Clinuvel Pharmaceuticals ((CUV)), Aroa Biosurgery, Immutep ((IMM)) and Clarity Pharmaceuticals ((CU6)).

With CSL its top pick, the broker highlights the company's plasma-derived therapeutic protein delivered consecutive sales records in the June and September quarters. Wilsons is anticipating the company can take market share gains in the immunoglobulin market in the coming year.

## Tight labour market provides advantage to contractors less reliant on labour force growth

Citi has reviewed its small cap contractors coverage, noting in the current tight labour market it places higher weighting on labour, pricing and competitive advantage. Given this, the broker highlighted a preference for Imdex ((IMD)), and is most cautious on Monadelphous Group ((MND)).

The broker considers Imdex most immune to labour constraints, while revenue and earnings upside are reliant on factors largely within the company's control rather than on increasing its workforce.

Index has also successfully grown its earnings per headcount at an 18% compound annual growth rate since FY19. Conversely, Monadelphous' earnings per headcount have declined at a -6% compound annual growth rate over the same period. Monadelphous' revenue and earnings growth are highly dependent on its ability to increase its workforce, with its engineering and construction and maintenance and industrial services segments both labour intensive.

Elsewhere within its contractor coverage, Citi is Buy rated on both NRW Holdings ((NRW)) and Perenti ((PRN)) but Neutral rated on Service Stream ((SSM)).



#### Classifieds appear well placed to navigate a difficult year ahead

Despite an uncertain year ahead, Goldman Sachs remains positive on the classifieds sector, seeing strong earnings potential and cashflow.

For REA Group ((REA)), the broker notes good visibility over its more than 10% growth target. The broker expects pricing power and uptake of the Premiere Plus, which should offer meaningful benefits to agents in a soft market, underpinning an acceleration during FY24.

For Seek ((SEK)), Citi has lifted its earnings outlook for the company following its AGM. The company is anticipating volumes to normalise over coming years, in line with unemployment forecasts, while Citi expects volumes will normalise ahead of the unemployment rate. Longer-term, the broker assumes a return to volume growth.

For Carsales ((CAR)), the broker highlights used car pricing remains resilient to date. The company has reported some impacts on display and lead volumes from new car supply, but this is being offset by strong pricing and depth uptake. Carsales continues to expect to reduce gearing while retaining an 80% dividend payout.

#### Household retail stocks price in decline, but could have further to fall than expected

With the market pricing a decline in household goods sales into relevant stock prices, Jarden has examined how far a decline may go. Extrapolating a household goods decline from the expected house price drop, the broker is anticipating a between a -15% and -20% decline. Jarden feels consensus earnings offer upside risk in the first half, but anticipates sales will bottom out in the second half.

Share prices across household retail stocks appear to be factoring in a -15-20% sales decline, but Jarden suggests this may not be deep enough to account for the actual impending fall. Given this, Jarden remains below consensus for JB Hi-Fi ((JBH)), Harvey Norman ((HVN)) and Beacon Lighting ((BLX)), but ahead for Wesfarmers ((WES)) and Metcash ((MTS)) and in line for Nick Scali ((NCK)).

Within its industry coverage Jarden retains its preference for Wesfarmers ((WES)), noting there remains some risk to the retailer's second half forecasts. The broker sees the most risk in JB Hi-Fi and Harvey Norman over the second half.

Within the wider retail space the broker noted a retained preference for fashion, including Premier Investments ((PMV)), Universal Store ((UNI)) and Accent Group ((AX1)), travel, including Flight Centre ((FLT)), Webjet ((WEB)) and Corporate Travel Management ((CTD)), fast-moving consumer goods, including Woolworths Group ((WOW)) and Metcash, and luxury, including Treasury Wine Estates ((TWE)), over household retail.

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