WEEK 21

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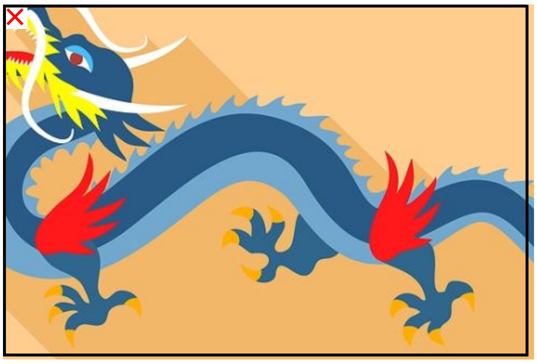
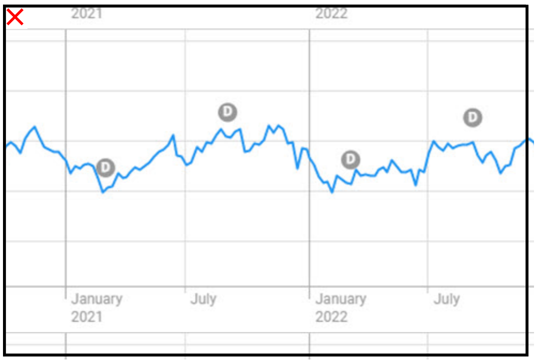
Innovation And Structural Growth Driving IDP Education



China's Failing Growth



Rudi's View: Dissecting The Next Share Market Rally

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AUSTRALIA

Innovation And Structural Growth Driving IDP Education

New research coverage highlights several growth drivers for IDP Education.

-Record student placements and IELTS volume for IDP Education
-Numerous structural tailwinds and innovation are key drivers
-Management response to rising competition for IELTS
-Interim results marginally missed the consensus forecast

By Mark Woodruff

In the wake of covid, international education services provider IDP Education ((IEL)) has experienced record levels of student placement and volumes for international English language testing services (IELTS).

The company primarily places prospective students from India and China in education institutions across Australia, Canada and the UK.

Many universities significantly reduced international recruitment staff during the pandemic and now have a greater reliance on student agents and digital platforms such as IDP Connect to source students.

Activity has been boosted by the structural growth tailwinds of supportive government policies and the rising middle class in emerging economies, along with improving global mobility due to the reopening of international borders, according to Bell Potter.

An increasing demand for an international education in English speaking countries also continues to be a key structural driver of growth, explains the broker, which began research coverage last week with a Hold rating and $30.35 target price.

Innovation, aided by the company's size and scale, is a key point that differentiates IDP's offerings in highly competitive markets and helps defend market share, according to the analysts.

Credit Suisse agrees on the company's scale advantage and points out the company's brand, scale and vertical integration with IELTS, along with its digital footprint, assist in yielding a lower cost of student acquisition relative to smaller student placement agencies.

This broker, which initiated research in March this year with an Outperform rating and $35.50 target, suggested a reduction in the sales and marketing capabilities of universities and rising immigration quotas by Canada are cyclical factors supplementing underlying demand over the medium term.

Local student tuition freezes and declining birth rates in major English markets have caused universities to pivot to international students to increase classroom utilisation, meet diversity targets and improve profitability, explained the analysts. International student tuition is often at multiples of their domestic peers, with tuition price rises determined by market forces.

Organic growth is also driven via the strategic expansion of office and testing centre networks, notes Bell Potter, along with the maintenance of strong relationships with organisations and governments.

The company is a one-third co-owner of IELTS, the world's largest high stakes English proficiency test, which Lighten-rated Ord Minnett sees as the strongest segment of the company. IDP is also the largest student placement agent in Australia with around 23% market share.

The reputations, in students' eyes, of IDP's key destination countries as top study and working destinations were rebuilt during the pandemic, observes Bell Potter. This was prompted by workforce shortages and weaker economic growth, which encouraged more supportive government policies.

<u>Competition</u>

IDP Education co-owns IELTS alongside the British Council and Cambridge Assessment. The exam is designed to assess the English language skills for non-English speaking students who wish to relocate to an English-speaking country.

Competitors of IELTS include the Pearson Test of English Academic (PTE), Test of English as a Foreign Language (TOEFL), Cambridge English (CAE) and Duolingo.

Credit Suisse believes IELTS' popularity is entrenched via network effects which gives IDP significant pricing power and higher margins than distributors of competing tests.

However, government acceptance for PTE mirrors IELTS across the major student placement markets of IDP, explains the broker, and wider acceptance of PTE in Canadian migration lowers the switching costs of consumers from IELTS to PTE.

At the end of April, Outperform-rated Macquarie noted IDP was losing market share to PTE, particularly in India, and reduced its forecasts for IELTS volumes and its target price to $34 from $36.

This broker highlighted Pearson had been gaining share since June 2021 and understood the drivers were due to increased marketing by Pearson and perception of an easier test.

But as Credit Suisse points out, IELTS has introduced innovation in the form of One Skill Retake, which allows students to retake failed test components. It’s hoped this will result in increased market share.

<u>Most recent reporting</u>

More growth appears to be on the horizon, suggested Ord Minnett back in February when reviewing first half results, as placement volumes from India and China remained below pre-pandemic levels.

The results were marginally lower than consensus expectations, noted Morgan Stanley, with IELTS volume weakness partially offset by price, which increased by 4% in constant currency terms.

Earnings margins expanded to 24.6% supported by operating leverage and digital investment, and the broker expected the reopening of China would support second half student placement volumes.

At the time, management expected IELTS volume growth of around 10% over the next three to five years from 5.5% in the first half.

The average target price of six brokers in the FNArena database is $31.48, which suggests around 17% upside to the latest share price. There are three Buy (or equivalent) ratings, two Hold and the one Lighten recommendation from Ord Minnett.

Outside of daily coverage, Jarden and Goldman Sachs have Buy (or equivalent) ratings with a target price of $33.45 and $35.70, respectively.

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AUSTRALIA

Qantas Flying High, But Sustainability In Question

Qantas Airways' trading update has received the thumbs up, but the demand outlook remains cloudy.

-Positive metrics in FY23 trading update for Qantas Airways
-Record free cash flow and lower than expected debt
-Management expects demand will stay strong into FY24
-Brokers are not as convinced on the FY24 outlook

By Mark Woodruff

Analysts generally approved of the FY23 trading update by Qantas Airways ((QAN)), as well as first time FY23 profit guidance from management which exceeded consensus expectations.

A record free cashflow performance and a materially lower-than-expected net debt position set the company up to fund its fleet reinvestment program, while also further rewarding shareholders, anticipates Morgans.

Confidence in the outlook and balance sheet is reflected by an increase for the current on-market share buyback to $600m from $500m, suggests the broker.

Management stressed the company is in a very strong position to fund its future capex requirements and reward shareholders. Travel demand is expected to remain strong into FY24 with current revenue intakes well above levels prior to the pandemic.

Fuel costs remain elevated, albeit off peak levels, observes Morgan Stanley, and management expects to deliver cost improvement of -$150m in the second half.

Australia's largest airline operates under two complementary airline brands, Qantas and Jetstar, flying international, domestic and regional services.

While still anticipating risks surrounding the upcoming capex cycle and the strength of demand heading into 2024, UBS has today upgraded its rating for Qantas to Buy from Neutral.

According to this broker, the share market has shown less and less response to forecast upgrades by Qantas over the last year due to the looming spectre of FY24 operating conditions.

This reticence may be overdone, suggest the analysts, given several insights into FY24 demand provided by yesterday’s trading update.

Greater cash from forward bookings is implied by management’s strong net debt guidance (while leaving capex guidance unchanged), notes UBS, while weaker International capacity guidance is likely a reflection of supply constraints rather than a strategic decision based on weak demand signals.

Moreover, the airline expects yields will remain "materially higher" than pre-covid through FY24.

Jarden is not as confident as management on yields and remains cautious given uncertainty around demand. It’s felt the yield environment is the most challenging aspect of the outlook to forecast accurately.

Yields

Despite competitive rationality, Jarden sees limited scope for Domestic yields to remain above pre-covid levels in the longer term. After also considering the strong recent rally in Qantas shares, this broker has downgraded its rating to Overweight from Buy.

Regarding yields for International flights, the analysts expect they will maintain a 24% premium to the pre-covid level over FY23-FY25, due to the greater premium travel demand environment, rational competition and moderating fuel costs.

Like Jarden, Neutral-rated Citi adopts a wary tone, by noting limited examples of ASX companies holding onto pandemic gains.

This broker describes the update as “uneventful” and awaits a “believable story” at the upcoming strategy day to justify how earnings can remain structurally higher.

While Citi analysts managed to imply material cash generation/revenue received in advance (RRIA) from other company-issued metrics, sustainability is uncertain due to limited disclosure on underlying drivers.

Irrespective of its wary tone, Citi has still lifted its target price to $6.90 from $6.70.

The average target price of six brokers in the FNArena database has, post market update, fallen slightly to $7.61, suggesting 18% upside to the latest share price. Ord Minnett and Macquarie have as yet not responded.

There are four Buy (or equivalent) ratings and two Hold recommendations.

Outside of daily coverage, Jarden has a Buy rating and $7.00 target, while Goldman Sachs (yet to refresh its research) has a Buy rating and $8.30 target.

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AUSTRALIA

Nufarm Crushes Seeds Of Doubt

After two strong years, brokers were not expecting much from Nufarm's result, but earnings far exceeded forecasts.

-Nufarm's Seeds business thrives
-Geographic diversity a buffer
-Weak cash flow will reverse
-Longer term opportunity in new products

By Greg Peel

Nufarm ((NUF)) develops, manufactures, and sells crop protection solutions and seed technologies across the globe, operating through two segments, Crop Protection (herbicides, insecticides, and fungicides) and Seed Technology (grains, vegetables, turf, trees and more).

Like all agricultural companies, Nufarm is forever subject to the vagaries of weather, and has also had to deal with covid disruptions in recent years. The company enjoyed strong revenue growth in the past two years, particularly due to the surging price of glyphosate (weed control), hence brokers did not hold high expectations for Nufarm's first half FY23 (year-end September) earnings.

Moreover, other ag companies, globally, have been reporting weak results due to the volatility of the ag market.

As it was, Nufarm reported slightly lower earnings than the bumper first half FY22, but still blew away broker forecasts.

The result was largely driven by a 34% increase in Seeds earnings, but also a solid result in Europe offsetting weakness in Asia-Pacific, after cycling those high glyphosate prices, and in North America, where farmers delayed purchasing as they watched ag-chem prices fall. The result underscores the value of the company's geographic diversity.

This, and the strong Seeds result, helped buffer against more normalised demand patterns post-covid, Macquarie notes.

<u>Not a Problem</u>

One stumbling block was a big miss on cash flow, leading to increased debt, but brokers have shrugged this off. It was largely due to timing issues around inventory movements and lags between customer orders and payments which are expected to normalise in the second half, reversing the cash flow position and lowering debt.

Management continues to guide to “modest” earnings growth in FY23 (cycling a very strong FY22), which implies solid growth in the second half from a year ago. Management has also tweaked its first half/second half earnings skew expectation to 70/30% from a prior 65/35%.

Second half trading conditions have started well, with seasonal conditions broadly favourable. Due to the material decline in active ingredient pricing and higher manufacturer inventories, Nufarm expects some margin pressure in the second half, particularly in North America.

Brokers agree this can be offset by new products, improved product mix, and from Seed Technologies.

<u>Longer Term</u>

It’s been a long road to date, but Nufarm continues to progress the development of its omega-3 and bioenergy (Caranita) seed products along the commercialisation path. Brokers all agree this presents a longer term re-rating opportunity.

Brokers also agree the company is on track to reach its unchanged FY26 revenue target, and reaching it also suggests upside.

Nufarm’s near term performance, and longer term potential, has five out of seven FNArena database brokers carrying Buy (or equivalent) ratings.

Given Nufarm is a global company, it is much better positioned to withstand potentially drier conditions in Australia than the rest of the sector, Morgans notes. But dry conditions will likely weigh on sentiment given Asia-Pacific represents around 20% of group earnings. For this reason, Morgans maintain a Hold rating, while retaining Nufarm as its key pick of the ag and chemical sector.

Morgan Stanley also sticks with Equal-Weight.

Nufarm increased its first half dividend by 25%, to 5c from 4c, but Ord Minnett points out a “pedestrian” 2.2% yield, unfranked, is not exactly exciting, but Nufarm is a growth story.

Not what you’d expect for a company established in 1916. Ord Minnett retains an Accumulate rating.

The FNArena database shows a consensus target of $7.12, suggesting 30% upside from the current trading price. Targets range from $6.64 (Morgans; Hold) to $7.70 (Ord Minnett; Accumulate).

While Wilsons (not included in FNArena's daily coverage) posted an upbeat response to Nufarm’s result, this brokers retains Market Weight with a low-end target of $6.04.

Wilsons includes valuations for omega-3 and Caranita potential, but does not include any attribution for Nufarm’s key New Seeds program at this stage.

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ESG FOCUS

ESG Focus: Here Come The EVs

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ESG Focus: Here Come The EVs

BloombergNEF estimates US$1.9trn in investment in Australia's energy sector and low-carbon technologies will be required to reach its net-zero ambitions and that EVs will get the lion's share – a staggering US$1trn.

-Australian power grids to attract US$11bn annually
-The Fossil-fuel and low-carb trade-off
-Here come the EVs
-Macquarie identifies winners and losers from fuel-efficiency standards
-Blue hydrogen gets the green light
-Strong role for fossil fuels

By Sarah Mills

BloombergNEF aims its sights Down Under in its *New Energy Outlook: Australia*, estimating investment of US$1.9trn will be needed to meet the country's 2050 net zero commitments.

Of that, 95% is expected to flow into low-carbon technologies or supportive infrastructure.

The analysis also estimates Australia could supply as much as 6% of expected low-carbon hydrogen demand in 2050, affirming the prospectivity of the nation's green hydrogen and blue hydrogen export ambitions.

But to do this, the analysis states Australia's power sector will need to rapidly scale up investment in wind and solar power, while deploying a fleet of low-carbon grid stabilising back-up energy – at least that's the cheapest option.

Fossil-Fuel And Low-Carb Trade-Off

BloombergNEF frames it as a race against time, observing that for every US$1 Australia invests in fossil fuel supply between 2022 and 2050, it will need to invest US$6 in low-carbon energy sources.

In other words, the more we spend on fossil fuels, the more our transition bill blows out (although it is not clear whether this is 2022 dollars versus 2022 dollars or 2050 dollars).

The analysis stresses there is still a role to play for Australian fossil fuels (most likely to fund global decarbonisation at the expense of Australian industry and consumers).

<u>Here Come The EVs</u>

BloombergNEF identifies the transport sector as one of the primary drivers of decarbonisation, and expects electric vehicles' share of new passenger vehicles to rise from just under 4% in 2022 to 100% in 2032.

The EV industry is estimated to constitute the single largest investment in Australian low-carbon technologies going forward, totalling US$1trn, out of the total forecast US$1.9trn.

This compares with a forecast US$391bn investment in low-carbon energy generation.

An average of US$11bn in grid investments will also be required, according to the report.

It is difficult to see how Australian consumers and investors will benefit from the EV rollout (outside of critical minerals exports, which is already a given), given the country does not manufacture cars and all fuel prices are high, and one would expect the lack of incentives might stymie adoption.

Bloomberg's solution is regulatory enforcement to drive adoption, but that is already on the cards.

The Australian Government published its inaugural EV strategy in April, which included a range of initiatives such as a Fuel Efficiency Standard for new light vehicles; recycling reuse and stewardship for EVs; and funding for EV guidance.

Macquarie says Australia is on track to introduce fuel efficiency standards as flagged in the government's April EV strategy by year-end to rapidly increase the supply and adoption of affordable and accessible EVs and supporting infrastructure.

The broker identifies Fleetpartners Group ((FPR)), McMillan Shakespeare ((MMS)), SG Fleet Group ((SGF)) and Smartgroup Corporation ((SIQ)) as likely beneficiaries; and expects it could prove a net negative for Eagers Automotive ((APE)).

BloombergNEF does identify a solid investment opportunity in the development of new supply chains for sustainable fuels. Downstream markets for spare parts should also offer opportunity.

<u>Hydrogen Gets The Green (And Blue) Light</u>

The BloombergNEF report posits that both green hydrogen and blue hydrogen (via carbon capture storage (CCS)) will be "pivotal" to decarbonising Australia's hard-to-abate sectors, suggesting it spies no near term competition domestically from nuclear energy or even biomass.

The analysis also concedes hydrogen transport and lack of concrete global demand remain major challenges for the industry's global ambitions.

There are no surprises here, nor in the Australian Government's 2022 State of Hydrogen report, published in April, save for the government announcing its support for the blue hydrogen prospect.

The Climate Change Authority has also published a new Insight Report on Carbon Sequestration that has come out in favour of carbon capture storage, which is likely to benefit blue-hydrogen prospects and fossil fuel stocks.

The report says CCS will be important in accelerating Australia's decarbonisation and calls for more investment (we examine the CCS prospect in greater detail in a later article).

It has identified cement, waste, agriculture, land and forestry as key sectors that would benefit from CCS.

Macquarie observes companies with CCUS exposures include: Beach Energy ((BPT)), Downer EDI ((DOW)), Santos ((STO)), Woodside Energy ((WDS)) and Worley ((WOR)).

The broker observes Santos's Moomba CCS project (in which Beach Petroleum holds a 33% stake) is 60% complete and is on track for first carbon dioxide injection in early 2024.

Beach Energy's feasibility study for the Otway CCS project is expected by year-end.

Woodside, meanwhile, has gained three greenhouse gas licenses in the Bonaparte Basin, Browse Basin and Northern Carnarvon to progress its own CCS.

Global incentives and subsidies remain a major obstacle for the development of the Australian low-carbon hydrogen export market.

Fossil Fuels Remain On Point

At this stage, the prognosis for Australia sharply reducing spending on fossil fuels in favour of low-carb alternatives appears poor given Environment Minister Tanya Plibersek's approval of several controversial and environmentally dubious onshore fracking projects.

Bloomberg's head of Australia Research at BNEF, Leonard Quong, while reaffirming the important role fossil fuels will play in the Australian economy on the one hand, calls for policy support in forcing this switch to decarbonisation in the other:

"The country will need to reform existing policies and energy-market design to accelerate investment in both technologies and workforce needed for the transition – if it is to realise the low-carbon opportunities that lay ahead," says the analyst.

Such statements are a tad disingenuous.

It is not Australians or the Australian government driving policy in this country but globalised big capital, which essentially benefits from Australia's quarry status and will continue to use fossil fuels to drive decarbonisation.

So basically, it's business as usual.

If anything, the green hydrogen prospect appears the loser out of recent developments as it will now have to compete with blue hydrogen for government favour and hence investment dollars.

It also makes Australia's claims to achieving green hydrogen superpower status ring hollow.

Green and synthetic methane are also likely to be drawn into the mix.

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FEATURE STORIES

China's Failing Growth

There were great expectations of a rapid Chinese economic rebound, but as some analysts warn, it's just not going to happen.

-Chinese data disappoint
-Confidence waning
-Property downturn
-Working population shrinking

By Greg Peel

"Something is rotten in the Chinese economy, but don't expect Wall Street analysts to tell you about it," wrote Ruchir Sharma, Chair of Rockefeller International, last week. "There has never been a bigger disconnect, in my experience, between some of the rosier investment bank views on China and the dim reality on the ground".

When Beijing suddenly, and unexpectedly, about-faced on its previously stubborn zero-covid policy early this year, analysts heralded a reopening rebound for the Chinese economy. And indeed, Chinese retail sales leapt 18.4% in April year-on-year, industrial production rose 5.6%, and fixed asset investment rose 4.7% year to date.

Which seem to corroborate reopening boom expectations, but in reality the opposite is true.

April data were anticipated to be significantly strong, as year-on-year the numbers were cycling China's lockdowns of a year ago when the economy was all but shut. But economists had forecast 21.0% retail sales growth, 10.9% industrial production growth and 5.5% for fixed asset investment. The results, therefore, fell well short.

DBS' senior economist Nathan Chow noted that on a month-on-month basis, China's industrial production declined by -0.5% in April. Monthly automobile sales also declined as consumers adopted a cautious stance while automakers reduced prices.

While high-frequency data showed spending surged during the Golden Week holiday, it likely represents pent-up demand rather than sustainable consumption growth, Chow asserts. Consumers have probably already taken most "revenge travel" trips, evidenced by the cooling services purchasing managers' index (PMI).

Modest 3.8% real income growth -- below pre-covid's 6.7% -- indicates households lack the purchasing power for persistently higher spending. This is reflected in the benign core inflation of 0.6-0.7% over the past three months. Both Beijing's and the independent Caixin manufacturing PMIs slipping below the expansion threshold in April illustrated the manufacturing sector is in no position to pick up the growth baton from consumption.

Plunging new loans in April pointed to deeper challenges, Chow warns. The slowdown in medium to long term corporate loans suggests private investment is unlikely to rebound swiftly. Declining mortgage lending despite supportive measures shows profound difficulties for the property sector. Externally, persisting strains in the banking sector and higher interest rates in the US and Europe are expected to pose lingering pressure on China's exports.

Lacking Confidence

Reopening set a good stage for China to grow the economy this year, notes Citi. In Citi's 2023 outlook, analysts assumed confidence would improve along with data akin to usual cycles, generating a broad-based and organic recovery of the Chinese economy. This hope now seems misplaced, Citi admits, with confidence revival lagging significantly within the recovery.

With the initial reopening impulse set to fade, weak confidence could become entrenched and self-fulfilling. Citi warns this could be the number one downside risk to the Chinese economy now.

There seems to be a persistent lack of confidence among consumers, homebuyers, corporates and investors, Citi notes. Some common factors could be responsible, such as the scarring effect from economic downturns, zero-covid and its exit, and policy excesses in the past few years, and the sectors could still be re-anchoring long-term expectations. Weak expectations could be reinforcing each other and become entrenched and self-fulfilling.

With weak confidence the major threat now, decisive policy actions are much needed to break the vicious cycle. All the sectors could be waiting for the government to make the first move. After the wait-and-see, cyclical macro policy tools such as rate cuts and targeted fiscal easing are back on the table, in Citi's view.

Missing Consumers

Hopes for a reopening boom were based on the premise that once released from lockdown, Chinese consumers would go on a spending spree, notes Ruchir Sharma, but company reports show no sign of one. If China's economy were growing at 5% -- which is Beijing's target (while some optimistic analysts have higher forecasts) -- then based on historical trends corporate revenues should be growing faster than 8%. Instead, revenues grew at 1.5% in the first quarter.

Corporate revenues are now growing at a slower rate than the officially stated GDP in 20 of China's 28 sectors, including consumer favourites from autos to home appliances, Sharma points out. Weak revenues are in turn depressing earnings for consumer goods companies, which normally track GDP growth quite closely, but shrank in the first quarter.

Instead of a reopening rush, the MSCI China stock index has fallen -15% from the January peak and consumer discretionary stocks are down -25% since then.

If the optimistic analysts are right, and consumer demand is picking up in a “boomy” economy, imports would be strong, Sharma suggests. Imports fell -8% in April. And, as noted, April retail sales and industrial production data came in way below economists’ estimates.

China’s credit growth is weakening too, to half as fast a pace as forecasters expected. The debt service burden of Chinese consumers has doubled in the past decade to 30% of disposable income, Sharma notes, a level three times higher than in the US.

Many Chinese youth need a job before they can join a spending spree: urban youth unemployment is rising and last month topped 20%.

China’s economic model has been based on government stimulus and rising debt, much of it pouring into the property markets, which became the main driver of growth. But with debts already so high, the government was much more restrained in its stimulus spending during the pandemic.

By the start of this year, the Chinese had accumulated excess savings during the pandemic equal to 3% of GDP, compared to 10% in the US. While the US enjoyed a big reopening boost from stimulus, China did not this time.

Much of the stimulus over the past decade had flowed through local governments in China, which used their own “financing vehicles” to borrow and buy real estate, propping up the property markets. Those vehicles are fast running out of cash to finance their debts, which is curbing their investment in the property market and industry as well. Industrial sectors are slowing faster, Sharma notes, than the consumer-related businesses at the centre of the reopening story.

The Property Problem

China’s broader property sector has long represented an outsized share of its economy, National Australia Bank economists note, when compared with advanced economies. At various times over the past two decades, Chinese authorities have adjusted policies around the property sector – including guidance to banks on mortgage lending, altering the size of deposits for purchases and purchase restrictions in different locations – to either stimulate or cool the broader economy.

In addition, local governments have been highly dependent on land sales to generate revenue – particularly in lower income provinces – providing an incentive to keep the property sector flourishing.

Concerns over the excesses of property developers and their high debt levels led to the implementation of government policies in August 2020 that severely restricted credit to the sector, NAB notes, leading to the high-profile collapse of deeply indebted developer Evergrande, along with a range of smaller firms.

According to Bloomberg, China’s property developers defaulted on over 140 bonds in 2022, with missed payments totalling a record -US$63.7bn, compared with -US$9bn in 2021.

Zero-covid policies encouraged an increase in savings and negatively impacted consumer confidence, NAB notes. This was exacerbated by property developers’ long running tendencies to abandon construction projects when funding was exhausted – leaving them unfinished – which led to a “mortgage strike”. Purchasers of unfinished properties simply refused to pay their mortgages and as of late 2022, the issue remained unresolved.

The combined effect of these factors was a steep downturn in the property sector – with residential sales volumes falling rapidly along with new construction starts.

A range of headlines have touted the increase in sales values in the first four months of 2023 – up 11.8% year-on-year according to the government – but as NAB points out, this followed a -32% fall over the same period in 2022 – meaning growth remains well below earlier peaks.

Although property sales data appear to be stabilising at a considerably lower level than the previous peaks, new construction activity remains relatively weak. Property developers may prove cautious, NAB suggests, particularly given the collapses of several firms in recent years – waiting for a clear turn around in sales before committing to new projects.

From an Australian perspective, this would be a negative trend, as residential construction is a key consumer of steel, an industry fed by Australian iron ore exports.

The Population Problem

The UN estimates that as of last month, India replaced China as the most populous nation on earth.

A few years ago, the Indian prime minister expressed concerns about India's "population explosion" and praised families who carefully considered the impact of more babies. In other words, families were producing too many children – a problem China addressed decades ago with its "one-child policy".

It is the fallout from that policy that has allowed India to pull ahead.

China has now experienced a decline in population for the first time in six decades, with the national birth rate reaching a record low of 6.77 births per 1,000 people in 2022. In comparison, the birth rate in the United States during the same period was 12 births per 1,000 people.

In recent months, the Chinese government has implemented several measures to encourage marriage and childbirth.

Potential for GDP growth is a function of population and productivity growth, notes Ruchir Sharma. China's negative population growth means fewer workers are entering the labour force, and heavy debts are slowing output per worker.

No economy has ever achieved economic growth amidst a decline in the working population, Sharma told CNBC.

By Comparison

The long-held view is that China will continue to gain ground rapidly on developed economies, achieving high income status and surpassing the US as the world's largest economy within the coming decade or so.

The analysts at Capital Economics are sceptical.

Over recent decades China has followed a similar growth trajectory to Japan, Korea and Taiwan, which are among the few emerging markets that have successfully made the transition to high income status. But China is reaching the limits of investment-led growth at a much lower level of income than its north-east Asian neighbours did.

With "remarkably good" infrastructure for its income level, and an "ample supply" of modern housing, the need for further rapid growth in construction has diminished, Capital Economics suggests.

And while Japan, Korea and Taiwan were still rapidly expanding their manufacturing sectors and exports at this stage in their development, China's share of world exports is already higher than its neighbours ever achieved, plus it is already running into a global protectionist response.

Capital Economics draws on the population problem in noting China is also growing older much sooner than its Asian peers. A declining working-age population means employment will start contracting – something that only happened to peers once they had already reached high income levels.

The Outlook

Although there has been some effort to move away from an emphasis on growth at all costs, China's leaders clearly still have high ambitions for future economic performance, Capital Economics notes. They have set a GDP growth target of "about 6.5%" for this year, and a prior commitment to double GDP by 2020 relative to 2010 levels in order to create a "moderately prosperous society" implies that they will target similarly rapid growth to the start of the next decade.

No "hard" growth targets have been set for growth beyond 2020 (noting covid rather got in the way), but Xi Jinping has set goals of China being a "modern socialist country" by 2035 and a "rich and powerful socialist country" by 2050.

Implicit in this bold vision, Capital Economics notes, is that China continues its rapid climb up the development ladder, reaching high income status in the coming decades.

"The odds aren't in his favour," the analysts warn.

Ruchir Sharma has a warning for other analysts – the ones who remain blindly optimistic on China's growth:

"While analysts may have little to lose from rosy forecasts, the rest of us do. 'Boomy' chatter has contributed to investors' loss of hundreds of billions of dollars in China in just the past four months. Further, global growth may prove weaker than expected in 2023, since the hope is that a US downturn will be countered by the China reopening boom, which may never come.

"It is time to expose this charade before the fallout gets worse."

Stop Press

China is now experiencing a new wave of covid, being the new omicron variant also turning up elsewhere, such as in Australia.

Medical experts in Australia have noted that each successive wave of covid is resulting in fewer cases than the last. The population is now up to its fifth vaccine – and specifically an omicron vaccine this time – being freely available.

China's previous covid waves were exacerbated, experts assume, by the ineffectiveness of its homegrown vaccines, and China refused offers of the more effective mRNA vaccines developed in the US.

China is now scrambling to come up with and distribute an omicron vaccine ahead of the northern winter. The latest wave is expected to peak next month at 65 million cases.

While Australia and others have now long abandoned lockdowns and learned to "live with covid", China's flip-flopping policies have not provided the same result.

RUDI'S VIEWS

Rudi's View: Dissecting The Next Share Market Rally

By Rudi Filapek-Vandyck, Editor

Dissecting The Next Share Market Rally

Despite all the ups and downs, the noise, the tribulations, the angst and intermittent periods of violent market volatility, the share price of Australia's largest biotech, CSL ((CSL)), is effectively unchanged from three years ago.

Whether this is a positive, or not, depends entirely on one's views on markets, investing and what likely follows next.

My personal view is that CSL's sidetracking since 2020 is almost entirely explained by the macro forces that have since dominated global equities; from covid, to lockdowns, to the outbreak of inflation, and the subsequent major reset in global bond yields, including the post-lockdown recovery trade and this year's economic slowdown.

Throughout the fog of today's slow-moving share price stasis, I see a long-term wealth generator whose valuation and operational momentum are once again aligned for a break-out to the upside, exact timing unknown.

Within this context I note CSL shares have risen circa 24% from January last year, and they are up 5.8% in 2023 thus far (last Friday).

Taking into account company-specific dynamics, the share prices of a number of healthcare stocks on the ASX do not look fundamentally different from CSL's trajectory, again emphasising the all-dominant macro influences for the sector throughout the past four years.

History suggests periods of relative stability in the CSL share price do occur, on occasion. It happened between 2002-2006, with the global industry oversupplied, and again from 2008 till 2012.

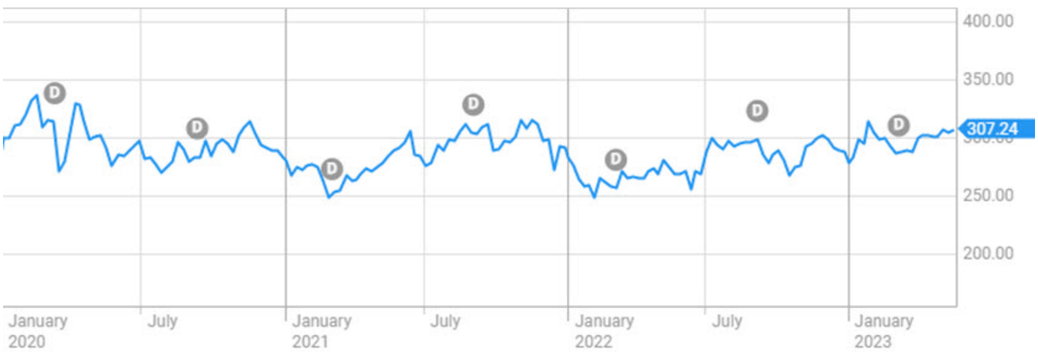
The latter period was quite impressive as it includes the GFC meltdown. Most importantly, both periods of stability saw the share price subsequently rally to fresh all-time record highs, and beyond.

The combination of all of the above suggests today's set-up could well turn out very favourable for patient shareholders and newcomers.

To add an extra cherry on the proverbial cake, most healthcare sector analysts seem to agree with that positive view, as are a number of investment strategists across the financial industry locally.

Having closely observed the Australian share market for more than two decades, I cannot recall ever seeing CSL popping up in as many Model Portfolios and Conviction Buy Lists as is the case this year.

CSL share price 2020-2023 (May 22) - source: ASX.



CSL Is Not Robinson Crusoe

There are many other stocks listed on the ASX whose share price today is similar to where it was in 2020 or 2021. The difference entirely depends on whether the shares initially sold off because of covid, or whether they functioned as a safe haven throughout the initial phase of the pandemic.

All four of Australia's major banks, for example, have not gained anything extra once the recovery rally into 2021 had been completed. Luckily, for loyal shareholders, Australian banks are among the world's best and most reliable when it comes to paying dividends, but the broader context for this sector doesn't look half as promising as for CSL.

Australian banks, with notable exception of CommBank ((CBA)), are still continuing their lost decade post-GFC. Shareholders who own the shares since 2007 have only enjoyed the twice-yearly dividends, plus franking tax benefits.

In the case of ANZ Bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)) they also had to endure a fair degree of capital erosion.

Two of the banks -ANZ and Westpac- are arguably caught inside a long-term, downsloping channel since that memorable, final hurrah share price rally for the sector up until April 2015.

Despite bank shares lagging the broader market this year, there aren't many analysts who are genuinely confident and positive about the sector's immediate prospects. Moreover, an oft-quoted market commentator such as **Bell Potter's Charlie Aitken**, who's uber-bullish on the 'new bull market' for local equities, still advises investors to dump their bank shares.

It is Aitken's view local banks will simply add a second lost decade to their share price performances. Can the sector leading CBA withstand gravity a second time around?

Cyclicals In The Spotlight

More surprising, maybe, given economies have not faltered and inflation remains too high for comfort, is the same observation also applies to large cap resources companies, with a sideways trajectory of approximately two years.

As all kinds of commodities indices and benchmarks peaked around mid-2021 and since have trended south, it should be of little surprise the share prices of BHP Group (BHP)), Rio Tinto ((RIO)), Fortescue Metals ((FMG)), Santos ((STO)), et cetera are all showing similar post-peak trends.

The commodities segment is much more diverse, so here the differences between share prices inside the basket are a lot larger, but many large cap producers globally are equally moving inside a sideways trending pattern.

Recent **research by Longview Economics** suggests this might signal a bad omen for the sector overall.

Longview's analysis of historical data involves an equal-weighted index of share prices for US cyclicals, comprising of energy, financials, consumer discretionary, materials and industrials. Such an index has been flat over the year past, as well as flat since late 2021, the researcher reports.

History suggests such prolonged periods of sideways movement for this index are subsequently followed by weakness, as shown on the graphic below.

On Longview's data analysis, the current sideways-moving period is the sixth since 1996. All five previous occurrences eventually saw the index fall to much lower levels, implying share prices were simply biding time before the next Big Sell-Off.

S&P500 equal weighted cyclical sectors shown with flat/sideways periods (& US recessions)

Equally important: Longview notes not all pullbacks for US cyclicals are equal in duration and severity with the Fed response seen as the dominant factor. In mid-cycle downturns, the Fed's policy adjustment is typically modest, and thus markets adjust swiftly and revert back into cyclical uptrend-mode.

In case of a US recession, however, the process takes a lot more time and the Fed's response is much larger in magnitude. This scenario tends to go hand-in-hand with much deeper sell-offs with overall sector weakness lasting longer before the next uptrend commences.

Longview's analysis provides no comfort for investors generally as on each occasion, whether cyclicals sell off mildly or more severely, the broader S&P500 index is pulled down substantially lower, regardless.

Longview also concludes that if US equities are poised for significantly higher levels, as suggested by some, its analysis suggests this will be achieved through technology and growth stocks instead.

Shorter-term, however, Longview's own technical and momentum indicators are flashing warning signals, indicating the uptrend in technology and growth stocks, short-term, looks overstretched.

The Pause That Triggers Relief

Thus far in 2023, global equities, including in the US, have refused to succumb to more dire forecasts.

While the Dow Jones (DJIA) is only narrowly positive since January 1st, the S&P500 year-to-date is up 9%-plus and the Nasdaq almost 21%. In comparison, New Zealand's NZ50 index has gained circa 5.50%, while the ASX200 is up less than 3.50%, held back by heavyweights banks and energy.

Arguably, uncertainty relating to the political games being played in the US as the Biden government approaches its debt ceiling is weighing on markets and risk appetite generally, so any positive resolution is likely to trigger the next risk-on rally higher.

Another source of ongoing investor optimism relates to the fact central banks, including the RBA and the Federal Reserve, are closer to a pause in their inflation-targeting tightening policies. Applying the same logic as with the US debt ceiling: a pause in rate hikes with the next move likely to see interest rates being cut might logically be seen as an important risk-on event.

Those investors and traders preparing for the next rally can fall back on a number of historical precedents, including late 2018 when the Federal Reserve changed course and markets rallied for months thereafter. Another prime example is 1994 when risk assets and bonds first paid the price of relentless Fed tightening, but once it stopped, a multi-year bull market phase opened up.

The problem here is that simply relying on such turning points from the past seems too simplistic. Plus history shows those two examples are the exception, rather than the standard outcome. What ultimately defines whether markets can rally, and continue moving upwards in a sustainable manner, is the broader context in the background of these policy turning points.

For example: in both examples of 2018 and 1994 central bank tightening had not led to an inverse yield curve for US government bonds. Such an inverse curve happens when longer duration bonds offer a lower yield than bonds closer to expiration. This is also seen as the classic signal an economic recession is on the horizon.

An economic recession, no matter how short or how mild, would likely still challenge earnings forecasts and valuations in today's markets. It would provide the thus far missing piece in, for example, the aforementioned analysis by Longview Economics. The US bond market this time around is significantly inversed, and has been for a long while.

Historic Differences Matter

Recent research released by analysts at **Morgan Stanley** has come to a similar conclusion. The research has identified nine significant Fed rate hike periods since 1974. On average, the time between the final rate hike and the first Fed cut is approximately 106 days (let's call it 3.5 months).

Only four of the periods between last hike and first cut produced a positive return for US equities, but those returns averaged an impressive 18%. One can see where any enthusiasm stems from! Also, in only two cases -1989 and 1995- did the market bottom before or coinciding with the first rate cut.

The research points out in both these cases markets had already pulled back significantly in advance; a point that is harder to make in today's context.

This leaves seven cycles when markets did not bottom out until 270 days, on average, post the final rate hike. The average drop in US equity indices for those seven instances is -23%.

The research suggests investors should not necessarily blindly follow the signal provided by US Treasuries, with economic and financial conditions equally important. Alas, including these in today's analysis do not improve the overall picture.

Morgan Stanley suggests unemployment is too low, inflation is too high and leading indicators are running firmly in negative territory. And when it comes to financial conditions and lending standards, the current banking stresses that have appeared in the US are causing a further tightening in credit availability, or worse.

Both in 1989 and in 1995 financial conditions were already improving from extreme stress when the Fed stopped hiking, points out the research. In 2023 conditions are worsening, and poised to deteriorate further. Though, admittedly, Morgan Stanley acknowledges US financial conditions overall remain loose, but they're getting worse, not better.

Morgan Stanley analysts also don't see a positive outcome from the US debt ceiling negotiations: if an agreement is reached that involves significantly reduced spending, as demanded by the Republican opposition, this will worsen the economic slowdown.

If, on the other hand, the US government is allowed to raise additional capital (through issuing bonds) this will drain liquidity from the system, which is equally a negative.

It's A Process!

In summary, while equities at face value have ostensibly surprised through stoic resilience thus far in 2023, still supported by positive technical set-up, underlying the financial and economic fundamentals continue to suggest a more conservative and defensive portfolio positioning seems warranted.

At the same time, investors should always keep in mind not every stock is equally affected, nor to the same extent, and there are always exceptions within sectors and baskets.

A common thread through institutional and professional portfolio views this year has been an emphasis on corporate characteristics such as "quality", "yield", "defensive", "strong operational momentum", and "structural growth". Analysis of historical precedents corroborates such preferences.

Investors should take note, and incorporate this to the best of their abilities in their portfolio and personal strategies. It is true the future is never set in stone, and surprises do occur from time to time, but successful investing is usually closely aligned with paying attention to risks and adjusting accordingly, not with keeping the fingers crossed and hoping for the best.

The process to contain inflation has been an elongated and enthusiasm-sapping process, and it's still ongoing, but one should never lose sight that this too shall pass, eventually. Nothing is forever, nothing stays the same. Patience remains the secret ingredient for share market longevity.

The **FNArena/Vested Equities All-Weather Model Portfolio** has 23% in cash and 5% in gold, with the largest portfolio holdings concentrated around Aristocrat Leisure ((ALL)), CSL ((CSL)), Telstra ((TLS)), HomeCo Daily Needs REIT ((HDN)) and NextDC ((NXT)).

The All-Weather Portfolio selects stocks from the curated lists that are 24/7 available to paying subscribers:

https://www.fnarena.com/index.php/analysis-data/all-weather-stocks/

****

For more insights as to how others are weaponising portfolios against potentially more negatives forthcoming:

https://www.fnarena.com/index.php/2023/05/04/rudis-view-rba-hikes-us-recession-portfolio-adjustments/

More reading:

-https://www.fnarena.com/index.php/2023/05/17/rudis-view-us-recession-debate-is-tightening/

-https://www.fnarena.com/index.php/2023/05/10/rudis-view-markets-weigh-plenty-of-positives-and-negatives/

-https://www.fnarena.com/index.php/2023/05/03/rudis-view-seeking-quality-growth-offshore/

-https://www.fnarena.com/index.php/2023/04/26/rudis-view-investing-in-megatrends-the-other-ones/

-https://www.fnarena.com/index.php/2023/03/22/rudis-view-all-weather-stocks-back-in-fashion/

Conviction Calls and Best Ideas:

-https://www.fnarena.com/index.php/2023/04/19/rudis-view-bond-market-says-regime-change-is-upon-us/

-https://www.fnarena.com/index.php/2023/04/12/rudis-view-wesfarmers-wisetech-worley/

-https://www.fnarena.com/index.php/2023/03/17/rudis-view-dominos-pizza-newcrest-qantas/

-https://www.fnarena.com/index.php/2023/02/10/rudis-view-aub-group-endeavour-lottery-corp-suncorp/

-https://www.fnarena.com/index.php/2023/02/03/rudis-view-csl-mineral-resources-ridley-readytech/

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(This story was written on Monday, 22nd May, 2023. It was published on the day in the form of an email to paying subscribers, and again on Wednesday as a story on the website).

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

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

RUDI'S VIEWS

Rudi's View: Aristocrat, BHP, Qantas & Westpac

By Rudi Filapek-Vandyck, Editor FNArena

In the seemingly never-ending public debate, the world around, **investment strategists at Canaccord Genuity** are resolute in their assessment: equities might have proven more resilient than most expected, they remain in a bear market, and another period of weakness should be prepared for.

To illustrate the importance of making preparatory adjustments to portfolios and asset allocation, the strategists quote late US businessman, investor and diplomat Shelby Davis who's believed responsible for the adage that **you make most of your money in bear markets; you just don't realise it at the time**.

What Davis was alluding to specifically, explain the strategists, is that if you protect your capital in a difficult market, there is more left afterwards to compound into the future.

With this credo in mind, Canaccord Genuity has once again moved its Model Portfolio into Underweight equities alongside an Overweight allocation to fixed income.

As far as the portfolio's equities exposure is concerned, the emphasis had already been on "stable earnings" through holdings in the likes of Woolworths ((WOW)), The Lottery Corp ((TLC)) and CSL ((CSL)), combined with beneficiaries of the post-pandemic recovery such as Qantas Airways ((QAN)) and Computershare ((CPU)), while also keeping some exposure to the recovery in China through BHP Group ((BHP)) and Rio Tinto ((RIO)).

Some changes have been made with both Qantas and Computershare now replaced with Sonic Healthcare ((SHL)) and Wesfarmers ((WES)). The overall position in Resources has been scaled back to Neutral from Overweight, even though South32 ((S32)) was added to replace OZ Minerals, now part of BHP.

The Portfolio remains Underweight Australian banks.

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The reluctance to embrace equity markets' resilience thus far also dominates sentiment at **Evans and Partners**, where Portfolio Strategist Max Casey and Chief Investment Officer Tim Rocks have downgraded their allocation to the local share market to -2% Underweight, while shifting allocation to interest rate securities to 2% Overweight.

"We continue to advocate for clients to build positions within the fixed income asset class given attractive yields, reasonably priced valuations, and, in the case of floating rate instruments, embedded inflation protection."

Evans and Partners notes earnings forecasts are "negligible" out to 2025, with risks pointing to the downside, in particular for financials (banks) and, on a stalling China recovery, the materials sector. Both sectors make up some 52% of the local index, the strategists add.

****

Adjustments were equally made to **Morgan Stanley's Asia Pacific Ex-Japan Focus List**. We spotted three Australian inclusions:

-Aristocrat Leisure ((ALL))

-CSL
-Evolution Mining ((EVN))

Some of the others include Alibaba Group, Bank Negara Indonesia, Kia Corp and Samsung Electronics.

****

Over at **Macquarie**, strategists have been preaching defensive portfolio positioning for quite a long while. In their recent update, Macquarie strategists state an inverted yield curve and the conference board leading indicator have both a good track record of predicting economic recession for the US.

Now that we can add tightening credit, Macquarie's call for defensive positioning has simply gained (even) more resolve.

Bigger picture, Macquarie finds **Australian equities look expensive** with Price-Earnings (PE) ratios already reflecting a large fall in real yields, while the EPS growth outlook is flat and risks are pointing to the downside.

For the most recent Model Portfolio adjustments we have to go back to April when allocation to the local healthcare sector was increased, while exposures to late cycle cyclicals and "expensive defensives" were scaled back.

****

In a separate research exercise, Macquarie analysts identify a number of ASX-listed companies that can be categorised as: **High Quality stocks, cheaply priced, with low distress risk**.

The list contains a dozen names:

-BHP Group
-CSR ((CSR))
-Ansell ((ANN))
-Woolworths
-Metcash ((MTS))
-Sonic Healthcare
-Insurance Australia Group ((IAG))
-JB Hi-Fi ((JBH))
-Orora ((ORA))
-Medibank Private ((MPL))
-Deterra Royalties ((DRR))
-The Lottery Corp

****

Those responsible for the **Conviction Buy List at Goldman Sachs** have made no changes since April when, on two separate occasions, Macquarie Telecom ((MAQ)) and Aristocrat Leisure had been added to the list.

Since those adjustments were made, the list consists of 15 Buy-rated (with High Conviction) nominations. The other 13 are:

-Fisher & Paykel Healthcare ((FPH))
-Iluka Resources ((ILU))
-Lifestyle Communities ((LIC))
-Omni Bridgeway ((OBL))
-Qantas Airways
-Qualitas ((QAL))
-REA Group ((REA))
-Rio Tinto
-Temple & Webster Group ((TPW))
-Webjet ((WEB))
-Westpac ((WBC))
-Xero ((XRO))

****

Morningstar's Best Stock Ideas now includes a2 Milk ((A2M)) with the May update of the selection also containing the following 12 New Zealand and Australian companies:

-AGL Energy ((AGL))
-Aurizon Holdings ((AZJ))
-Fineos Corp ((FCL))
-InvoCare ((IVC))
-Kogan.com ((KGN))
-Lendlease Group ((LLC))
-Newcrest Mining ((NCM))
-Santos ((STO))
-TPG Telecom ((TPG))
-Ventia Services Group ((VNT))
-Westpac
-WiseTech Global ((WTC))

Recent Updates On Conviction Calls and Best Ideas:

-https://www.fnarena.com/index.php/2023/04/19/rudis-view-bond-market-says-regime-change-is-upon-us/

-https://www.fnarena.com/index.php/2023/04/12/rudis-view-wesfarmers-wisetech-worley/

-https://www.fnarena.com/index.php/2023/03/17/rudis-view-dominos-pizza-newcrest-qantas/

-https://www.fnarena.com/index.php/2023/02/10/rudis-view-aub-group-endeavour-lottery-corp-suncorp/

-https://www.fnarena.com/index.php/2023/02/03/rudis-view-csl-mineral-resources-ridley-readytech/

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P.S. I - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

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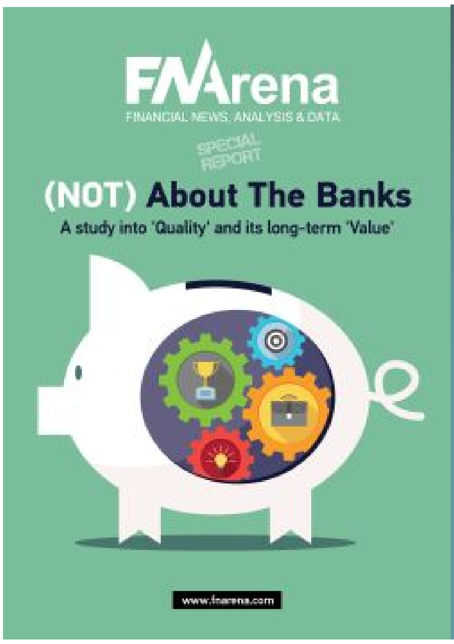

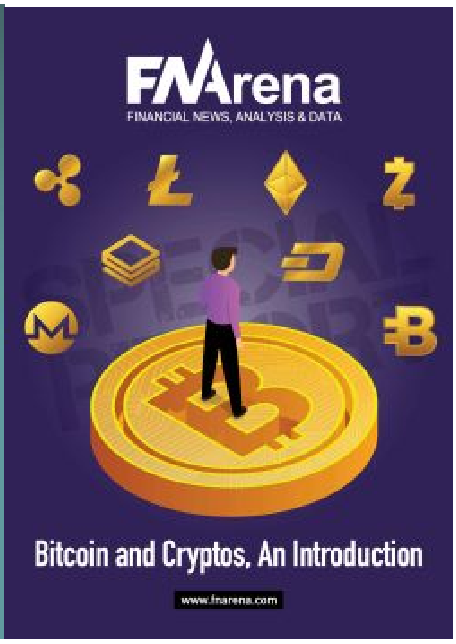

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FNArena is proud about its track record and past achievements: Ten Years On

SMALL CAPS

Numbers Are Adding Up For Life360

Brokers remain enthusiastic on the outlook for Life360 following first quarter results.

-Life360's first quarter results show cost control and subscriber growth
-Strong execution of price increases
-Brokers remain confident on the outlook
-Potential for guidance upgrade later in the year

By Mark Woodruff

Last week's first quarter results for global family safety service company Life360 ((360)) exceeded brokers' expectations for both subscription growth and cost control.

Overweight-rated Morgan Stanley suggests these drivers are more important than less predictable hardware sales.

The company's subscription business aims to protect people, pets and "things". Features of the Life360 mobile app range from communications to driving safety, as well as location sharing.

Life360 operates a "freemium" business model where the basic app is available to users at no charge. Goldman Sachs believes the company's valuation is attractive relative to offshore fremium app service peers, when the growth profile is taken into account.

Over the last five years the company has been monetising its user base by providing premium subscription options, as well as introducing a membership program.

In the first quarter, global monthly users increased by 5% quarter-on-quarter to 50.8m. While there was an operating cash outflow of -US$9.2m, Bell Potter had expected this outcome, and management reiterated operating cash flow will be positive from the second quarter onwards.

The first quarter is typically the company's softest for monthly active users (MAU)/subscriber growth, points out Goldman Sachs, yet US paying circle net additions rose to 38,000 versus the broker's forecast for 30,000 in the first half, after conversion/churn stabilised.

Paying circles increased by 73,000 quarter-on-quarter to 1.6m, which also exceeded Bell Potter's estimate for a rise of 35,000. In addition, average revenue per paying circle (ARPPC) of US$121 beat the broker's US$116 forecast.

Even after assuming a second half ramp-up in marketing spend, Goldmans Sachs expects cost control will result in upside to management's reiterated FY23 earnings guidance of US$5-10m.

Analysts consider **Life360 is executing strongly on price increases while growing subscriber volumes with less user-acquisition spending.**

Price increases

In the US, the ARPPC for the quarter was US$140 compared to US$138 in January, as the Android price rise was rolled out in April. This metric is on track to meet Morgan Stanley's FY23 target of US$149.70.

Price increases of around 50% are being implemented across the entire US monthly paying user base. Back-book Android price increases (in line with iOS pricing) will result in a relatively muted second quarter for net additions, according to company management. Goldman Sachs is forecasting additions of 20,000.

The benefits of Tile bundling (lower churn and improved retention) will becoming apparent in the second half, suggests this broker. An acceleration in subscribers is also expected as price increases are fully digested by the user base.

The analysts are comfortable with their FY23 revenue growth outlook given around 70% is driven by pricing.

The Outlook

Bell Potter now sees **potential for an upgrade to guidance later in the year**, with management possibly waiting until results for the traditionally strong third quarter.

This broker continues to forecast mid-to high-teens percentage growth in revenue in 2024 and 2025 and at least a doubling of adjusted earnings (EBITDA) in each period.

The next potential share price catalyst is expected to be the release of interim results, when the analyst anticipates another good quarter, and importantly, positive operating cash flow.

Goldman Sachs agrees and also sees upside risk to earnings guidance as the year progresses. Even with assumed reinvestment into growth, operating leverage will be on show as the business continues to scale.

Following Life360's first quarter results, Bell Potter and Morgan Stanley have targets of $9.00 (up from $8.75) and $8.50, respectively, in the FNArena database. The resultant average target price suggests just under 27% upside to the latest share price.

Outside of daily coverage, Buy-rated Goldman Sachs raises its target to $8.35 from $7.85.

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

SMALL CAPS

Dr Boreham's Crucible: Chimeric Therapeutics

Tim Boreham reports cancer treatment biotech Chimeric has struggled, but may yet have a sting in its tail

By Tim Boreham

ASX code: ((CHM))

Market cap: $17m

Share price: 4c

Shares on issue: 425,278,237*

Chief executive officer: Jennifer Chow

Board: Mr Hopper (executive chair), Ms Chow, Leslie Chong, Dr Lesley Russell, Cindy Elkins, Dr George Matcham

Financials (March quarter 2023): revenue nil, loss of -$687,000, cash of $2.82m

Identifiable major holders*: Paul Hopper 21%, Dr Christine Brown 2.75%, Dr Michael Barish 2.7%

***** Ahead of capital raising, which if fully subscribed would add an extra 153,913,040 shares

The imperative for cash-strapped ASX biotechnology companies to get money through the door has been highlighted by oncolytic drug developer Chimeric's quest to raise up to $6.25m, by way of a placement and a follow-on share purchase plan (SPP).

Chimeric listed in January 2021 after raising $35m at 20c to fund its CLTX Car-T immune-oncology programs, acquired from the City of Hope Hospital in Los Angeles.

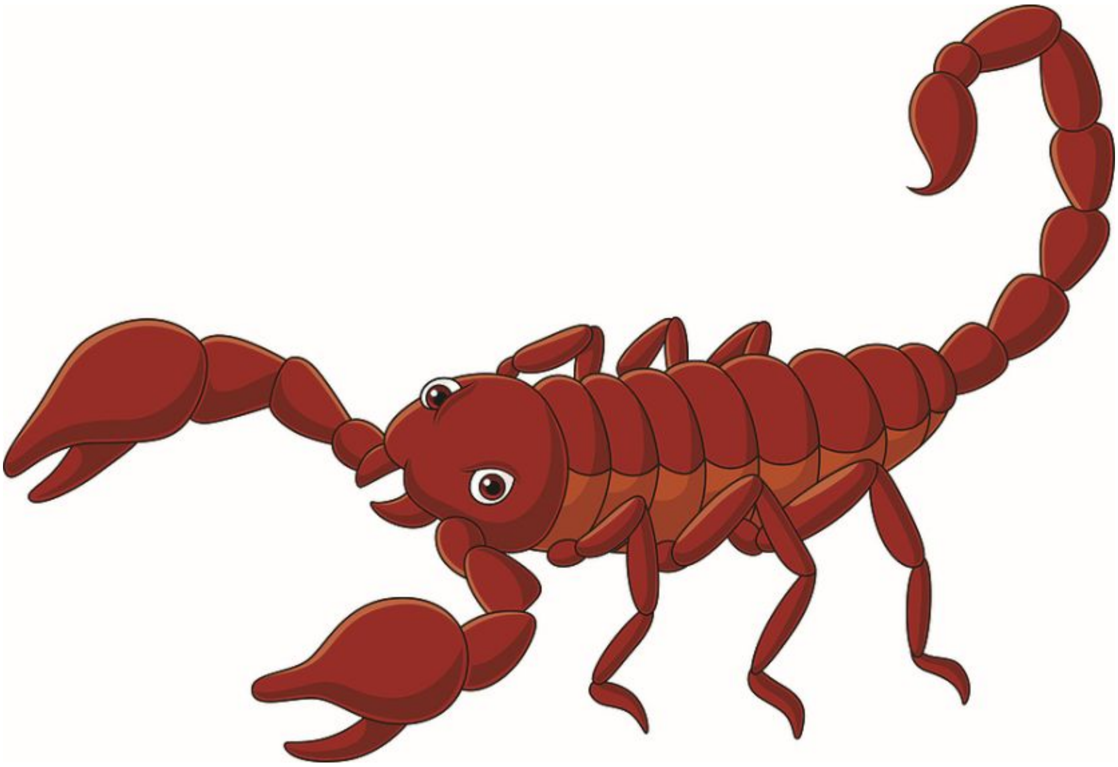
In those buoyant times investors had oversubscribed for $60m in the initial public offer (IPO), which was put together by legendary biotech entrepreneur Paul Hopper.

Reality has since bitten with the venom of a deadly scorpion.

As the company announced on Monday, May 15, share plan subscribers are invited to subscribe at 4c a share, a -13% discount on the undisturbed closing price on Friday May 12.

The placement is subscribed by board and management, which Mr Hopper describes as a sign of confidence in the potential of the company's programs.

Meanwhile, other ASX biotechs raising equity include Dimerix, 4D Medical, while Mesoblast has just done so.



Kiss of the scorpion

CLTX refers to chlorotoxin, while Car-T is short for chimeric antigen receptor T-Cell.

Initially, Chimeric's main program involved a treatment for the difficult-to-treat glioblastoma, a form of brain cancer.

In an exotic vein, the active ingredient derives from the venom (peptide) of the deathstalker scorpion - chlorotoxins that bind to unique targets in the body.

This scorpion juice is worth something like $9,000 a gram, but fortunately for researchers the active ingredient is derived synthetically and they don't have to chase the arachnids across the Sahara Desert.

The toxin is familiar to the oncolytic community, because for years it has been used as an imaging agent to detect cancers.

"Logically if you have something that will tell you where cancer cells are, it will attach to these cells," says Chimeric chief executive Jennifer Chow.

Search and destroy

Car-T therapies work by 'supercharging' the body's T-cells to fight cancers.

The genetically-engineered cells are grown by the millions in a laboratory and then re-injected, resulting in the patient getting a turbo-charged version of their own T-cells.

Car-T treatments are known to be effective with blood-based cancers such as leukaemia, with six drugs approved in the US.

Formally known as a 36 amino acid peptide, the scorpion toxin recognizes a cancer marker called membrane-bound matrix metallo-protease-2 (MMP2).

The healthy cells are unharmed.

Ms Chow says Chimeric has focused on "first-in-class assets with novel design".

Chimeric's work has also expanded into so-called 'natural killer' cells, based on assets derived from Case Western Reserve University in Ohio (a state hitherto better known for its Rock 'n Roll Hall of Fame).

It's all about the people

A former executive at Car-T specialist Kite Therapeutics, the Toronto-born Ms Chow was Chimeric's chief operating officer before being anointed in the top job in August 2021.

She had also held roles at Roche, Nycomed/Takeda and Schering Canada.

Ms Chow says the Chimeric team has 75 years' collective experience in the space, having been involved elsewhere in taking four of six of the approved Car-T drugs to market.

Chimeric's foundation intellectual property was devised by City of Hope researchers Prof Christine Brown and Dr Michael Barish. The former chairs Chimeric's scientific advisory board.

Mr Hopper has founded - or been involved in - no fewer than 14 drug companies, including fellow ASX-listed immuno-oncology play Imugene. We only mention this because Imugene chief Leslie Chong moonlights as a Chimeric director.

The board also includes Cindy Elkins, an erstwhile Juno Pharmaceuticals heavyweight.

Don't mention the C word

While the C (cure) word is still only mentioned in hushed tones in the oncolytic community, Ms Chow cites the example of a 33-year-old US woman undertaking Car-T-cell therapy for aggressive acute myeloid leukaemia (AML) at an Ohio research centre.

Within days, the patient's condition had stabilized and within 33 days the cancer had disappeared. More than two years later, she was still cancer-free.

"I have worked in cancer for my whole career and have never seen outcomes like this before," Ms Chow says.

She says cancer treatment had developed incrementally over decades, with the advent of chemotherapy and targeted and immune therapies.

"It wasn't until the introduction of Car-T therapies that we measured the improvement in term of years, the outcomes have been really dramatic."

Unrelated to Chimeric, an early-stage Italian Car-T clinical paediatric trial has shown encouraging results in the solid tumor neuroblastoma, a nerve tissue cancer that affects the adrenal glands.

Carried out at Rome's Bambino Gesù Children's Hospital, the study showed that nine of the 27 enrolled children exhibited no sign of cancer after six weeks. It wasn't entirely a feel-good story in that two later relapsed and died, bearing in mind that all the kids were in a bad way.

Natural born thriller

Chimeric's 'natural killer' platform - CHM0201 - was developed by Dr David Wald of Ohio's Case Western Reserve University. The parties are jointly developing the program through an exclusive global licence.

The autologous (off-the-shelf) therapy involves a healthy donor providing the material, from which the natural killer (NK) cells are isolated, enhanced and made into thousands of doses and frozen.

The patient's blood is sent to a facility where the T-cells are supercharged. The claret is then shipped back to the same patient.

In March 2022, the company said a previous nine-patient, phase I study established safety across three dosing levels, with no sign of graft-versus-host disease (rejection).

Six of the patients enrolled had colorectal cancer, with disease control evident in two. The other three were acute myeloid leukaemia patients including the aforementioned 33-year-old lady. The other two showed disease stabilization, but not a complete response.

Chimeric is undertaking a trial combining its therapy with the existing agent inhibitor Vactosertib, for advanced colorectal and blood cancers.

"Because it's an off-the-shelf therapy, this one can move a bit quicker," Ms Chow says.

"We expect enrolment to be completed by the end of this calendar year and it will take another six months to get the data."

Tackling glioblastoma

The asset on which Chimeric's IPO was based, CHM1101 (CLTX-Car-T) is in a phase I clinical trial at City of Hope, as a potential glioblastoma treatment.

"Glioblastoma is a disease for which next to nothing works," Ms Chow says.

"Sadly, the drug approval bar is very low because there has been no new drug for 10 years."

Enrolling 18 to 36 patients, the ongoing phase I dose escalation trial involves four dose strengths. The third cohort was dosed in December 2022, with all patients progressing beyond 28 days without any toxicity issues. In early March, the fourth cohort was dosed, with results pending.

“If the data is good enough, we will want to expand the trial and engaging other sites puts us in a good position to do that,” Ms Chow says.

And gastro-intestinal tumours…

Bought in from the University of Pennsylvania, CHM2101 targets CDH17, an antigen expressed on tumours.

CHM2101 was developed by the university’s Dr Carl June, who in 2018 was nominated by Time magazine as one of the world’s most 100 influential people for his earlier work in developing the first FDA-approved Car-T therapy, tisagenlecleucel, marketed as Kymriah.

Kymriah initially was approved for paediatric acute lymphoblastic leukaemia, with the indication later expanded to non-Hodgkin’s lymphoma in adults.

Pre-clinical data from the CHM2101 program showed “strong evidence of efficacy, with complete eradication of eight different types of gastrointestinal tumors with no relapse or toxicity”.

Chimeric held an investigation new drug meeting with the US Food and Drug Administration in March, in view of paving the way for a clinical trial at the university.

Finances and performance

The Chimeric board has done the shareholder-friendly thing by pitching the share purchase plan at a better price than the placement.

The placement was struck at 4.6c, equal to the previous Friday’ May 12 ‘undisturbed’ closing value.

The share plan will be at four cents, a -13% discount to the May 12 close and a whopping -25% discount to the 10-day volume weighted average price (VWAP) leading up to May 12.

The entry price could be even cheaper: a -5% discount to the five-day VWAP leading up to - and including - the June 2 closing date for the share plan.

The placement is subject to shareholder approval at an extraordinary general meeting, likely to be held in late June.

Chimeric reported cash of $2.82m at the end of the March 2023 quarter, having burnt through $687,000 in the three months. Given the company had outflows of -$13.3m for the first nine months of the financial year, this implies a considerable improvement.

The raising is not Chimeric’s first post-IPO top-up.

In February 2022, the company tried to raise $18.1m in an institutional and retail rights issue, at 17c a share. After some struggle, it banked $14.4m.

Chimeric also has another funding mechanism: in June last year it entered an equity placement agreement with the Melbourne-based L1 Capital, by which the boutique fundie provides up to $30m of equity over 24 months.

Struck at a -5% discount to the prevailing price, the drawdowns are at the company’s discretion and the facility need not be used at all. Self-evidently, the facility does not preclude the company from raising funds elsewhere.

Chimeric shares shot to a high of 41c from the 20c listing price, but since then reality has bitten (or stung, given we’re talking about scorpion venom).

With a circa 21% Chimeric stake pre-placement, Mr Hopper has plenty of skin in the game and is about to add some more dermis.

Dr Boreham’s diagnosis:

While Chimeric has a few clinical irons in the fire to pique investor interest, any hopes of a lucrative short-term payday have been dashed.

Chimeric certainly doesn’t look like being a repeat of Mr Hopper’s immune-oncology play Viralytics, acquired by Merck & Co in 2018 for $502m.

(By the way, last October Merck quietly ditched Viralytics' key drug candidate, the melanoma treatment Cavatak as part of its "routine pipeline prioritization.")

Ms Chow notes that cell therapies are expected to be the fastest-growing cancer sector in the next decade, growing from a $US1bn market in 2020 to around $US22bn by 2030 (a compound annual growth rate of 21%).

Martin Luther King Jr once said: "We must accept finite disappointment but we must never lose infinite hope."

And while he probably wasn't talking about the Australian biotechnology sector, Chimeric holders should draw some comfort from the longer-term potential.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. We only mention that because a 'fake medico' accusation would really sting.

This column first appeared in Biotech Daily

www.biotechdaily.com.au

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 19-05-23

By Mark Woodruff

Guide:

The FNArena database tabulates the views of eight major Australian and international stockbrokers: Citi, Bell Potter, Macquarie, Morgan Stanley, Morgans, Ord Minnett, Shaw and Partners and UBS.

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

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

Summary

Period: Monday May 15 to Friday May 19, 2023
Total Upgrades: 10
Total Downgrades: 11
Net Ratings Breakdown: Buy 57.63%; Hold 33.74%; Sell 8.63%

For the week ending Friday May 19 there were ten upgrades and eleven downgrades to ASX-listed companies by brokers in the FNArena database.

A review of the target price and earnings tables below shows a positive week for accounting software firm Xero and Avita Medical, while agricultural names Elders and Incitec Pivot experienced negative reviews by analysts.

Following FY23 results that exceeded expectations, Xero appeared atop the tables for both the largest percentage increase in average target price and forecast earnings by the six covering brokers in the database.

Morgan Stanley now has the highest target price of the six after an increase to $125 from $100. It’s felt actions by the new CEO have been decisive and make strategic sense, which in turn has started to de-risk the outlook for equity holders.

In particular, the broker praised management’s new commitment to further cost reductions. The technical team's efficiency program is expected to finish by July, and, as a result, Citi envisaged upside risk to margin guidance based on current top-line trends.

After an around 20% share price rally in the last few months, Morgans lowered its rating to Hold from Add, while also raising its target to $101 from $97.

One of Xero’s key performance metrics is the “rule of 40”, which tries to strike a balance between growth and profitability by targeting the revenue growth and free cash flow margin percentage to total at least 40%.

Ord Minnett estimated the total has hovered around 30% in the last five years and will remain at a similar level for the next decade. A Sell rating is retained though the target was increased by 10% to $66.

Avita Medical came second behind Xero for percentage increase in target price and fifth on the list for increase in average forecast earnings by brokers after achieving March quarterly guidance and maintaining full year revenue guidance.

For broker opinions on the result and some potentially exciting upcoming share price catalysts please refer to: https://www.fnarena.com/index.php/2023/05/17/avita-medical-preps-for-enlarged-us-opportunity/

On the negative side of the ledger, Elders topped the list for the largest percentage decrease in average target price (-25%) and forecast earnings, after five covering brokers in the database updated research.

First half results reflected a volatile agricultural backdrop impacted by weaker livestock trading conditions, softer crop input prices and unseasonably wet weather, explained Macquarie, which downgraded its rating to Neutral from Outperform and lowered its target to $7.77 from $14.35.

The earnings margin fell to 5.0% from 8.8% and the return on capital (ROC) declined to 16.9% from 27.8% in the previous corresponding period.

While FY23 earnings guidance was a -5% miss against the consensus forecast, it met the prior forecast by Neutral-rated UBS, suggesting an uptick in the September half. Shaw and Partners (Buy) felt achieving this guidance will be assisted by the positive outlook for the Australian winter crop.

Incitec Pivot was second behind Elders for percentage fall in average target price last week and fourth on the earnings downgrade table.

While the company's first half results materially missed consensus expectations, largely due to a significant fall in fertiliser prices over recent months, some brokers see value on offer. More details are available from: https://www.fnarena.com/index.php/2023/05/18/incitec-pivot-misses-expectations-demerger-pending

NextDC was second on the table for lower forecast earnings after Ord Minnett updated its research for a $618m equity raising at $10.80 per share, which was announced in the previous week.

Funds raised will be used for new data centre developments in Kuala Lumpur and Auckland, together with the accelerated data hall fit-out in the third Sydney centre. Management is also evaluating Singapore and Tokyo as potential markets.

Returning to positive earnings upgrades last week, the SaaS industry group was well represented with increased forecasts for Serko, Tyro Payments and Appen.

Following FY23 results, Ord Minnett suggested the market has overlooked the likes of expense management company Serko (that may evolve into a serious player in its industry) in taking a broadly negative approach to long-duration growth assets that have been generating negative free cash flow.

The loss for the period was smaller than expected and the broker forecast Serko will be generating material free cashflow of $35m by FY26.

When contemplating revenue growth of 40% and falling cash burn, Buy-rated Citi suggested the current valuation was undemanding and raised its target to $4.10 from $3.60, while Morgans upgraded its rating to Outperform from Neutral on what was considered a quality beat for the Booking.com joint venture.

Booking.com offers and promotes Serko's travel booking and expense management tool Zeno to its business traveller customers, while Booking.com content is displayed on Zeno.

Macquarie raised its earnings forecast and upgraded its rating for Tyro Payments to Outperform from Neutral following a third upgrade to FY23 guidance, which eased concerns around management's ability to manage a weaker consumer demand environment.

Brokers also raised earnings forecasts for Appen, which raised $600m in equity to provide balance sheet flexibility and help fund one-off costs associated with its previously announced cost reduction program.

Bell Potter upgraded its rating to Hold from Sell, noting no requirement for the company to take on debt or do another capital raising for at least the next three years.

Total Buy recommendations in the database comprise 57.63% of the total, versus 33.74% on Neutral/Hold, while Sell ratings account for the remaining 8.63%.

Upgrade

APPEN LIMITED ((APX)) Upgrade to Hold from Sell by Bell Potter .B/H/S: 0/1/3

Bell Potter updates forecasts to allow for the capital raising that Appen announced. There are no changes to underlying revenue and EBITDA forecasts.

Modest reductions in forecast losses are made and the broker has removed the borrowings it previously assumed would be drawn in 2023 and 2024.

Bell Potter envisages no need for the company to take on debt or do another capital raising for at least the next three years.

Rating is upgraded to Hold from Sell and the target increases to $2.20 from $2.05. The broker suspects the main negative catalysts have now passed.

AVITA MEDICAL INC ((AVH)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/0/0

As the share price of Avita Medical has moved through the trigger level, Ord Minnett upgrades to Accumulate from Hold. Target is $5.60.

BEACH ENERGY LIMITED ((BPT)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/1/1

Following the withdrawal of guidance relating to Waitsia and a -10% decline in the share price since April, Citi assesses the impact is minimal and upgrades to Buy from Neutral.

The broker expects a three-month delay at Waitsia and an extra -$30m in capital expenditure, a smalll dent in valuation.

Meanwhile, Waitsia 2P is being audited and may be updated prior to the August results, providing a catalyst. The Trigg-1 exploration results are also imminent. Target is reduced to $1.65 from $1.70.

CHARTER HALL GROUP ((CHC)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/1/0

Citi upgrades its rating for Charter Hall to Buy from Neutral on evidence of rebounding transaction activity for office assets. Also concerns have been dissipating on further downside to office values and further downside for FY24 consensus estimates.

These FY24 consensus estimates are likely to be supported by a further recovery in transaction activity and a rising CPI (20% of platform income CPI-linked), in the analyst's view.

Citi also sees upside to FY25 earnings on performance fees.

The target falls to $14.60 from $14.80.

INCITEC PIVOT LIMITED ((IPL)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/3/0

Despite a negative share price reaction yesterday, first half underlying profit for Incitec Pivot was slightly ahead of Ord Minnett's forecast. The interim dividend of 10cps also exceeded the 9cps anticipated and the broker highlights the attractive yield on offer.

A strong margin performance from Dyno Nobel Americas countered softer-than-expected margins across other segments, explains the analyst.

Management noted a favourable 2H skew for underlying earnings, without producing any numbers.

Ord Minnett upgrades its rating to Accumulate from Hold and maintains its $3.50 target price.

See also IPL downgrade.

POINTSBET HOLDINGS LIMITED ((PBH)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/0/0

Ord Minnett bypasses an Accumulate rating and upgrades PointsBet Holdings to Buy from Hold after the "'bold call" to sell its US business. The target is also raised to $1.70 from $1.45.

The company has entered into a binding agreement with Fanatics Betting and Gaming to sell its US operations for US$150m though PointsBet will need to fund up to -US$21m up to transaction close after the late-June shareholder meeting.

The net proceeds will likely be distributed to shareholders, along with excess capital, in two tranches, explains the broker. It's felt around $30-40m will remain on the balance sheet of the remaining Australian and Canadian business.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Lighten from Sell by Ord Minnett .B/H/S: 3/2/0

As the share price of Premier Investments has moved through Ord Minnett's trigger level, its rating is upgraded to Lighten from Sell.

The broker's target price remains at $19.

SERKO LIMITED ((SKO)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/0/0

After some trepidation, the market should read Serko’s FY23 result as a quality beat for the Booking.com JV, Macquarie suggests. The final instalment of development workaround the hotel shop experience is scheduled to go online in the September quarter.

Investors will likely also take comfort in healthy cash balance/burn and cash flow breakeven within reach.

While slower than the broker had originally anticipated, the result provided some comfort that the JV funnel is working well, leading to an upgrade to Outperform from Neutral.

Target rises 32% to NZ$3.51.

TECHNOLOGY ONE LIMITED ((TNE)) Upgrade to Buy from Hold by Bell Potter .B/H/S: 1/4/0

Bell Potter upgrades TechnologyOne's rating to Buy from Hold ahead of the company's interim FY23 results on May 23, expecting a good result (including a 10% increase in the interim dividend to 4.62c).

The broker's eye is peeled to total annual recurring revenue, which it expects will have grown 21% to $350m, putting it on track to meet its $500m target by 2026 (although Bell Potter now believes it will meet that goal by the end of FY25) and expects management to guide to such by the end of 2023.

Target price rises 6% to $17.

TYRO PAYMENTS LIMITED ((TYR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/1/0

Tyro Payments has upgraded FY23 guidance for the third time, with each upgrade derived from a different source (costs, volumes, margin/pricing), Macquarie notes. FY23 earnings guidance is up 8% compared to the latest update and materially above initial guidance.

Increased pricing increases churn risk, the broker warns, however the competitive environment has likely eased more recently with less funding for start-ups looking to take share.

Upgrades demonstrate evidence of Tyro effectively controlling the controllables, which gives Macquarie more confidence on the ability to manage a weaker consumer demand environment. Upgrade to Outperform, target rises to $1.80 from $1.65.

<u>Downgrade</u>

EAGERS AUTOMOTIVE LIMITED ((APE)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/3/0

Macquarie welcomes the FY23 revenue guidance of $9.5-10bn, as it was ahead of expectations, although recent delays at ports and subdued Toyota volumes present some downside risk.

The broker suspects achieving guidance will be contingent on total market volumes accelerating in the second half.

Although BYD Co could provide material upside for Eagers Automotive through the joint venture, longer term aspirations are likely to face competition, the broker asserts. Rating is downgraded to Neutral from Outperform and the target lowered to $15.00 from $15.50.

ELDERS LIMITED ((ELD)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/4/0

Elders reported first half underlying profit of $51m, below Macquarie's $56m forecast. The company expects FY23 earnings to be $180-200m, with the midpoint -18% below FY22 but 14% above FY21 and -13% below the broker's prior forecast.

The first half saw a volatile agricultural backdrop impacted by softened livestock trading conditions, weaker crop input prices and unseasonably wet weather.

Operating cashflow was weak reflecting seasonal inventory build which is expected to unwind in the second half. The broker has changed analysts and downgraded to Neutral from Outperform, warning of possible El Nino development and uncertainty over a new CEO.

Target falls to $7.77 from $14.35.

FINEOS CORPORATION HOLDINGS PLC ((FCL)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 3/1/0

As the share price of Fineos Corp has moved through the trigger level Ord Minnett downgrades to Accumulate from Buy. Target is $3.40.

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Hold from Add by Morgans .B/H/S: 3/3/0

Incitec Pivot's 1H result materially missed consensus expectations largely due to a significant fall in fertiliser prices over recent months, which Morgans thinks will likely decline further in the near term.

Corporate costs were also materially higher than expected and interest costs rose. The broker lowers its target to $3.29 from $4.55 and the rating is downgraded to Hold from Add.

The analysts also list other 1H headwinds including third party gas supply issues at Phosphate Hill, the closure of Gibson Island in January, unfavourable currency hedging on fertiliser sales and extreme weather also impacted Dyno North American explosives volumes.

See also IPL upgrade.

NEWCREST MINING LIMITED ((NCM)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/5/0

Macquarie expects the deal for Newcrest Mining shareholders to receive 0.4 Newmont shares and a $1.10 dividend will be completed and thus drops its target to $30 from $33 to roughly match the offer (which remains subject to Newmonth share price movement) and pulls back to Neutral from Outperform.

Newcrest anticipates a shareholder vote will be held in September or October 2023 with implementation of the scheme expected by the end of the year.

NORTHERN STAR RESOURCES LIMITED ((NST)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 4/1/1

Ord Minnett slightly reduces estimates for FY23-25 earnings, noting the March quarter result was softer than expected. Still, Northern Star Resources remains the pick among large gold stocks when considering growth, balance sheet, capital management and valuation.

The KCGM mill optimisation, due by the end of the year, is considered a key catalyst. Ord Minnett retains a target of $14.20 but reduces the rating to Accumulate from Buy.

REA GROUP LIMITED ((REA)) Downgrade to Hold from Add by Morgans .B/H/S: 1/2/1

Following a 3Q trading update by REA Group, Morgans raises its target to $145 from $133 and downgrades its rating to Hold from Add on valuation. The update indicated a tougher quarter, particularly in terms of listings volumes, which remain subdued.

The new target also takes into account a valuation roll forward and higher medium-term volume growth, as the analyst expects volumes will begin to recover from Q2 FY24.

The broker also highlights solid revenue growth for REA India, which increased by 63% on the previous corresponding period.

REGION GROUP ((RGN)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/4/0

Morgan Stanley estimates asset level expense for a typical mall will escalate by around 8% next year, due to big increases for insurance, energy, and statutory charges. Administration, security, cleaning, and repairs could also experience 4-5% cost escalation.

The analyst points out landlords generally pass through 30-50% of mall operating expenses to the occupiers.

While the likes of Scentre Group ((SCG)) and Vicinity Centres ((VCX)) recover around 50% of costs from occupiers, the broker notes Region Group only recovers around 30%.

Anchor tenants, who dominate Region's neighbourhood centres, don't pay cost recoveries, explains Morgan Stanley. The rating is downgraded to Equal-weight from Overweight and the target falls to $2.70 from $2.95.

TPG TELECOM LIMITED ((TPG)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 3/2/0

Morgan Stanley questions whether the market is under-estimating the displacement of legacy telco revenue by cloud-based software.

The broker suspects a shift in wallet share is occurring towards software vendors from large telcos, especially in fixed-line enterprise products, and as a result envisages earnings headwinds for TPG Telecom.

The broker makes reductions to EBITDA estimates of -2-7% for 2023-24. Rating is downgraded to Equal-weight from Overweight and the target lowered to $5.60 from $7.70.

UNITED MALT GROUP LIMITED ((UMG)) Downgrade to Neutral from Buy by UBS .B/H/S: 0/4/0

United Malt's first half earnings were slightly ahead of recently downgraded guidance while FY23 guidance was reaffirmed. This was underpinned by improved demand and margins, although UBS is conservative and forecasts the lower end of the EBITDA range of $140-160m.

A strong recovery is expected in FY24. The broker downgrades to Neutral from Buy after lifting the target to Malteries Soufflet's indicative bid price of $5.00, from $3.80.

XERO LIMITED ((XRO)) Downgrade to Hold from Add by Morgans .B/H/S: 3/2/1

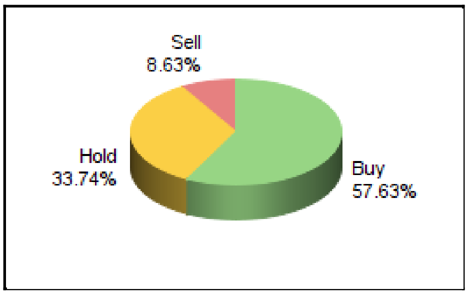
Morgans assesses Xero displayed financial resilience over FY23 and expects this to continue into FY24. A "good" FY23 result revealed year-on-year revenue and subscriber growth of 28% and 14%, respectively, and 8% higher average revenue per user (ARPU).

A highlight for the analyst was an impressive rise in free cash flow to around NZ$102m.

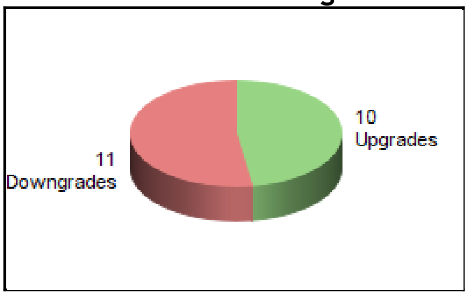
Management didn't provide any subscriber growth targets though expects to deliver revenue growth from a combination of subscriber and ARPU growth.

After an around 20% share price rally in the last few months, Morgans lowers its rating to Hold from Add, while the target rises to $101 from $97.

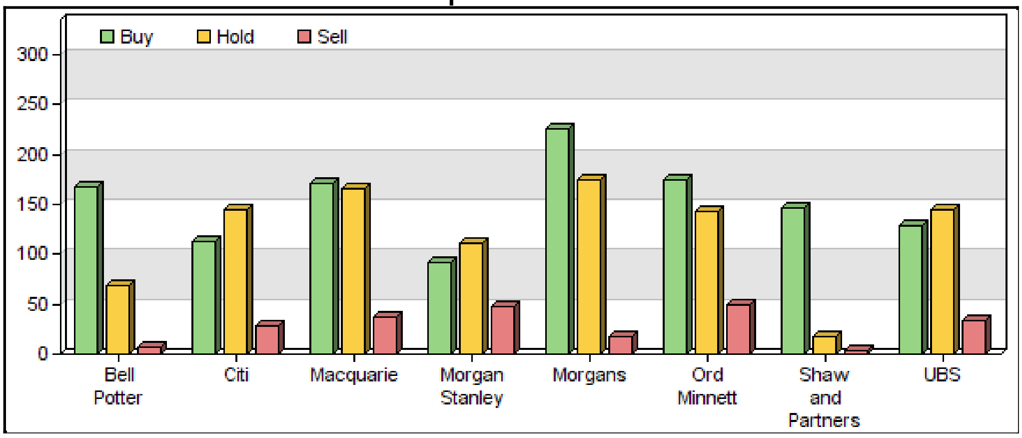
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	APPEN LIMITED	Neutral	Sell	Bell Potter
2	AVITA MEDICAL INC	Buy	Neutral	Ord Minnett
3	BEACH ENERGY LIMITED	Buy	Neutral	Citi
4	CHARTER HALL GROUP	Buy	Buy	Citi
5	INCITEC PIVOT LIMITED	Buy	Neutral	Ord Minnett
6	POINTSBET HOLDINGS LIMITED	Buy	Neutral	Ord Minnett
7	PREMIER INVESTMENTS LIMITED	Sell	Sell	Ord Minnett
8	SERKO LIMITED	Buy	Neutral	Macquarie
9	TECHNOLOGY ONE LIMITED	Buy	Neutral	Bell Potter
10	TYRO PAYMENTS LIMITED	Buy	Neutral	Macquarie
Downgrade				
11	EAGERS AUTOMOTIVE LIMITED	Neutral	Buy	Macquarie
12	ELDERS LIMITED	Neutral	Buy	Macquarie
13	FINEOS CORPORATION HOLDINGS PLC	Buy	Buy	Ord Minnett
14	INCITEC PIVOT LIMITED	Neutral	Buy	Morgans
15	NEWCREST MINING LIMITED	Neutral	Buy	Macquarie

16	NORTHERN STAR RESOURCES LIMITED	Buy	Buy	Ord Minnett
17	REA GROUP LIMITED	Neutral	Buy	Morgans
18	REGION GROUP	Neutral	Neutral	Morgan Stanley
19	TPG TELECOM LIMITED	Neutral	Buy	Morgan Stanley
20	UNITED MALT GROUP LIMITED	Neutral	Buy	UBS
21	XERO LIMITED	Neutral	Buy	Morgans

Target Price

Positive Change Covered by at least 3 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	XRO	XERO LIMITED	103.567	92.617	11.82%	6
2	AVH	AVITA MEDICAL INC	5.777	5.217	10.73%	3
3	STX	STRIKE ENERGY LIMITED	0.483	0.440	9.77%	3
4	JHX	JAMES HARDIE INDUSTRIES PLC	42.830	39.500	8.43%	5
5	AGL	AGL ENERGY LIMITED	9.556	8.986	6.34%	5
6	APX	APPEN LIMITED	1.888	1.808	4.42%	4
7	TPW	TEMPLE & WEBSTER GROUP LIMITED	4.675	4.525	3.31%	4
8	TNE	TECHNOLOGY ONE LIMITED	13.608	13.264	2.59%	6
9	NWS	NEWS CORPORATION	29.333	28.667	2.32%	3
10	SHL	SONIC HEALTHCARE LIMITED	36.044	35.244	2.27%	5

Negative Change Covered by at least 3 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	ELD	ELDERS LIMITED	8.864	11.822	-25.02%	5
2	IPL	INCITEC PIVOT LIMITED	3.432	3.820	-10.16%	6
3	TPG	TPG TELECOM LIMITED	6.010	6.430	-6.53%	5
4	HCW	HEALTHCO HEALTHCARE & WELLNESS REIT	1.687	1.800	-6.28%	3
5	BPT	BEACH ENERGY LIMITED	1.850	1.894	-2.32%	7
6	PSI	PSC INSURANCE GROUP LIMITED	5.503	5.627	-2.20%	3
7	RGN	REGION GROUP	2.692	2.752	-2.18%	5
8	PTM	PLATINUM ASSET MANAGEMENT LIMITED	1.790	1.828	-2.08%	4
9	MFG	MAGELLAN FINANCIAL GROUP LIMITED	8.824	8.984	-1.78%	5
10	NCM	NEWCREST MINING LIMITED	28.992	29.392	-1.36%	6

Earnings Forecast

Positive Change Covered by at least 3 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	XRO	XERO LIMITED	85.299	26.867	217.49%	6
2	SKO	SERKO LIMITED	-12.612	-26.435	52.29%	3
3	TYR	TYRO PAYMENTS LIMITED	0.722	0.642	12.46%	5
4	APX	APPEN LIMITED	-30.925	-34.450	10.23%	4
5	AVH	AVITA MEDICAL INC	-75.629	-84.095	10.07%	3
6	GNC	GRAINCORP LIMITED	112.080	107.000	4.75%	5
7	NWS	NEWS CORPORATION	79.336	77.201	2.77%	3
8	ALL	ARISTOCRAT LEISURE LIMITED	192.883	188.667	2.23%	5
9	WDS	WOODSIDE ENERGY GROUP LIMITED	292.339	286.757	1.95%	6
10	AGL	AGL ENERGY LIMITED	37.980	37.360	1.66%	5

Negative Change Covered by at least 3 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	ELD	ELDERS LIMITED	72.600	88.575	-18.04%	5
2	NXT	NEXTDC LIMITED	-0.317	-0.283	-12.01%	6
3	TPG	TPG TELECOM LIMITED	15.740	17.120	-8.06%	5
4	IPL	INCITEC PIVOT LIMITED	36.333	38.867	-6.52%	6
5	PTM	PLATINUM ASSET MANAGEMENT LIMITED	14.350	15.275	-6.06%	4
6	STX	STRIKE ENERGY LIMITED	-0.600	-0.567	-5.82%	3
7	QBE	QBE INSURANCE GROUP LIMITED	154.406	161.451	-4.36%	6
8	JHX	JAMES HARDIE INDUSTRIES PLC	201.092	209.880	-4.19%	5

9	REA	REA GROUP LIMITED	275.917	282.350	-2.28%	5
10	NCM	NEWCREST MINING LIMITED	140.443	143.514	-2.14%	6

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WEEKLY REPORTS

Uranium Week: Closing In On Russia

The US, UK and G7 have moved to further turn the screws on Russia, including a timeframe towards banning uranium imports in the US.

-US looking to wean itself off Russian uranium
-G7, UK announce further sanctions on Russia
-Spot market remains quiet

By Greg Peel

A bill banning Russian uranium imports to the US passed a House of Representatives subcommittee on May 16, advancing the draft legislation closer to a vote. However, the ban would not begin until 2028.

The Prohibiting Russian Uranium Imports Act also contains a provision for waivers, which would allow the import of low-enriched uranium from Russia if the US Secretary of Energy determines there is no alternative source available for operation of a commercial nuclear reactor or US nuclear energy company, or if the shipments are of national interest.

A similar bill has been referred to the Energy Committee in the US Senate.

The US is clearly in no rush to ban Russian imports as the nuclear energy industry remains reliant on Russian enriched uranium at this stage. The challenge is for the industry to wean itself off that reliance.

Hence, a Senate committee is considering legislation including a Nuclear Fuel Security Act which would establish a nuclear fuel program with the purpose of "onshoring nuclear fuel production".

The aim is to "to ensure we can meet the domestic demand of our current and future nuclear fleet, while also sanctioning Russian entities to ensure the market is not undercut by state-subsidised Russian fuel."

Greetings from Hiroshima

On the subject of sanctions, the G7 met in Japan on the weekend and announced further sanctions on Russia, restricting any exports of industrial machinery, tools, and technology useful to Russia's war effort and to stop "sanctions-busting".

The UK also announced a new wave of sanctions against Russia that affect 86 individuals and entities "connected to Russia's capacity to fund and wage the war".

The sanctions include companies connected to Russia's state-controlled nuclear energy group Rosatom, as well as directors of state-controlled energy providers, and other Russian sectors including metals production, transport services, defence companies, and banks.

Still Quiet

While uranium markets have been on edge over possible sanctions on Russian uranium imports, a bill which still needs to pass through the legislative pipeline and does not come into effect until 2028 is not spot market-moving news.

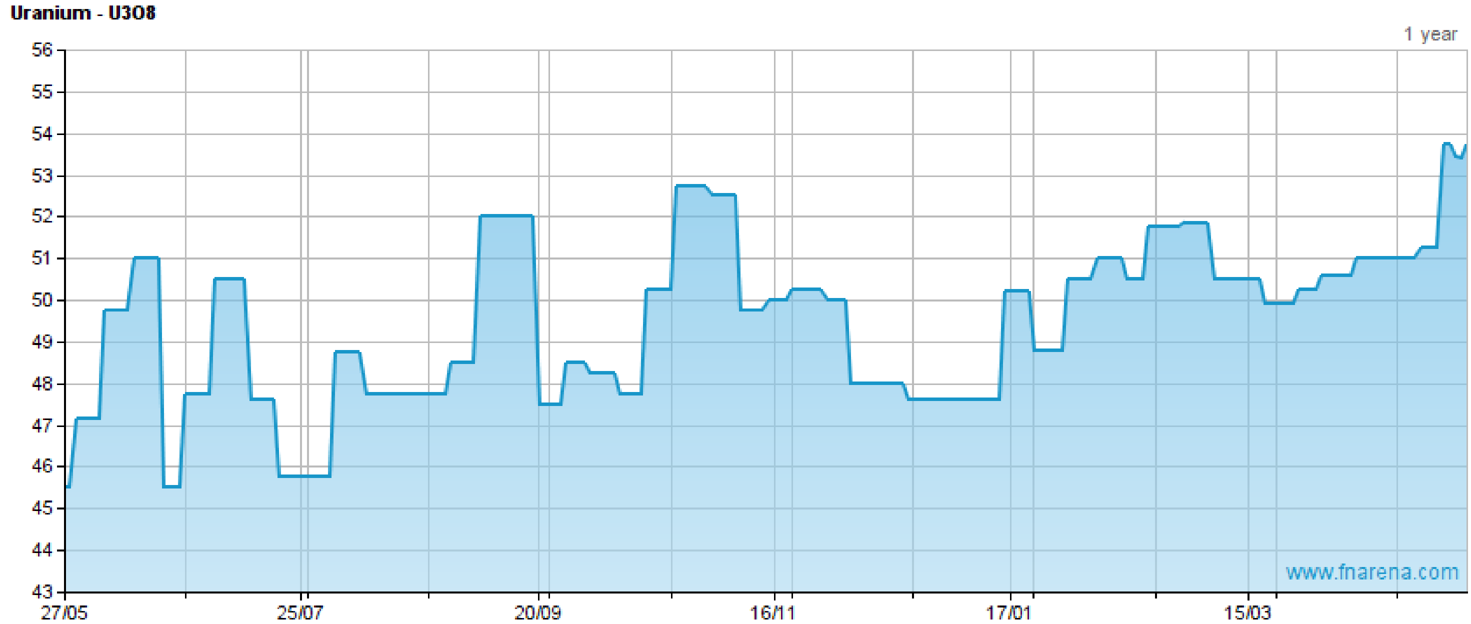
Industry consultant TradeTech reports five transactions in the spot market last week totalling 500,000lbs U3O8. Disparity of pricing continues between Europe and North American delivery but the preferred yet more expensive Canadian delivery location won out last week, taking TradeTech's weekly spot price indicator up US35c to US$53.75/lb.

There were no transactions reported in term markets.

TradeTech's term price indicators remain at US$54.00/lb for both mid- and long-term contracts.

Uranium companies listed on the ASX:

ASX CODE	DATE	LAST PRICE	WEEKLY % MOVE	52WK HIGH	52WK LOW	P/E	CONSENSUS TARGET	UPSIDE/DOWNSIDE
AGE	19/05/2023	0.0300	▼- 5.56%	$0.08	$0.03			
BKY	19/05/2023	0.3800	▲ 2.67%	$0.46	$0.25			
BMN		1.3700	▼ 0.00%	$2.49	$0.21			
BOE	19/05/2023	2.7900	▲ 2.92%	$3.03	$1.61		$3.310	▲18.6%
DYL	19/05/2023	0.6200	▲ 4.17%	$1.25	$0.48		$1.040	▲67.7%
EL8	19/05/2023	0.3200	▼-16.22%	$0.64	$0.30			
ERA	19/05/2023	0.0300	▼- 9.09%	$0.31	$0.03			
LOT	19/05/2023	0.1900	▼- 5.00%	$0.30	$0.15		$0.350	▲84.2%
NXG	19/05/2023	5.9300	▼- 3.13%	$7.51	$0.00			
PDN	19/05/2023	0.6700	▲ 3.05%	$0.96	$0.53	-19.9	$1.097	▲63.7%
PEN	19/05/2023	0.1600	▲ 3.23%	$0.22	$0.12		$0.340	▲112.5%
SLX	19/05/2023	4.0800	▲13.57%	$5.32	$1.22		$5.000	▲22.5%



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WEEKLY REPORTS

The Short Report - 25 May 2023

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

Summary:

By Greg Peel

Week Ending May 18, 2023.

Towards the end of last week, the ASX200 initially fell hard, led by Wall Street's debt ceiling fears, before rebounding sharply when Biden (prematurely) suggested optimism. The index tested support at 7200 and it held.

As I write, the index has dropped through 7200 on ongoing debt ceiling concerns and this time may struggle to hold until there is a resolution.

There was very little movement in short positions over the week.

One move was in Appen ((APX)), which I suggested in last week's report would likely fall further than the -9.6% it did, having leapt up to 10.5% shorted the week before from 5.6% after announcing a capital raising.

Raisings spur short arbitrage positions against receiving discounted stock. Clearly the process is not over yet, unless there remain those happy to stay short.

Weekly short positions as a percentage of market cap:

10%+
FLT 11.9

Out: APX, ZIP

9.0-9.9%

APX, CXO, ZIP

In: APX, ZIP, CXO

8.0-8.9%

LKE, JRV, SYA, SHV

Out: CXO, PBH

7.0-7.9%

PBH, AMA, TPW, BRG, JBH, BET

In: PBH Out: MP1

6.0-6.9%

MP1, PLS, BRN, ACL, ARB, OBL, NVX, DOW, NXT

In: MP1, OBL

5.0-5.9%

BOQ, IEL, CCP, INA, AWC, SGR, IMU, ABB, BOE, LLC, SYR, EML, WEB

In: SYR

Out: OBL, VUL

Movers & Shakers

Nothing this week.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.3	0.3	NCM	0.3	0.6
ANZ	0.6	0.8	RIO	1.3	1.2
BHP	0.3	0.3	S32	0.5	0.5
CBA	1.5	1.6	STO	1.0	1.0
COL	0.8	0.6	TCL	0.5	0.6
CSL	0.4	0.4	TLS	0.3	0.2
FMG	1.4	1.4	WBC	1.8	1.8
GMG	0.7	0.6	WDS	1.0	1.0
MQG	0.7	0.7	WES	0.9	0.8
NAB	0.9	0.9	WOW	0.4	0.6

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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WEEKLY REPORTS

In Brief: House Prices, Gambling, Mining Dividends & Insurance

Reality check on house prices; potential impact of a lower TV gambling advertising spend; global dividend payouts & usage of bots for insurance quotes.

-Recent house price rises not suggestive of a boom
-The impact of potential cuts to gambling advertising on TV
-Mining dividends slump in Australia
-Bots stalking the Australian insurance industry

By Mark Woodruff

Recent house price rises not suggestive of a boom

Despite media coverage around a recovery in house prices, feedback to Jarden from a panel of real estate agents provides a reality check.

Prices have risen by around 3% since the beginning of the year, albeit on low volumes, with little indication of another boom.

The lack of good stock on the market has been a key driver of rising prices, note the analysts. It's thought a rise in listings could well see the balance shift back to buyers.

The outlook for spring listings remains tight, with low stock likely to continue into August, but more is coming online by September.

Volumes are down around -20-30% year-on-year, with little sign of near-term improvement, suggests Jarden.

While the real estate agents expect financial stress will result in more sales, there is still a lot of uncertainty about when this will emerge and how demand and prices will react to an increase in supply.

Distressed sales are still low, though Jarden's expectations are for them to lift, particularly in Sydney's East.

Renovated family homes are highly sought after, observes the broker, while properties requiring major renovations and vacant land/development sites remain under pressure due to construction and interest costs.

The real estate agents on the panel have absorbed recent price increases by online portals REA Group ((REA)) and Domain Holdings ((DHG)), though suggest further rises may force a choice between the two, with Domain regarded as the most likely casualty.

In a sign of rising sensitivity to costs, agents are increasingly being asked by customers to either defer online payment costs or deploy an "off-market" process, observes Jarden.

The impact of potential cuts to gambling advertising on TV

Morgan Stanley examines the impact of a change in strategy by Tabcorp Holdings ((TAH)) to significantly reduce its TV advertising spend and support much tighter limits on all sports-betting advertising on TV.

Currently, both sides of the Federal Government are making public comments about wishing to tighten/reduce the amount of gambling advertising on TV.

This is likely to have negative consequences for TV broadcasters such as Nine Entertainment ((NEC)) and Seven West Media ((SWM)), suggests the broker, given the huge tailwind provided by sports betting/wagering over the last decade.

These two companies dominate sports broadcasting and have very high earnings leverage within their free-to-air (FTA) and broadcaster video on demand (BVOD) business models.

From a total $300m outlay on gambling advertisements in 2022, 50-60% was directed to the FTA and BVOD market, gauge the analysts. This spending represented around 6% of total TV advertising revenues of circa $3.2bn for the period.

The balance of the $300m was largely spent across digital (20%), with radio and outdoor accounting for around 10% and 5%, respectively.

To be clear, Morgan Stanley has made no changes to base case earnings estimates or valuations for either Nine Entertainment or Seven West Media. This inaction is due to uncertainty over Tabcorp-specific changes or any government changes to overall rules.

That said, after making a raft of assumptions and assuming no offset/compensation is provided by the government to the TV industry, the broker judges a potential loss of advertising revenue for both companies could be in the range of -$12.5m-$32m apiece.

Potentially lessening the blow, any reduction in TV licence fees/broadcasting tax paid could reduce the bottom-line impact, note the analysts. The TV industry is estimated to have paid around $50m in licence fees/broadcasting taxes to the Australian government last year.

Morgan Stanley retains its Overweight rating for Nine Entertainment and Underweight recommendation for Seven West Media.

Mining dividends slump in Australia

Due to the largest contribution from special dividends in nine years, global dividends jumped by 12% on a headline basis to a first-quarter record of US$326.7bn.

Janus Henderson's Global Dividend Index shows Ford and Volkswagen accounted for almost a third of the world's special dividends in the period, while the Transport, Oil and Software sectors also contributed strongly.

Unfortunately, Australian dividends failed to match the global trend and fell by -6.6% in the first quarter, largely due to a heavy concentration of mining companies, afflicted by lower commodity prices and variable dividend policies.

The weakness in Australia and emerging markets due to lower mining dividends, and a seasonal bias towards slower-growing Switzerland also helped lower the growth rate in the first quarter, explains Janus Henderson. This weakness was countered by headline growth of 8.3% in the US.

The highly seasonal nature of dividends in most parts of the world means the first quarter is dominated by the US, where payouts are spread more evenly through the year.

BHP Group ((BHP)) was the world's largest dividend payer in 2022, but reduced its first quarter dividend, as did Fortescue Metals ((FMG)), while Rio Tinto ((RIO)) sharply reduced its second quarter payout.

The underperformance in Australia occurred despite CommBank ((CBA)) raising its dividend by 20% and growth from most other companies making dividend payments in the first quarter, notes Janus Henderson.

Underlying growth of 3% for global dividends was significantly slower than the headline 12% figure in the asset manager's Global Dividend Index, given this measure strips out special dividends, exchange rate effects and other technical factors.

Janus Henderson highlights a more encouraging picture for Europe than was expected three months ago, as 2022's robust profit performance is reflected in higher dividend payments.

Bots stalking the Australian insurance industry

Insurance bots, or robots, that simulate human activity, are being rolled out by insurance brokers in Australia to more broadly compare pricing for personal and commercial insurance products.

Using individual broker licences to gain access, explains Macquarie, these bots input the specific renewal details, scrape the comparison data, and then link the data with broker systems to automatically provide multiple quotes.

The first manual point of data entry required by an insurance broker is to ultimately bind the broker and customer to a mutually acceptable price and coverage terms.

Insurance Advisernet, part of AUB Group ((AUB)), has been rolled out across the group in the last six months, and has also been used by Steadfast Group ((SDF)) and PSC Insurance ((PSI)).

Macquarie points out the usage of these bots has implications for not only insurers' customer acquisition costs, but also for the business models of some technology platforms.

Over the longer-term, broking groups could gain a greater slice of total commission payments by using these bots, explains Macquarie. This outcome would be achieved if flows were directed towards their own platforms away from the likes of the Sunrise platform, owned by Ebix Australia, which charges fees per quote.

In FY22, Macquarie estimates around 36% of gross written premiums (GWP) for the SME sector were placed on insurance broker placement platforms. Around 56% of this amount was placed through Ebix's platforms, which at circa $2/quote potentially adds up to $1.6m in customer acquisition costs.

The Steadfast and AUB Group platforms, known as SCTP and ExpressCover, respectively, charge fees when the quote is bound, explains Macquarie. Hence, bots that increase the number of quotes have no impact on their revenue.

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