Week
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Cleanaway Waste Still On Top Of Recycling

Several brokers assert the share price of Cleanaway Waste has overshot on the downside as the company has high-quality earnings and substantial opportunities in waste management.

-Headwinds from China's National Sword policy and weak macro economy -Value comparisons to international peers remain favourable -Funds being retained for acquisitions and growth projects

By Eva Brocklehurst

Cleanaway Waste Management ((CWY)) attempted to soften market expectations by providing a cautious outlook with its FY19 results. However, a track record of consistently beating forecasts may have accentuated the negative share price reaction, Ord Minnett suggests.

The company took the opportunity to ease market expectations for FY20 particularly given the current market in recycling, where lower commodity prices and a lack of investment have been exacerbated by policy settings in foreign markets regarding the acceptance of contaminated recyclables.

Yet, Morgans notes, the quality of the results was high, with 100% cash conversion of operating earnings (EBITDA) and operating cash flow lifting 59%. The company expects that Toxfree acquisition synergies can also be achieved on time and on budget.

While general economic softness could be an obstacle, Ord Minnett upgrades to Accumulate from Hold, suggesting the Australian waste management industry is poised for structural change and the company remains well-positioned.

Some headwinds may persist for the near term, particularly with respect to lower volumes as the macro economy slows. Still, Cleanaway Waste has a national presence, vertical integration and significant capacity on its balance sheet and the recent sell-off is considered overdone.

Morgans also upgrades, to Add from Hold, agreeing the share price has overshot on the downside. Each business segment benefited from the acquisition of Toxfree and the company asserts that, excluding the Toxfree acquisition, organic growth of 10.7% was achieved in the second half.

UBS agrees the stock offers defensive characteristics, calculating the added benefit of Toxfree synergies will deliver incremental earnings (EBIT) growth of 7% and 2% in FY20 and FY21 respectively.

A softer economy and the issues with China National Sword are weighing but Macquarie finds an opportunity still exists, as valuation comparisons to international peers remain favourable and the stock offers a unique exposure to the Australian waste industry.

Credit Suisse is more cautious, highlighting that management refrained from reiterating margin targets, suspecting this stems from lower prices for recyclable commodities and higher sorting costs. Taking in accounting standard changes, the broker cuts FY20 estimates for earnings per share by -14%. Credit Suisse believes market conditions require a discounted valuation and incorporates a -10-15% discount to multiples, downgrading to Underperform from Neutral.

National Sword

China's National Sword policy, which contains higher specifications for the purity of imported recyclable waste, has resulted in increased sorting costs and variability in pricing for recyclable commodities.

The company anticipates this will be mitigated through price increases. However, Credit Suisse suspects Cleanaway Waste is struggling to obtain these price increases because of softer economic conditions and potentially higher levels of competition.

The broker was previously of the view that the business had relatively low exposure to the travails in the broader economy, but it appears that around 10% of the commercial & industrial business is based on on-demand waste collection services rather than regular scheduled services.

Macquarie notes management's assessment of the negative impact of China National Sword appears to have swelled to -$5-6m from the -$1m originally forecast in February, pointing out that, since February, old corrugated cardboard prices have halved.

Funds For Growth

Morgans had thought Cleanaway Waste would undertake some form of capital return but management instead chose to retain funds on the balance sheet for acquisitions and growth projects. The company has indicated it will be considering the Victorian SKM recycling business which is gone into voluntary administration.

Cleanaway Waste has around $318m in headroom under its existing banking facilities and has no intention of changing its pay-out ratio, Macquarie notes, ahead of the tapering in landfill remediation cash flows which starts in FY21.

The broker anticipates a path to solid investment-led growth in recycling, alternative treatment and disposal projects. The company is integrating a healthcare bolt-on to the Daniel's sharps management solutions, which brings a plastic container manufacturing capability to the business.

The ResourceCo joint venture is also ramping up the extraction of processed engineered fuels, although this is been slowed by the ability to sell the fuel into south-east Asian markets, where waste bans affected import processes.

These issues are being resolved which should mean the JV will make a positive contribution in FY20, Macquarie suggests. ResourceCo is a global operator focused on recovering resources to manufacture recycled materials and alternative fuels.

The broker sees a substantial opportunity in the downstream processing of waste streams and considers this would be a logical addition to the company's value chain. The remediation of the Clayton landfill is on track for a step down in cash outflow going into FY21.

FNArena's database shows three Buy ratings, one Hold (UBS) and one Sell (Credit Suisse). The consensus target is $2.25, signalling 5.7% upside to the last share price. Targets range from $1.85 (Credit Suisse) to $2.60 (Macquarie).

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Less Gold In The Pan For Newcrest

Newcrest Mining is likely to face several years of falling gold production as Cadia grades decline, and a delay at Wafi Golpu raises doubts over whether this development will compensate.

-Large capital expenditure requirement to develop Cadia underground -Delays raise doubts over whether Wafi Golpu will be next major growth project -Volatility in global markets driving increase in gold price, stocks

By Eva Brocklehurst

The Cadia mine has passed its peak. The impending decline of gold grades at this top performing asset was starkly laid out by Newcrest Mining ((NCM)) in the FY19 results. Unfortunately, brokers suspect delays and expenditure requirements at replacement assets are likely to mean an earnings hole opens up. The company reported its lowest annual costs per ounce (AISC) in FY19 after a record year of production at Cadia.

Newcrest has completed the acquisition of its 70% interest in Red Chris and will operate the mine in surrounding tenements in British Columbia, Canada, and aims to unlock significant value in applying its technical expertise in block caving. The mine has potential to host a higher grade deeper block-caving opportunity, but the near-term focus is on achieving operating improvements to stop the cash burn.

Newcrest will provide a briefing on August 21 and Macquarie looks for some clarity on the near-term outlook for Red Chris. Red Chris provides a large-scale development opportunity that could offset some of the uncertainty around the development of Wafi Golpu. All up, UBS assesses Newcrest Mining is a growth stock rather than the yield play as there are many capital projects that are yet to be executed.

Cadia

Macquarie suggests Newcrest is on the cusp of a multi-year trough in production. Expenditure to fully develop the Cadia underground is in the order of US$6.9bn and this, the broker asserts, is being overlooked by the market. Credit Suisse agrees that the capital holiday has ended, citing, in the near term, the US$540m that is required to build the next cave for first production in FY22.

Cadia is being affected by lower grades ahead of schedule and Shaw and Partners points out there is a shut-down planned for the September quarter. Intensive maintenance is occurring at the SAG mill after a failure a couple of years ago.

Gold grades at Cadia are forecast to decrease to 0.6g/t by FY23 from 0.9g/t, while copper grades remain consistent. Guidance is for 760-840,000 ounces in FY20, down from the 913,000 ounces produced in FY19.

UBS expects production will decline towards 500,000 ounces in FY22. The fact that this key asset has peaked, having generated around 70% of operating earnings in FY19, is the main driver of the broker's Sell rating. UBS is of the view the major block cave potential development at Red Chris or Wafi Golpu will not change this peak production scenario until the mid 2020's.

Wafi Golpu

Political issues in PNG have stalled the development of Wafi Golpu, and the decreasing grade at Cadia as well as a cessation of Telfer and Gosowong will result in a declining future production profile for Newcrest.

This was to have been alleviated by the ramping up of Wafi Golpu, but the recent delays have put this in jeopardy. Shaw and Partners points out that the delays at Wafi Golpu are not related to Lihir, which is an operating mine.

The dispute is about allocation of royalties. Credit Suisse surmises that the ultimate capital required for Wafi Golpu could vary significantly depending on the equity arrangement with the PNG government and there are doubts over whether this will be the company's next major growth project.

Gold Upside?

The company has generated significant cash flow, through increased production and lower costs, which has allowed a significant reduction in its debt position. While the Australian dollar gold price is at recent highs, factors contributing to its appreciation remain largely unresolved, Morgans suggests.

The rapid increase in gold prices and gold miner stocks is primarily driven by the expectation that volatility will be a notable feature across global markets in the medium term. As a result, Morgans increases the value attributed to in-situ resources outside of the current mine plan.

The broker upgrades to Hold from Reduce, suspecting the factors that have caused Australian dollar gold price to rally are still unresolved and there may be further upside ahead. Citi goes the other way and downgrades to Sell from Neutral. The broker acknowledges there is upside risk if the gold price continues to move higher, but notes Newcrest Mining's share price has gained 75% over the past year.

Moreover, declining production after FY20 and the amount of capital needed to sustain earnings per shares signal to Citi the medium-term risks are to the downside.

Credit Suisse is relieved there were no additional impairments after the write-down in FY18 of the Namosi investment and the final write-down (perhaps?) of the decision in 2002 to re-invest in Telfer. The broker finds the former even more challenged at current copper prices, but acknowledges it could be an economic means of recovering the large copper-gold resource in future.

Meanwhile, Telfer's outlook is potentially more interesting, subject to continuing good exploration results at satellite Havieron. Telfer has become neutral in terms of cash consumption although this could turn negative because of redundancies and remediation.

Ore sorting trials, if successful, could postpone Telfer's closure, while the recent strength in the Australian dollar gold price supports a more positive outlook, Credit Suisse believes. Meanwhile, Gosowong's contribution has become less meaningful and the asset is unlikely to be sustained in the portfolio.

Shaw and Partners, not one of the seven stockbrokers monitored daily on the FNArena database, has a Hold rating and $30 target. The database has five Sell ratings and one Hold (Morgans) with a consensus target of $26.84 that signals -24.1% upside to the last share price. Targets range from $20.30 (Credit Suisse) to $33.71 (Morgans).

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Superior Technology Puts Netwealth Ahead

Netwealth Group is likely to benefit from wealth advisers seeking its specialist platform and technology, although further reductions in official cash rates loom as a risk.

-Outlook for net flows "in excess of $7bn" for FY20 -Downside risk to revenue and pricing if official cash rates head lower -Leveraging superior technology should allow for protection of margins

By Eva Brocklehurst

The specialist platform market may be volatile and prevailing economic conditions uncertain yet Netwealth Group ((NWL)) has not been deterred, achieving record flows and strong growth in earnings while absorbing any price pressures. Pricing pressures grew last financial year when BT Panorama re-set its rates.

The company expects funds under administration (FUA) to exceed $30bn by the end of FY20, assuming no adverse impact from financial markets, and will be looking to reinvest in order to sustain its leadership position with advisers rather than pursue margin gains.

The outlook for net flows is "in excess of $7bn" which, UBS surmises, assumes existing advisers continue to add around $4bn per annum from new member accounts and new adviser wins add around $3bn.

Assuming normalised market returns this, in turn, implies average funds under management (FUM) could lift by around 35%. However, allowing for heightened revenue margin pressures and fee compression, UBS suspects a 20% lift is more likely.

UBS upgrades to Neutral from Sell, assessing net flows are sustainable and the downside risks have eased. The broker considers Netwealth is now be in a better position to absorb ongoing revenue margin pressures.

This is particularly the case if new third-party platform competitors emerge or further cuts to official rate cuts put pressure on cash account spreads. Ord Minnett assesses future benefits will stem from advisers seeking boutique licensing and adopting open product lists as well as innovative technologies.

The broker forecasts growth in earnings per share (EPS) to compound over the next five years at 23% per annum and upgrades to Buy from Accumulate. Morgans, on the other hand, is sticking with a Hold rating, preferring a higher "margin of safety" before taking a more positive view, as the stock is trading on elevated near-term valuation metrics.

Credit Suisse is confident the company can continue to grow earnings, forecasting FY20 flows of $7.25bn. The growth profile may not be quite as high as once envisaged, because of pricing pressure, but growth of 15-20% in EPS is still expected over the next three years.

In the first quarter the ANZ Private account will transition onto Netwealth platforms, which the broker estimates to be worth around $800m, although it could be up to $2.5bn. Any further wins from large institutions remain an upside risk.

Citi expects net flows to pick up in FY20, driven by market share gains and an improvement in adviser activity levels but also envisages downside risks to overall industry pricing, particularly as official cash rates head lower.

Leveraging Technology

Netwealth is introducing a range of software-as-a-service style pricing for services that are not readily available from other investment platforms in the market and Bell Potter believes this should enable the company to protect its margins. Morgans agrees it makes sense for Netwealth to monetise its superior technology.

Yet Macquarie speculates whether a company with 2.5% market share and strong growth needs to diversify its revenue streams and build out the platform. The broker also highlights the potential risk of further reductions to the Reserve Bank cash rate as, when these are passed on, the total cost to the client goes up.

Margins

Citi considers revenue margins are likely to be lower going forward, reflecting the skew towards clients with higher balances and the reduction in the official cash rate. Still, guidance for operating earnings (EBITDA) margins to be

slightly lower than FY19 appears conservative, and the broker forecasts an expansion of 20 basis points to 52.4% in FY20.

Cash margin revenue can be sustained above an official cash rate of 0.5%, Morgans asserts. If Netwealth were to absorb 25 basis points of margin pressure (from an official rate cut), the broker calculates this would have a negative -9% earnings impact on a full year basis.

Credit Suisse is forecasting a revenue margin decline of -7 basis points in FY20, partly because the ANZ Private business is very low margin and partly from competition.

While market noise may be focused on revenue margins, cash spreads and competition, Ord Minnett points out structural momentum should still mean both funds under administration and profit quadruple over the next eight years.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, has reiterated a Buy rating and $10.14 target. The database has one Buy rating (Ord Minnett), four Hold and one Sell (Macquarie). The consensus target is $7.68, suggesting 1.0% upside to the last share price. This compares with $8.15 ahead of the results. Targets range from $6.20 (Macquarie) to $8.95 (Ord Minnett).

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BlueScope's North Star Expansion Compelling

An unfavourable earnings impact dents the first half outlook for BlueScope Steel, although most of the negatives should reverse and brokers welcome the approval of the North Star expansion.

-Soft outlook overshadows approval of North Star expansion -Will steel spreads improve sufficiently to buoy the stock? -North Star expansion viewed favourably

By Eva Brocklehurst

Disappointing guidance is the hallmark for the first half of FY20 for BlueScope Steel ((BSL)), although improved sentiment has been noted amid demand stemming from infrastructure projects. A modest overall pick-up in volumes is expected, helped by re-stocking.

Nevertheless, earnings are likely to be softer in the first half because of an unfavourable impact from export pricing, lower coke export earnings and blast furnace instability in the the Australian Steel Products business.

First half guidance is for a -45% decline in earnings, half on half, implying around $275m in EBIT. Citi expects most of the negative factors should reverse and forecasts second half earnings of $396m while Ord Minnett also suspects guidance errs on the conservative side.

Credit Suisse acknowledges the pain in being wrong-footed by guidance. In the case of BlueScope Steel, the broker points out, minor exposures within segments can cause a major variance to earnings when there are extreme price moves that are not obvious.

For example, BlueScope Steel consistently exports around 150,000t per half year to the US. The collapse in US steel prices from one half to the other could mean a -US$180/t reduction in average pricing on 150,000t, creating a -$35-40m impact on earnings for an exposure that is not closely watched by the market.

In addition, UBS notes the share of value-added production sold domestically declined in the June half by -7%, in line with the slump in detached housing, while the shift to exports contributed to a lower earnings margin of 7% versus 11% in the first half.

Housing approvals may have troughed, but the broker suspects it will take 6-12 months before activity bottoms, which adds downside risk to margins outside of steel spreads - the difference between the raw material price and finished product.

The results mark the peak earnings in this cycle, Citi agrees while noting the balance sheet is strong and there is growth from the North Star expansion. North American operations were affected by the fall in steel prices, and customers de-stocked as a result. Re-stocking has now commenced in the US, the broker points out, and should emerge in Australia.

The soft outlook overshadowed the announcement the board had approved the North Star expansion. The project offers medium-term growth and, given a share buyback is due to re-start, Citi recommends buying the dip in the stock price.

Morgan Stanley agrees that the focus is now on cash flow and further capital management, although further upside in steel spreads may be required to reach its $14 price target, and the softer guidance does diminish the upside potential.

In contrast, Credit Suisse does not envisage sufficient improvement in steel spreads, volumes or coke prices to motivate new buyers of the stock.

North Star

Ord Minnett suggests investors should look at the expansion of North Star favourably, noting that around 70% of the costs of the project is already sitting in the bank. The broker does not envisage risks to the ability to fund the required $1bn over three years for the expansion, despite weakness in steel margins and the softer outlook.

The company has approved the US$700m expansion of the mini mill which should lift capacity by 43% to 3.0mt. Completion is expected by mid FY22. A further potential increase to 3.5mtpa was reaffirmed, subject to de-

bottlenecking of the hot strip mill. If this incremental expansion were to progress, Citi assesses overall expenditure per tonne would improve significantly.

Supply and demand is expected to be balanced in North Star's region and the company is targeting a minimum 15% return on invested capital based on long-term historical spreads of US$250-300/t.

The close proximity to both scrap suppliers and customers provides a freight advantage at North Star, Citi asserts, and the ability to continuously run the facility at full capacity ensures operations are maximised. Citi reiterates a Buy rating and includes the North Star expansion in its forecasts. At the 15% return target, operating earnings (EBITDA) improve by around $180m per annum from FY24. in the broker's calculation.

The company has written down a -$64m impairment related to the business in Thailand and remains focused on cutting costs. BlueScope Steel has conceded a mistake in assessing the Thai home appliance market. This appears more likely to be 100,000tpa as opposed to the prior expectations for 400,000tpa, largely because of heavy imports from China. This miscalculation has resulted in the idling of the older plant.

Higher raw material costs from coal, scrap and alloys as well as electricity and freight prices drove a material decline in profitability in the NZ and Pacific steel business in FY19. Credit Suisse remains concerned about the NZ business and its seeming dependence on elevated vanadium credits to generate an acceptable return.

There are four Buy ratings, one Hold (UBS) and one Sell (Macquarie, yet to update on the results) on FNArena's database. The consensus target is $13.61, suggesting 13.9% upside to the last share price. Targets range from $11.15 (Macquarie) to $15.30 (Credit Suisse).

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Margins Colour McMillan Shakespeare's Outlook

Brokers say McMillan Shakespeare could outperform as car leasing and salary packaging businesses continue to grow.

-Investment in Beyond 2020 program to help expand margins -Increased automation will add to margin expansion -Novated leasing volumes have proven to be very resilient in the face of falling new vehicle sales. -NDIS administration unit Plan Partners posts first profit, with momentum going into FY20

By Nicki Bourlioufas

Shares in car leasing and salary packaging company McMillan Shakespeare ((MMS)) jumped after the company announced an $80m share buyback and rise in net profit after tax (NPAT).

Analysts are upbeat on the company's earnings outlook, expecting margin expansion driven by the company’s Beyond 2020 program Plan Partners expansion into the disability sector.

Net profit jumped 26.6% to $63.7m for the year to June 30, while underlying net profit, which strips out one-off items, fell -5.1% to $88.7m. While that was down, it was at the higher end of management's guidance. Group revenue rose 0.8% to $549.7m on the previous period.

The result was underpinned by strong performance in the group’s core Group Remuneration Services (GRS) business, with a 2.5% increase in salary packages and 7.4% increase in novated leasing units despite weak new car sales.

McMillan Shakespeare said it would return around $80m to shareholders through an off-market ordinary share buyback, to be funded from cash reserves. The buyback is expected to boost earnings per share (EPS), as the number of shares on issue will be reduced.

Investment in the group’s Beyond 2020 comprised $3.1m in operating expenses and $6.0m in capital expenditure for FY19, assisting to drive improved productivity and novated lease conversion rates during the year, with the full program impact to be realised in future years. The National Disability Insurance Scheme (NDIS) administration business Plan Partners recorded its first profit of $580,000, with $400,000 being the company's share.

Margin expansion expected

One of the most upbeat brokers is Citi, which says the NDIS business Plan Partners is gaining momentum will help McMillan Shakespeare achieve sustained growth in FY20 and beyond. In addition, the company's robotics and automation program will improve efficiency and margins.

Already, McMillan Shakespeare's accelerated spend as part of the Beyond 2020 program has started to deliver improved productivity and better conversion rates in novated leasing. Citi has increased its target price by 7% to $17.15 and says the resilience shown in the core novated leasing and salary packaging division “is a real reminder of the ‘acyclical’ appeal of the offering.”

Citi also notes that McMillan Shakespeare has just won a Victorian Health contract and retained six Tier 1 contracts for a minimum of three years, adding to the robustness of earnings.

Credit Suisse too is very optimistic about earnings growth and expects McMillan Shakespeare to Outperform. The broker expects the buyback to boost EPS by about 6% and has raised its target price to $16.55 from $14.00 due to higher GRS earnings.

The company has shown it can grow novated lease growth well ahead of the car market, comment the analysts. When a cyclical recovery in new car sales occurs, “MMS should be well geared to upside.” The Beyond 2020 investment too will drive future margin expansion.

Morgan Stanley also expects McMillan Shakespeare to outperform, noting the Beyond 2020 program and Plan Partners' strategy bring further upside growth potential. “Based on our normalised FY20 EPS estimate, we derive a P/E-based valuation of $15.80.”

UK Exit Would Be Welcomed

Morgan Stanley notes that if the economic environment becomes more negative, this would lead to steeper decline in new vehicle sales. Uncertainty regarding the UK's exit from the European Union could also weigh on earnings.

The net amount of assets financed grew by 11.3% across the year to nearly $1.0bn in the UK, albeit price pressure continued to impact revenue growth. McMillan Shakespeare is currently undertaking a strategic review of the UK businesses.

Macquarie observed that underlying volume growth in GRS as well as improved consumer and economic conditions provides a solid foundation for improving for margin expansion combined with investment in the Beyond 2020 program. Macquarie maintains a Neutral call on the stock with a 12-month price target of $15.64.

Ord Minnett too is sticking to its Hold rating on the stock, though it has revised higher its target price to $15.10. The broker says the UK asset management business continues to struggle, and the outlook for the next six months remains "muted". The announcement the UK operations are under a ‘strategic review’ came as a welcome piece of news to the broker.

According to FNArena's database, the consensus target price is $16.21, suggesting +3.5% upside to the last share price. Targets range from $15.10 (Ord Minnett) to $17.15 (Citi).

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Material Matters: Gold Rises, Nickel Shines, Iron Ore Suffers

Gold up on safe haven buying; base metals drop on economic uncertainty; nickel shines; China steel-making slowdown hits iron ore and metallurgical coal.

-Gold miners glitter as investors seek safe haven from economic uncertainty -Copper, aluminium, zinc sag on fears of global slowdown -Indonesia's ban on nickel ore exports buoys nickel price -Slowdown in China steel making depresses iron ore, metallurgical coal

By Nicki Bourlioufas

As the US-China trade war goes on, gold has hit its highest levels in over six years and analysts are upgrading forecasts for the precious metal. UBS now forecasts gold will reach US$1,600 in 2020-21, though the risks are skewed to the upside. It has adjusted its overall strategy towards the minerals sector, tilting towards bulk commodities rather than base metals and increasing its weighting towards gold.

UBS's moves are largely a response to the failure of the US and China to resolve their trade tensions, which have prompted a downgrade of growth expectations in both countries through 2020. Pessimism on growth has dragged down industrial metals, pushing investors into gold as a safe haven asset.

Rise of gold creates opportunities for discerning investors

UBS raised its price target for gold by +7-10% over the next 18 months, pushing its estimate to between US$1,550/oz and US$1,600/oz in 2020-21. Its favoured gold equity is Alacer Gold Corp ((ACQ)), which is still trading at a small discount to UBS's Net Present Value (NPV) calculation for the stock. "The rest of the gold space appears to us to be expensive in absolute terms, trading at or above our NPVs," UBS analysts said.

UBS gave Neutral ratings to Evolution Mining ((EVN)) and Oceanagold ((OGC)), and posted Sell ratings on Newcrest Mining ((NCM)), Northern Star Resources ((NST)) and Regis Resources ((RRL)).

In relative terms, UBS recommended Evolution for investors seeking exposure to Australian/North American gold assets. Newcrest is its least preferred stock, with UBS estimating near-term production will peak in 2020.

Macquarie said it may upgrade its estimates for copper-gold miner Sandfire Resources' ((SFR)) 2019-20 earnings by 25%. By contrast, UBS cut its forecast for Sandfire's Net Profit After Tax (NPAT) for 2020-21 by about -10%, noting that the remaining life of its Degrussa mine is only three years.

Copper, aluminium and zinc gloom casts a pall over base metal miners

UBS lowered its estimates of prices for copper, aluminium and zinc by up to -10% over the next 18 months. The UBS team downgraded its forecast for copper to US$2.80/lb in 2020 and US$3.00/lb in 2021. UBS maintained its Buy rating on OZ Minerals ((OZL)), which it said continues to stand out against other copper miners, with a large number of options to deploy capital on new projects or expand production. The company's Carrapateena copper-gold project is expected to post its first production in the fourth quarter of 2019.

UBS cut its rating on mineral sands specialist Iluka ((ILU)) from Buy to Neutral after the company announced an expected cost blowout at its rutile mining hub at Sembehun in Sierra Leone. The UBS team believes lithium and graphite miners are challenged by the risk of further falls in the prices of the commodities.

Nickel shines on fears Indonesia may tighten ban on ore exports

The exception to the depressing outlook for base metals is nickel. UBS raised its price forecast for nickel to US$6.50/lb in the second half of 2019. Macquarie Wealth Management points out nickel prices have remained high for some time due to speculation that Indonesia might tighten its ban on nickel ore exports. This continued strength has created significant potential that nickel miners' earnings will come in above forecasts.

Macquarie said it may raise its nickel price estimate by 100% for Western Areas ((WSA)), Panoramic Resources ((PAN)) and Independence Group ((IGO)).

UBS nominated Independence Group ((IGO)) as its preferred exposure to nickel, raising its 2019-20 Net Profit After Tax (NPAT) outlook for the gold, nickel and copper, zinc and silver producer by 26%. However, UBS maintained its Neutral rating given that the stock is trading above its valuation of $5.13.

UBS also maintained its Neutral rating for Western Areas ((WSA)) while raising its NPAT forecast by 41%. The forecast reflects Western Areas' greater sensitivity to nickel prices.

Iron ore and metallurgical coal suffer from China uncertainty around steel

Macquarie notes that iron ore prices have fallen about -25% in August, driven by sentiment and a fall in steel prices, both of which have been affected by the depreciation in the Chinese currency, the renminbi (RMB).

The possible counterweight to this negativity is the potential for another round of government stimulus in China, focused on infrastructure investment, which could stimulate demand for steel.

UBS lowered its forecasts for metallurgical coal, used in steel making, by -6% in 2019-20 to reflect increased supply from Australia and import restrictions in China.

The turmoil surrounding iron ore has split opinion among analysts regarding leaders BHP Group ((BHP)) and Rio Tinto ((RIO)). UBS says it prefers BHP to Rio Tinto because of lower exposure to iron ore.

By contrast, JP Morgan retains its Neutral rating on BHP, which has fallen -12%, and upgrades Rio Tinto to Overweight in response to the stock's price fall. JP Morgan argues that the aggressive sell-down of Rio means the stock is now trading at a significant discount, opening up a trading opportunity.

Fortescue Metals Group ((FMG)) "continues to offer the highest risk/reward and remains our top iron ore play", JP Morgan said. Fortescue is likely to pay a dividend of about 20% in 2019-20, and generates a 63% margin for Earnings Before Interest Tax Depreciation and Amortisation (EBITDA), putting it at the head of its sector.

UBS raised its rating on Fortescue from Sell to Neutral following the recent -20% fall in the share price.

Explorer Watch List highlights potential miners of tomorrow

Canaccord Genuity has launched its new Explorer Watch List, which it says is "designed to highlight speculative, un-rated companies with active exploration programs on quality gold and base metal exploration and/or development projects". Canaccord does not provide ratings, estimates or target prices for the 16 companies, which range across gold and base metals.

The Watch List comprises 13 gold hopefuls and three with a base metals focus. The companies have returned an average of +52% over three months and +174% over six months, compared to the ASX Gold Index returns of +28% and +35%. These returns would be + 27% and 36% if gold venture Spectrum Metals ((SPX)) is excluded. Spectrum shares have risen +424% in three months and +2100% in six months.

The other gold companies are Apollo Consolidated ((AOP)), Breaker Resources ((BRB)), Calidus Resources ((CAI)), Carnaby Resources ((CNB)), Catalyst Metals ((CYL)), Exore Resources ((ERX)), Matador Mining ((MZZ)), Musgrave Minerals ((MGV)), Navarre Minerals ((NVM)), NTM Gold ((NTM)), Oklo Resources ((OKU)), and Prodigy Gold ((PRX)).

The base metals interests are Adriatic Metals ((ADT)), Blackstone Minerals ((BSX)), and Canterbury Resources ((CBY)).

Canaccord says there is a relative shortage of developers among ASX-listed gold and base metal companies. But with gold prices reaching all-time highs in A$ terms, there is likely to be greater speculative interest in earlier-stage explorers and stronger capital flows into these companies.

This will boost exploration activity and may spark mergers and acquisitions (M&A) activity from established producers.

At the same time, market valuations for larger, more established gold producers have started to contract, perhaps in recognition that valuations for large-capitalisation companies are stretched. This could indicate that investors are now seeing greater potential in smaller-cap producers or earlier-stage developers and explorers.

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ESG Focus: A Steady Diet Of Plastic

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A Steady Diet Of Plastic

By Richard (Rick) Mills

Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

People eating fish are advised to watch carefully for bones, but how about tiny pieces of plastic?

For years it has been known that plastic breaks down into microscopic particles that are consumed by shellfish, fish and mammals higher up the food chain, presenting a danger to human health if consumed.

However new research is showing that plastic too small to be detected by the human eye is also showing up in drinking water, rain, snow and even in the air.

The plastic is not only ingested or breathed in by animals and humans, it can also carry bacteria and diseases.

According to a 2018 study by the University of Singapore, more than 400 types of bacteria were found on 275 pieces of "microplastic" collected from local beaches. The bacteria included those that would cause gastroenteritis in humans or wound infection, and bacteria associated with coral bleaching.

Microplastics are pieces of plastic smaller than 5mm. They are either produced as barely perceptible microbeads found in cosmetics or toothpaste, or when larger plastics like grocery bags get broken down in the environment.

Sea of plastic

Most people have heard of the Great Pacific garbage patch, or the Pacific trash vortex. The gyre of floating marine debris is estimated at anywhere between 700,000 square kilometers, about the size of Texas, to over 15 million kilometers squared. First noticed by a sailor completing a yacht race in 1997, the Pacific trash vortex is both emblematic of our careless, materialistic society, and a serious hazard to marine and aquatic life.

As the plastic decomposes it is mistaken as food, and ingested by marine animals such as mussels, fish and sea birds. Some of it ends up in people's stomachs, evidenced by microplastics found in human feces for the first time in 2018. Thousands of birds, fish and sea mammals die each year after eating plastic or getting entangled in it.

Plastic is one of the biggest threats to coral reefs after global warming, according to National Geographic. The long-running nature magazine says over 11 billion pieces of plastic have been found on a third of coral reefs in the Asia Pacific - a figure that is expected to grow to 15 billion by 2025. Plastic bags, bottles and rice sacks found on reefs raise the risk of disease outbreaks on coral reefs, putting over 275 million people who rely on them for food and tourism in jeopardy.

It is estimated there are over 150 million tonnes of plastic in the ocean. Around 8 million tonnes enters the seas every year. Of that, about a quarter-million is thought to be floating, while the rest either sinks or washes up on beaches.

Plastic takes over 400 years to degrade, meaning most of it still exists, and only 12% has been incinerated. About 90% of plastic is not recycled. National Geographic says the problem of discarded plastic is so severe, that if nothing is done, by 2050 the oceans will contain more plastic than fish, ton for ton.

Insidious problem

Plastic in the ocean, far out of sight and mind, is easy to ignore. Less so is plastic found in the water supply. Microplastics have been discovered in tap water around the world, and to have been consumed by people in Europe, Japan and Russia.

One of the surprising facts about microplastics is how entrenched they are in the global ecosystem. Samples taken from the River Thames in London showed 80 microplastic particles per liter. They were detected in other UK lakes and rivers too. Tiny pieces of plastic have been found in limestone aquifers - a type of groundwater source that provides a quarter of the world's drinking water - in rivers, mountains and ocean trenches hundreds of meters deep.

According to National Geographic, researchers found up to 3,400 microplastics per liter in samples of seawater taken from 18,000 feet under the Greenland Arctic Sea.

How did they get there? A recent Guardian article says Microplastics are shed by synthetic clothing, vehicle tyres and the spillage of plastic pellets used by manufacturers. The physical breakdown of plastic litter also creates them. Rain washes them into rivers and the sea, but they can also be blown by the wind and end up in fields when treated sewage waste is used as fertiliser.

The US Geological Survey wanted to know how much nitrogen pollution was in Colorado rainwater. Instead, the USGS found something else. Researchers collecting rainwater samples, put under a microscope, saw tiny plastic fibers, beads and shards.

The USGS study correlates with another recent piece of research showing evidence of microplastics in the Pyrenees mountains, proving that microplastics can become airborne and carried by the wind to remote corners of the earth.

As for how plastic gets into the atmosphere, scientists think that tiny particles shed by anything plastic get incorporated into water droplets when it rains, then wash into lakes, rivers and oceans. When the water evaporates, the particles can end up in groundwater. They are then consumed by animals and people via drinking water and food, or breathed in. Microplastics can also attach to heavy metals or hazardous chemicals such as mercury, and adhere to particles from furniture and carpets containing toxic flame retardants, according to a microplastics rearcher quoted by The Guardian.

Microplastics in food

If nano-scale plastic has become prevalent in drinking water, oceans, rainwater, and the animals that mistakenly eat them, it's not a stretch to say that microplastics are probably in our food.

One study looking for synthetic particles in sea turtles found microplastics in the guts of all 102 turtles that were examined. They have also been detected in quantities up to 273 particles per pound of sea salt, 300 fibers per pound of honey, and around 109 fragments per liter of beer.

Mussels and oysters harvested for eating reportedly had 0.36 to 0.47 particles per gram, meaning that shellfish consumers are ingesting up to 11,000 pieces of microplastic per year, according to Healthline.

Effects on human health

While microplastics' effects on human health have not been widely studied, it's safe to say that inhaling or ingesting them should be avoided. This may be extremely difficult however; one study found plastic fibers in 87% of the human lungs studied.

Chemicals associated with plastics are known to be harmful. The most well-studied is BPA - found in plastic packaging or food storage containers. When BPA leaks into food it can interfere with reproductive hormones in women.

Another chemical, phtalates, is used to make plastic flexible. The presence of phtalates in a petri dish was shown to increase the growth of breast cancer cells.

When microplastics were fed to mice, they accumulated in the liver, kidneys and intestines, stressing these organs. Plastics also increased the level of a molecule that may be toxic to the brain, says Healthline.

The Daily Mail quotes a senior lecturer in Biomedical Science at Cardiff Metropolitan University, stating that ingesting microplastics could cause a number of potentially harmful effects, such as:

Inflammation: when inflammation occurs, the body's white blood cells and the substances they produce protect us from infection. This normally protective immune system can cause damage to tissues. An immune response to anything recognised as 'foreign' to the body: immune responses such as these can cause damage to the body. Becoming carriers for other toxins that enter the body: microplastics generally repel water and will bind to toxins that don't dissolve, so microplastics can bind to compounds containing toxic metals such as mercury, and organic pollutants such as some pesticides and chemicals called dioxins, which are known to cause cancer, as well as reproductive and developmental problems. If these microplastics enter the body, toxins can accumulate in fatty tissues. In a limited study, Canadian researchers estimated the average person ingests over 74,000 plastic particles a year. Examining just a few food categories including fish, shellfish, sugar, alcohol, honey, bottled versus tap water, plus air, the study authors found the most microplastics in air, bottled water and seafood.

Although their assumptions were based on only 14% of an average American's daily calorie intake, "if our findings are remotely representative, annual microplastic consumption could exceed several hundred thousand," Science Alert reported.

It is probable that the effects of microplastics ingestion build up over time. Researchers studying microplastics in seafood found that eating accumulated plastic could damage the immune system and upset a gut's balance. Science Alert states:

Once microplastics enter the gut, they could release toxic substances causing oxidative stress or even cancer, according to the researchers. Particles small enough could be taken up by cells in the lungs and gut; while larger ones might be absorbed in the digestive tract. What happens from here is anyone's guess.

Ways to avoid ingesting plastic

Considering the ubiquity of plastic, it may be impossible to completely avoid it from entering the human body. However, the authors of the above-mentioned study suggest quitting bottled water first. They found bottled water contained 90 more microplastic particles per liter compared to piped-in water. Those who drank bottled water had a daily intake of 349 particles compared to just 16 particles for tap water.

Cutting down on plastic usage is another step in the right direction. Suggestions include choosing re-usable grocery bags instead of single-use plastic bags, buying in bulk, and avoiding goods wrapped in plastic packaging - which account for about 40% of non-fibrous plastics. Participating in your city's plastic-container recycling program is a non-brainer.

No help from Big Oil

Reducing plastic usage is complicated and challenging. More than that, though, the plastics industry is tied to Big Oil. Plastic is made from petroleum, and the oil industry shows no signs of letting up. When oil prices dropped in 2014 it actually became cheaper to produce a plastic bottle than to recycle it. According to the International Energy Agency (IEA), the petrochemical industry will represent the largest source of additional oil consumption through 2040 - with the manufacturing of petrochemicals like plastics adding 6.2 million barrels a day of oil demand.

The oil industry obviously does not want to see plastics recycling increase, because it would mean less demand for crude. States Oilprice.com: For instance, if recycling increases from 15 percent to 33 percent, and if end use plastic consumption were reduced by five percent through ‘light-weighting' (reducing the weight of products, and thus using less plastic), it could eliminate roughly 1.5 mb/d of oil demand by 2040.

Countries with plastic bans

Still, a groundswell of public support is surging in the war against Big Plastic. Several countries and cities have passed laws banning plastic bags and other forms of plastic packaging.

As of April 2018, the list includes the UK, France, Canada, Australia, New York, Seattle, Montreal, Victoria, plus some surprisingly eco-progressive jurisdictions such as Kenya, Zimbabwe, Rwanda and New Delhi.

Kenya holds the distinction of having the most draconian law against plastic bags. Anyone found using, producing or selling a plastic bag faces up to four years in jail or a $38,000 fine.

The United Kingdom and Canada have both banned plastic microbeads such as those found in toothpaste. Even the Queen is reportedly on board with less plastic use, banning plastic straws and bottled water from the Royal Estate.

Last year Seattle became the first US city to slap a ban on plastic straws and single-use plastic utensils.

Down Under, state-wide plastic-bag bans include South Australia, the Australian Capital Territory, Tasmania, the Northern Territory, and most recently, Queensland.

In Hamburg, coffee drinkers won't find non-recyclable plastic coffee pods, while in New Delhi, illegal burning of plastic at garbage dumps forced a ban on all single-use plastic in 2017.

The most improved award must go to Morocco, which used 3 billion plastic bags a year - a shameful 9,000 bags per person - before a ban was passed in 2016.

Carrying a plastic bag in Rwanda could cost you a jail sentence, although most offenders get a slap-on-the-wrist fine of $61, according to Plastic Oceans, a campaign group. The African country has an ambitious plan to become the world's first plastic-free nation by 2020, according to Global Citizen.

Conclusion

Plastic is a scourge of modern society. In our quest to keep products fresh and safe before sale, we have over-done it. In most Canadian cities, one can't go to a mainstream grocery store without being loaded up with plastic along with your weekly shop. Many products sport multiple layers of packaging.

It took a long time for plastics recycling to be the norm in North America; Europe was doing it decades earlier. We thought it was enough, but it's not. Plastics have become so ubiquitous - in un-recycled plastic bags, packaging of all shapes and sizes, single-use straws and utensils, coffee pods, plastic microbeads, etc. - that they have literally become part of us. Only 10% of plastic containers are recycled. The rest ends up in landfills, rivers, lakes and finally, the ocean.

Tiny particles shed from thousands, maybe millions of plastic items are getting into the soil, the water, the air and the food chain.

We are now eating, breathing and drinking plastic. Time will tell what its effects will be, but it can't be good.

Richard (Rick) Mills

aheadoftheherd.com

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

Weekly Ratings, Targets, Forecast Changes - 19-08-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday August 12 to Friday August 16, 2019 Total Upgrades: 24 Total Downgrades: 13 Net Ratings Breakdown: Buy 38.26%; Hold 44.12%; Sell 17.62%

The combination of the local share market seemingly hitting a speed bump and an acceleration in corporate results releases has swung around the dynamic in stockbroker ratings during the week ending on Friday, 16th August 2019.

For the week, FNArena registered 24 upgrades being issued for individual ASX-listed stocks against 13 downgrades. Previously, the pendulum had been firmly in favour of more downgrades.

Somewhat tempering the at face value positive turnaround is the observation only 12 out of the 24 upgrades moved to Buy; the other half got stuck in the Neutral/Hold section. In similar fashion, six of the 13 downgrades moved to Sell. This remains a hugely divided market.

Magellan Financial was the sole receiver of two downgrades to Sell. Star performer CSL is represented on both sides, as is Cleanaway Waste Management.

Plenty of target prices moving up by double digit percentages with take-over target Aveo Group commanding the week's top-of-the-table position, followed by AP Eagers (consolidation), James Hardie (result), Austal (new contract) and gold miner Evolution Mining.

The negative side looks a whole lot more sober, with Orora (result) suffering the largest reduction, followed by Appen, AGL Energy (result) and Tabcorp (result).

The week's table for positive revisions to earnings estimates is filled with large increases with Cooper Energy (result) on top, handsomely beating the likes of Evolution Mining (result), Treasury Wine Estates (result), Cleanaway Waste Management (result) and Breville Group (result).

On the negative side, and as should be expected, we find some of the early disappointers this August reporting season with Whitehaven Coal, AGL Energy, Insurance Australia Group and Woodside Petroleum receiving the largest cuts to forecasts.

The August reporting season speeds up a few notches this week, while the macro background remains closely watched by less than comfortable local investors.

Upgrade

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

Credit Suisse upgrades to Outperform from Neutral on the back of an expected recovery in geochemistry. July marked the highest exploration activity for six months. The total number of exploration projects was up 36% on June.

Compositionally, gold and other exploration projects were up 46% and 18%, respectively. Credit Suisse expects this will deliver a re-rating of ALS shares, and the target is raised to $8.40 from $7.40.

The company has also acquired Laboratorios de Control ARJ, a pharmaceutical testing company based in Mexico.

AMP LIMITED ((AMP)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/5/1

First half results beat Credit Suisse estimates. The result was affected by lower earnings in the businesses that are up for sale but retained units were ahead of forecasts by 7%.

The broker now considers the price structure in the revised terms for the sale of the life business is more favourable, and the deal should gain regulatory approval. The company has also announced a $650m equity raising.

Credit Suisse upgrades to Outperform from Neutral (prior to a short restriction). Target is $2.

AVEO GROUP ((AOG)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 1/2/0

The company has entered into a scheme agreement with entities controlled by Brookfield Property for the acquisition of securities for $2.195, inclusive of the annual distribution of 4.5c.

Macquarie calculates the cash consideration represents an acquisition multiple of around 29x enterprise value/EBITDA. The broker upgrades to Neutral from Underperform and raises the target to $2.15 from $1.61.

AP EAGERS LIMITED ((APE)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/0/0

The merger with Automotive Holdings ((AHG)) is likely to drive material accretion and a consequent re-rating, Credit Suisse believes.

Since the merger announcement the stock has appreciated 51%, which mostly reflects merger dynamics. Credit Suisse upgrades to Outperform from Neutral.

2019 estimates allow for a -7% decline in first half earnings from both automotive and truck divisions, and a recovery is expected in automotive earnings in 2020. Target is raised to $12 from $7.

CSL LIMITED ((CSL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/4/0

Net profit in FY19 was in line with Credit Suisse estimates. There was robust sales growth in key products although specialty sales declined in the second half.

Credit Suisse upgrades to Outperform from Neutral as earnings estimates are upgraded and the model is rolled forward. The broker remains cautious on the outlook for specialty products.

Target is raised to $249 from $199. As the stock is trading at a discount to key Australian healthcare peer Cochlear ((COH)) and in line with ResMed ((RMD)) upside is envisaged at current levels.

See also CSL downgrade.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Upgrade to Accumulate from Hold by Ord Minnett and Upgrade to Add from Hold by Morgans .B/H/S: 3/1/1

FY19 earnings were below Ord Minnett's forecasts. The broker suspects any general economic softness is likely to be a near-term headwind.

The Australian waste management industry is poised for structural change, with Cleanaway Waste ideally positioned to take advantage of any changes, in the broker's view.

Rating is upgraded to Accumulate from Hold and the target raised to $2.30 from $2.10.

FY19 results missed growth expectations as revenue was softer than expected. However, Morgans believes the share price has overshot on the downside and upgrades to Add from Hold. The company expects underlying operating earnings growth in FY20 to moderate slightly.

The broker notes the balance sheet is strong but, in a period where capital return initiatives are becoming increasingly common, the company prefers to retain its firepower to fund growth. Target is reduced to $2.31 from $2.56.

See also CWY downgrade.

FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/4/1

UBS upgrades to Neutral from Sell after the trade tensions and local growth weighed on the sector and the Fortescue Metal share price fell -16%. The target is reduced to $6.60 from $7.20.

GENWORTH MORTGAGE INSURANCE AUSTRALIA LIMITED ((GMA)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/1/0

Brookfield Business Partners has entered into a share purchase agreement for all the shares in Genworth Canada.

Macquarie observes the transaction would be removing one of the barriers in completing the acquisition of Genworth Financial by China Oceanwide, which still needs to receive clearance for currency conversion and funds transfer from Chinese authorities.

Macquarie upgrades Genworth Australia to Outperform from Neutral, given the recent decline in the share price and the increase in Genworth Financial's capital flexibility. Target is $3.25.

INVOCARE LIMITED ((IVC)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/6/0

InvoCare's interim report came out below expectations and has triggered reductions for future estimates. Citi has decided to upgrade to Neutral from Sell, inspired by the share price fall, while leaving its price target unchanged at $13.75.

All in all, the analysts continue to expect a normalisation of the death rate, which should make management's task a lot easier in the years ahead. They note the company did not provide any guidance, but also there is a significant amount of operational leverage that will kick in with better numbers.

JAMES HARDIE INDUSTRIES N.V. ((JHX)) Upgrade to Buy from Neutral by UBS .B/H/S: 6/0/0

First quarter results were stronger than UBS expected and the outlook remains robust. The broker upgrades to Buy from Neutral.

Volume growth in the US was partially the result of improved management of distribution channels, management asserts, rather than channel stocking or a pulling forward of sales.

UBS assesses the outlook for margins is strong, as both input costs and cost reductions are supportive. UBS raises the target to $23.80 from $19.90.

NRW HOLDINGS LIMITED ((NWH)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/0/0

Citi has upgraded to Buy from Neutral with a revised price target of $2.65 (we had $3.01 since May) while asserting the share price has fallen too far. On the stockbroker's forecasts, the stock is now trading at a -38% discount to the Small Ordinaries.

The analysts acknowledge the risks associated with being a contractor to the mining sector, but nevertheless believe the present discount is simply "excessive".

Revised forecasts assume any exposure to the Dalgaranga Gold project will be written off, plus lower group margins are also assumed.

NEWS CORPORATION ((NWS)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/0/1

Credit Suisse found the FY19 results solid and ahead of expectations, despite a miss at the revenue line. The highlight has been the relatively consistent performance of news and information services.

The focus on value is also more evident. The value of the company's assets, excluding REA Group ((REA)), has effectively halved since the split from Fox back in 2013 and Credit Suisse does not believe this is justified.

An increasing focus on value by management can act to close the gap. Rating is upgraded to Outperform from Neutral and the target raised to $22.50 from $18.90.

ORORA LIMITED ((ORA)) Upgrade to Equal-weight from Underweight by Morgan Stanley and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/3/0

FY19 earnings were below Morgan Stanley's estimates. Australasia was modestly ahead but North America was soft. No guidance was provided. Further challenging conditions are expected in FY20, amid cost pressures.

Morgan Stanley assesses the difficult outlook is now encapsulated in the share price and upgrades to Equal-weight from Underweight. Price target is reduced to $3.00 from $3.20. Sector view is Cautious.

FY19 net profit was below estimates. Cash conversion was also lower than expected. Ord Minnett was disappointed with the performance in North America, where the earnings (EBIT) margin fell to 4.5% from 5.6%. Australasian earnings were ahead of forecasts.

Nevertheless, after the sell-off in the share price, the broker envisages value at current levels and upgrades to Accumulate from Hold. Target is reduced to $3.00 from $3.40.

REA GROUP LIMITED ((REA)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/3/1

Ord Minnett believes the worst of the property downturn is behind the company and there is flexibility around costs. FY19 net profit was below the broker's forecast.

Margin expectations are increased for FY20-21 because of a much lower cost base. Listings are also expected to improve going into the second quarter when easier comparables will be cycled.

Rating is upgraded to Hold from Lighten and the target raised to $90 from $71.

RIO TINTO LIMITED ((RIO)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 3/3/1

Following a significant market sell-off, Ord Minnett trims near-term iron ore and metallurgical coal price forecasts by -5%. The broker suggests a trading opportunity has opened up, given the aggressive -20% sell-off in Rio Tinto, versus BHP Group ((BHP)) at -12%.

Further Chinese policy support is considered likely, despite the uncertainty around trade tensions and the steel production outlook. The broker upgrades Rio Tinto to Buy from Hold. Target is reduced to $105 from $106.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/2/5

Ord Minnett updates gold price forecasts, which are now 3-7% higher across the forecast period. The broker upgrades Regis Resources to Hold from Lighten following the change. Target is raised to $5.30 from $4.50.

SUPER RETAIL GROUP LIMITED ((SUL)) Upgrade to Add from Hold by Morgans and Upgrade to Accumulate from Hold by Ord Minnett and Upgrade to Buy from Neutral by UBS .B/H/S: 5/2/0

FY19 results were in line with Morgans. The broker expects benign growth in FY20, with management noting there are some positive signs in consumer behaviour at the start of the new financial year.

Morgans envisages upside to the current multiples and upgrades to Add from Hold. Target is raised to $9.87 from $9.01.

FY19 results were below forecasts although Ord Minnett notes the external environment is improving.

The broker believes the company has an attractive business mix, anchored by a resilient automotive business and sports segments that are benefiting from cost savings.

While outdoor has been disappointing, BCF is showing signs of stabilising and Macpac has been a strong performer despite tough comparables.

Rating is upgraded to Accumulate from Hold and the target raised to $10.00 from $9.50.

Underlying earnings (EBIT) were below estimates in FY19 but FY20 trading in the early stages is encouraging and UBS upgrades to Buy from Neutral.

The upgrade reflects accelerating momentum in July sales, with no material shift in discounting as well as upside from tax reductions. The broker raises the target to $9.90 from $9.00.

TELSTRA CORPORATION LIMITED ((TLS)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/3/2

FY19 results and FY20 guidance, at first glance, are better than Ord Minnett expected. However, once the impact of new lease accounting standards are incorporated, guidance is slightly below expectations.

Management has targeted lower capital intensity in the outer years post the NBN migration. This leads Ord Minnett to raise the target to $4.25 from $3.55. Rating is upgraded to Accumulate from Hold.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Add from Hold by Morgans and Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/4/1

First half results were weaker than Morgans expected. The result was driven by extra costs attributed to Pluto. The broker has gained some confidence in the prospect of the Browse JV signing a gas processing agreement with the North West Shelf.

While finding fears around longer-term LNG supply risks justified, Morgans also envisages upside for global LNG demand. The broker upgrades to Add from Hold and reduces the target to $34.97 from $35.24.

First half financials were weaker than expected. Moreover, management commentary did little to ease Ord Minnett's concerns about the viability of development projects.

Still, the stock is trading below the broker's risk-weighted valuation, leading to an upgrade to Hold from Lighten. Target is reduced to $32.50 from $33.70.

Downgrade

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

Morgans was unimpressed with news of the resignation of AdAlta's chief executive officer Sam Cobb, noting six months of solid progress which included the completion of a $5m placement and entitlement offer.

The broker adjusts its model to include the issuance and places a -25% discount on the valuation to account for leadership uncertainty and also delays near-term licensing and long-term commercialisation assumptions.

Target price falls to 18c from 82c and rating downgraded to Hold from Add.

AUSTRALIAN FINANCE GROUP LTD ((AFG)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/0

Australian Finance Group has entered into a binding merger with mortgage aggregator Connective Group Pty Ltd. The broker believes the deal will prove earnings-per-share accretive, pending approvals - a major proviso.

The deal will hang on court and ACCC approval and the risk is high enough for the broker not to factor completion into earnings forecasts and valuations.

Meanwhile, the company's full-year result outpaced consensus by 7.5% and the broker expects consensus upgrades to outer year earnings.

Target price rises to $2.30 from $2. The broker downgrades to Hold from Add.

ANSELL LIMITED ((ANN)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/5/0

FY19 earnings were ahead of Credit Suisse estimates. However, the top line disappointed, as global markets weakened further. The broker notes FY20 is all about cost reductions and the buyback.

Credit Suisse forecasts FY20 earnings per share of US$1.17, aided by the US$10m earnings (EBIT) benefit from the transformation program and a modest tailwind from raw material costs.

The broker includes a US$70m buyback in FY20 estimates. Following the strong share price performance the rating is downgraded to Neutral from Outperform.

Credit Suisse remains cautious about the continued weakness in the global environment and the impact on revenue and earnings. Target is reduced to $28.00 from $28.60.

ALLIANCE AVIATION SERVICES LIMITED ((AQZ)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/0

Ord Minnett downgrades to Hold from Buy following the FY19 results, which were broadly in line with forecasts. The business remains strong but, with an expanding fleet, the broker suspects the pressure on expenditure will remain.

The broker also notes the ACCC is continuing to review the Qantas ((QAN)) stake and the process is likely to conclude in coming months. Target is reduced to $2.60 from $2.90.

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

Earnings (EBIT) guidance for FY19 of $92m has been provided, consistent with prior revenue guidance of $1.8-1.9bn, Ord Minnett notes.

FY20 earnings guidance of at least $105m is ahead of expectations, driven by an improvement in the Australasian shipyards as well as a strong performance at the two major vessel programs for the US.

Austal now holds a substantial order book of commercial ferry contracts following major expansion in the Philippines and the establishment of the leased shipyard in Vietnam.

Ord Minnett downgrades to Hold from Accumulate, assessing the recent run in the share price means the stock is now fully valued. Target is raised to $3.60 from $2.45.

AURIZON HOLDINGS LIMITED ((AZJ)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/4/1

Aurizon's full-year result beat the broker (+4%) and consensus (+6%), thanks to a reversal of a QNI bad debt.

The highlight was the capital restructure which will unlock $1.2bn to underpin an extension of the $0.3bn buyback, which should boost earnings per share.

Otherwise, networks eased -1%, and coal -2%, and bulk posted a strong performance.

Earnings per share forecasts rise 1.5% in FY20 and ease -1% in FY21.

Macquarie perceives Aurizon's valuation as stretched and retains an underperform rating. Target price $5.28.

CSL LIMITED ((CSL)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/4/0

FY19 results were in line with UBS estimates. In updating key operating assumptions the broker increases estimates for earnings per share in FY20 by 4%.

Seqirus EBIT in FY19 was US$154m, on track to hit guidance. Behring revenue growth of 10% was underpinned by immunoglobulin.

Based on the recent performance in the share price UBS downgrades to Neutral from Buy. Target is raised to $245 from $223.

See also CSL upgrade.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 3/1/1

Cleanaway's FY19 result was largely in line with forecasts but FY20 guidance has been impacted by China's new policies on exported waste.

These have led to volatile recycled material prices and increased waste sorting costs, Credit Suisse notes. Management has refrained from reaffirming margin assumptions.

The broker downgrades to Underperform from Neutral, cutting its target to $1.85 from $2.15.

See also CWY upgrade.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/3/4

It appears FY19 revealed itself as a small "miss" by circa -3%%, but Citi's downgrade to Sell from Neutral has been inspired by the elevated share price. The company released full FY19 production numbers only last month, point out the analysts.

Citi analysts point out the share price has enjoyed a jolly good ride on the back of the balance sheet deleveraging over years past, but that story is nearing its end. Higher wage costs are reducing future estimates. Target drops by -10c to $4.20.

JB HI-FI LIMITED ((JBH)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 0/5/2

Sales growth for JB Hi-Fi was better than Morgan Stanley feared in the fourth quarter, accelerating to 3.3%. July trading is also better than expected, although the broker notes the business was lapping relatively easy comparables.

The outcome for JB Hi-Fi was solid in FY19, when set against market concerns regarding the lack of post-election momentum. However, Morgan Stanley notes, The Good Guys is experiencing a tough demand backdrop for white goods.

FY20 estimates are increased by 0.5%. Ultimately, the broker suggests the near-term outlook will test the flexibility of the company's model.

Rating is downgraded to Equal-weight from Overweight after the recent outperformance in the shares. Target is $28. Industry view: Cautious.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Sell from Neutral by Citi and Downgrade to Sell from Hold by Ord Minnett .B/H/S: 0/1/5

FY19 results were broadly in line with expectations. Citi finds the risk/reward less compelling now as the stock is trading well above peers, performance fees are lumpy and the medium-term growth prospects are some time away.

Rating is downgraded to Sell from Neutral. The broker believes the company has taken an innovative approach to funds management, offering eligible investors 7.5% loyalty units if they subscribe to the new high conviction trust IPO. Target is steady at $54.

Ord Minnett downgrades to Sell from Hold on valuation grounds. While supporting the strategy to continue investing in listed structures through manager-funded priority offers, the broker considers this simply an incremental driver of growth.

The company has raised capital to further invest in listed products, which tend to come with loyalty bonuses funded by the manager.

While supportive of the building of direct-to-consumer relationships and retirement products, Ord Minnett believes the market is paying up for success. Target is raised to $49.60 from $40.33.

MIRVAC GROUP ((MGR)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/1/2

FY19 results were in line with Credit Suisse estimates. The earnings outlook for FY20 is better than the broker expected. The company is guiding for free funds from operations of 17.6-17.8c per security, indicating growth of 3-4%.

The growth in recurring income is the key positive, in the broker's view. Residential pre-sales have trended lower but the broker expects FY20 should be a strong year for residential earnings.

Rating is downgraded to Underperform from Neutral on valuation grounds. Target is raised to $3.04 from $2.85.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ALS LIMITED Buy Neutral Credit Suisse 2 AMP LIMITED Buy Neutral Credit Suisse 3 AP EAGERS LIMITED Buy Neutral Credit Suisse 4 AVEO GROUP Neutral Sell Macquarie 5 CLEANAWAY WASTE MANAGEMENT LIMITED Buy Neutral Morgans 6 CSL LIMITED Buy Neutral Credit Suisse 7 FORTESCUE METALS GROUP LTD Neutral Sell UBS 8 GENWORTH MORTGAGE INSURANCE AUSTRALIA LIMITED Buy Neutral Macquarie 9 INVOCARE LIMITED Neutral Sell Citi 10 JAMES HARDIE INDUSTRIES N.V. Buy Neutral UBS 11 NEWS CORPORATION Buy Neutral Credit Suisse 12 NRW HOLDINGS LIMITED Buy Neutral Citi 13 ORORA LIMITED Neutral Sell Morgan Stanley 14 REA GROUP LIMITED Neutral Sell Ord Minnett 15 REGIS RESOURCES LIMITED Neutral Sell Ord Minnett 16 RIO TINTO LIMITED Buy Neutral Ord Minnett 17 SUPER RETAIL GROUP LIMITED Buy Neutral Morgans 18 WOODSIDE PETROLEUM LIMITED Buy Buy Morgans Downgrade 19 ADALTA LIMITED Neutral Buy Morgans 20 ALLIANCE AVIATION SERVICES LIMITED Neutral Buy Ord Minnett 21 ANSELL LIMITED Neutral Buy Credit Suisse 22 AURIZON HOLDINGS LIMITED Sell Neutral Macquarie 23 AUSTAL LIMITED Neutral Buy Ord Minnett 24 AUSTRALIAN FINANCE GROUP LTD Neutral Buy Morgans 25 CLEANAWAY WASTE MANAGEMENT LIMITED Sell Neutral Credit Suisse 26 CSL LIMITED Neutral Buy UBS 27 EVOLUTION MINING LIMITED Sell Neutral Citi 28 JB HI-FI LIMITED Neutral Buy Morgan Stanley 29 MAGELLAN FINANCIAL GROUP LIMITED Sell Neutral Citi 30 MAGELLAN FINANCIAL GROUP LIMITED Sell Neutral Ord Minnett 31 MIRVAC GROUP Sell Neutral Credit Suisse Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AOG AVEO GROUP 17.0% -17.0% 34.0% 3 2 APE AP EAGERS LIMITED 88.0% 63.0% 25.0% 4 3 JHX JAMES HARDIE INDUSTRIES N.V. 92.0% 75.0% 17.0% 6 4 ALQ ALS LIMITED 58.0% 42.0% 16.0% 6 5 RIO RIO TINTO LIMITED 29.0% 14.0% 15.0% 7 6 NAB NATIONAL AUSTRALIA BANK LIMITED 21.0% 7.0% 14.0% 7 7 SUL SUPER RETAIL GROUP LIMITED 43.0% 29.0% 14.0% 7 8 ORA ORORA LIMITED 43.0% 29.0% 14.0% 7 9 NWS NEWS CORPORATION 50.0% 40.0% 10.0% 4 10 RRL REGIS RESOURCES LIMITED -71.0% -79.0% 8.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MFG MAGELLAN FINANCIAL GROUP LIMITED -83.0% -57.0% -26.0% 6 2 MGR MIRVAC GROUP -30.0% -10.0% -20.0% 5 3 TAH TABCORP HOLDINGS LIMITED 25.0% 42.0% -17.0% 6 4 APX APPEN LIMITED 33.0% 50.0% -17.0% 3 5 ASB AUSTAL LIMITED 33.0% 50.0% -17.0% 3 6 JBH JB HI-FI LIMITED -29.0% -14.0% -15.0% 7 7 EVN EVOLUTION MINING LIMITED -57.0% -43.0% -14.0% 7 8 ANN ANSELL LIMITED 29.0% 43.0% -14.0% 7 9 AMC AMCOR LIMITED 50.0% 58.0% -8.0% 7 10 REA REA GROUP LIMITED 17.0% 21.0% -4.0% 6 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AOG AVEO GROUP 2.150 1.857 15.78% 3 2 APE AP EAGERS LIMITED 10.588 9.338 13.39% 4 3 JHX JAMES HARDIE INDUSTRIES N.V. 24.392 21.783 11.98% 6 4 ASB AUSTAL LIMITED 3.880 3.497 10.95% 3 5 EVN EVOLUTION MINING LIMITED 4.031 3.641 10.71% 7 6 MFG MAGELLAN FINANCIAL GROUP LIMITED 49.033 44.686 9.73% 6 7 MGR MIRVAC GROUP 3.182 2.926 8.75% 5 8 NWS NEWS CORPORATION 22.847 21.235 7.59% 4 9 JBH JB HI-FI LIMITED 28.881 27.327 5.69% 7 10 SUL SUPER RETAIL GROUP LIMITED 9.410 9.033 4.17% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ORA ORORA LIMITED 3.167 3.460 -8.47% 7 2 APX APPEN LIMITED 26.330 27.995 -5.95% 3 3 AGL AGL ENERGY LIMITED 18.186 18.883 -3.69% 7 4 TAH TABCORP HOLDINGS LIMITED 4.853 5.008 -3.10% 6 5 AMC AMCOR LIMITED 16.836 16.917 -0.48% 7 6 NAB NATIONAL AUSTRALIA BANK LIMITED 26.929 26.986 -0.21% 7 7 RIO RIO TINTO LIMITED 101.587 101.753 -0.16% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 COE COOPER ENERGY LIMITED 16.267 0.503 3134.00% 3 2 EVN EVOLUTION MINING LIMITED 19.271 13.530 42.43% 7 3 TWE TREASURY WINE ESTATES LIMITED 73.200 61.266 19.48% 7 4 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 8.060

6.854 17.60% 5 5 BRG BREVILLE GROUP LIMITED 60.000 52.900 13.42% 4 6 TLS TELSTRA CORPORATION LIMITED 20.886 18.543 12.64% 7 7 REA REA GROUP LIMITED 269.333 240.029 12.21% 6 8 ANN ANSELL LIMITED 163.542 149.331 9.52% 7 9 KMD KATHMANDU HOLDINGS LIMITED 22.906 21.033 8.91% 3 10 CSL CSL LIMITED 640.839 592.070 8.24% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WHC WHITEHAVEN COAL LIMITED 32.971 54.200 -39.17% 7 2 AGL AGL ENERGY LIMITED 128.443 154.443 -16.83% 7 3 IAG INSURANCE AUSTRALIA GROUP LIMITED 37.486 42.329 -11.44% 7 4 WPL WOODSIDE PETROLEUM LIMITED 188.744 208.786 -9.60% 7 5 BEN BENDIGO AND ADELAIDE BANK LIMITED 75.067 81.033 -7.36% 6 6 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 13.500 14.400 -6.25% 5 7 CPU COMPUTERSHARE LIMITED 93.686 99.013 -5.38% 7 8 APE AP EAGERS LIMITED 43.473 45.243 -3.91% 4 9 TAH TABCORP HOLDINGS LIMITED 19.598 19.872 -1.38% 6 10 VCX VICINITY CENTRES 17.760 17.967 -1.15% 5 Technical limitations

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

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Uranium Week: One Is The Loneliest Number

Volume soared in the spot uranium market to one transaction last week following the prior week's lack of any transaction.

-Australian government to look at nuclear power solution -Are small modular reactors a viable option for the future? -Uranium market activity remains stagnant

By Greg Peel

The Australian government is preparing to hold a parliamentary inquiry into the possibility of pursuing nuclear power. Australia has a long history of dismissing any nuclear power option both from a community fear perspective (dating back to Three Mile Island, on to Chernobyl and more recently Fukushima) and as a result of the power of the coal lobby.

Debate rages nevertheless, given Australia's legacy coal-fired power plants are due for decommissioning and the issue of future baseload power is becoming critical. The obvious proposition from the coal lobby and its supporters in parliament is to build new coal-fired generators. The community on the other hand, at least those not involved in the coal mining industry, is supporting renewable energy solutions, and home/business solar take-up is increasing a-pace.

The coal lobby has managed to prevent state governments over time to allow even uranium mining in some states, whereas any appeal to wind down thermal coal exports on a climate change basis is met with contempt. It is before this backdrop one Queensland state parliamentarian last week suggested "Nuclear energy has evolved since it was last seriously considered in Australia. This inquiry will provide the opportunity to establish whether nuclear energy would be feasible and suitable for Australia in the future, taking into account both expert opinions and community views".

Renewed interest in nuclear power is being spurred by federal Minister for Energy and Emissions Reductions Angus Taylor's interest in small modular reactors (SMRs). Proponents of SMRs believe there is an opportunity for Australia to become specialized in SMRs, which require less capital to build and can be deployed in clusters to replace larger coal stations.

I'd say good luck with that one.

In the US the uranium industry remains in a state of flux. Participants were expecting last week to be able to learn why the Department of Commerce had supported a request under section 232 to force US utilities to buy US uranium or suggestions of a tariff being placed on uranium imports – recommendations the president has since dismissed in favour of an industry-wide review.

But the DoC missed its own self-imposed deadline to publish its recommendations, even in redacted form.

Which is of no help to a uranium market beset by uncertainty as the president's Working Group prepares its own recommendations on the nuclear fuel cycle.

Sellers became a little more anxious last week, but volumes did not exactly surge. The week before saw not one transaction in the uranium spot market. Industry consultant TradeTech reports last week saw just the one, for 100,000/lbs U3O8 equivalent.

TradeTech's weekly spot price indicator has fallen -US35c to US$24.90/lb.

TradeTech's term price indicators remain at US$28.50/lb (mid) and US$31.00/lb (long).

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

The Short Report - 22 August 2019

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.

Summary:

Week ending August 15, 2019

Last week saw the ASX200 began with the ASX200 trying to recover from the China currency fear wash-out before US yield curve inversion sparked another sell-off.

All the while the local earnings season was ramping up.

On that note I suggested last week that a jump in JB Hi-Fi's ((JBH)) share price on result would likely reflect short-covering. Well, it appears not. JB Hi-Fi shorts have increased to 14.5% from 14.4%.

GWA Group ((GWA)) delivered a disappointing result this week and it looks like the shorters were ahead of the game. Last week GWA shorts rose to 9.9% from 8.3%.

Dacian Gold ((DCN)) saw its shorts rise to 8.3% from 7.10%. The gold miner had issued a production downgrade the week before.

The big mover & shaker last week was AMP ((AMP)). Its shorts fell to 6.5% from 9.7%. See below.

Weekly short positions as a percentage of market cap:

10%+ ING 19.5 NUF 18.7 GXY 16.0 ORE 15.9 BAL 15.8 JBH 14.5 SYR 14.2 NXT 14.0 DMP 12.0 BWX 11.9 HUB 11.6 PLS 11.2 BGA 11.0 RWC 10.3

In: RWC Out: HVN

9.0-9.9

GWA, BIN, HVN, SGM, MTS, BOQ, IFL, KGN

In: HVN, GWA Out: RWC, AMP 8.0-8.9%

PPT, BKL, IVC, SDA, DCN, SUL, CGC

In: BKL, DCN , CGC Out: GWA, WSA

7.0-7.9%

WSA, CLH, MYR, CSR, CGF

In: WSA Out: BKL. DCN, CGC

6.0-6.9%

GEM, A2M, AMP, NEC, SFR, COE, CTD, NCZ

In: AMP, SFR, CTD Out: ELD, GMA

5.0-5.9%

ELD, LNG, GMA, OML, CLQ, CUV, MSB, NWL, SXY, AWC

In: ELD, GMA, AWC Out: CTD, SFR, SAR

Movers & Shakers

To cap off its annus horribilis, the once-great AMP managed to post a slight beat of expectations with its FY19 result. But a 12% leap in the share price over two days post-result was all about the sale of the company's Life business.

We recall that the New Zealand regulator knocked back the sale to Resolution Life back in July, sparking a -16% share price plunge. AMP's reinvention and recovery strategy had to that point been based on funding from the Life sale. In order to progress the sale, AMP was forced to take a lower price to cover Resolution's cost of seeing to the regulator's issues.

AMP was also forced to announce an equity raising. Such an announcement is music to a shorter's ear. Profits can be taken on short positions simply by participating in the (discounted) raising. Given a drop in shorts to 6.5% from 9.7%, that opportunity was not completely dismissed.?

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.5 0.9 RIO 4.8 4.7 ANZ 0.7 0.7 S32 1.1 1.4 BHP 3.3 3.0 SCP 0.7 0.7 BXB 0.2 0.3 SUN 0.7 0.5 CBA 1.2 1.1 TCL 0.5 0.8 COL 1.0 1.0 TLS 0.4 0.4 CSL 0.2 0.3 WBC 1.1 1.1 IAG 0.5 0.4 WES 1.0 1.1 MQG 0.7 0.7 WOW 1.6 1.8 NAB 0.5 0.6 WPL 0.9 0.9 To see the full Short Report, please go to this link

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

Baby Bunting's Growth Spurt To Continue

Favourable industry restructuring has allowed Baby Bunting to become the dominant player in the baby goods segment and brokers expect strong earnings growth over the next several years.

-Gross margin upside and operating expenditure leverage envisaged -Few in the industry have the capability to compete effectively -Acquisition of car-seat fitting business considered strategically sound

By Eva Brocklehurst

Baby Bunting's ((BBN)) growth spurt shows no sign of slowing, as its market dominance is becoming entrenched in a relatively defensive baby goods sector. The industry structure is favourable, with the number of players having contracted by around 30% in recent years.

The company beat broker estimates in FY19 and raised its guidance for FY20 operating earnings (EBITDA) to $34-37m, expecting to sustain mid single-digit comparable growth rates. Gross margins are expected to exceed 36%. Citi calculates an FY20 price/earnings ratio of 17x is undemanding considering the growth that is forecast.

Morgans believes strong top-line growth will continue over several years, as the footprint expands and the company continues to take market share. This will convert at a much higher operating earnings rate, given gross margin upside and operating expenditure leverage.

Gross margins have been assisted by range improvements, increased direct imports and less industry discounting. Macquarie agrees the exit trends from the second half indicate momentum will continue into FY20. The broker observes, while the company is investing ahead of the curve, there should be operating leverage in FY20 as the maturing of FY18/19 store openings supports growth.

Macquarie considers the stock a core small retail holding and valuation undemanding in a relatively defensive category. The clean inventory position as of June was in line with store growth and resulted in strong cash conversion. The penetration target of private label and exclusive products, ultimately to 50%, is strategically important in differentiating the business from competitors, in the broker's view.

Around $20m will be invested over the next two years to improve the digital offering, loyalty, customer service and brand and from this Morgan Stanley assesses that few in the industry have the capability and access to capital to compete effectively. Digital sales penetration did slow as the offering was re-jigged, but this should provide benefits in FY20, the broker adds.

Morgan Stanley envisages FX volatility will widen the company's cost advantage versus peers, as 90% of stock is bought in Australian dollars and suppliers must provide three-months notice of price changes, which are subject to negotiation.

Ancillary Services

The expansion into ancillary services has kicked off with the acquisition of car-seat businesses in the fourth quarter. While the earnings impact is immaterial at this point, Macquarie believes this is a positive strategic step to build customer loyalty and engagement. Citi agrees the acquisitions are strategically sound and could help defend against pure-play online competition and less-nimble discount department stores.

This is one of the new growth strategies which have emerged from the results, the broker notes. The acquisition of the four car-seat fitting companies, which were previously run by partners, will allow Baby Bunting to provide standardised car seat fitting services, which other retailers do not offer.

The installers will be able to make add-on sales during the 30-minute fitting time. The company also plans to expand its hiring services, the development currently underway in Queensland and South Australia. However, Citi assesses a risk this could cannibalise existing sales, particularly when it comes to long-term hiring.

Store Targets

The new format Chadstone Mall store, Victoria, has performed well and the company is targeting further expansion of this format. Chadstone is the company's highest volume store and has significant penetration in high-margin categories. However, the fit-out requires a larger investment versus large-format retail stores.

Citi notes Baby Bunting entered the Chadstone and Bankstown, NSW, catchments following the closure of Toys "R" Us/Babies "R" Us. Doncaster, Victoria, is being targeted for opening in October.

Another prong to the company's strategy is the additional stores being rolled out. Baby Bunting will review its target of 80 stores over the next few months, to incorporate the success of its shopping centre format as well as survey recent store closures by competitors. Morgan Stanley believes few retailers offer the roll-out potential of the company as well as such dominance of the category.

While there could be upside to the long-term target of 80 stores, over time Citi envisages stores may also close, should online growth negate the need for a physical footprint in some areas. The broker points out Mothercare, a UK-based baby goods retailer, has reduced its footprint by -51% since FY16 while increasing online sales and re-positioning stores.

FNArena's database shows four from four Buy ratings with a consensus target of $3.17 that suggests 14.4% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.4% and 5.3% respectively.

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

Smartgroup Cruising Comfortably

Smartgroup Corp has proved resilient in the first half of 2019, recording growth in novated leasing and salary packaging despite a difficult macro environment.

-Two small Victorian health contracts not renewed -Yet new business has more favourable pricing -Risk remains for ASIC placing lower cap on trailing commissions

By Eva Brocklehurst

Brokers were impressed as salary packaging and novated leasing company Smartgroup Corp ((SIQ)) seemed to cruise through a tough first half. The established businesses performed well, given no acquisitions made contributions.

While growth was below the double digits usually recorded by the company, at 2.7% for novated leasing it was delivered not only with no contribution from acquisitions but against a decline of -9% in new car sales over the six months period.

Both salary packaging (up 4.3%) and novated leasing were affected by the non-renewal of some contracts late in the half. Yet, while two small contracts were not renewed, brokers note new business has more favourable pricing. There was some yield compression, although increased cross selling and new products helped offset the impact Credit Suisse points out, highlighting the 20% increase in clients using two or more services.

The full impact of vehicle manufacturers extending their mechanical warranties and a skew towards lower-priced vehicles contributed to a decline in novated lease revenue yields of around -2%, Macquarie assesses.

No explicit guidance was provided but the interim result implies an earnings skew of 50:50 for H1:H2, Morgan Stanley calculates. This compares with 48:52 historically, and indicates acquisitions made in the first half will support the second half to the tune of $700,000.

Partially offsetting this is the loss of two Victorian health contracts, which the broker estimates creates a -$1-1.5m drag on the second half as the contracts were only lost in March and June. These contracts will be fully cycled in June 2020. Macquarie notes Smartgroup has lost only three contracts since it listed on ASX. Its third largest client, comprising around 3% of revenue, has recently been secured to 2022.

Citi will scrutinise the Victorian health market in more detail to determine if customer losses were one-off or indicative of competitive pressures. The broker's upgrades to earnings estimates are driven purely by margin expansion as top-line forecasts are unchanged.

New Partnerships

The company has entered five new partnerships in the first half although no meaningful earnings are expected to emerge in the near term. Ord Minnett continues to believe there are further accretive acquisitions in the pipeline, providing a source of potential upside. Pricing in particular was above the broker's expectations but volumes in novated leasing and salary packaging as well as margins and distributions were all better than expected.

Credit Suisse expects similar growth figures in the second half and this should accelerate in 2020 as conditions become easier, upgrading to Outperform from Neutral. Citi reiterates a Buy call with increased vigour, given the resilience shown in the first half. However, the broker lowers the target slightly because of more modest longer-term assumptions.

Morgans also upgrades, to Add from Hold, assessing there to be upside risk over the next 12-18 months from potential acquisitions or capital management. This is based on strong cash flow and modest gearing.

Trailing Commissions

Demand is resilient, as the company appears to have benefited from increased penetration of the existing novated lease market with products that pay trailing commissions. In the longer term, however, the broker has some reservations around the sustainability of earnings from add-on insurance commissions. Market expectations centre on the insurance commission of 20%, currently recommended by the industry, being implemented.

Morgans asserts the risk of a lower cap will not disappear until the Australian Securities and Investments Commission actually finalises and introduces the cap, timing of which is unknown. While company does not provide specific

revenue details regarding add-on insurance, which includes extended warranties, earnings are likely to be significant. Morgans estimates this to be around 20%.

Smartgroup has reduced the number of premises to 6 from 17 over the past 18 months and reduced personnel by -4%. Citi notes, while any remaining acquisition targets may be smaller, the company's ability to extract synergies has never been higher. The broker calculates acquisitions up to $155m could be funded by debt before net debt/operating earnings reaches 1.5x, and there remain a number of organic opportunities in the industry.

FNArena's database has five Buy ratings and one Hold (Morgan Stanley). The consensus target is $10.84, signalling -2.7% downside to the last share price. Targets range from $9.80 (Credit Suisse) to $11.83 (Citi).

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

August Reporting Season: Early Signals

Dear time-poor reader: early beats and misses from corporate results, plus an update on global dividends.

In this week's Weekly Insights:

-Value & Growth, The Debate That Never Ceases -August Reporting Season: Early Signals -Rudi Talks -Rudi On Tour

By Rudi Filapek-Vandyck, Editor FNArena

Value & Growth, The Debate That Never Ceases

Value investing is dead. Can I quote you on such?

The question recently was thrown at me via an avid podcaster & blogger. While rather amusing, I wasn't quite happy that such a controversial quote would be published with my name attached to it.

Because, slight detail, it isn't quite what I have been writing about all these years. So the invitation followed to provide a more accurate quote, upon which I wrote a few paragraphs. That then proved too much information for what was intended.

Long story short. I wrote the paragraphs below, from which a tiny amount was used in the blog. I think too many value investors get way too prickly when someone (as in myself) points out the obvious.

To set the record straight, here are my paragraphs:

"The debate about Value versus Growth style of investing seems to have made a decisive swing in favour of the latter in recent years with US data signalling Growth has now performed (decisively) better than Value in each of the past eleven years. In Australia a similar trend has established itself since early 2013.

The past 18 months in particular have proven too much of a challenge for many a typical Value investor. In response, many are pointing fingers towards easy money policies by the world's central bankers, or towards exceptionally low bond yields, and investors falling in love with modern day disruptors.

In my view, it is too easy to blame all of these factors. On my observation, many a typical Value investor has completely ignored the seismic changes taking place across the globe post GFC. These changes are not only highlighting the impact from disruptors, they are equally creating structural challenges for many of the companies whose shares today trade on cheap valuations.

This, I believe, is the real story behind the Value versus Growth debate. Grown up, intelligent and experienced men ignoring or refusing to accept that the world, yes indeed, has changed profoundly, and will continue changing for a lot longer."

Here is the blog: https://qavpodcast.com.au/2019/08/15/is-value-investing-really-dead/

I have suggested I am available for an intelligent, well-researched and educated discussion about why Value investing hasn't worked out well for many investors in recent years, including many professional funds managers.

August Reporting Season: Early Signals

FNArena only started to produce detailed coverage of Australian corporate results in August 2013. In the six years since we haven't monitored one season yet in which released financial performances consist of more "misses" than "beats", but early indications are this August reporting season can possibly turn into "the one".

Having updated on exactly 80 corporate releases on Monday, 19th August 2019, the tally currently stands at 33.8% "misses" (27 reports) against 21.3% "beats" (17 reports) and the remaining 36 reports or 45% in-line.

Of course, there is no real need to get overly downbeat just yet. This is by all accounts still but a relatively small sample. In two weeks' time our daily updated Corporate Results Monitor will contain assessments on 300+ corporate releases, but history suggests it's usually at the end when the real nasties come out while at the beginning of the season, profit warnings not included, the news usually carries a more positive bias.

Not this year, or so it seems. Unless, of course, this is the good news. Let's hope not.

The worst seasons on FNArena's record thus far had both "misses" and "beats" on equal footing. Similar to the US, corporate reporting usually generates more "beats", thus when the numbers end up being equal we all know life for corporate Australia is really, really tough.

Those two seasons were August 2017 and February this year. The latter has also been followed up by an equally "balanced" out-of-season period of lacklustre financial reports, including what might have been one of the busiest seasons for corporate confessions (profit warnings galore). No need to look any further as to why the RBA is cutting interest rates; and why that's exactly what it should be doing.

Quality Retains Its Value

There is no end in sight for the corporate earnings recession in Australia. Early signals thus far are firmly suggesting overall it's not getting better; corporate Australia needs all the support it can muster, with a watchful eye on the multiple international uncertainties.

Not everyone is suffering equally. Observation number one remains the Australian share market continues to be sharply divided between the Haves and the Have Nots; high quality versus low quality, structural growth with a defendable moat versus much weaker and vulnerable business models.

As such we have witnessed, once again, how financial performances from companies including REA Group ((REA)), ResMed ((RMD)), CSL ((CSL)) and Cochlear ((COH)) are holding up reasonably well, and so far these companies' share prices have been rewarded for it.

A similar observation applies to companies such as JB Hi-Fi ((JBH)), Baby Bunting ((BBN)) and Super Retail ((SUL)), operating under maximum stress in a retail sector that is facing multiple challenges, all at once. Here, we can also throw in Smartgroup ((SIQ)), Credit Corp ((CCP)) , Magellan Financial Group ((MFG)) and Treasury Wine Estates ((TWE)); all are proving their mettle when others are faltering.

Plenty Of Vulnerabilities On Show

On the other hand, some of the businesses that had been regarded relatively resilient up until this August reporting season have shown more vulnerability instead and they are being punished for it, including the likes of Orora ((ORA)) and GUD Holdings ((GUD)). One other surprising disappointment was delivered by Cleanaway Waste Management ((CWY)).

Weak performances are thus far what binds together most financials, be they insurers (Suncorp, Insurance Australia Group), financial services providers (Computershare, Challenger), wealth managers (Janus Henderson), small banks (CYBG, Bendigo and Adelaide Bank) or Australia's highest quality lender (CommBank); all updated with soft performances, at best not disappointing too much to the downside, or trying to placate investors with a higher dividend.

Even the resources companies report card thus far looks rather mixed with Rio Tinto ((RIO)) also feeling the need to compensate for slight disappointment with a higher dividend but with Woodside Petroleum ((WPL)) disappointing on both accounts. Both Whitehaven Coal and Coronado Global Resources ((CRN)) performed well but remain beholden to whatever happens to the price of coal.

Observation number two is that FY19 report card driven share price volatility can be quite extreme, as has been the case in all reporting seasons in recent years. Probably the most puzzling sell-off followed a much better-than-guided performance by Jumbo Interactive ((JIN)). Post event weakness might be related to one large seller who's keen to abandon its holding, in which case a recovery most likely will follow once the majority of stock has been offloaded.

Both Blackmores ((BKL)) and Pact Group ((PGH)) are likely to feature on the list of most prominent failures this season, together with AMP ((AMP)). All three have repeatedly proven in recent years that a falling share price does not by definition represent an opportunity for bottom-dwelling investors, and that story has simply continued into this month.

JP Morgan Finds August Challenging And Puzzling

Equity strategists at JP Morgan point out while star performers such as JB Hi-Fi are managing to withstand the pressure from "recessionary" conditions for Australian retailers, in reference to a description used by the South African owners of David Jones, there is no such escaping the retail blues for landlords including GPT ((GPT)) and Vicinity Centres ((VCX)).

JP Morgan has found the opening gambit to the August reporting season "puzzling", providing "little clear direction on the state of the economy". The strategists note similarly mixed messages from companies exposed to the local housing cycle, while demand for credit overall seems to be subdued, still.

One thing stands out: JB Hi-Fi is most likely to surprise to the upside when it reports financials. JP Morgan has six years and twelve reporting seasons to back up that observation. Something to keep in mind for next February, maybe?

JP Morgan goes as far as call August an "unhappy hunting ground for Australian equity investors" and notes the month has seen only one positive performance in the past six reporting seasons. Similar as with FNArena's observations, JP Morgan's stats equally show more misses than beats, but also with only a tiny group of companies forcing analysts to revise forecasts upwards. Healthcare is the standout sector so far.

Coincidentally, that one positive August season was last year when healthcare stocks, led by a 15% rally in CSL shares, were equally among the standouts.

Dividends Still Growing

Elsewhere, Janus Henderson reports the more challenging context for companies globally is having an impact on global dividends. On its numbers, total dividend payouts reached a new all-time record in Q2 of US$513.8bn, but this only marks an increase of 1.1% compared to a year ago (when dividends were growing at 14%+). The rate of growth is slowing noticeably, though this is also due to the impact from a stronger USD.

Janus Henderson had already anticipated a slowing pace of growth in total dividend payouts, with Europe in particular lagging the rest of the world. Janus Henderson's dividend index for the continent is at its lowest level in over a year. Australia remains inside a five-year long trend of stagnant dividend growth with QBE Insurance ((QBE)) the only bright spot locally ahead of August reporting.

For 2019 as a whole, Janus Henderson is forecasting 4.2% growth in dividends to a total payout of US$1.43trn, equal to 5.5% growth underlying; in line with the long term trend.

FNArena continues to updating daily during this reporting season: https://www.fnarena.com/index.php/reporting_season/

Rudi Talks

Audio interview about the August reporting season from Wednesday last week:

https://www.youtube.com/watch?v=2BGws8IJIqI

Rudi On Tour In 2019

-AIA and ASA, Perth, WA, October 1

In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday 19th August 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. There will be no Part Two this week).

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