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Stories To Read From FNArena

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Party Like It's 1998

A US recession is not looming in 2020, argues Longview Economics. Rather, 2019 looks a lot like 1998.

-US recession fears heightened -Trade war likely trigger -Impact contained to manufacturing -Economy otherwise well supported

By Greg Peel

There is currently a consensus among economists, notes Longview Economics, that the US will enter recession in 2020. This fear is based on a variety of reasons, but the predominant reason is the trade war.

While talks between senior trade delegates from the US and China are set to resume next month, tensions have only escalated in the lead-up. Last month President Trump introduced tariffs on a new tranche of Chinese imports, and the Chinese duly retaliated.

There have been some concessions – Trump pushed around half of his initially planned tranche out to December and the Chinese have removed some import items from their list – but both parties have threatened tariff increases across the board if no progress can be made.

If Trump follows through on his plans, Longview calculates the average tariff on Chinese goods will rise sharply to 26.6% by year end (up from 12.0% in early June). Retaliatory tariffs on US goods will also rise to high levels (from 16.5% June to 25.1% by December).

Bears on the US economy have many concerns, but the trade war disturbs them most. In particular, they expect weakness in trade and manufacturing to increase and spread through the value chain into services, Longview notes, and the US economy more broadly. A recent survey by Bank of America-Merrill Lynch found US investors considered the trade war the biggest risk, and the likely trigger of recession.

And US yield curve inversion only confirms a looming recession, many (but not all) believe.

The key question for Longview therefore is whether that collective judgment is correct? Or, instead, the US is merely in the midst of a late cycle slowdown akin to 1998?

Of note, 1998 shares many parallels with today, Longview suggests. It was a year of slower economic growth, heightened recession fears, a yield curve inversion and a series of Fed rate cuts. The recession, though, didn't begin until 2001, three years later.

Those were the days

In the mid-nineties, the great economic success story was that of the "Asian Tigers" – South East Asian nations that fuelled export-led economic growth via a number of government-driven subsidies, easy finance and pegged currencies. In 1997, the Thai government decide to abandon its US dollar peg and let the baht float.

It didn't float, it sank, along with the currencies of the other Tigers, by as much as -38%.

The crisis reverberated across the globe, leading ultimately in 1998 to Russia defaulting on its sovereign debt and heavy investor in Russian debt – hedge fund Long Term Capital Management – going under to the tune of US$6bn. In the context of the 2008 GFC, it's hard to believe that only ten years earlier it was feared that US$6bn would be enough to bring down the entire global financial system, as the dominos fell.

As was the case in 2008, the crisis was averted by central banks. The "Great Recession" was ended in 2009 by central banks printing money. In 1998, central banks moved to end the crisis by selling gold.

On balance, believes Longview, and while trade war risks bear watching closely, the evidence suggests that 1998 is the correct template for today and that economic reflation, not recession, is the most likely outcome for the US in 2020.

Key pieces of evidence support that view, including the resilience of the service sector, the recent (and notable) easing of credit conditions, the pick-up in housing activity and house prices (which should underpin an ongoing household wealth effect) and the (cyclically) strong health of the corporate sector.

Impact Contained

Generally, bouts of weakness in the US economy can be classed in one of two ways, notes Longview. Either as "economy-wide" recessions, or "manufacturing-only" recessions. In the latter, service sector activity is typically supported by a central bank policy response and, as such, it keeps expanding while manufacturing activity contracts.

The Fed has this year provided two rate cuts, supporting a sharp easing of credit conditions and offsetting weakness in manufacturing: While US manufacturing PMI readings have moved sharply lower, service sector readings have held up well. Measures of CEO expectations have a similar message: In manufacturing, they have fallen sharply, but in the service sector they have remained stable/mid-range.

On balance, therefore, and while tariffs are due to rise later this year, weakness in the US economy does not appear to be spreading more broadly, Longview points out. Generally, US recessions begin after a sharp tightening of credit conditions. In recent months, though, the opposite is true. For small businesses, for example, the "availability" of loans has risen to a 17-year high. Expected credit conditions for small businesses have improved to their "best" level since 2001.

On that basis, recession risk is therefore low and growth in credit and money should remain underpinned, says Longview.

US housing activity is re-accelerating. That should result in stronger US house price growth and a positive wealth effect on the consumer. Of note, the sharp fall in bond yields and mortgage rates has had its usual effect on housing activity, Longview points out: Mortgage refinancing has accelerated; measured demand for mortgages has picked up sharply; and housing transaction volumes, which were shrinking year on year, have begun to grow.

The trend in house price growth typically follows the trend in housing transactions (with a lag time of around six months.

A re-acceleration in house prices in 2020 is therefore likely and should help support (already strong) growth in household consumption, Longview believes. Evidence of a turn in housing activity (and stronger house prices) also suggests recession risk is low.

The US corporate sector remains healthy, in a cyclical sense, and therefore, Longview suggests, faces little pressure to retrench. Ahead of recessions, companies become over-stretched by relying heavily on externally generated sources of cash. A shock then forces them to retrench, and retrenching is the recession dynamic.

Note that "retrench" in this context does not specifically refer to laying off employees, rather "business retrenchment" implies reducing one or more business operations with the view to cut expenses and reach to a more stable financial position. Which of course may then lead to employee retrenchment.

All of the past ten US recessions began when companies were running a cash flow deficit, Longview notes. Currently the cash flow position of companies is neutral and, on that measure, recession risk is therefore low.

In addition, the usual "shocks" that cause companies to retrench are not in place and, if anything, are having a positive impact on companies and the broader economy: Monetary policy is relatively loose (not tight); oil prices are not up, but down -18% year on year; and, while wage inflation is rising, growth in unit labour costs remains relatively low and range-bound.

So if 2019 really is mimicking 1998, we have nothing to fear, at least for three years.

The New Brave New World

Yet it should be noted the US recession of 2001 did not represent a lagged reaction to the events of 1997-98. It was in the late nineties that wider world became very excited about something called a "dotcom". The bail-out of Long Term Capital Management may have averted a financial crisis, but it was the dotcom bubble that drove the US stock market into the heavens.

The bubble burst in 2000. 2001 brought 9/11. The US stock market did not bottom out until 2003.

The dotcom bubble featured a series of IPOs of companies with little more than a promise of great things to come in this Brave New World, with "infinite" price/earnings ratios given they were yet to make a profit, and price/revenue ratios through the roof.

Just like Tesla, Uber, Beyond Meat, WeWork…

Indeed, it does look a lot like 1998.

The good news, however, is Wall Street appears to be showing signs of "once bitten, twice shy".

Yes, Beyond Meat did rally about 500% from its May listing price but it has since stabilised, and analysts do genuinely see growth potential in veganism. The more familiar Tesla is down -35% from its 2018 high as it continues to walk a financial tightrope, the much vaunted Uber remains around -30% below its May listing price, and the planned WeWork IPO has been pulled due to perceptions of serious overvaluation.

These are but four examples, and the list of recent US IPOs is extensive, particularly in the cloud-based SaaS space (the new "dotcom"), but Wall Street has not turned "parabolic", as it did in 1998.

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.

E-commerce Makes Goodman Group Attractive

Goodman Group represents an attractive opportunity, Shaw and Partners believes, for those looking for a stock that continues to benefit from the growing e-commerce sector.

-Sustainable performance fees amid future development opportunities -At a time when many A-REITs lack catalysts -Significant upside from converting warehouse space to data centres

By Eva Brocklehurst

Faced with mediocre expectations across the market, Shaw and Partners suggest investors need to be active to obtain reasonable, risk-adjusted returns. This involves sector and security selection playing a significant role in investment management.

Hence, the broker believes Goodman Group ((GMG)) represents an attractive investment opportunity for those looking for a stock with a strong balance sheet that continues to benefit from the growing e-commerce sector.

UBS recently upgraded to Buy to reflect the structural tailwinds from e-commerce, believing these tailwinds are strong enough to cut through global economic uncertainty. The broker also points to the sustainability of Goodman Group's performance fees, portfolio quality and future development opportunities.

UBS agrees this is a sustainable growth stock in a low bond yield environment and short-term concerns regarding Goodman Group's exclusion from several indices have largely passed. Since the stock peaked in early July it has underperformed global peers by -18%, the broker assesses, and underperformed the Australian market by -14%.

In the wake of the FY19 result, Credit Suisse downgraded to Neutral, although acknowledges FY20 looks to be another strong year in the making. External funds under management have grown 22% to $42.9bn and the company expects the development pipeline to add further $3.5-4.0bn per annum. The broker also notes the self-funding business model is now in full operation.

Credit Suisse acknowledges a conundrum in whether to consider the stock a fund manager or an "expensive REIT". At a time when many A-REITs (Australian Real Estate Investment Trusts) lack earnings catalysts the broker expects the stock will retain investor support.

Shaw considers Goodman Group an integrated real estate group (rather than a REIT) that owns, develops and manages industrial and commercial property including warehouses, logistics facilities, data centres and offices and has derived more than 70% of earnings in FY19 from active investments.

The broker, not one of the seven monitored daily on the FNArena database, initiates coverage with a Buy rating and $15.25 target, expecting Goodman Group to deliver operating earnings growth of over 9% for the next three years.

Shaw observes, over the last decade, growth has been supported by both the management and development divisions. The company remains prudent about investments and developments, despite the structural shift to online and convenience shopping, which has resulted in significant rise in demand for industrial property.

Management is likely to be the driver of growth over the next three years, while performance fees are also expected to be sustained at current levels, with the company reporting a total return of 15.5% over the last six years.

UBS also notes substantial embedded performance fees and anticipates a higher level of sustainable performance fees than the market has factored in going forward. In FY19 the company generated $600m in development profits that should drive performance fees in later periods.

The main downside risk in the near term is a potential second strike on the remuneration structure, Shaw asserts. Management has attempted to address concerns by introducing an operating performance hurdle range of between 6-9% over a three-year period.

Ord Minnett differs in its view and believes the business is over-earning, despite being well run and retaining strong near-term growth prospects. Multiples are considered elevated, although the broker forecasts growth in earnings per share of 10% in FY20 and 8% in FY21.

Data Centres

Shaw believes there is significant upside for the company to convert some of its existing warehouses into data centres, which has not been priced into valuation. It remains difficult to assess this, given the early stages, but it should be an expanding theme, particularly in Hong Kong.

Data centre rents in Hong Kong are double industrial warehouse rents. However, the broker does highlight the rising risks in Hong Kong from geopolitical issues. The company's Hong Kong portfolio is currently valued at $7.5bn.

Currently a premium is required to be paid to the Hong Kong government when converting an industrial site into a data centre.

Dark Stores

Online grocery has grown significantly over the last four years and, despite this, most orders are still picked and packed from supermarkets. The number of “dark” stores (online shopping warehouses) being opened has been minimal so far and Shaw believes there is significant room for dark store growth in Australia, given the trends overseas.

Woolworths ((WOW)) opened its first dark store in 2014 and a further two stores have opened since then. Coles ((COL)) now has two dark stores, one in Melbourne and one in Sydney.

FNArena's database has three Buy ratings, one Hold (Credit Suisse) and one Sell (Ord Minnett). The consensus target is $15.44, signalling 11.2% upside to the last share price. Targets range from $12.20 (Ord Minnett) to $17.60 (Citi).

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Growth In The Bag For Premier Investments

All domestic apparel brands improved market positions and achieved strong sales growth in FY19 for Premier Investments yet bellwether Smiggle turned in a soft performance.

-Strong sales growth across all regions so far in FY20 -Able to leverage the Smiggle brand with minimal capital commitment -Wholesale growth for Smiggle provides the main positive impetus

By Eva Brocklehurst

Premier Investments ((PMV)) has been successful with its strategy over FY19, improving its profit outcomes on limited investment, although bellwether performer, Smiggle, turned in a soft performance.

In FY20 to date like-for-like sales growth is 5.2% and positive in all regions. The company's core brands are expected to continue providing momentum in the first quarter of FY20 because of the peak in the federal government's tax stimulus from August to October. However, Citi suspects this momentum will not be maintained and forecasts a -1.2% decline in core brands for FY20 in terms of like-for-like sales, given the strong FY19 base.

Apparel sales were up 6.9%, or 7.8% like-for-like, and Macquarie points out earnings visibility has improved. The Just Group brands achieved retail sales growth of 7.5% and constant currency like-for-like sales growth of 4.2% as well as a retail earnings (EBIT) margin expansion of 47 basis points. Other positive aspects include the delivery of the growth plan for Peter Alexander a year ahead of schedule, with sales up 13.3% in FY19.

Management continues to focus on ensuring a clean inventory position at the end of each period. Sourcing initiatives and disciplined markdowns are expected to improve gross margins in FY20.

Smiggle

Underlying growth slowed materially for Smiggle, to 1% in FY19, ex wholesale and concessions, from 23% in FY18. This was largely driven by a slowdown in the UK. Citi attributes this to the tough macro environment and the opening of 30-40 stores between FY16-18, cannibalising the existing network. Following a slowing down of new store openings, the broker acknowledges sales will stabilise.

The headwinds from Brexit culminated in Premier Investments exercising clauses enabling the breaking of leases for the majority of its UK store base. This will provide the flexibility to drive rents down over the next 2-3 years. Management has stressed that closing down stores is not a desired outcome.

Credit Suisse suggests debates regarding the UK exposure are becoming peripheral to the overall investment case and the company appears able to mitigate market weakness through rental reductions. The broker emphasises Premier Investments' ability to leverage the Smiggle brand with minimal capital commitment.

Moreover, Smiggle continues to expand its global footprint through third-party websites and has successfully launched on Amazon in France, Italy and Spain. Third-party relationships continues to be explored with other global operators, including Alibaba, with a focus on countries where the brand is not operating but remains in high demand.

The concession performance in Selfridges and Harrods in the UK remains robust and the brand has opened its first Asian concessions, with three trading in Singapore at the end of FY19.

Wholesale Smiggle

Citi expects Smiggle will return to growth in FY20 as it sells into the wholesale channel, expecting retail sales of $474m by 2021, 5% ahead of management's target. Bell Potter also believes the company will achieve its target ahead of schedule. This profile would represent a 15% compound growth rate from FY19-23. New wholesale and concession channels are expected to contribute more than half of this growth.

Wholesale is the main positive in the outlook, Macquarie agrees, with around $35-45m in incremental retail sales projected for the first half. This remains the source of upside risk and the broker upgrades to Outperform from Neutral. Morgan Stanley also notes the aggressive global wholesale expansion, while Credit Suisse suggests profit from wholesale is likely to exceed UK store profitability in FY20.

The key years of growth for the wholesale channel will be FY20-21, Citi observes. Smiggle will be filling the channel over this period as new retail partners order stock for the first time. However, the broker maintains a conservative view over the longer-term for wholesale.

Citi ascertains the runaway success of the specialty store experience for Smiggle in new markets cannot be achieved in the wholesale environment, given the lack of fit-out and dedicated labour.

The company's strategy of clarifying its market position for each of the apparel brands and further investing in products and merchants has delivered results, in Macquarie's view. The focus has also be on store profitability with 35 stores closing over the last 12 months and a total of 138 closing over the last seven years.

Citi acknowledges, while there is an initial loss of sales at the headline from these closures, this has likely boost productivity across core brands. The pace of store closures is expected to continue, and the broker factors in 11 closures for FY20 and eight for FY21.

Citi downgrades to Sell, following an excessive response in the share price to the 3-4% earnings upgrade now incorporated in its forecasts. The share price has lagged retail peers in the current cycle but is now trading at a premium to discretionary retail peers. the broker considers the re-rating potential is limited as incremental earnings upgrades are required to drive further outperformance.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, goes the other way, upgrading to Buy from Hold with a target of $20.80. The broker believes a materially improved outlook for Smiggle, continued strength in Peter Alexander and the apparel brands, as well as an undemanding valuation for Just Group, underpin the business.

The database has three Buy ratings, one Hold (Morgan Stanley) and one Sell (Citi). The consensus target is $19.23, suggesting 6.1% upside to the last share price. This compares with $18.01 ahead of the results.Targets range from $16.80 (Citi) to $20.56 (Credit Suisse).

Afterpay Touch In The Box Seat

Increasing customer usage and avenues for growth both vertically and internationally have put Afterpay Touch in the box seat in the Buy Now, Pay Later segment.

-Could investors be underestimating the growth potential? -Heavy investment in growth making it hard to forecast short-term earnings -Business model does carry credit risk that may increase in economic downturns

By Eva Brocklehurst

Afterpay Touch ((APT)) has enjoyed rapid growth in the Buy Now, Pay Later segment and remains a market leader in Australasia, amid increasing usage of its product and avenues for expansion.

Citi estimates that consumers using Afterpay for more than three years are now using it twice a month. The US business saw over $1.7bn in total transaction value in June and customer numbers are now over 2.1m.

UK customers have grown to over 200,000 as of August, overtaking US customer numbers at the same point in the period of operation. Bell Potter also notes the success in the UK, through Clearpay, is in line with the US expansion trajectory.

The company recently formed a new partnership with Visa, which will not require Afterpay Touch to provide credit but which management believes could benefit merchant integration.

Citi suspects investors could be underestimating the growth potential, amid ongoing penetration of existing markets, new verticals and new markets, while initiating coverage with a Neutral rating and $33.70 target because the investment cost could be higher than many expect as the company expands internationally.

Moreover, increasing competition could negatively affect industry returns and regulation uncertainty is also a hindrance. Of note, the interim AUSTRAC audit report on the company is due by September 24.

Wilsons is encouraged by the fact over 95% of sales come from existing customers, reflecting strong loyalty and future revenue retention, but will closely monitor the rise of various competitors, including ZIP Co ((Z1P)) and Humm ((FXL)).

The broker, not one of the stockbrokers monitored daily on the FNArena database, has a Hold rating, with a $27.48 target, believing the valuation is full. That said, Wilsons expects trading momentum should support the stock even in the face of stretched assumptions being discounted in the price. This implies investors should be at least market weight.

E-commerce

Afterpay Touch appears to be riding the secular growth trend in e-commerce. Merchant sales are likely to double over the next three years, primarily because of increasing usage by existing customers and in-store roll-out.

A modest increase in the penetration of online retail is also expected, driven by increased frequency of usage and growth in e-commerce. In-store was the fastest-growing channel in FY19 and Citi estimates this represented around 26% of merchant sales in Australasia in June.

Afterpay Touch is increasing the investment in its platform and product functionality, expecting to release new features such as variable upfront payment, cross-border trade and new data services for merchants.

Bell Potter remains cautious, given the heavy investment that is occurring, and finds it hard to forecast short-term earnings, yet remains confident in the overall trajectory of the business. The broker, also not one of the seven, has a Buy rating and $38.41 target and assesses Afterpay Touch is onto a winning formula as it enjoys rapid growth across key markets.

Credit Risk

Citi points to widespread client interest in the stock, given the growth in the sector to date and the potential in international markets. However, the broker suspects opinions and outlook will vary, depending on the individual investor's view of what Afterpay Touch stands for.

Does Afterpay Touch represent a brave new way to pay, particularly for new generations? Other issues for analysis centre on whether Afterpay Touch can be defined as a marketing platform/channel for merchants and also whether it is a short-term lending solution that can withstand the credit cycle.

The broker highlights the business model carries credit risk which could also increase during economic downturns. Still, in the near term, Citi expects the share price will be driven by customer additions and merchant sales growth.

The broker assesses the FY22 target of gross merchandise value of over $20bn is conservative, estimating merchant sales will grow at 70% compound, reaching $26bn by FY22. This should be underpinned by penetration of the US & UK markets, and in-store growth & new verticals in Australasia.

There are two Buy ratings and one Hold (Citi) on FNArena's database. The consensus target is $33.52, signalling 4.3% upside to the last share price.

See also, Afterpay Touch Steams Into The US on June 7 2019.

Plenty Of Other Earnings Drivers For Webjet

Webjet has assured the market the impact from its partner Thomas Cook's liquidation is minimal and there are plenty of other earnings drivers.

-Most of the 3000 direct hotel contracts acquired from Thomas Cook are being sold at full margin -The partnership did position Webjet for expansion -Webjet retains structural and market share benefits

By Eva Brocklehurst

An era in holiday packages is coming to an end as Thomas Cook has announced it is shutting shop. Webjet ((WEB)), which entered a sourcing partnership with Thomas Cook for sun-and-beach hotel inventory three years ago, has felt some of the impact.

Thomas Cook, a customer of the WebBeds B2B (business-to-business) operations, has entered compulsory liquidation and Webjet expects the collapse will reduce its FY20 operating earnings (EBITDA) by up to -$7m. There will be a -$150-200m total transaction value loss in B2B. This was the forecast provided by the company at the FY19 results, downgraded at the time from $300-450m because of weakness at Thomas Cook.

Thomas Cook also owes Webjet EUR27m in receivables which will be impaired. Webjet does not expect a material adverse impact on liquidity from the impairment, nor does it expect other FY20 earnings drivers to be affected.

There are more than 3000 direct hotel contracts acquired from Thomas Cook which remain under Webjet's ownership and the company does not expect any impact on these. Most of the contracts are currently sold at full margin and have been a driver of profit growth for the European business over the last three years.

Nevertheless, Morgans is among the brokers which assumed an incremental improvement in earnings when the agreement with Thomas Cook shifted to a volume-based model from June 1, 2019 and marks down estimates substantially.

Ord Minnett asserts the decision to enter the partnership was controversial from the beginning, although the transaction was a critical building block to Webjet becoming the number two player in the global B2B hotels segment.

The original upfront payment of GBP21m to Thomas Cook was originally intended to cover a two-year transition period - pushed out by six months - over which Webjet would be paid a fixed management fee. A volume-based service fee arrangement was expected to follow from June 1, 2019.

Issues also arose when the company elected to treat the upfront payment as an asset and the management fees as income. Auditors disagreed and Webjet was forced to record the upfront payment as a loan and the management fees as capital repayments relating to this loan.

However, the transfer of the 3000 direct hotel contracts to Sunhotels at the time of the deal provided credibility and scale, Ord Minnett acknowledges, which ultimately led to Webjet's acquisition of JacTravel and Destinations of the World (DOTW).

Webjet has indicated that the WebBeds business transaction value is up over 50% for the first 10 weeks of the year to date, although Morgans points out the previous corresponding period did not include the contribution from the DOTW acquisition.

No information was provided regarding the B2C (business-to-consumer) business and guidance is expected at the AGM on November 20. Ord Minnett assesses the investment thesis around the company's growth profile in the B2B segment from market share gains is unchanged, as others lack scale and the ability to invest in technology.

UBS agrees Webjet has structural and market share benefits as well as synergies from DOTW and these features differentiate the company relative to other travel-related peers.

FNArena's database has three Buy and two Hold ratings for Webjet. The consensus target is $15.08, suggesting 35.7% upside to the last share price. Targets range from $12.18 (Morgans) to $18.65 (UBS).

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

Caution Required For Formula And Supplements

Common themes exist for a2 Milk, Bubs Australia and Blackmores in their exposure to Chinese demand, and Wilsons sounds out the market while initiating coverage of the three.

-Niche infant formula products with functional benefits best positioned for growth in China -Continued product development in supplements segment required -Cost of doing business increasing in China for foreign brands

By Eva Brocklehurst

The revenue potential for infant formula and, more broadly, food & beverages in China, has been well flagged, although Wilsons suggests caution is warranted given the changes to Chinese sales channels and associated costs.

The broker initiates coverage on a2 Milk ((A2M)) with a Hold rating and $12.08 target, Bubs Australia ((BUB)), with a Hold rating and $1.30 target, and Blackmores ((BKL)) with a Sell rating and $70.30 target, in this sector.

Wilsons notes some common themes across the three, given their exposure to Chinese demand. A2 Milk is well-positioned to capitalise on the infant formula opportunity as it has a niche product, strong brand awareness and regulatory registration.

Nevertheless, the near-term warrants caution as the more direct distribution model in China is accentuated by uncertainty around the returns available from increased marketing expenditure.

Meanwhile, Bubs Australia is an emerging brand with significant potential, in the broker's view, as it has a niche product and multiple distribution alliances. However, the risk profile is elevated as brand recognition is being built.

While there is strong brand awareness of Blackmores the growth profile is challenged by China's regulatory structure which limits the company's prospects outside of online business, and there is heightened competition in food supplements.

The broker believes a2 Milk is the best positioned of the local brands to capitalise on the opportunity in China as it has multiple points of access to the consumer. The broker is less certain about Blackmores as its main channel, cross-border e-commerce, is being disrupted. The broker also considers the current share price excessive for the outlook.

Demographic Indicators

A declining birth rate in China since 2016 is the key headwind for infant formula demand and cost of living in major cities continues to be high relative to average income. Hence, the introduction of the two-child policy, while encouraging for the industry, may not be as significant as it appears.

In contrast, an ageing population provides the impetus for vitamins, minerals and supplement purchases, and the percentage of people above the age of 40 has increased to 48% in China over the last two decades from 31%.

While premium products feature as China's middle-class grows, the fact they are imported is no considered longer sufficient. Hence, Wilsons believes niche infant formula products with functional benefits, such as a2 Milk's product and goats milk are the best positioned.

A2 Milk sourcing is largely from Australasia. A2 milk is from dairy cows that are genetically tested for producing milk that only includes the A2 type of beta casein. Supply, particularly out of New Zealand, has increased substantially over the last five years.

The broker points out Europe has the most developed dairy goat sector and the Netherlands and Germany are major exporters of the milk. Australasia remains the next logical candidate with a "reasonable" goat dairy industry. However, there are constraints around supply of goats milk, as production per goat is significantly lower than per cow.

Product development is key for the supplements industry, which has a less sticky consumer profile. The broker cites the recent emergence of edible supplements that have functional benefits such as "anti ageing" as a fast-growing segment.

Wilsons also points out the Australian supplements industry has a higher cost base versus offshore peers, as Australia is the only country where manufacturers are required to produce to a pharmaceutical standard and certified for good manufacturing practice.

Channels

China has instigated increased scrutiny on social e-commerce and, in infant formula, the re-emergence of channels outside of the online segment and expansion in lower-tier cities are likely to be the next drivers of growth, in the broker's view.

Most of the conversion to online purchasing has now occurred and competition amongst e-commerce platforms has intensified. This highlights the importance of China's SAMR (State Administration for Market Regulation), which is required for infant formula sales.

The broker believes foreign infant formula brands that have an integrated channel approach are likely to be the most successful and “Mother and Baby” stores remain the dominant channel for the category. In this regard, the supplements industry does not have the same growth opportunities outside of online business because of a lack of consumer trust and the regulatory complexity.

Cross-border e-commerce remains the more important channel for foreign supplement brands. The broker suspects the supplements industry will go through a similar period of reforms to that which ensued for the infant formula industry in 2016/17 culminating in the introduction of SAMR.

The cost of doing business in China for foreign brands is also increasing along with heightened competition, especially for those mature brands transitioning from the low-cost daigou (product purchased outside China for sale in China) to a more direct distribution.

Wilsons assesses small daigous will fade out or consolidate into social e-commerce platforms because of low profitability and regulatory hurdles and the larger corporate daigous will need to partner with the platforms to stay compliant with the new rules.

Treasury Wine Toasts China With Penfolds

Treasury Wine Estates expects to drive growth by investing in its French portfolio and offering the premium Penfolds brand to a wider consumer base in China.

-Penfolds from France likely to be sold predominantly in China from FY22 -Increased confidence Treasury Wine can achieve margin targets in the US -Acquisitions considered unlikely in the near term

By Eva Brocklehurst

With its restructuring plans bearing fruit in the US, Treasury Wine Estates ((TWE)) remains upbeat about the significant opportunity in China, looking to grow overall wine market share via imported wine and expand its distribution in Chinese cities by 50% over the next three years.

Growth will be driven by investment in the French portfolio as well as the regional expansion, which should help reduce working capital. The broad Asian growth strategy is to be supported by a continuing focus on elevating the Penfolds brand where demand remains strong.

The first Penfolds French vintage is underway and Penfolds from France is likely to be sold predominantly in China from FY22. The company has reiterated its intention to become the number one importer of French wine into Asia, expecting to achieve this by FY22. To this end, vineyards have recently been purchased in Bordeaux.

Treasury Wine intends to increase usage of its Shanghai warehouse and reduce reliance on the container model for distribution. Nevertheless, Macquarie points out a strong reliance on untried new regional ranges creates uncertainty in the Chinese market. Citi is also cautious, noting Penfolds is an Australian brand and a French product is an untested risk.

Credit Suisse believes the Chinese mid-autumn festival in August was testament to the strength of the Penfolds brand and came despite the geopolitical climate. Growth has occurred against a much weaker backdrop for the wine industry which stemmed from competitor de-stocking in a slower economy.

In the Americas, Macquarie notes branding improvement is evident while cost controls have improved. Treasury Wine has undertaken some structural changes in an effort to reduce costs and extract synergies from the acquisition of operations from Diageo.

The strategy is to access the 18% distributor margin in key parts of the US and the company has indicated it is "tracking in the right direction". Macquarie assumes 20% of distributor margin is recaptured but assesses 50% retention is possible.

Expansion will also include increased availability of the over US$10 wine segment which includes luxury and masstige. A target of 25% margin in the Americas is slated and Credit Suisse models 23% by FY23. From the briefing, Ord Minnett is now more confident the company can achieve its margin aspirations via improved availability and distribution.

Acquisitions?

A de-merger of the commercial portfolio is off the table, it appears, unless there is a transaction whereby the luxury portfolio can be expanded at the same time the commercial business is offloaded.

Credit Suisse points out the acquisition front is quiet at present, as those that are up for sale do not fill the requirements of the Treasury Wines portfolio. Still, if such a transaction were to occur and involved a luxury, high-growth brand then the company's stock could add around $1, in the broker's assessment.

Macquarie suggests a de-merger of the lower-priced portfolio, which represents around 30% of sales, could still happen, if the commercial portfolio of the acquired company and that of Treasury Wine are de-merged together.

Without such a benefit, the broker concurs this is an unlikely development as the commercial business is now more profitable. Citi points out the company's commercial wines have fallen to 30% of revenue from 50% five years ago and are likely to shrink further.

Citi suggests Constellation Brands' wine business potentially fits with Treasury Wine's profile but such a large acquisition would require equity, or potentially a share issue to Constellation Brands. UBS, too, is doubtful M&A is on the cards for the near term and remains more likely beyond 2020.

Elsewhere

As Australasia is a mature market the strategy is now one of incremental growth and vintage quality remains of importance. The company has pointed to continued premiumisation and increased its investment in the luxury portfolio as a result. UBS envisages upside in the medium-term stemming from this effort. There is an emerging consumer preference for light and refreshing styles, the company notes amid growth in red varietals such as grenache.

Treasury Wine has made a $150-180m capital investment in its luxury wine expansion in Australia. Grape supply will come from additional grower contracts and improved luxury grape conversion. New grower contracts are becoming available as competitor volumes exported to China weaken.

The European market remains challenged and Brexit is a headwind. The company is addressing the Brexit-related challenges by having a separate supply chain to continental Europe. Opportunity is still envisaged in luxury brands amid further innovation in packaging and the prioritising of certain countries and cities.

New guidance is for a earnings margin in Europe in the mid teens. Credit Suisse models a flat margin, it was 15% in FY19, with the potential impact from higher costs relating to Australian grape prices.

There was no trading update and the company reiterated FY20 guidance and medium-term targets. Australasian market share of 25% is envisaged, now 22%. FY20 earnings growth guidance is 15-20%, slightly skewed to the second half.

All up FY21 risk is skewed to the upside, in Macquarie's view, driven by the supply of luxury products, growth initiatives in China and margin improvement in the US. Citi retains a Sell rating, assessing margin gains in the Americas need to be realised in order to meet consensus expectations along with a better vintage in FY21. The main risk, UBS envisages is material slowdown in Asia and any stumble in executing the restructure in the Americas.

FNArena's database has five Buy ratings, one Hold (Morgan Stanley) and one Sell (Citi). The consensus target is $18.79, suggesting 4.3% upside to the last share price. Targets range from $15.60 (Citi) to $20.50 (UBS).

Uranium Sector Won't Catch A Break

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.

Uranium sector won't catch a break

One week ago Cameco announced it will maintain low output levels until uranium prices recover. The Canadian uranium miner also said itmight cut production further, having already closed four mines in Canada and laid off 2,000 of its workers in the uranium mining hub of Saskatchewan.

Cameco share price

News like this has stalked the uranium market for years, and while 2018 was a great year for the nuclear fuel, hope for a price pick-up is dim; once an important commodity at resource investing shows, uranium is now mostly ignored. Uranium bulls are as rare as white unicorns, having switched allegiance to metals that support Ahead of the Herd's electrification of the transportation system thesis, like lithium, nickel and cobalt.

Fortunately, there is a way to be both a supporter of nuclear energy - still one of the safest and most efficient means of baseload power generation - and ditch uranium, which is quickly becoming a dinosaur of a commodity we think best left alone. We've been banging the drums of thorium-based nuclear reactors for a while. In this article we present thorium's case vis a vis a sick and dying uranium market.

No end to supply glut

"We are not restarting mines until we see a better market and we may close more capacity, although no decision has been taken yet," Cameco CEO Tim Gitzel told Reuters recently at the World Nuclear Association's annual conference.

Just over a year ago Cameco made the difficult decision to close its MacArthur River and Key Lake mines, in response to low uranium prices, leaving the company's flagship Cigar Lake facility as its only operating mine left in northern Saskatchewan, home to the world's highest grade uranium deposit.

The mine closures by Cameco were preceded by 20% production cuts in Kazakhstan, the number one uranium-producing country. The former Soviet bloc country has said 2020-21 output will not rise above 2019 levels. In Canada, the second largest U producer, 2018 production was cut in half to 7,000 tonnes.

An estimated 35% of uranium supply has been stripped from the market since Kazakhstan's supply reductions in December 2017.

Uranium spot price

While the mine closures kicked up the price of uranium in 2018, they haven't been enough to build momentum. Spot uranium finished last year up just over 20%. Year to date 2019, triuranium octoxide, or U_3O_8, is down a disappointing 11.9%, trading at $25.10 per pound, as of Sept. 11.

The downward spiral of production and prices can be blamed on a supply glut. When uranium crashed after the 2011 nuclear meltdown at Fukushima, Japan, producers thought they could weather the storm by producing more to compensate for lower prices. The unsurprising result was to create a supply glut that pushed spot to a record low of $17.75 a pound on Nov. 28, 2016. By 2018 the price had recovered to around $20, but that meant around 95% of producers were operating at a loss. Uranium miners were left with a grim choice: go bankrupt, or significantly cut production, until prices return to a profitable level. And so we wait.

According to the World Nuclear Association, Kazakhstan's uranium production went from 5,000mt in 2006 to over 24,000mt in 2016. That country is now the leading low-cost producer. Renowned investor Marin Katusa believes uranium will stay low because the world's largest uranium producer, Kazatomprom, will continue to produce at high levels - the Russians and Kazakhs plan to position themselves as the dominant source of uranium over the next 20 years.

Uranium demand and China

In response to the supply glut/ low price argument, uranium bulls like to present China as the country that will save the day and float everyone's long-sunken uranium stock boats. It's true that, of 453 operating nuclear reactors and

55 new reactors under construction, globally, China has the most reactors in the pipeline including 43 operating, 15 under construction and 179 planned or proposed.

China then, will demand millions of tonnes of yellowcake, that it will have to import, right, pushing up the price? In fact, China has been working to reduce its dependence on imported uranium, and fossil-fueled power generation, by developing domestic uranium deposits and either partnering with or buying mine properties overseas. The Asian superpower has started building its own uranium supply chain, such as starting the Husab mine in Namibia. In November 2018, China National Uranium Corp bought the Rossing mine in Namibia from Rio Tinto.

According to the World Nuclear Association, China has become self-sufficient in most aspects of the nuclear fuel cycle: China aims to produce one-third of its uranium domestically, obtain one-third through foreign equity in mines and joint ventures overseas, and to purchase one-third on the open market.

The China Nuclear International Uranium Corporation (SinoU) set up the Azelik mine in Niger and has agreed to buy a 25% stake in Paladin Energy's Langer Heinrich mine in Namibia for $190 million. In 2007 SinoU bought a share in the Zhalpak mine in Kazakhstan, through a joint venture with Kazatomprom.

Prospects in Kazakhstan, Uzbekistan, Mongolia, Namibia, Algeria and Zimbabwe, Canada and South Africa are also seen as potential suppliers for SinoU, writes WNA.

In other words, China is well on its way to figuring out how it will supply uranium to all the new nuclear reactors it plans to build; it probably doesn't need the West to discover new uranium deposits and ink more offtake agreements.

Another expert body, the Nuclear Energy Agency, states that an expected increase in demand for U3O8 needed for competitively priced baseload electricity derived from nuclear power plants, particularly in developing countries, will adequately be met by current uranium supplies.

In a bi-annual report known as the ‘Red Book', the NEA points to the public's fear of nuclear power post-Fukushima, and low-cost natural gas, as the two main factors that have dampened the prospects for growth in nuclear generating capacity, and are likely to keep uranium prices depressed:

[T]he Fukushima Daiichi accident has eroded public confidence in nuclear power in some countries, and prospects for growth in nuclear generating capacity are thus being reduced and are subject to even greater uncertainty than usual. In addition, the abundance of low-cost natural gas in North America and the risk-averse investment climate have reduced the competitiveness of nuclear power plants in liberalized electricity markets…

"The currently defined resource base [6.1 million tonnes of recoverable insitu uranium] is more than adequate to meet high case uranium demand through 2035, but doing so will depend upon timely investments to turn resources into refined uranium ready for nuclear fuel production. Challenges remain in the global uranium market with high levels of oversupply and inventories, resulting in continuing pricing pressures.

Nuclear demand shrinking

Of course the entire investment case for uranium is anchored on the idea of healthy demand for nuclear power especially as the world moves off fossil-fueled power generation to cleaner forms of power like hydro-electric and renewables.

A key piece of that argument has been Japan re-starting its nuclear reactors that were shut down for safety checks and refurbishment following Fukushima. Before the 2011 earthquake and tsunami caused three reactors at Tokyo Electric Power's Fukushima plant to overheat, Japan was the world's third largest consumer of nuclear power, behind the US and France, operating 54 nuclear reactors.

Eight years later, only nine of 33 remaining reactors have been re-started, and Japan's nuclear operators are reportedly starting to sell their uranium fuel, as the chances fade of more reactors coming online, and adding to the six currently operating. Long-term contracts are also being canceled.

In another blow to the industry, Japan's new environment minister,Shinjiro Koizumi, has said he wants all reactors shuttered to avoid a repeat of the Fukushima catastrophe that leaked radiation and forced 160,000 people to flee the area, many of whom have not returned.

As reactors close in the United States, Germany, Belgium and other countries, "traders and specialists say the market is likely to remain depressed for years," Reuters reported in August.

Germany has pledged to shut down all its reactors by 2022 and the Belgian government has agreed to a new energy pact that will see nuclear power phased out over the next seven years. Germany currently gets nearly half (47%) of its energy from renewable sources, although 30% is generated from coal - needed to replace the gap in the energy grid left by nuclear power plant closures.

When the Duane Arnold nuclear plant in Iowa shuts down in 2020, and assuming other planned closures occur, it will mean 10 less reactors in the United States - from 99 to 89 - by 2025. To put that into perspective, the energy lost from those 10 reactors amounts to 23% more than all the solar electricity generated by the United States in 2017.

Uranium/ nuclear consequences

Nobody needs to warn the Japanese about the potentially deadly impacts of uranium-fueled nuclear reactors if something goes wrong. Nor the good people of Chernobyl, Russia, many of whom are suffering the long-term effects of radiation exposure.

Russians were reminded in August of what can happen, after a failed missile test resulted in an explosion that killed five scientists. The scientists were reportedly working on a small-scale nuclear reactor, located on an oil platform in Russia's White Sea near the Arctic Circle, when the blast occurred.

While "only" 31 people were directly killed in 1986 at Chernobyl, the United Nations predicts another 4,000 could eventually die from diseases such as thyroid cancer linked to radiation exposure.

The Guardian reports there was in fact an epidemic of thyroid cancer after Chernobyl, while in Japan following Fukushima, children screened for radioactive iodine were found to have been exposed to dangerous levels of radiation:

An initial ultrasound survey of thyroid glands two years after the accident – well before any cases of thyroid cancer from radiation would be expected to show up – found large numbers of cysts and nodules on thyroid glands. There were 113 cases of thyroid cancer, compared with the four that doctors would expect to diagnose in a normal population of the same size without screening.

Nuclear accidents not only hurt people, but the environment.

After Fukushima, millions, perhaps billions, of tonnes of radioactive water - generated in a process to cool melted nuclear fuel at the three damaged reactors - flowed into the Pacific Ocean, putting fisheries and other marine life at risk.

The utility in charge of the complex, Tokyo Electric Power Company Holdings, tried to block contaminated water from entering the ocean, by building an underground ice wall. However, the wall has only managed to reduce the flow of groundwater from about 500 tonnes a day to about 100 tpd.

Last year, a study found that radioactive water continued to flow into the ocean at a rate of about 2 billion becquerels a day. While that sounds bad, it is in fact a dramatic improvement from 2013, when 30 billion bequerels a day leaked cesium 137, a radioactive isotope.

A rate of 0.02 bequerels per liter of seawater, considered safe for the local fishing industry, was measured in samples collected from a coastal town 8 km from the Fukushima No. 1 plant, Japan Times reported.

But the plant continues to have problems dealing with contaminated water. The Guardian reported on Thursday that Tokyo Electric Power will have to dump a huge amount of contaminated water that has been accumulating, into the ocean.

Over a million tonnes is being stored in close to 1,000 tanks but the utility has warned it will run out of space by 2022. According to one study, it could take 17 years to safely discharge the water, after it has been sufficiently diluted.

The case for thorium

Fukushima has soured the world on nuclear, and started scientists looking more closely at thorium as a "greener" alternative. Some scientists believe thorium is key to developing a new version of cleaner, safer nuclear power.

While conventional nuclear power plants are only able to extract 3-5% of the energy in uranium fuel rods, in molten salt reactors (MSR) favored by thorium proponents, nearly all the fuel is consumed. Where radioactive waste from uranium-based reactors lasts up to 10,000 years, residues from the thorium reaction will become inert within 500.

A key advantage of MSRs is the reactor cannot melt down, as we saw in Japan's Fukushima when electric pumps were inundated by the tsunami, failing to cool the fuel rods, which overheated and caused radiation emissions. MSRs can also be made cheaper and smaller than conventional reactors, since they do not have large pressurized containment tanks, meaning they could be used in factory settings.

Where radioactive waste from uranium-based reactors lasts up to 10,000 years, residues from the thorium reaction will become inert within 500. Nuclear waste (ie. plutonium) from uranium fueled reactors can be recycled to recover the fissile materials needed to create the nuclear reaction. In this way, thorium reactors not only generate less waste than conventional reactors, but also help to rectify the nuclear waste disposal problem.

Importantly, because plutonium is not created as a waste product in a thorium reactor, it cannot be separated from the waste and used to make nuclear weapons.

The portability of MSRs is another major advantage over the capital-intensive, permanent nuclear power plants we currently have.

Other than the fact that uranium is better than thorium in building nuclear weapons, how do the two nuclear fuels stack up against one another? According to the Royal Society of Chemistry, thorium's benefits include:

Thorium is three to four times more abundant than uranium. There is estimated to be enough thorium on the planet to last 10,000 years. Thorium is more easily extracted than uranium. Liquid fluoride thorium reactors (LFTR) - a type of molten salt reactor - have very little waste compared with reactors powered by uranium. It is more efficient. One tonne of thorium delivers the same amount of energy as 250 tonnes of uranium. LFTRs run at atmospheric pressure instead of 150 to 160 times atmospheric pressure currently needed for water cooled reactors. Thorium is less radioactive than uranium. As far as disadvantages, thorium takes extremely high temperatures to produce nuclear fuel (550 degrees higher than uranium dioxide), meaning thorium dioxide is expensive to make. Second, irradiated thorium is dangerously radioactive in the short-term.

Detractors also say the thorium fuel cycle is less advanced than uranium-plutonium and could take decades to perfect; by that time, renewable energies could make the cost of thorium reactors cost-prohibitive. The International Nuclear Agency predicts that the thorium cycle won't be commercially viable while uranium is still readily available.

Arguably though, the technology exists, so why not develop it?

Examples of companies and countries that are testing thorium's viability as a nuclear fuel keep growing. In 2017 a Dutch nuclear institute started experimenting with MSRs. NRG, the name of the facility, on the North Sea coast of the Netherlands, launched the Salt Irradiation Experiment in collaboration with the EU. New Scientist reports the researchers will use thorium as the nuclear fuel for the reactor where both the reactor fuel and the coolant are a mixture of molten salt. The experiment will also examine how to deal with the nuclear waste.

In Norway, Thor Energy started producing power from thorium at its Halden test reactor in 2013, with help from Westinghouse. The third phase of a five-year thorium trial operation got underway in 2018.

India's thorium program is well advanced. The country envisions meeting 30% of its electricity demands through thorium-based reactors by 2050. With large quantities of thorium and little uranium, India wants to use thorium for large-scale energy production. It plans to construct and commission a fleet of 500 sodium-cooled fast reactors - which burn spent uranium and plutonium - in order to breed plutonium to be used in its advanced heavy water reactors that employ thorium as the nuclear fuel.

Indonesia, which has a large amount of thorium contained within monazite, signed an agreement with US company ThorCon Power, to develop molten salt reactors. A 1,000-megawatt thorium-based reactor would be used for base-load power and produce 5 gigawatts a year. The country wants around 20% of its energy mix to come from thorium molten salt reactors by 2050.

In the United States, the Department of Energy is partnering with TerraPower, Vanderbilt and the Oak Ridge National Lab, among others, to build a molten chloride fast reactor - a type of MSR - Oilprice.com reported. Southern Company in 2016 was the second firm to receive a grant from the DOE.

China, seemingly always on the leading edge of new energy, has put aside US$3.3 billion to build two molten salt reactors in the Gobi Desert, to be up and running by 2020, the South China Morning Post said. The reactors could spawn new uses for the radioactive element, including applications in warships and drones.

Closer to home, the New Brunswick government has committed $10 million towards building a "nuclear research cluster" that includes a demonstration Stable Salt Reactor - Wasteburner (an SSR-W is suitable for grid-scale power, between 300 megawatts and 3GW) to be powered by spent uranium. SSRs can also use thorium as the nuclear fuel. A full-sized SSR-W is planned for 2030.

Think about British Columbia's energy needs. Instead of meeting them with the Site C dam, which comes with its own environmental problems - flooding a 100-km stretch of the Peace River Valley - how about deploying thorium reactors?

The Site C dam is slated to provide 1,100 megawatts of capacity - enough to power half a million homes.

New Brunswick's planned SSR and BC's Site C are of equivalent size; $10.7B Site C has a design capacity of 1.1GW compared to 1GW for the $2B SSR.

The levelized cost of energy (the price a power station must receive over its lifetime to break even) of an SSR is one third the cost of coal, natural gas and conventional nuclear power - $45 a megawatt-hour.

That means New Brunswick's plan for future emissions-free, green power is 80% cheaper, in terms of capital costs, than BC's Site C hydroelectric dam, and 87.5% the cost of Site C plus LNG Canada tax breaks.

So not only does BC's wrong-headed energy strategy cost taxpayers eight times as much as New Brunswick's, it is also a lot worse for the environment. When will the people of BC wake up and see what a colossal mistake the province is making in embracing liquefied natural gas, with its fugitive methane emissions and the continuation of fracking BC's northeast where hundreds of natural gas well will be drilled and fracked to supply BC's growing LNG industry, wasting and poisoning our fresh water, causing earthquakes, releasing cancer-causing benzene into the water supply, and setting up a massive increase in tanker traffic, the effects of which will result in the disappearance of already endangered killer whales?

Conclusion

This article has focused on the drawbacks of uranium and the futility of investing in uranium companies, at least for the foreseeable future. At Ahead of the Herd, we know energy markets inside and out, and we just don't see an upside in uranium.

Yes, as the world transitions from fossil fuels to clean energy, nuclear will have to be in the mix of alternatives, along with hydro-electric and renewables ie. solar and wind. But that doesn't mean we are tied to uranium. Thorium is a safer, more efficient and far more cost-efficient means of achieving the same amount of power as a hydro-electric dam - as in the Site C vs SSR example above - or a conventional water-cooled uranium-fed nuclear reactor.

China will remain a big source of uranium demand, but the market for U_3O_8 continues to languish as Western countries turn away from nuclear.

At Ahead of the Herd, we see thorium playing a critical role in the inevitable shift from fossil-fueled to clean (including nuclear) power generation. Electricity generated from thorium could also help to meet the extra power loads on electricity grids, expected to be demanded by the huge increase in electric vehicles, all needing to be regularly plugged in.

We see two markets for EVs during this transition. The first is fully-electrics for urban environments, maybe plug-in hybrids for drivers with longer commutes, and the second is full hybrids for longer journeys and commutes that don't need to depend on battery-only power or charging infrastructure.

If the future is EVs, the near future is hybrids. Even a significant penetration of hybrid vehicles into urban markets would be a great start. As drivers get more comfortable with battery power, and technology advances, we predict a gradual shift from hybrids and plug-in hybrids to battery EVs.

With hybrids as the bridge, we also see a path forward to helping stop the advance of the global warming shadow. At the same time, switching from uranium to thorium is a way to bring badly needed trust back to the nuclear industry, at much lower capital expenditures and shorter time frames than it takes to build conventional, uranium-based nuclear facilities.

"In the 1980s there was a new nuclear reactor commissioned every 2½ weeks, on average. Today there are just 53 under construction world-wide, nearly all in Asia, according to the WNA, and many of the world's 448 existing plants face decommissioning." Wall Street Journal

Uranium's story is not one of a shortage of supply. Rather the narrative is despite all the primary/ secondary supply cuts the spot price only went up 20% in 2018, has given back half of that in 2019 and the price is still going down. As discussed above there are too many negatives at play.

Perhaps it's time to ditch uranium, along with a large chunk of our fossil fuel use, and go with thorium?

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

Behind The Lithium Market Meltdown

By Tim Boreham, Editor, The New Criterion

Behind the lithium market meltdown

The stronger-for-longer lithium story is not exactly panning out as such, with a global oversupply emerging and the upbeat blue sky stories supplanted by tales of woe from the emerging producers. The same thing's happening with that other wonder battery metal, graphite.

Suddenly a litany of woes has enveloped the lithium sector, although arguably the downturn has been years in the making.

Last month Alita Resources ((A40)) entered voluntary administration just months after getting its Bald Hill lithium concentrate plant in WA into production. Alita's problem – meeting banking covenants – shows there are no new corporate ways of getting into trouble other than having too much debt and too little cash flow.

Pilbara Minerals ((PLS)) has tapered back expansion plans for its Pilgangoora project, while Galaxy Resources ((GXY)) cut the value of its Mt Cattlin mine by $178 million. Even the privately owned Greenbushes, the world's biggest mine and previously Australia's only lithium producer – has curtailed expansion plans.

Meanwhile, grateful Kidman Resources ((KDR)) holders voted overwhelmingly in favour of Wesfarmers' $776m takeover offer.

That's not to say the battery material theme underlying the surge of interest in the metal is invalid. But not all lithium material is the same and not all the projects are the same, so now's the time for investors to take a discerning stance.

"We see many analysts compare companies by resource size and grade," says Pan Asia Metals chief Paul Lock. "In reality these comparisons often mean little when one considers geology, geography, political risk, policy settings and the location of end markets."

The only rule that counts is being a relatively low cost producer, because even a decent 100 million tonne resource means little if you can't extract it economically.

"Once a discovery has been made then the barriers to entry are low," he says. "As a result (hard rock) spodumene concentrate has become a commodity."

Lock attributes the price malaise to oversupply of spodumene concentrates from Australian suppliers, China's decision to cut electric vehicle (EV) subsidies and bottlenecks in conversion capacity.

On the flipside, demand for lithium ion batteries has not abated, although growth has not met expert forecasts. CATL, China's biggest lithium ion battery maker, reported a 166% surge in half year revenue, while Chinese EV sales overall have grown 81% in the year to June.

Given favourable longer term demand, Pan Asia Metals is as keen on developing a lithium mine as any of its overzealous peers. The company plans to list on the ASX in early 2020, based on its Reung Kiet Lithium Project near Phuket in southern Thailand.

As well as being South East Asia's only lithium project, Reung Kiet's star attribute is that it would mine lepidolite, which can be processed into lithium carbonate or lithium hydroxide using a simple heap leach process.

Known in new age circles as a healing stone, lepidolite is a crystal containing a high amount of lithium. Now may it cast its soothing aura on the rattled lithium market.

Koppar Resources ((KRX))

While Pan Asia Metals has the only lithium project bin South East Asia, Koppar owns the only lithium project in Europe - and one that oozes green credentials.

Led by Volkswagen, the European car makers have set ambitious targets for electric car production - but the trouble is the scarcity of locally produced battery-grade lithium.

Koppar has outlined unusual plans to produce the coveted material from lithium-rich brines deep under Germany's Upper Rhine Valley.

The other oddity that sets Koppar and its Vulcan project apart from other early-stage lithium plays is that the brines are in geothermal deposits that already produce plenty of electricity to power the region's industrial machine.

Before it injects the heated fluids back into the ground, Koppar will extract the lithium material to produce battery-grade lithium hydroxide. The lithium is produced in a carbon-neutral manner demanded from the car makers.

Koppar chief executive Francis Wedin previously had a private company with a lithium asset that was sold to Pilbara Minerals.

He then teamed with German geothermal guru Dr Horst Kreuter to build a package of assets and – yada yada – Koppar listed in May last year after raising $4.5m at 20c apiece.

Wedin says European car makers – and governments generally – won't tolerate relying on Chinese and South American sources for lithium, a crucial ingredient in EV battery cathodes.

"From analyst forecasts Europe will produce about 16% of the world's lithium ion batteries from cathode material by mid 2020," he says. "That number represents the entire battery lithium market now."

Permitted across 78,000 hectares, , the Vulcan project is in scoping study stage, with an "exploration target" of 10 to 35 million tonnes of contained lithium carbonate equivalent.

Unlike spodumene lithium producers, the project won't require open cut mining (pretty much verboten in Europe) or an expensive plant. The recovery method of direct precipitation will also be much quicker than evaporation, the technique used by South American brine producers.

"Because the project is a cross between a minerals and geothermal play, you do a lot of desk top and seismic interpretation, rather like an oil and gas play," Wedin says. "You don't drill your wells until you are 80% certain of success because of the cost of doing so."

With grades at the lower of South America's so-called salar deposits, Vulcan's location is a key attribute in terms of resource security and achieving carbon neutral status.

"Our understanding is when you buy an EV in Europe the lithium in your battery essentially has travelled 50,000 km, which is a lot of carbon emissions," Wedin says.

Stung by the 'diesel gate' scandal, VW has stated a consumer and regulator friendly goal of producing net zero carbon EVs from the end of this year. When procuring parts such as batteries, the car maker will give weighting to sustainability just as much as price.

At Stuttgart – a mere 60 km from the project – Mercedes Benz and Porsche are embracing EVs with renewed zeal, while even the hitherto reluctant Toyota has jumped on the high-voltage band wagon.

With a $7m market cap supported by $4.5m of cash, Koppar is being priced for failure.

Wedin admits the geothermal lithium concept is untested, although others are having a crack.

Should Koppar's lithium quest stall, there's the fall-back option of joining the Rhine Valley's six other generators as a pure geothermal power play.

Meanwhile, Wedin says lithium prices are at more sustainable levels, having roughly halved over the last 12 months.

"If you can't make money at these prices you shouldn't be in the business."

Ioneer ((INR))

A special mention as well to Ioneer, which is seeking to develop its Rhyolite Ridge deposit in Nevada, the same state in which Tesla is constructing a battery gigafactory in what will be the world's biggest building.

In definitive feasibility stage, Rhyolite Ridge boasts a 130 million tonne resource of lithium and boron (measured and indicated). Ioneer is talking about annual production of 20,000 tonnes of lithium carbonate and 170,000t of boric acid over a 30 year life time, with the project operating at the "lower end of the cost curve".

Of course it's all a gamble, but the odds are better than at Las Vegas down the road.

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Material Matters: Coal, Oil & Diamonds

A glance through the latest expert views and predictions about commodities. Coal; oil; alumina; iron ore; gold; and diamonds.

-Thermal coal seaborne market likely to be in surplus in 2020 -Immediate concerns centre on global availability of diesel fuel after attacks on Saudi Arabian supply -Negative sentiment on Iluka Resources considered overdone -Morgan Stanley considers gold sector overbought -Synthetic diamonds gaining market share

By Eva Brocklehurst

Coal

Citi revises thermal coal price forecasts lower, down -19% to US$70/t in 2020 and down -6% in 2021 to US$75/t, on the back of lukewarm global energy demand and falling natural gas prices. Rising supplies from India, Colombia and South Africa appear set to shift the seaborne market into surplus in 2020.

Chinese thermal coal prices have stayed in a narrow range around RMB580-620/t so far in 2019 as domestic supply outweighs demand and Citi notes the appetite for imported coal remains strong as seaborne thermal coal prices have fallen even faster. Outside of China, demand is set to gradually weaken amid the slowdown in advanced economies, which should more than offset increases in demand in Southeast Asia and India.

The switch in European utilities into natural gas and away from thermal coal continues to affect demand, the broker asserts. Low natural gas prices because of an oversupply of LNG and robust exports from Russia have dragged on thermal coal demand and pricing.

Macquarie reduces forecasts for both thermal and coking coal (metallurgical) prices by -6% and -4% respectively for 2019, which in turn weakens the outlook for both New Hope Corp ((NHC)) and Whitehaven Coal ((WHC)). Given uncertainty surrounding the future of New Acland the broker also downgrades New Hope to Underperform from Neutral.

Whitehaven Coal is downgraded to Neutral from Outperform because of the weaker earnings outlook. Citi also substantially reduces its earnings estimates in FY20 and FY21 for both stocks.

Meanwhile, long-term coking coal prices are expected to reach US$140/t justifying investment in greenfield Australian hard coking coal assets. Citi notes BHP Group ((BHP)) may be able to expand capacity at cheaper prices but others need that level of pricing to keep supply steady amid potential depletion of existing mine blocks over the long-term.

Australian supply will be needed for newly-constructed blast furnaces and coke ovens in China and India as, outside of Australia, premium hard coking coal supply growth appears limited. China is struggling to grow its capacity because of constraints on domestic resources and will need to rely on imports from the seaborne market.

Oil

Citi observes the oil market has lost virtually all surplus production capacity after the attacks on Saudi Arabia's oil centre. The damage to the processing facilities has affected the capacity to separate associated natural gas for up to 7m bopd as well as the ability to stabilise oil in order for it to be shipped safely to international destinations.

Depending on how rapidly damage is repaired, Citi notes immediate concerns centre on the global availability of diesel fuel in the months ahead.

In the short term the surge in the oil price should not change supply or demand, in the broker's opinion, and associated gas production will still have to wait for tight oil production to rise, which could be a nine-month process. In the longer term, gas prices could come down as a prolonged oil price increase could encourage some extra production of tight oil and associated gas.

Alumina

Macquarie makes material reductions to alumina forecasts, cutting estimates by -5% and -10% for 2019 and 2020, respectively. The reductions reflect the rapid ramp up at Alunorte and an increase in assumed Chinese domestic supply.

As a result of reductions to both alumina and coal prices the near-term outlook for South32 ((S32)) has weakened and the broker downgrades to Underperform from Neutral. Earnings estimates in FY20 are reduced by -18% and FY21 by -5%.

Morgan Stanley, on the other hand, notes South32 has underperformed significantly because of sentiment towards manganese, future power negotiations and fee negative moves in coal and alumina. The broker finds the negative sentiment relating to manganese overdone and marks the stock as its second most preferred for value under coverage.

Iluka Resources ((ILU)) retains top spot, with Morgan Stanley assessing the fall in the stock of -30% since the financial result that reflects delays at Sierra Rutile and concerns about the zircon market are overdone. Macquarie upgrades Iluka Resources to Outperform from Neutral, agreeing the slump in the stock has been excessive.

Iron Ore

Morgan Stanley downgrades Fortescue Metals ((FMG)) to Underweight from Equal-weight, believing the risks in the iron ore price are to the downside despite the company being a quality operator. The broker expects the headline iron ore price and 58% price realisation to recede from current highs, commencing in the first half of 2020 as supply increases and Chinese mill profitability benefits from lower raw material prices.

Macquarie reiterates a preference for Fortescue Metals among bulk commodity miners, and considers pure iron ore stocks Champion Iron ((CIA)) and Mount Gibson ((MGX)) are also offering material upside at current prices. The recent decline in spot iron ore prices has eroded momentum for both BHP Group and Rio Tinto ((RIO)) in FY20 but the broker continues to envisage a strong earnings upgrade risk under a spot scenario for FY21 and beyond.

Gold

Morgan Stanley upgrades Regis Resources ((RRL)) to Equal-weight, noting it has been left behind in the rally in gold stocks. While a higher gold price deck improves the targets for gold stocks, the broker continues to believe the sector is overbought.

Macquarie has reduced Newcrest Mining ((NCM)) to Underperform from Neutral following the recent rally in the share price. The broker continues to prefer those gold stocks with positive production, headed by Northern Star ((NST)) and Saracen Mineral ((SAR)).

Diamonds

UBS highlights a mixed outlook for the diamond jewellery market, with potential pressure on sales in the US caused by the volatility and downside risk to US equities. There are some signs of improving sentiment in China as a trade war becomes the "new normal".

After an expected contraction in global diamond jewellery demand in 2019 the broker forecasts only a modest recovery in 2020. Natural diamond jewellery demand is likely to lag luxury expenditure because of lower marriage rates, relative under-expenditure on marketing and the growth in synthetic diamonds.

There is increasing indications that synthetic diamonds are gaining market share, including in the Chinese engagement ring market, although demand growth for natural diamonds is still expected over the medium term.

In the near term any potential recovery in diamond fundamentals is considered unlikely as consumer sentiment remains fragile. In the year to date the broker estimates global jewellery demand is likely to be down -1-2% but rough diamond demand is down more than -25%, driven by material re-stocking by cutters/polishers in India and more recently by jewellery manufacturers and retailers.

Weak rough diamond demand has also forced de Beers and Alrosa to reduce sales to prevent excessive discounting and their inventories of rough diamond are expected to build.

Weekly Ratings, Targets, Forecast Changes - 20-09-19

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 September 16 to Friday September 20, 2019 Total Upgrades: 5 Total Downgrades: 7 Net Ratings Breakdown: Buy 37.94%; Hold 46.43%; Sell 15.63%

The wide gap between total Hold/Neutral ratings and total Buy (and equivalent) ratings among stockbrokers continues to widen. FNArena registered five upgrades and seven downgrades for the week ending Friday, 20th September 2019 from the seven stockbrokers monitored daily.

When it comes to fresh Buy ratings (four out of the five), stockbroking analysts seem to chase falling and lagging share prices, while companies that issue profit warnings receive the knee-jerk punishment through downgrades. Sims Metal received two downgrades, of which one went to Sell, during the week, and Nufarm received one to Neutral.

Positive changes to valuations and target prices are dominated by gold producers as analysts are recalibrating their views for bullion at a time when central bankers continue to gravitate towards zero. EclipX Group, Qantas and Magellan Financial are the week's exceptions.

There really is not much happening on the negative side, with only two of the negative revisions noteworthy; Sims Metal Management and New Hope Corp.

The table for positive earnings revisions is equally dominated by gold producers, but this time the exceptions are Synlait Milk, Independence Group, Whitehaven Coal and EclipX Group. New Hope Corp, Sims Metal Management and Coronado Resources sit on top of the table for negative adjustments to forecasts, with little else to report on from this side of the ledger.

Out-of-season reporters take a little break this week with only Nufarm on the calendar, but there is no shortage of macro-influences and considerations. With September traditionally the weakest month on the calendar, investors might be breathing a sigh of relief the month has only one more week to run.

Then we still need to survive the first half of October, assuming calendar swings count for anything in 2019.

Upgrade

ECLIPX GROUP LIMITED ((ECX)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/1/0

The company has announced the divestment of its commercial equipment finance business. As the core fleet & novated leasing has returned to a dominant position, and with just two further divestments in the pipeline (Right2Drive and consumer), Citi upgrades to Buy from Neutral.

While lowering net operating income forecasts, the broker's estimates of operating earnings (EBITDA) increase as the losses from commercial equipment are removed. FY20 estimates of earnings per share are upgraded by 15%. Target is raised to $1.96 from $1.56.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/2/5

Following a recent de-rating in the share price along with relative outperformance, Macquarie upgrades to Neutral from Underperform. Target is $50.

The company's $275m capital raising in isolation would result in just under -3% dilution, the broker calculates. Offsetting this, the proceeds will be used to launch the Magellan High Conviction Trust as well as a new retirement product and seed new investment strategies.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/0/0

Credit Suisse observes Haile finally appears set to perform, with a 2022 target for over 200,000 ounces per annum of low-cost production. Throughput is considered sustainable at over 4mtpa and a recovery uplift to 85%.

The Horseshoe underground development is expected to deliver over 800,000tpa of higher average grade ore. The appeal in the Philippines court is set for September 18 and, if favourable, could be a positive catalyst, in the broker's view.

The share price appears to be pricing a negative outcome and the broker upgrades to Outperform from Neutral on valuation. Target is $4.25.

QANTAS AIRWAYS LIMITED ((QAN)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/1/0

Morgan Stanley assesses, while some early demand indicators for FY20 are subdued, there is more confidence the downside risks are captured and there is limited near-term impact from volatility in the oil price.

While oil is a risk, the company is fully hedged for FY20. Qantas has guided to a worst-case fuel bill of -$4.1bn.

Loyalty growth, meanwhile, has accelerated and this has become increasingly separate from the vagaries of the airline industry.

Morgan Stanley now explicitly accounts for loyalty in its valuation and upgrades to Overweight from Equal-weight. Target is raised to $7.00 from $5.90.

RAMSAY HEALTH CARE LIMITED ((RHC)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/5/0

Macquarie expects contributions from Australian brownfield projects will support above-industry hospital growth in the near to medium term, although reduced participation in private health insurance presents a headwind for hospital volumes in Australia.

The outlook for the UK and France has also improved. Valuation appears undemanding at current levels and the broker upgrades to Outperform from Neutral. Target is steady at $71.50.

Downgrade

BEACH ENERGY LIMITED ((BPT)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/5/0

Post a share price rally of 50% in the past month (!), Ord Minnett has decided it's time to downgrade this stock to Hold from Buy. The target price remains at $2.55 but is now below the share price.

The broker remains positive on the company's outlook and cites further strengthening potential for the oil price as a key risk to its decision. A further US$10/bbl rise in the oil price would translate into a 20%-plus lift in forecasts.

CENTURIA METROPOLITAN REIT ((CMA)) Downgrade to Neutral from Buy by UBS .B/H/S: 0/2/0

The company has acquired two assets for $380.5m, funded with a $273m equity raising. UBS increases the valuation, raising the target to $2.82 from $2.74, after incorporating the transaction, but downgrades to Neutral from Buy on valuation grounds.

The company has acquired 8 Central Avenue Eveleigh, Sydney, and William Square, Northbridge, Western Australia.

UBS assesses the overall transaction is neutral or marginally dilutive to free funds from operations (FFO). The company expects FFO in FY20 to be 18.7c per security.

DACIAN GOLD LIMITED ((DCN)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/1/1

Net profit in FY19 was stronger than Macquarie expected, largely because of the better depreciation expense. Mount Morgans continues to be essential to meeting guidance in FY20.

Macquarie downgrades to Underperform from Neutral because of recent share price strength. The broker notes the processing plant needs to perform well in excess of nameplate, given the recently revised life of mine plan.

The company is also relying on continuing improvements from the Westralia underground mine. Target is steady at $1.20.

KATHMANDU HOLDINGS LIMITED ((KMD)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 0/3/0

FY19 net profit was at the top end of guidance and above forecasts. Credit Suisse found the results solid, reflecting the full year impact of the Oboz acquisition as well as operating efficiencies.

The company expects Oboz to continue delivering double-digit growth and this should largely offset the FX impact on gross margins in the core retail business. Same-store sales growth in FY20 to date has been strong, up 6.1%.

While continuing to believe Kathmandu has attractive medium-term growth options there was nothing in the result to drive a materially higher valuation, in the broker's view. Rating is downgraded to Neutral from Outperform. Target is raised to NZ$3.15 from NZ$3.00.

NUFARM LIMITED ((NUF)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/3/0

Seasonal conditions continue to be tough, particularly in northern NSW and Queensland. Macquarie reduces estimates for earnings per share by -19% and -8% in FY20 and FY21, respectively.

Rating is downgraded to Neutral from Outperform and the target reduced to $5.30 from $5.77. After a small rally from its lows the stock is now trading at parity to global peers, the broker notes. The company reports its results on September 30.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Downgrade to Neutral from Buy by Citi and Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/2/2

Upon the company's sudden -and quite heavy- profit warning so soon post the August reporting season, Citi analysts have pulled back their recommendation to Neutral from Buy. As earnings estimates receive the chainsaw massacre treatment, the price target tumbles to $11.50 from $12.50.

The analysts point out that, taking guidance from company management's commentary, the near term outlook for scrap markets appears weak with management noting volumes are falling.

Sims Metal expects first half results to be substantially weaker than in the previous year. Weak macro economic conditions, falling scrap prices and higher freight costs are cited.

Macquarie reduces estimates for earnings per share by -40.5% for FY20 and -12.6% for FY21. The broker downgrades to Underperform from Neutral and reduces the target to $9.30 from $11.70.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ECLIPX GROUP LIMITED Buy Neutral Citi 2 MAGELLAN FINANCIAL GROUP LIMITED Neutral N/A Macquarie 3 OCEANAGOLD CORPORATION Buy Neutral Credit Suisse 4 QANTAS AIRWAYS LIMITED Buy Neutral Morgan Stanley 5 RAMSAY HEALTH CARE LIMITED Buy Neutral Macquarie Downgrade 6 BEACH ENERGY LIMITED Neutral Buy Ord Minnett 7 CENTURIA METROPOLITAN REIT Neutral Buy UBS 8 DACIAN GOLD LIMITED Sell Neutral Macquarie 9 KATHMANDU HOLDINGS LIMITED Neutral Buy Credit Suisse 10 NUFARM LIMITED Neutral Buy Macquarie 11 SIMS METAL MANAGEMENT LIMITED Sell Neutral Macquarie 12 SIMS METAL MANAGEMENT LIMITED Neutral Buy Citi Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SBM ST BARBARA LIMITED 13.0% -67.0% 80.0% 4 2 AQG ALACER GOLD CORP 100.0% 33.0% 67.0% 3 3 EVN EVOLUTION MINING LIMITED -14.0% -43.0% 29.0% 7 4 ECX ECLIPX GROUP LIMITED 80.0% 60.0% 20.0% 5 5 OGC OCEANAGOLD CORPORATION 90.0% 70.0% 20.0% 5 6 QAN QANTAS AIRWAYS LIMITED 80.0% 60.0% 20.0% 5 7 NCM NEWCREST MINING LIMITED -50.0% -67.0% 17.0% 6 8 MFG MAGELLAN FINANCIAL GROUP LIMITED -71.0% -83.0% 12.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SGM SIMS METAL MANAGEMENT LIMITED -25.0% 8.0% -33.0% 6 2 NHC NEW HOPE CORPORATION LIMITED 50.0% 67.0% -17.0% 4 3 NUF NUFARM LIMITED 50.0% 67.0% -17.0% 6 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SBM ST BARBARA LIMITED 3.190 2.920 9.25% 4 2 NCM NEWCREST MINING LIMITED 30.652 28.818 6.36% 6 3 AQG ALACER GOLD CORP 6.867 6.533 5.11% 3 4 ECX ECLIPX GROUP LIMITED 1.732 1.652 4.84% 5 5 EVN EVOLUTION MINING LIMITED 4.324 4.153 4.12% 7 6 QAN QANTAS AIRWAYS LIMITED 6.570 6.350 3.46% 5 7 OGC OCEANAGOLD CORPORATION 4.780 4.660 2.58% 5 8 MFG MAGELLAN FINANCIAL GROUP LIMITED 49.171 49.033 0.28% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SGM SIMS METAL MANAGEMENT LIMITED 10.600 11.333 -6.47% 6 2 NHC NEW HOPE CORPORATION LIMITED 2.738 2.890 -5.26% 4 3 NUF NUFARM LIMITED 6.082 6.160 -1.27% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 OGC OCEANAGOLD CORPORATION 18.134 16.233 11.71% 5 2 SBM ST BARBARA LIMITED 34.915 31.787 9.84% 4 3 SM1 SYNLAIT MILK LIMITED 49.439 45.538 8.57% 4 4 AQG ALACER GOLD CORP 40.973 38.754 5.73% 3 5 OZL OZ MINERALS LIMITED 47.909 45.709 4.81% 7 6 EVN EVOLUTION MINING LIMITED 24.386 23.871 2.16% 7 7 NCM NEWCREST MINING LIMITED 165.057 161.938 1.93% 6 8 IGO INDEPENDENCE GROUP NL 27.938 27.438 1.82% 4 9 WHC

WHITEHAVEN COAL LIMITED 27.920 27.686 0.85% 7 10 ECX ECLIPX GROUP LIMITED 10.400 10.340 0.58% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NHC NEW HOPE CORPORATION LIMITED 25.445 42.787 -40.53% 4 2 SGM SIMS METAL MANAGEMENT LIMITED 66.560 86.855 -23.37% 6 3 CRN CORONADO GLOBAL RESOURCES 54.157 57.894 -6.45% 3 4 ILU ILUKA RESOURCES LIMITED 68.533 69.700 -1.67% 6 5 IAG INSURANCE AUSTRALIA GROUP LIMITED 37.729 37.914 -0.49% 7 6 ORE OROCOBRE LIMITED 0.472 0.474 -0.42% 6 7 TWE TREASURY WINE ESTATES LIMITED 73.186 73.483 -0.40% 7 8 WBC WESTPAC BANKING CORPORATION 203.643 204.200 -0.27% 7 9 TLS TELSTRA CORPORATION LIMITED 20.597 20.647 -0.24% 6 10 BOQ BANK OF QUEENSLAND LIMITED 78.843 78.986 -0.18% 7 Technical limitations

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

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Uranium Week: Ignoring Uncertainty

While there are many and complex reason why the world's uranium and nuclear energy markets remain in a state of uncertainty, some buyers have decided they can't wait any longer.

-Three Mile Island retires after 45 years -Uranium market uncertainty compounded -Buying interest emerges nevertheless

By Greg Peel

The film The China Syndrome premiered in March, 1979, at the Cannes Film Festival. Jack Lemon portrayed a supervisor at the fictitious nuclear plant who discovered that what appeared to be a pending meltdown was in fact due to a stuck dial on the instrument panel.

Twelve days later Three Mile Island reactor in Pennsylvania started leaking radiation. A relief valve had become stuck open, and control room indicators were deemed to have been "ambiguous". Three Mile Island became the world's first "nuclear accident", ultimately dwarfed by subsequent accidents in 1986 and 2011.

Last Friday Three Mile Island was shut down, for good, after 45 years of operation. The decomissioning process will take 60 years.

Meanwhile last week Duke Energy announced it would seek a second licence renewal for its eleven reactors across six sites in North and South Carolina, which would see those reactors operating up to 80 years by 2066.

Duke Energy, which also generates electricity via coal-fired and gas-fired plants, last week revealed a plan to cut its carbon emissions by -50% by 2030 from 2005 levels and be zero-carbon by 2050, noting nuclear energy will be an important factor.

Nice timing. Go Greta.

Not Waiting Around

The US uranium/nuclear energy market remains in a state of flux as it awaits the recommendations of President Trump's Working Group, and uncertainty has now been further compounded by additional sanctions being placed on Iran.

Were the White House to go further and levy sanctions on countries providing nuclear fuel products and services to Iran, this would rope in Russia, and already there is uncertainty around existing sanctions on Russia and the Russian Suspension Agreement, which limits US imports of Russian nuclear fuel to 20% of US requirements, and expires at the end of next year.

While such a level of uncertainty has put off many utilities from entering the uranium market, it has not deterred all. Last week several parties concluded transactions in the mid-term delivery market, industry consultant TradeTech reports, and several more are exploring potential purchases both formally and informally.

Those deals sparked buying interest in the spot market, leading to over 1mlbs U3O8 equivalent being purchased over the course of the week by a variety of buyers. Traders were the primary sellers, and backed off their offers as the week progressed.

TradeTech's weekly spot price indicator rose US55c to US$25.80/lb.

TradeTech's term priced indicators remain at US$28.00/lb and US$30.00/lb respectively for medium term and long term delivery contracts.

The Short Report - 26 Sep 2019

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

Summary:

Week ending September 19, 2019

Last week saw the ASX200 again track a choppy path gradually higher.

From last week's Report:

"Otherwise we might point out that as of last week, Tasmanian dairy product producer Bellamy's Australia ((BAL)) was 15.0% shorted. The next day, a Chinese state-owned company made a takeover offer and the stock jumped 55%. There would have been some blood on the short-side floor.

"As to whether the government will let Beijing takeover our baby formula industry to avoid having to pay the margins, at what we might call a somewhat "sensitive" time in Sino-Australian relations and the public's perception of them, is another matter."

Bellamy's shorts have fallen from 15.0% to 6.6%. Blood indeed.

Outside of Bellamy's, there is a lot of red and green on the table below, but no other stock's shorts moved by more than one percentage point either way.

That makes Bellamy's the only Mover & Shaker, and the above sums things up.

Otherwise, we might note Fortescue Metals ((FMG)) had popped its head into the table the week before and out again last week. Newbies to the table this week – or at least stocks that have not appeared for a long time – are furniture retailer Adairs ((ADH)) and fund manager Janus Henderson ((JHG)).

Speaking of fund managers, IOOF Holdings ((IFL)) was 9.3% shorted last week and this week has rallied 10% on a positive decision from the Federal Court, so one to keep an eye on in next week's Report.

Weekly short positions as a percentage of market cap:

10%+ NUF 17.9 SYR 16.6 ORE 16.1 GXY 15.6 ING 14.9 NXT 14.3 JBH 13.4 GWA 12.1 HUB 11.2 DMP 10.0

Out: BAL, BWX

9.0-9.9

BKL, BOQ, BWX, IFL, CGC, BIN, MTS

In: BWX Out: SGM, BGA, HVN, IVC 8.0-8.9%

IVC, BGA, HVN, SGM, PPT, SDA, RWC, SUL, CGF, OML

In: SGM, BGA, HVN, IVC, CGF, OML Out: DCN

7.0-7.9%

CLH, DCN, CSR, MYR, SAR, NEA, AMP, PLS

In: DCN, SAR, NEA Out: CGF, OML

6.0-6.9%

A2M, PGH, BAL, SFR, CUV, NCZ GEM, NEC, CTD

In: BAL, CUV, NCZ Out: SAR, NEA, GEM, NEC, CTD

5.0-5.9%

NEC, GEM, CLQ, COE, ADH, GMA, KGN, ALG, WEB, MSB, BAP, LNG, EHL, MIN, JHG, RSG

In: NEC, GEM, CTD, ADH, LNG, JHG, RSG Out: CUV, NCZ, FMG, ELD, NWL

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 1.0 1.0 RIO 4.9 4.9 ANZ 0.6 0.6 S32 1.2 1.0 BHP 3.4 3.6 SCP 1.2 0.9 BXB 0.1 0.1 SUN 0.5 0.7 CBA 0.9 1.0 TCL 0.4 0.3 COL 1.0 0.9 TLS 0.3 0.2 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.4 0.5 WES 0.9 0.9 MQG 0.6 0.5 WOW 0.8 0.8 NAB 0.6 0.5 WPL 0.7 0.8 To see the full Short Report, please go to this link

Guide:

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

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

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

Summary:

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 1.0 1.0 RIO 4.9 4.9 ANZ 0.6 0.6 S32 1.2 1.0 BHP 3.4 3.6 SCP 1.2 0.9 BXB 0.1 0.1 SUN 0.5 0.7 CBA 0.9 1.0 TCL 0.4 0.3 COL 1.0 0.9 TLS 0.3 0.2 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.4 0.5 WES 0.9 0.9 MQG 0.6 0.5 WOW 0.8 0.8 NAB 0.6 0.5 WPL 0.7 0.8 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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The Wrap: RBA, House Prices, Banks & Copper

Weekly Broker Wrap: monetary policy; house prices; banks; and copper.

-Potential for unconventional policy measures from the RBA looms closer -Significant acceleration in credit and easing of lending standards required for a strong rebound in house prices -Banking sector squeezed amid further official rate reductions and open data -Copper demand from renewable energy greater than many envisage

By Eva Brocklehurst

Monetary Policy

The Reserve Bank of Australia has recently outlined the options for consideration if economic growth fails to garner momentum and the unemployment rate rises significantly. Unconventional measures used by global central banks including taking official rates negative, purchasing government bonds or private assets (quantitative easing), funding banks to support credit or intervening in the foreign exchange market.

UBS suspects the RBA would begin by injecting liquidity, were it to undertake unconventional policy, by increasing both the size and terms of its open market operations. The primary aim would be to lower risk-free rates across the curve and reduce term funding costs for lenders as well as maximise the pass-through of cash rate reductions. Lower cash rates would also put downward pressure on the Australian dollar.

The RBA deputy governor Guy Debelle has recently indicated it would be helpful if the Australian dollar would depreciate further, both in terms of economic growth and also inflation. Dr Debelle has also noted that other central banks use of unconventional policy occurred when official rates were reduced to 0.5% or lower. UBS expects the RBA to reduce the cash rate to 0.25% by May 2020.

House Prices

Morgan Stanley expects a sustained recovery in Australian house prices is likely to be linked to fiscal policy, not re-leveraging. Regardless of recent positive house price signals, the broker believes challenges continue, linked to volume, credit and demand. Demand has improved somewhat but remains affected by record low turnover.

The main issue about whether a sustained housing recovery can occur centres on whether demand can absorb a higher price and volume environment. The credit environment is tight and, linked to this, Morgan Stanley's analysis shows that loan approvals are the leading indicator of both house prices and retail sales.

Another challenge is the continuing strong supply of new dwellings, particularly apartments. The broker suggests a trough in house prices, not a large bounce, remains the most likely scenario. A reduction in official interest rates will improve mortgage serviceability but there needs to be a significant acceleration in credit along with an easing of lending standards for a strong rebound, and neither is expected.

Banks

Further reductions in official rates from the RBA will add to margin headwinds and require even more re-pricing of home loans, Morgan Stanley asserts. This creates downside risk to forecasts for bank margins in FY20 and FY21. The broker expects the RBA will reduce the cash rate by -25 basis points at both the November and December meetings although the implied probability of a rate cut in October is recognised at around 80%.

The broker calculates that over 35% of major bank deposits already have interest rates below 50 basis points, meaning deposit spreads will be squeezed further. Morgan Stanley forecasts major bank margins to fall by an average of -7 basis points in FY20 and -2 basis points in FY21, with downside risk if re-pricing does not offset the headwinds from further rate cuts.

Two thirds of the funding for banks comes from customer deposits with half in the form of at-call deposits. Hence, Credit Suisse reports, it goes without saying that each subsequent reduction to official interest rates reduces the price-addressable deposit base.

This makes it more difficult for banks to maintain margins and pass through the full reduction in the cash rate to loan customers. The broker calculates that at-call deposit rates need to be reduced by around -51 basis points in order to offset a -25 basis points reduction in cash rates, and to pass through fully to standard variable loans.

Macquarie suggests banks need to focus on expense management to support profitability. The broker expects disruption across the industry to result in lower returns while the major banks face the greatest risk in the high-returning business verticals such as foreign exchange, mortgages and payments. As data sharing becomes more widely accepted Macquarie assesses the competitive landscape will intensify.

Customers are more likely to choose products that offer convenience and price as opposed to simply selecting sub-par product offered by their current financial institution. The introduction of open data is likely to have limited consequences on incumbent banks and, the broker assesses, should contribute to better transparency and more seamless movement between providers.

Nevertheless, the structural headwinds create some uncertainty about the sustainability of the long-term returns of the banks. Given the sector is trading at around -10% below the long-term average, Macquarie calculates structural headwinds are partially reflected in current share prices.

Copper

Analysts at ANZ Bank suggest the outlook for copper is not as bad as the macro economic environment implies. The US/China trade conflict continues to weigh on sentiment, amid signs of weaker economic growth globally.

Taking into account the shift in investment towards renewable energy, the analysts find that copper consumption is actually better than the investment data indicates. Traditionally, grid investment in China is used to calculate copper demand from the power sector. Year-to-date, expenditure has been down -14%.

Apparently, five times more copper is used in the construction of wind generators than in coal-fired or hydro generators. Overall, the analysts calculate copper demand from the sector is up 20% in 2019. Supply issues are expected to push the copper market into deficit so downside for the price is envisaged to be limited. Any resolution of the trade conflict should allow prices to respond positively as well.

Treasure Chest: AP Eagers Empowered

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. The combination of AP Eagers and Automotive Holdings is now assured and, in reviewing the outlook, brokers find the merger compelling.

-Structural factors detracting from the industry have played out -Options to further consolidate the sector amid likely capital management -Opportunity to expand penetration of vehicle finance

By Eva Brocklehurst

The way is now clear for AP Eagers ((APE)) to drive prospective synergies after scooping up Automotive Holdings, and the merged group will be a formidable operator in Australia's car dealership space.

The merger was always considered a sound strategic fit from a geographical point of view, because this enabled AP Eagers to immediately obtain a significant footprint in Western Australia, as well as the Sydney market where it had only one site previously. The proposed new name is Eagers Automotive Group, represented in each state and territory of Australia, bar ACT, and in New Zealand.

The merger is both strategically and financially compelling, in Macquarie's view, as headwinds that plagued the industry recently are observed to be ebbing. Credit availability appears to have been the main driver of the current down cycle, where new car sales have been in decline for 17 consecutive months.

The car dealership industry has been affected by uncertainty and re-regulation stemming from the ASIC review and recommendations from the Royal Commission into the financial services industry.

Macquarie suggests growth in house prices should now support demand, conforming with normal trends, and assumes a gradual recovery in used car sales. In sum, structural factors detracting from the industry are likely to have played out, while dealership profitability has been re-based following the regulatory changes.

After the settling of the property sales recently announced by AP Eagers combined net corporate debt will fall to $271m, Morgans assesses. Moreover, after the likely divestment of the Automotive Holdings refrigerated logistics division as well as synergy costs and tax on recent divestments, the broker calculates net debt may be closer to $150m by end of 2020.

Morgans takes refrigerated logistics out of its forecasts and assumes this is sold in 2020 for $150m. AP Eagers will then have options to further consolidate the car dealership industry and/or embark on capital management. The broker considers the latter more likely.

Macquarie, too, suspects capital management is probable, as the asset sales being targeted imply over $380m in proceeds, although industry consolidation is expected to continue and the stronger balance sheet means AP Eagers is well positioned for either. The automotive industry remains highly fragmented, with the broker noting there are around 1500 dealership owner groups spread across Australia of varying sizes and structures.

The combined entity would have a market capitalisation of $3.5bn based on the AP Eagers closing price of September 20 and approximately 11.9% of the Australian new vehicles market. The combined portfolio represents 242 new car and 69 truck/bus sites.

Synergies

The company anticipates $30m per annum in synergies within the first 12 months with the initial focus on duplicated cost structures and middle management. Further afield, sourcing, funding and back-end services as well as the rationalisation of underperforming businesses will be reviewed.

Cost reductions are likely to be significant, as management believes around 30% of operating costs can be removed. Morgans estimates there could be as much as $123m in synergies, although assumes just $90m over five years, underpinned by the rationalisation of staff, a reduction in average employee wages and improved bailment (contract to transfer purchases) rates for Automotive Holdings post merger.

This quantum excludes any upside from selling underperforming businesses or more favourable lease renewals. One stumbling block, Macquarie points out, is the lease tenure of Automotive Holdings, which signals consolidation will not be immediate.

Automotive Finance

Macquarie also notes an opportunity to offset the changes to finance and insurance income from regulatory impositions such as the capping of add-on commissions. The opportunity comes from growth in the penetration of finance for new vehicles. More than 90% of Australian vehicle sales are purchased on finance, suggesting the opportunity for further market penetration by AP Eagers is significant.

However, as a cautionary note, the broker notes that around one third of vehicle sales in Australia are typically financed via mortgage/home loan-related facilities, which may encounter more challenges in converting to dealer-arranged financing.

Management believes that achieving finance penetration of around 41% would offset the recent changes imposed by ASIC but has delayed its initial target of achieving 50% by 2019, given market conditions. On a medium-term view management remains confident in achieving a 80% penetration rate in finance by 2022.

While there is a risk that ASIC may place a cap on margins for extended warranties, feedback suggests to Macquarie this is probably immaterial for the group. The broker remains confident, given management's track record in executing on synergies and positioning its business to adapt to an evolving environment.

Macquarie initiates coverage of AP Eagers with a Outperform rating and $15.60 target and ceases coverage of Automotive Holdings. While the share price has run up heavily in anticipation of the merger and expected accretion, Morgans suggests there are still plenty of catalysts over the next 12 months. Morgans has also absorbed Automotive Holdings into its forecasts, resulting in an increase in its target to $15.55 from $12.56.

The consensus target on the FNArena database at this point is $13.89, signalling 2.1% upside to the last share price. Targets range from $12.50 (Ord Minnett, still to factor in the merger) to $15.60 (Macquarie). There are five Buy ratings.

See also, Merger Dominates Outlook For AP Eagers on September 2 2019

Market Rotations Are Not The Key Message

Dear time-poor reader: global strategists at Citi suggest rotations between "Value" and "Growth" stocks will not last long, and I agree.

In this week's Weekly Insights (published in two parts):

-Market Rotations Are Not The Key Message -No Weekly Insights For Next Two Weeks -Conviction Calls -Is Everybody Into iSignthis? -Rudi On Tour

Market Rotations Are Not The Key Message

By Rudi Filapek-Vandyck, Editor FNArena

"Growth/Value rotation may continue, especially if bond yields rise further. But history suggests the long-term outperformance of Growth will continue until the end of this bull market, which we don't believe is imminent." [Global strategists at Citi in their most recent update on markets]

Unless you only joined recently as a reader of my Weekly Insights, you'd be well aware that I remain firmly on the side of the "Growth" investors when it comes to assessing outlook and best investment opportunities in today's share market.

As you may have deduced from the above opening quote, the global strategy team at Citi remains fully sympathetic to my view, which is quite handy as this allows me to update on the sharp division that continues to characterise momentum and performances inside equity markets worldwide, not just in Australia.

"Growth" and "Value" are typical terms used by professional wealth managers, and they can be confusing as they do not always cover what we might think they do. To confuse matters a little more, there are idiosyncratic differences behind both terms in between geographic markets, and these differences can evolve over time.

But let's keep this simple for the purpose of cohesion and a basic understanding of what rules in today's equity markets. With "Growth" investors usually refer to technology stocks, healthcare and emerging new business models that can grow independently of GDP or the economic cycle. In most instances, these companies are enjoying earnings growth well in excess of the market average.

In Australia, think CSL, Carsales, Goodman Group, Afterpay Touch and WiseTech Global, among many others.

"Value", in this particular interpretation, does not necessarily refer to stocks that have not fully participated in this bull market. In this context, "Value" refers to cyclical industrials, such as discretionary retailers, and to miners and energy producers, as well as the banks. Prior to 2007, "Value" was killing it in the share market, but those days have long gone.

"Value" in the US is now underperforming for the twelfth year in succession. In Australia, it was pretty much the end of the European credit crisis of 2011-2012 that marked the start of noticeable outperformance by "Growth". That was 8.5 years ago. If, however, we start counting after Australian banks peaked in May 2015, then we are now in the fifth year of significant outperformance of "Growth" over "Value" as an investment style in the local share market.

Most investors globally, but in particular in Australia, are "Value" investors. Strictly taken, "Value" used in this sense does not mean they only buy discretionary retailers, commodity producers and banks. It means they have a never-wavering belief that optimal investment returns are achieved from buying cheaply priced shares.

Thus, while in theory there is a difference between "Value" as determined in usage number one and "Value" in the second scenario, in practice there usually isn't. This is also because your typical "Value" investor does not understand "Growth". It's like both groups of investors communicate through incompatible languages.

The latter is important. Because once we get this far through a share market bull phase, the first group tends to be quick, and persistent, in calling the share market "a bubble", "grossly overvalued", "full of complacency" and more similar cautionary warnings. In 2019, for instance, these are the expert voices that are most likely warning about the next spike higher in global bond yields, and what this might do to your average "Growth" stock.

Alternatively, they can also be part of that group of experts that continue to warn about the next recession coming, which surely will end the share market madness in "Growth" stocks.

The team at Citi does not think this bull market is nearing its end. There are rotations along the way, this time around typically triggered by long term bond movements, but outside of these rotations, which only last so long, as long as this bull market continues, the team believes "Growth" stocks are the ones most likely to outperform.

There are a number of factors underpinning this view.

Observation number one. When looked at the current share market valuations within a historical framework, it seems "Growth" stocks as a group are not that expensive. Low inflation and low bond yields support higher valuations for assets in general. What is the case is that the gap between "Growth" and "Value" is excessively wide, only superseded by the TMT rally up until the March 2000 Nasdaq crash.

In simple terms: "Growth" stocks are not cheap, but equally not excessively expensive. "Value" stocks, on the other hand, seem extremely cheap.

On Citi's calculations, the gap between both groups of stocks has risen to a relative premium/discount of 80%. The highest this relative difference has ever been measured was in 2000; back then the corresponding valuation gap was 92%.

This is not simply a result of falling bond yields. On current global analysts forecasts, "Growth" companies are expected to lift their profits for shareholders by an average of 12%. For "Value" companies projected growth is no more than 5%. Again, there are regional differences, but as a general discrepancy these numbers illustrate the point.

In Australia, the same differences revealed themselves (once again) during the August reporting season. We can all criticise investors who continue to chase the likes of Jumbo Interactive, Xero and Nanosonics, to name but three examples, but it remains the simple fact that profit warnings and dividend cuts and other kinds of negative announcements are predominantly coming from the cheap end of the market, otherwise known as "Value".

In Australia, the difference between "Growth" and "Value" is not determined by twice as much growth; over here the contrast is between high growth and no growth.

How much does one pay for a struggling business model that is going backwards? Most investors simply do not wait around wondering, leaving professional wealth managers such as Perpetual, Pendal, etc behind in sheer frustration.

For this one-sided momentum trend to end, something needs to happen that either disrupts the growth momentum among "Growth" companies or that significantly benefits the "Value" sections. A sharply higher oil price driven by increased demand could be such a catalyst (note the demand side of that statement). A sizeable and sustainable upswing in global PMIs could also turn into a positive catalyst for "Value". But probably the most likely swing factor at this point in the markets are government bond yields.

Whenever bond yields correct sharply higher (meaning: bonds are selling off), market rotation kicks in, favouring beaten down "Value" stocks while punishing popular "Growth" stocks.

Thus far, these rotations have been nothing but temporary interruptions for a bull market in equities that very much favours "Growth" over "Value". In line with Citi's thoughts, I agree investors will have to get used to the ever-present prospect of such rotations happening, but they should not get carried away by them.

"Growth" still very much rules in this bull market. It is likely to continue doing exactly that, until this bull market ends, which would probably happen on the back of an outbreak in inflation a la 1970s or the plain old economic recession.

When it comes to the latter option, "Value" investors should be extremely careful in what they wish for. As also emphasised by the August reporting season, while "Growth" companies might prove too expensively priced in a recession, the real operational vulnerabilities would most likely open up on the "Value" side where companies such as Sims Metal Management, Incitec Pivot, CYBG and Boral would simply issue yet another profit warning - and cut or scrap their dividend.

To put this in the words of Citi strategists: "Maybe value investors will have to wait until the next meaningful early-cycle economic recovery before they see sustained outperformance. The problem is their portfolios would be too cyclical in the recession beforehand."

Note that last week UBS strategists in Australia predicted US bond yields will resume their downtrend towards the low point seen in August. In terms of momentum differences between "Growth" and "Value", this implies the same view as Citi's.

Back "Growth". You can do a lot worse in this market.

No Weekly Insights For Next Two Weeks

Next week I'll be presenting to investors and local members of the Australian Investors Association (AIA) and the Australian Shareholders Association (ASA) in Perth, hence I won't be writing my regular Weekly Insights update that week.

The following week New South Wales celebrates a long holiday weekend, which explains why Weekly Insights will have a two-week break and returns in the week commencing on Monday, 14th October.

This schedule will grant me the opportunity to close off my observations from the August reporting season and -finally- put together the next update on the CSL Challenge. Stay tuned. Don't get desperate in the meantime.

If anyone happens to be in the neighbourhood, both events in Perth are open to the general public. Come over and say 'Hi' afterwards.

Is Everybody Into iSignthis?

For the duration of a few weeks, it appears I was unable to be dragged into a conversation about the share market without one of the bystanders exclaiming "I have shares in iSignthis" ((ISX)).

For those who are as yet not familiar with this technology midget listed on the local bourse: iSignthis helps clients with online transactions including the necessary identity processing, required to comply with anti-money laundering regulations. A recent story on the company by the Australian Financial Review likened iSignthis to an alternative to PayPal.

As the share price has exploded from below 15c in January to a peak so far of $1.76, clearly there have been a large number of fresh supporters who have been making some extra dough along the way.

I also note three of the top eight contestants in the Sun-Herald's Shares Race hold iSignthis in their (imaginary) portfolio.

Next thing I know a research report pops into my inbox, with analyst Martyn Jacobs from Patersons reiterating his High Conviction Buy on the stock. According to the report, Jacobs also owns shares in the company.

I am yet to be mansplained by the next cab driver, or Uber driver, what a great investment opportunity this emerging fintech company is. In the meantime, let's find out why Patersons rates this stock a High Conviction Buy.

Reading through the report, issued after the company released interim results in late August, analyst Jacobs spotted sufficient progress and achievements to retain strong growth forecasts for the years ahead. As is standard in these emerging new business models, the inherent leverage is enormous, which implies that series of good news can quickly morph into a fantastic outcome for risk-carrying shareholders.

For good measure, Patersons did not increase its valuation for the stock post the result, but the analyst is flagging the potential payout of a maiden dividend in FY20 of 1.4 cent per share, while, in the meantime, "content to let the share price run ahead of our valuation". That valuation sits at $1.16.

iSignthis reported a breakeven result at the "underlying EBITDA" level which is seen as a significant improvement from the heavy losses of only a year earlier, which occurred during a time of supply disruption to the company's intermediary network. Investors should note this "disruption" occurred because one of the customers, KAB or Kobenhavns Andelskasse in Denmark, had collapsed under the weight of too many suspicious transactions without proper action taken being investigated by Danish regulators.

Since then, reports Patersons, iSignthis has accelerated the build of its own Tier 1 banking network in Europe with merchant clients coming on board over the past four months. According to media reports, customers for the new network include online trading platforms and gambling operators.

The interim report revealed the European business is already profitable at the pre-tax level, with merchant and deposit account approvals accelerating in July. Next thing that needs to happen is the leverage kicking in and all of a sudden the financial metrics of this company do not look overly demanding - all else remaining the same.

Patersons' Jacobs suggests there is upside risk to his forecasts which already, on a relative comparison with selected "peers" including Afterpay Touch, Zip Co and Xero, suggests iSignthis shares might not appear as expensive tomorrow as they look at face value today.

Though it has to be noted, most of the international peers cited in the research report are trading on much lower multiples, probably also because they might be a little more mature in their corporate development. On cited forecasts, most financial metrics are expected to grow parabolically, with Patersons estimating earnings per share (EPS) wil grow from 1.1c this year (Jan-Dec) to 2.7c next year, then 3.1c in 2021.

iSignthis originally started public life as Otis Energy (backdoor listing in 2014) in one of regular corporate transformations that characterise the smaller end of the ASX. Since the interim results release less than one month ago, some upheaval has been triggered by the awarding of performance milestone rewards to company executives, which subsequently led to a report by Ownership Matters criticising governance at the company, including calling the company's ownership structure opaque. The company has rejected the criticism.

Long story short: the share price went from $1.76 to below $1 in a flash. It has now recovered back to $1. The stock is now included in the ASX300.

Maybe this is as opportune as any other time to highlight the two highest quality technology companies in Australia are Altium ((ALU)) and WiseTech Global ((WTC)), while TechnologyOne ((TNE)) is at arm's length the superior software services provider on the ASX. Out of the three, TechnologyOne has the superior track record in Australia (it stretches out over a much longer time) with no sign on the horizon its habit of achieving double-digit growth per annum is about to end anytime soon.

All three highest quality tech stocks are part of the FNArena/Vested All-Weather Model Portfolio, in quantities that won't allow any unforeseen disaster to potentially destroy the portfolio's performance.

Investors should always attempt to understand the risks involved with (potential) opportunities on the stock exchange. A cautious Macquarie currently has no exposure to the local IT sector in its Model Portfolio. The above mentioned All-Weather Portfolio has exposure in moderate holdings, and only to high quality names. Small cap high flyers such as iSignthis, even though its market cap has now quickly risen above $1bn, are well up on the risk ladder.

Treat accordingly.

Conviction Calls will be published as Part Two on Friday morning on the FNArena website.

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 and Tuesday, 23 & 24 September 2019. Part One was published on the Tuesday in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part Two will be published on Friday).

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

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