WEEK 11

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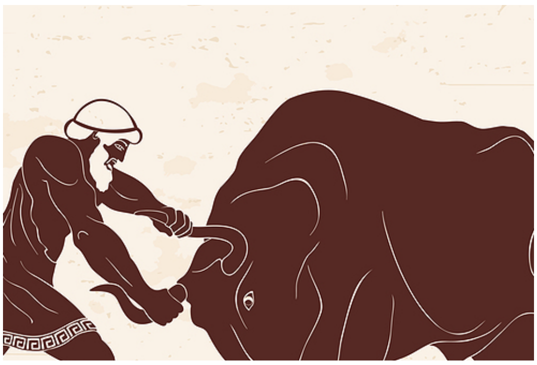
# STORIES TO READ FROM FNArena

Friday, 12 March 2021

Bumper Outlook For Elders

Material Matters: Copper Bull, Gold & Nickel Bear



Rudi's View: Will The Fed Tame The Beast?

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AUSTRALIA

# Bumper Outlook For Elders

Improved farm income from bumper crops is good news for Elders, while livestock & wool conditions should also contribute to earnings growth

**-Livestock pricing close to record levels**
**-Cropping conditions well ahead of prior year**
**-Should Elders trade at a higher multiple?**

By Eva Brocklehurst

Resurgent farm incomes should flow through for Elders ((ELD)) after a recovery in seasonal conditions in 2020. Farm incomes, rural forecaster ABARES assesses, are likely to rise 15% in 2021 before easing back to more average levels.

Moreover, lower energy prices have reduced the cost of fertiliser as well as fuel, while fodder and seeds costs are also expected to be lower. Livestock prices have been strong, as graziers re-stock herds.

Citi upgrades assumptions as a result, which drives expectations of 7% growth for Elders in FY21 and considers the high return on capital and resilient growth profile attractive. The broker now expects rural product retail sales will grow by 20% in the first half. Rural products accounted for 43% of the company's gross profit in FY21.

Macquarie forecasts 8% growth in earnings for the three years to FY23, at the upper end of the company's 5-10% growth target. The outlook is for continued rainfall on the east coast and pasture growth through autumn, so re-stocker demand for cattle and sheep should maintain livestock prices close to record levels.

Bell Potter totts up the annualised benefit to Elders of recent acquisitions, including the migration of genetic veterinary chemicals and agricultural chemical sales to the Titan & AIRR portfolios. Along with favourable tailwinds in livestock & wool agencies the broker expects all divisions will contribute to growth in FY21-23.

Macquarie points out Australia's rural exports are forecast to fall -4% in 2021 as herds continue to be re-built, and despite the benefit from higher grain production. In contrast, a record 6% increase in exports is anticipated in 2022 because of higher cotton, wool and dairy exports.

Elders should trade at a higher multiple compared with peers, in the broker's view, as the business is more diversified and this results in relatively defensive earnings during seasonally weak conditions. The broker notes the multiples of comparable agricultural companies trade an average of 14.4x FY21 earnings (EBIT) while Elders currently trades on 13.2x.

Livestock

Producers have actively retained stock to re-build herds and take advantage of better pastures which has meant sale yardings have been down significantly over the year to date, despite this being a seasonally higher period for yardings.

**Australian cattle prices have become disconnected from international export fundamentals** during the re-building of herds after the drought and when re-stocking demand subsides processors will need to pick up the slack, Citi observes.

In turn, given current export demand is subdued, they may find it hard to do so at current prices. From the second half, the broker expects livestock prices will decline amid an influx of lambs after a productive breeding season and as re-stocker demand for cattle eases back.

The impact of increased slaughter supply on prices should be more pronounced in FY22, particularly for cattle, although the impact on Elders could be partially offset by enlarged saleyard volumes.

Cropping

A record winter crop harvested over summer supported farmers, although the latest 2020-21 summer crop forecasts has meant production was revised downwards because of a drier spring (November).

Nevertheless this summer crop is still well ahead of the previous year. Meanwhile, **global shortages, supply chain constraints and increased domestic demand have meant crop input markets are tight**. Diammonium phosphate fertiliser prices were up 45% in January, with industry feedback indicating prices for crop protection remain firm.

Climate

ABARES is currently expecting just one El Niño year to occur in the next five years, with the other years in neutral territory. Based on historical probabilities, Citi assesses 2023 will be the El Niño year and currently factors in a deceleration in growth in FY23.

The La Niña phase peaked in early January and the Bureau of Meteorology expects settings will return to neutral or average conditions for many parts of NSW and Victoria over autumn/winter.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, retains a Buy rating with a $13.60 target. FNArena's database has two Buy ratings and one Hold (Morgans). The consensus target is $12.89, suggesting 9.5% upside to the last share price. Targets range from $11.68 (Morgans) to $13.80 (Macquarie).

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AUSTRALIA

# Austal Offers More Questions Than Answers

Can a revived order book and the transition of its business model turnaround near-term uncertainty and any reputational damage overhanging shipbuilder Austal?

**-Austal shares look grossly undervalued, but brokers see plenty of uncertainty**
**-A declining order book in particular is seen as a major negative**
**-Austal has the potential to win new contracts, reversing negative momentum**
**-Reputational damage remains an added overhang**

By Mark Story

Tough operating conditions saw shipbuilder Austal's ((ASB)) half-year to December revenue ($840.3m), drop -19.1% on the previous corresponding period, including added headwinds from a higher USD/AUD exchange rate, a lower throughput in the US, and a reduction in Australasia commercial shipbuilding volume, following the delivery of three large ferries.

Covid-related travel restrictions also affected demand for commercial ferries in the past 12 months, and Austal's sustainment services in the short to medium term.

However, the market took some solace from the recent successful delivery of Hull 419 by Austal's Philippines business to Fjord Line of Norway. Despite the market's enthusiasm for the Norway delivery, which gave the share price a badly needed kicker, the shares are still trading well down on the last 12 months.

Given the many question marks, Citi ponders whether there is deep value emerging in the shipbuilder's lagging share price, which has largely been off radar for most investors.

The shares have gradually trended lower since peaking at $4.50 in September of 2019 and are trading around $2.40 in the second week on March 2021, despite value stocks making a fierce come-back since late 2020.

When backing out the support business, for which Citi assumes a multiple in line with global defence peers, the broker estimates investors are paying only around 4x earnings (EBIT) for Austal's shipbuilding business, which is a whopping -56% discount to peers.

In Citi's view, this sizeable discount reflects the market's limited faith in Austal's ability to replenish its shipbuilding pipeline, despite multiple opportunities in the US, Australia and the Philippines.

Given the company still has an order book of $2.9bn and multiple opportunities, Citi believes the discount appears high.

The robust nature of the company's balance sheet, with $166m of net cash at first half, should provide Austal with capacity for acquisitions or to return capital to shareholders. Citi suspects Austal may use its strong cash position to acquire a dry dock facility in San Diego, which the company currently lacks.

The broker also notes a key upside risk to its $3.30 target price is Austal winning a new US defence contract, and Asian defence opportunities.

Commentary provided by company management indicates anticipated baseline revenue for FY22 is currently $1.4bn (based on AUD/USD at 0.77), including contracted shipbuilding, the expeditionary fast transport (EPF 15) program which has been appropriated but not yet awarded, and support revenue at the first half run rate.

But given that Guardian Class Boat Patrol (GCBP) and Cape Class Boat Patrol (CCPB) alone constitute $1.3bn of the company's top-line in FY22, Credit Suisse regards $1.4bn baseline guidance as conservative.

Due to recent weakness in share price, the broker has upgraded the stock to an Outperform from Neutral rating on valuation grounds.

But Credit Suisse notes that less favourable foreign exchange moves, and defence funding and program award decisions, particularly in the US, could pose a risk to its rating.

Despite the many headwinds, and ongoing question marks, Citi also rates the stock a Buy. The broker’s $3.30 price target suggests considerable upside (38%) if the tide turns for Austal.

Citi's Buy rating is carried by the belief Austal has multiple opportunities to replenish its US order book, while there is increased focus on smaller autonomous ships in the US, plus revenue should increase as more Littoral Combat Ships (LCS) and Expeditionary Fast Transport (EPFs) enter service.

Citi also notes naval shipbuilding opportunities are emerging in Asia.


Declining order book

While Austal indicated it has an aspirational long term support revenue target of $500m, Shaw and Partners believes shorter term order book issues remain concerning.

The broker wants to see greater evidence that the longer-term pipeline of construction work in the US business is being rebuilt from FY24 onwards.

A declining order book for shipbuilding and now also relative weakness in sustainment at least through 2021 are, from Shaw’s perspective, key reasons why the near-term outlook for Austal remains uncertain.

Echoing similar sentiment, Macquarie concedes while Austal’s many growth ambitions help underpin current valuation, new contract wins are required to build the pipeline beyond FY22.

While earnings (EBIT) improvement, driven by better shipbuilding margins in both the USA and Australasia, was encouraging, the broker wants to see new contract wins to boost current FY22 revenue above current circa $1.4bn baseline guidance.

Macquarie also wants to see greater confidence in the US operations sustainability beyond the LCS program, which is expected to wind down late FY23/24.

Battling reputational issues

Order book issues aside, Shaw suspects various investigations and findings by regulatory authorities here in Australia and the US, that put Austal’s reputation into question –which culminated in the resignation of the US CEO late February- also remain an overhang for the company.

However, what’s encouraging observes Shaw is management’s insistence that the reputational risk from these investigations is limited. Austal has outlined several potential awards/contracts that could improve the outlook for revenue over the coming years.

These include SEC East panel in the next month or so, SEC West later this year, the first steel order from the US Navy by end of 2021, and Several US Navy steel (and the autonomous EPF) programs are likely to be awarded in FY22-23, which coincide with the launch of Mobile's steel capability in mid-2022.

What's also encouraging, adds Citi, are the Australian Government's 2020 Force Structure Plans for investment of $50bn in naval shipbuilding till 2030, which could be a significant opportunity for Australian defence manufacturers like Austal, especially given the government's focus on local sourcing and maintaining a healthy shipbuilding base.

While acknowledging the near-term risks from a current lack of visibility on post 2022 work, Shaw views Austal as attractively valued versus peers.

Based on the discounted valuation, and on balance more likely positive than negative catalysts, Shaw continues to rate the company a Buy.

Operational risks

Ord Minnett equally remains cautious on the company's outlook. Fuelling the broker's caution are the operational risks as the business transitions its business model, including deploying capital, and market earnings expectations as the business moves from profitable mature programs -70% of group earnings (EBIT)- to new and as-yet-unawarded steel shipbuilding programs.

While Macquarie maintains its Outperform recommendation, it also shares Ord Minnett's order book concerns, with the failure to win new contracts in FY21/22- to ensure continuity of US operations- as the key risks to its recommendation.

Ord Minnett notes that after losing out on the FFG(x) (guided-missile frigate) program to a competitor, Austal has had to pivot its business model in the US, expanding its shipyard and transitioning to a steel shipbuilding operation.

With the US government having assisted with the required capital expenditure, and with Austal investing US$100m (half funded by the US government) over the next two years, Ord Minnett believes the company is now in a position to win steel ship manufacturing contracts.

Ord Minnett assumes more EPFs will be awarded (small in contract size, albeit high-margin). But Austal management has also highlighted a number of different programs the company could win, including an offshore patrol cutter (OPC), light amphibious warship (LAW) and unmanned vessels, to refill the US construction pipeline.

Ord Minnett doesn't disagree that Austal will likely win some work. But it's concerned about Austal's earnings profile as it transitions from mature, highly profitable aluminium programs to as-yet-unawarded new steel shipbuilding programs.

Adding to the broker's concerns is the expected margin differential from new versus mature programs and design/build versus build-only roles.

Ord Minnett has retained its FY21 earnings (EBIT) guidance of $125m, and Hold recommendation on the company.

Broker ratings on the FNArena database show one Buy rating, two Outperform, and one Hold.

Consensus EPS growth forecasts for the coming two financial years are negative while annual dividends are currently projected around 9c for both FY21 and FY22 for an implied yield of circa 3.8%.

The consensus target is $2.85, suggesting 19.2% upside to the last share price, with Citi the high marker at $3.30.

AUSTRALIA

# Lift In Exploration Augurs Well For ALS

As the outlook for minerals exploration improves and concerns over the economic impact of the pandemic ease, the laboratory services of ALS Ltd will be in demand

**-Gold underpinning revenue in third quarter**
**-Infra expenditure signals copper to follow**
**-Plenty of liquidity to fund acquisitions**

By Eva Brocklehurst

As mineral exploration ramps up and economies re-open the laboratory services of ALS Ltd ((ALQ)) are to the fore. Increased volumes of minerals testing meant geochemistry sample flows were up 13% in the third quarter.

Goldman Sachs notes essential services demand has also ensured life sciences volumes remain stable, while the industrial division is more mixed and asset care activity challenged. Yet, the latest update shows both junior and medium-sized miners contributed to the growth in geochemistry in the third quarter.

Macquarie notes the amount of money raised by junior explorers is yet to be used in a significant way, given the northern hemisphere winter, but the field season will open up over the next few months this should become more evident.

Capital raisings for mineral exploration in Canada have increased 207% for the six months to February and are up 15% in Australia over the same period. There is a typical three-month lag between capital raising and exploration activity and gold and copper represent around 50% and 20%, respectively, of global mineral exploration expenditure.

Macquarie points out **gold has done the heavy lifting so far**, representing 62% of revenue in the third quarter, but a large rally in copper prices should mean exploration activity in that area gathers pace, along with other base metals.

Macquarie also points out expenditure by governments on infrastructure, such as renewable energy and electric vehicles, will underpin copper-related exploration going forward.

The broker highlights commentary from Major Drilling, which noted that in the last growth cycle Canadian activity picked up first followed by Latin America, and commodity prices are now attractive enough for this to occur again. Current copper prices, that company asserts, signal “there is money to be made”, and gold is in a similar position.

All this augurs well for ALS and Macquarie highlights **the stock is currently trading at a -24% PE discount to global diversified peers** compared with a five-year average of -9%.

The main headwind UBS observes is the Australian dollar, leading to reductions to FY21-22 forecasts of -4%, yet the broker remains encouraged by the ongoing recovery in geochemistry testing. Nevertheless, UBS believes the stock is adequately pricing the improvement in exploration activity and the normalisation of life sciences demand as economic activity recovers post the pandemic.

Group earnings (EBIT) in FY21 are expected to decline -7%, which UBS asserts is "remarkable" in the face of the impact of the pandemic on global economic activity.

CLSA found the trading update reasonable and infers that, even in local currency terms, ALS is resilient, although agrees there is a material currency headwind going forward.

Ord Minnett raises its rating to Hold from Lighten in acknowledgement of the improvement in the geochemistry outlook, and reduced concerns about the impact of the pandemic amid ongoing roll-out of coronavirus vaccination programs.

Acquisitions

The company has acquired Investiga, a pharmaceutical testing business with operations in Brazil and the US east coast. This business focuses on cosmetic and personal care and generated $20m in revenue in FY20.

Macquarie observes ALS has been disciplined as it goes about making acquisitions. This one is considered sound as the US is strategically significant, representing over a quarter of the global market.

Moreover, the acquisition will be funded via debt and there remains a solid balance sheet with more than $600m in available liquidity. ALS is acquiring the business at 11x FY20 earnings. Assuming margins of 20-25% Goldman Sachs calculates a purchase price of $44-55m.

The broker, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and envisages around 26% upside potential to its $12.00 target. CLSA, also not one of the seven, has an Outperform rating and $10.26 target.

There are four Buy ratings and three Hold on the database with a consensus target of $10.18 that suggests 8.5% upside to the last share price.

AUSTRALIA

# Eclipx On Route To Stellar Earnings

Despite the constraints created by a shortage of new cars, robust used car prices have ensured Eclipx can deliver substantial earnings growth

**-Used car pricing benefit underpins FY21 earnings**
**-While short supply of new cars creates order backlog**
**-Industry consolidation implies upside risks**

By Eva Brocklehurst

A surge in end-of-lease income has placed Eclipx Group ((ECX)) in a strong position to deliver earnings growth across its portfolio. An update on trading just one month out from the end of the half year (March) has revealed that, despite the constraints being experienced with new cars in short supply, orders are growing.

Eclipx has been a beneficiary of higher used car prices, showing up in stellar end-of-lease income, partially offset by constraints on renewing fleet values and meeting novated leasing demand.


Credit Suisse assesses the high profits from this end-of-lease income are unsustainable and a reversion to the norm poses a headwind to FY22 earnings. Still, the cash is being banked now and will help reduce debt.

The broker is also comfortable that consensus forecasts take current circumstances into account in FY22-23. Furthermore, new business should grow as the economy recovers and new vehicles and shipping returns to normal.

End-of-lease income was $26.4m to the end of February, with just one month ago to the end of the first half. First half FY20 end-of-lease income was $15.5m, and Eclipx anticipates the relevant benchmark in future will be more like this. Results are expected in mid May.

Morgan Stanley found the operating performance consistent with its expectations and appreciated the extra detail regarding new business which, although still below pre-pandemic levels, has revealed a build-up in demand.

As a result the broker believes Eclipx is progressing towards a forecast net profit in FY21 of $56.7m. The company has also reported $300m in asset-backed securitisation which will reduce the cost of funding.

Supply Risks

Macquarie explains that the risk from a lack of new vehicle supply, which is driving higher used car prices, centres on the company's ability to secure vehicles to meet new business demand in fleet and novated leasing.

As a result, the total fleet value could depreciate faster than new business would counter it. Higher fleet yields act as an offset, but the broker notes **lower book values and the impact on novated activity remain the key downside risk**.

Still, Macquarie agrees operating conditions should support FY21 earnings, driven by end-of-lease income. Moreover, should vehicle supply problems extend into FY22 and support used car prices, then upside risks to estimates are still envisaged.

Value?

Credit Suisse finds the valuation undemanding and suspects a resumption of dividends should be forthcoming in FY21. Moreover, the company could be a potential beneficiary of corporate action in the medium term.

Eclipx has also confirmed no cash tax will be paid in FY20 and Credit Suisse understands this situation should continued for 4-5 years. Given organic growth opportunities and the upside risks from sector consolidation, UBS agrees the stock's multiple is undemanding. A consolidation scenario could mean $20-40m in synergies that implies material upside risks for Eclipx.

Growth, too, should be delivered in novated leasing, as **Eclipx will be the first to market an end-to-end digital offering**. The broker notes the company is materially underpenetrated across eligible customers, at 1.6% compared with its peers at 5-8%.

This should drive above-market growth in corporate fleet, with a focus on sale-and leaseback opportunities. Also, distribution partners are likely to have a positive impact in the small-medium enterprise segment. FNArena's database has four Buy ratings for Eclipx. The consensus target is $2.32, signalling 25.1% upside to the last share price.

Disclaimer: The writer has shares in Eclipx Group

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AUSTRALIA

# Caution Over Treasury Wines' Restructure

A divestment process in the Americas has started as Treasury Wine aims for a leaner, more profitable business, but where will growth come from?

**-Cautious reaction given lack of detail on further restructuring**
**-Significant uncertainty around volumes previously destined for China**
**-Takeover speculation continues**

By Eva Brocklehurst

Treasury Wine Estates ((TWE)) has commenced the restructure of its Americas business, flagged at the first half update, with the of exit of several low-priced brands. Additional restructuring, where both Penfolds and the Americas units are separated internally, should be undertaken over the next six months.

The latest announcement pertains to a significant share of volumes in Americas that is likely to be rationalised, and Goldman Sachs, while believing this is a positive start, is cautious.

The broker's reticence stems from a lack of detail on terms and clarity around the timeline to completion of the remaining restructuring program.


Credit Suisse downgrades to Neutral from Outperform, noting the share price has largely closed the valuation gap to peers. The broker also notes FY22 earnings forecasts are relatively depressed because of the import tariffs imposed by China on Australian wine. Moreover, a large part of business in Asia outside of China relies on global travel retailing to return to normal.

The broker envisages **intensive price competition in Australia and Europe as grape supply previously destined for China competes in these low-end wine markets**.

Ord Minnett, too, downgrades, to Hold from Accumulate, following the outperformance in the share price since the first half result, believing the risk/award equation is now less attractive. Nevertheless, the broker acknowledges Treasury Wine is delivering on its plans to realise at least $300m in proceeds from brand and asset sales in 2021.

Jarden believes the deal is good and should provide increased confidence in management's ability to execute on its other plans. The deal should also be accretive to margins over time given the shift in mix towards quality.

UBS considers the overall impact of the deal modest, but is increasingly confident in the ability of the company to move to a lower volume/higher margin business. The broker reduces earnings (EBITS) estimates for the Americas by -2-6% to reflect a faster divestment process.

While there is a strong portfolio of brands and tangible asset backing, the broker's assessment of the stock price suggests it is already factoring in a recovery year despite the market risks.

Morgan Stanley finds management commentary increasingly positive regarding the US turnaround but also highlights the significant uncertainty surrounding the re-allocation of wines previously destined for China and the impact on the Australian market from supply/demand imbalance.

<u>Licensing Agreement</u>

A licensing agreement with The Wine Group, bringing in $100m plus ongoing licence fees, is the first step in the promised $300m wine divestiture plan for 2021.

The brands, such as Beringer Main & Vine and Founders Estate, Coastal Estates and Meridian, will be offloaded and while this will reduce volumes in the Americas by -35% it should only lower group earnings by -3%, Citi points out.

The broker would like further product innovation and more marketing investment in order to apply a higher multiple to its Americas valuation, and suspects the residual business in the Americas will have an EBITS margin of nearer 25%.

The issue will then become one of clarity regarding future growth, which is currently concentrated on 19 Crimes and Matua. The broker expects volumes in the Americas will settle at around 7m cases, down from 12m in 2020. A further scaling back of Lindemans and others should result in a further -1m reduction.

Citi expects **the additional divisional restructure, including the fate of Penfolds, should be more of an influence on the share price**, and an investor briefing on May 13 could provide more detail.

Bid Speculation

Jarden notes recent speculation of M&A activity, with a purported $15.67/share offer by Pernod Ricard, or a US firm. Ord Minnett also suspects recent speculation regarding takeover interest has supported the share price but considers a bid would be opportunistic, noting commentary that Pernod Ricard was selling much of its wine portfolio in 2019.

Jarden, not one of the seven stockbrokers monitored daily on the FNArena database, has an Underweight rating and $9.70 target. In order to become more positive the broker requires an understanding of the new earnings base and changing corporate structure, as well as detail on the reallocation of volumes from China where the uncertainties create risk.

Goldman Sachs, also not one of the seven, has a Neutral rating with a $9.30 target. The database has six Hold ratings and one Sell (Citi). The consensus target is $10.61, signalling -7.2% downside to the last share price. Targets range from $9.30 (Citi) to $11.50 (Ord Minnett).

COMMODITIES

# Material Matters: Nickel, Bulks, Oil, Gold

**-Tsingshan's battery contract triggers nickel over-supply concern**
**-Steel: major production cuts mooted**
**-Is an oil price consolidation period due?**
**-Bulks well supported, demand cooling for base metals**
**-Gold loses appeal**

By Mark Story

Nickel: market fears over-supply threat

LME nickel prices fell sharply last week due largely to an announcement by China's Tsingshan, the world's largest nickel and stainless-steel producer, to sell 75kt of nickel to Chinese battery raw material makers derived from nickel pig iron (NPI) - a product previously only sold to the stainless-steel industry.

A massive over-supply in NPI has been driving growing price discounts to LME nickel and nickel sulphate for NPI and ferronickel since November 2020, and the possibility of arbitrage between these forms of nickel has scared the market.

What's even more concerning to Macquarie are Tsingshan's plans to ramp up its own nickel production from 600kt this year to 1.1mt by 2023, 350kt higher than the broker's current assumptions.

Macquarie notes this underscores the over-supply potential for nickel in the next few years before meaningful deficits begin to emerge.

Steel production: Potential -40% cut in crude in Tangshan

Revelations of a potential -40% cut in crude steel production in Tangshan spooked the Chinese steel market, with both Shanghai Futures Exchange rebar and HRC (hot-rolled coil) prices having risen more than 4% in two days, with the latter surpassing the December high to more than RMB5,000/t.

Tangshan's environmental bureau stated it's planning a "pilot plant" aimed at reducing steel's carbon emissions by -40% this year, a target which would inevitably require production cuts, and in Macquarie's view a change in raw materials mix would not be sufficient.

While the narrative of the past few weeks clearly indicates China is preparing to restrict output/capacity growth in steel (and other heavy industries, potentially including **aluminium**) this year, Macquarie suggests announcements made by local officials should be treated with a pinch of salt.

The broker notes that while this could a drive a structural improvement in steel prices/margins similar to that seen during China's supply-side reforms in 2017-18, there should be greater clarity on the Central Government's policy in the coming days.

Quo Vadis Crude Oil?

After significant supply cuts (and strong quota compliance) in the past 12 months, Longview Economics expects OPEC to decide to increase production levels over coming months.

Assuming Longview Economics' assessment is correct, global oil inventories should stabilise in the first half of this year (and indeed rise somewhat in the second quarter), before then resuming their downtrend in the second half 2021.

Longview notes that given the current oil price rally – with the Brent oil price having rallied significantly (242%) since the lows in April last year - is not supported by market fundamentals and is over-extended to the upside, a period of consolidation is due.

However, given the bullish outlook for global synchronised growth in the second half of the year, ANZ Bank expects the recovery in crude oil demand to accelerate.

ANZ Bank is thus decidedly more robust than Longview on the outlook for oil markets. While the bank does not expect demand to exceed pre-pandemic levels until early 2022, it is forecasting growth in second half 2021 of 7mb/d (from the first half).

In contrast with Longview Economics, ANZ maintains the likelihood of OPEC increasing output looks low. ANZ doesn't expect to see any substantial rise in output until data suggest a sustained level of strong growth in demand.

The analysts note OPEC would rather overtighten the market than remove support too early.

As a result, ANZ is upgrading its short term (0-3mth) target for Brent crude to USD70/bbl.

While any further upside will be determined by how OPEC and Saudi Arabia tackle the transition back to full production, ANZ notes the process looks likely to be longer than it originally thought.

[Footnote: OPEC-Plus agreed on Thursday last to maitain current production levels to at least the end of April, when the next production meeting will be held.]

Commodities: Strong demand meets tight supply

Rising bond yields are taking the shine off investment demand for non-yielding assets like **gold**, with ANZ Bank noting nearly -97t of gold were liquidated from ETFs in February alone.

With the Federal Reserve reiterating its commitment to loose monetary policy, ANZ expects this to help bullion prices to find a floor in the short term.

Investment demand is waning, but falling prices are stimulating physical demand in key Asian countries, with

Indian gold imports having been strong since October last year.

While prices of bulk commodities look well supported, with indicators suggesting further upside, ANZ also notes signs of demand cooling in the base metals sector, following an impressive run in February.

As a case in point, high-grade iron ore premium remains elevated, which is motivating steel mills to maximise output, lifting production to fresh highs in recent weeks.

Supply tightness in iron ore is showing no sign of easing, and with exports from Australia and Brazil falling due to supply disruptions, this is expected to keep supply tight in the second half of calendar 2021.

Amid high prices, China's copper wire and products inventories are up, which ANZ suggests will become a drag on demand in the near term. ANZ suspects China's commitment to curbing aluminium capacity could slow supply growth, which is likely to show up in rising aluminium premiums across most regions.

With daily Chinese property sales growing, combined with the global recovery, the bank suspects the prospects for China's steel exporters look strong.

Fuelling this bullish outlook are China's new export orders which climbed to a multi-year high while rebounding steel mill margins are encouraging production.

COMMODITIES

# Material Matters: Iron Ore, Nickel, Aluminium, Oil

A glance through the latest expert views and predictions about commodities: iron ore; nickel; aluminium; and oil

**-Iron ore prices remain buoyant but should peak in 2021**
**-New production route signals disruptions for nickel**
**-Limited impact on aluminium from China's energy control plans**
**-Global growth rebounding, buffering higher oil prices**

By Eva Brocklehurst

Iron Ore

JPMorgan finds value support among the large miners, particularly the diversified miners and large **iron ore** producers. Upgraded cash flow forecasts, low gearing and limited capital expenditure should mean pay-out ratios remain strong for several years. Prices have hit a fresh cyclical highs at US$177/t, levels not seen since 2011.

Fiscal stimulus in the US has led JPMorgan to revise up growth forecasts to 6.2% and this should have a positive impact on the rest of the world.

On the supply side, the major miners have maintained production guidance. Moreover, iron ore price tension has been tighter than the broker previously estimated, and in the absence of an unexpected supply response there are limited catalysts to cause prices to correct materially lower.

JPMorgan believes the mood should remain buoyant and upgrades 2021 estimates for iron ore prices to US$162/t. In the second half, the broker suspects trader enthusiasm may settle down because of more subdued outlook in 2022 and forecasts prices ending this year at US$150/t.

Nickel

**Nickel** prices on the London Metal Exchange have corrected, falling -16% and underperforming copper by around -18% over the year to date. Morgan Stanley attributes this to news coming from Tsingshan. A statement from the company has been sufficient to trigger an aggressive sell-off.

Tsingshan has indicated that, from October 2021, it will start to produce 75,000tpa of nickel-in-matte from satellite ore in Indonesia for conversion into sulphate for the electric vehicle battery market.

The significance for the market, the broker asserts, is similar to the commercialisation of nickel pig iron for stainless steel production in China in the mid 2000's. Moreover, the route to market will now be both quicker and easier as, until now, efforts are centred on producing nickel pig iron for stainless steel and HPAL (high pressure acid leach) for processing laterite ore into sulphate.

There will be costs from the new production route, and the broker finds it unclear just where the long run level of support will be. Tsingshan has indicated overall volumes of matte are likely to grow to 1.3mt by 2023 from 600,000t in 2021.

The broker notes stainless steel industry globally has produced at a very high rate while there has been supply disruptions at number one nickel producer, Norilsk.

As a result no further drop in nickel to cost support levels is anticipated but equally, without incremental bullish news, a rebound is considered unlikely. Morgan Stanley retains a base case forecast for nickel of an average of US$16,066/t in 2021.

Aluminium

**Aluminium** prices have rallied, spurred on at the Shanghai Futures Exchange. Nevertheless, Macquarie envisages limited impact on the physical market as supply losses are small and cost increases minimal when compared with elevated smelter margins. There are risks around future supply including potential for more frequent disruptions in China from government energy consumption control plans and delays to new capacity additions in Inner Mongolia.

Inner Mongolia, with 15% of China's smelting capacity, has announced fees will be raised on captive power plants while three smelters have been advised to reduce energy consumption.

The provincial government will stop approving new capacity for both aluminium and **alumina** from 2021. Macquarie notes this comes at a time when China's primary aluminium production has been ramping up quickly.

Yet aluminium smelters are enjoying average margins of RMB4000/t and the broker highlights the smelters in Inner Mongolia, where power costs are lower than average, have probably enjoyed even higher margins.

Currently, the market is in surplus although China has moved into primary deficit. Once China reaches its estimated aggregate capacity cap of 46-47mtpa Macquarie notes several issues come to the fore, including a progressively tighter market and global deficits.

Oil

Morgan Stanley notes the futures are pricing an average **oil** price of US$65/bbl for 2021, up from US$50/bbl at the start of the year. Oil prices have risen to US$67/bbl this year (Brent). When this happens in such a short span of time the broker suggests the most immediate reaction is this is negative for global growth.

In reality, what matters most, the broker asserts, is why as, if prices are moving higher because of factors such a stronger demand, then the impact is more manageable compared with supply shocks or geopolitical tensions.

Global growth is rebounding as economies re-open and there are also mitigating factors, such as high levels of savings on the part of consumers, which provide a buffer against higher oil prices.

A new capital expenditure cycle is also kicking off, particularly in Asia. Productivity growth tends to rebound alongside stronger investment growth and this should provide an impetus for emerging markets, the broker adds.

Still, the rise in oil price will result in a different impact on different economies. Higher oil prices are less of a challenge for developed markets and net oil exporters such as Brazil, Russia, Colombia, Argentina and Malaysia should benefit from stronger terms of trade.

The oil burden, with an expected average oil price of US$65/bbl, is expected to rise to 2.5% of global GDP in 2021 and, as Morgan Stanley, notes this is well below the long-term average of 3.2%.

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COMMODITIES

# Material Matters: Copper Bull, Gold & Nickel Bear

A glance through the latest expert views and predictions about commodities: assessments and predictions for copper, nickel, gold, iron ore, and met coal.

**-Forecasts for copper price increasing as deficit looms**
**-Did China's Tsingshan kill the nickel bull?**
**-Gold bullion price cheer likely to remain capped for now**
**-China reiterates aims to further trim its steelmaking capacity substantially**
**-Russia looking to increase coal exports to Asia by up to 30%.**

By Mark Story

Copper: Electric shock

Macquarie has reworked its **copper** model, revising its 2021 balance forecast to a -226kt deficit from 247kt surplus and now also projects tighter long-run balances, with the likelihood that **structural deficits** will emerge from 2025.

Macquarie's short-term revisions reflect a stronger than previously anticipated rebound in global manufacturing demand into late 2020, with 2021 global refined consumption still seen expanding by around 3%, but from a higher base of effectively flat year-on-year global demand in 2020.

Further out, Macquarie has revised its ex-China demand forecasts to account for rising intensity of use in energy transition. The net effect is what the broker regards as an "electric shock".

Macquarie has therefore increased 2021 average prices to US$8,438/t, expecting a 2Q average peak of US$9,000/t.

The broker's copper price forecasts rise 20-26% for 2021-2023, and 32-33% for 2024-2025, with the long-term copper price in real terms lifting 13% to US$3.15/lb.

The material increases to Macquarie's copper price forecasts have triggered a significant increase in forecast earnings for miners with copper exposure.

Recent upgrades have transformed the earnings outlook for copper specialists OZ Minerals ((OZL)) and Sandfire Resources Ltd ((SFR)), enhancing Macquarie's bull case for both names.

Major copper producers BHP Group ((BHP)) and Rio Tinto ((RIO)) both see solid upgrades, with their price targets rising by 10% to $55.00, and by 5% to $142.00 respectively.

Higher by-product credits also enhance the outlook for nickel miner Panoramic Resources ((PAN)) and gold miner Newcrest Mining ((NCM)), which it has upgraded to Outperform.

Macquarie has also lifted its long-run (copper) real price to US$6,950/t, noting that the market needs to incentivise a combination of new mine projects, increased scrap supply and marginal demand destruction – via thrifting and substitution – to avoid post-2025 deficits blowing out well beyond -1Mtpa.

Against the backdrop of 'elevated investor length' (aka investor bullishness), now present across the LME (UK), CME (US) and SHFE (China) exchanges, and with visible inventories so thin, Macquarie believes there is scope for a period of extremely elevated prices and steep backwardations this summer.

Beyond that, the broker believes a distinction needs to be made between positive, but incremental, structural trends and the likelihood global growth eases from its currently supercharged rebound.

Macquarie is therefore anticipating a period of softer, albeit still historically elevated, prices between 2022 and 2024. But after this round of supply growth, the broker sees the market facing sustained tightness.

In light of the super-cycle for copper, Citi recommends investors to keep 'buying the dip' and has raised its 0-3 month copper point price forecast to US$10,500/t (from US$9,000/t), an all-time record high.

Citi's incremental near term bullishness reflects its new and proprietary work showing that there is an all-time record 'call on scrap' copper supply (similar to the oil market's 'call on OPEC'), pointing to equilibrium prices above US$10k in the short run and reflecting a more bullish crude market.

The broker believes the tightening in refined copper spreads and increase in net speculative copper positioning has been correlated with the massive increase in its call on scrap indicator, which suggests scrap has not been able to respond quickly enough to date.

With the call on scrap even higher than during 2011, and with two years less to respond relative to the 2009-2011 bull market, Citi suspects at least US$10k/t prices will be needed to incentivise more scrap than during 2011.

Citi believe deficits in copper and oil are likely to dominate the impact of a potentially stronger US dollar, at least until the Federal Reserve actually turns hawkish (perhaps in late 2021/early 2022), and sees near-term China tightening related fears, as temporary and as dips to buy.

Nickel collapse

The price of nickel collapsed -11% as news that Chinese firm Tsingshan, the world's top stainless steel producer, was throwing its resources into class 2-to-class 1 conversion, triggering a positioning exodus.

Credit Suisse believes Tsingshan's plan to lift contained nickel output by about 700kt to 1.1 million tonne per annum (Mtpa) by 2023 looks likely to oversupply nickel and undermine prices.

Given that 1.1Mtpa is 40% of global consumption on the broker's estimates, the broker suspects that following Tsingshan's expansion, nickel may be in surplus by over 300kt until mid-decade.

With the battery cathode market remaining small, accounting for 100-110kt in 2021, Credit Suisse expects most of Tsingshan's output to end up as ferronickel for the stainless market.

Credit Suisse notes that if Tsingshan wants to run at full capacity, it may need to force the top 260kt of the cost curve to curtail, perhaps needing a price of US$5.50/lb or lower for a sustained period.

The broker cites Sorowako – Vale's nickel matte producer in Indonesia with C1-plus capex costs of US$5.10 – as its best estimate for Tsingshan's cost of nickel matte production, with this price possibly being the lower limit to prices where Tsingshan might reduce supply.

In light of Tsingshan's puzzling strategy to oversupply nickel, Credit Suisse suggests investors look for clues to two key questions: Does Tsingshan intend to lift output to match capacity, and secondly does Tsingshan have ore supply confirmed? The broker suspects the latter point will be the greatest constraint to Tsingshan's plans.

News of Tsingshan's plans to substantially lift contained nickel output coincide with signed agreements to provide nickel matte, which is used to make batteries for electric vehicles (EVs), to Huayou Cobalt and battery materials maker CNGR Advanced Material.

Citi notes matte projects, a major act of cost deflation, are likely to destroy its medium-term bull case for nickel.

The broker has lowered its 0-3m price target to US$18k/t (from US$20k/t) owing only to a likely cyclical uptick in market sentiment, with medium term underperformance likely.

<u>Gold: Downward pressure</u>

Despite equity index levels being broadly off their record peaks, the S&P 500/spot gold price ratio hit 2.25x last week, resulting in large cap US stocks trading at their highest levels since April 2019 (in gold terms).

The price ratio is now above the 20-year (2000-2019) average of 2.12x and has been trending steadily higher since October.

While this outcome is difficult to unravel, Citi believes a significant amount of geopolitical risk premium and tail risk holdings for gold were structurally unwound following the decisive November US presidential vote tally - some of which can be observed via the gold options market.

Citi also suspects that inflows into oil, copper, value equities, and Bitcoin have taken some notional investment away from gold as well.

While Citi remains sympathetic to gold bulls, given the current inflation and fiscal outlook, it thinks bullion price cheer will be capped for now given Fed funds rate probabilities at the short-end, broadly higher US nominal and real yield trends, and a rebounding US dollar headwind.

Citi previously thought the 2020/2021 gold price outlook could mirror 2011/2012, at least through the middle of this year.

But the prospects of Fed tightening materialising a bit sooner, with little pushback from Chair Powell last week, has put downward pressure on the broker's 2021 and 2022 base case average gold price forecasts of US$1,800/oz and US$1,700/oz, respectively.

Citi believes its bear case scenario, calling for a US$1,500/oz average gold price next year at 20% indicative probability, looks increasingly viable given the accelerating pace of ETF redemptions in the first week of March, following a steep month of outflows in February totalling some -83 tonnes.

<u>Iron Ore: China Caution</u>

While China's steel mill margins are turning profitable as steel prices surge to nine-year highs, iron ore offtake from ports –a proxy for iron ore consumption– is relatively weak in comparison, having barely lifted from 2019 and 2020 levels.

However, now that mills are profitable, Credit Suisse expect this will soon change, making raw materials affordable. The broker maintains its iron ore forecast of US$170/t for the first half of 2021.

Credit Suisse notes the key risk for steel demand going forward is China acting to cool the steel market. So far, there is no negative news from the National Congress, but the broker remains cautious for the second half of the year when it expects demand to soften and iron ore prices to ease.

Xiao Yaqing, head of China's Ministry of Industry and Technology reiterated that China aims to further trim its steelmaking capacity "substantially" as well as to curtail steel output so as to reduce power consumption and carbon emission in the long term.

China's iron ore imports rose 2.8% for the first two months of 2021 from a year earlier, customs data showed on Sunday, as demand for the steelmaking ingredient was supported by a firm consumption outlook.

The world's top steelmaking nation brought in 181.5m tonnes of iron ore in January and February, up from 176.6m tonnes for the same period a year earlier, according to data released by the General Administration of Customs.

While the rise was within analysts' expectations, the industry ministry has repeatedly urged companies to cut China's crude steel output this year in line with President Xi Jinping's goal of carbon neutrality by 2060.

Closer to home, Rio Tinto launched an investigation after its West Australian iron ore ports were hit by a third fire in the space of 26 months. The latest fire occurred on Friday within a section of the sprawling port complex the miner operates near the town of Dampier.

Fortescue Metals Group ((FMG)) has begun cancelling major construction contracts at its troubled Iron Bridge magnetite project in the Pilbara as it grapples with cost blowouts at the project.

It is understood the iron ore major wrote to contractors late last week cancelling remaining work being conducted under existing contracts, and ordering them to prepare to demobilise equipment and redeploy staff assigned to work at Iron Bridge.

Met coal: Russia has plans

Russia is gearing up to take advantage of Canberra's poor relationship with China to expand the country's coal exports, as Chinese authorities allow some of the millions of tonnes of Australian coal stranded off its coast on dozens of ships to be offloaded.

Russian President Vladimir Putin last week met industry executives and government officials to plan ways to increase Russian coal exports to Asia by up to 30% over the next three years, suggesting an increase to output of 34m tonnes a year by 2024, according to a recent Wood Mackenzie report.

ESG FOCUS

# ESG Focus: BHP and Rio Defy “S” in ESG - Part 2

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

**ESG focus: BHP and Rio defy “S” in ESG – Part 2**

The Apache land transfer to BHP Group and Rio Tinto in Arizona (see link below) has been rescinded and more heads topple at Rio Tinto as global resolve steels to reinforce ESG narratives.

(*BHP And Rio Defy The "S" In ESG - Part 1*:
https://www.fnarena.com/index.php/2021/03/03/esg-focus-bhp-and-rio-defy-s-in-esg-part-1/)

**-The deal in Arizona has been reversed, signalling social intent**
**-More investors focusing on social investing**
**-ESG narrative critical to winning younger generations**
**-Zooming in on social materiality**

By Sarah Mills

The United States Government has reversed a decision to transfer Apache land in Arizona to Resolution Copper, a joint venture between mining giants BHP Group ((BHP)) and Rio Tinto ((RIO)).

The land was earmarked for an underground copper mine. Billed as the largest in the world, it contains enough copper to supply US demand for 40 years.

The US Agriculture Department, responsible for the rescission, concluded additional time would be necessary to "fully understand" the concerns outlined by Native American tribes and to "ensure the agency's compliance with federal law." The process could take several months.

The battle for Oak Flat is not yet over, but the government's decision is telling on many levels.

Should it hold, it speaks to the future demand for copper post 2035; the potential pace of disruption in electrification; progress on circularity; and the global commitment to the "S" in ESG.

Meanwhile, closer to home, Rio Tinto announced chairman Simon Thompson and non-executive director Michael L'Estrange, a former Australian High Commissioner to the United Kingdom, would leave the company.

Mr Thompson will seek re-election as chairman at this year's annual general meetings in April and May but will retire from the board next year. Mr L'Estrange will step down after this year's annual general meetings.

The recent transgressions on indigenous rights by BHP and Rio Tinto in Australia’s Juukan Gorge and Arizona’s Oak Flat Arizona have served to undermine the ESG narrative, particularly the “social” component.

They have also raised questions about the environmental narrative: How successful will the green transition be if highly polluting copper, which is totally recyclable, is still being excessively mined in “the largest copper mine in the world” in 15 years? But we will save that question for future articles on circularity.

This article explores the ESG narratives and the strength of big capital’s commitment to the "social" reform of corporate activity: because plausibility of the narrative is critical to gaining social agreement.

The Oak Flat and Juukan Gorge incidents are interesting because, as FNArena wrote previously, every such incident that is not responded to by the ESG community represents a chink in the ESG brand armour.

This is critical in these early stages because the ESG and climate change narratives are essential for gaining the support of not just investors, but millennials and succeeding generations for the green transition; and its fallout.

<u>The social setting - inspiring a new generation for a new world</u>

ESG is very much a story of the new world replacing the old.

The world is on the cusp of a one-in-centuries transition, and the captaining of this transition is being vested largely with the younger generations.

In the West, young people are demonstrating a clear desire to favour the environment – so much so that many would prefer to jump off the development merry-go-round altogether.

They wish to avoid their parent's experience of being bound by financial chains and trapped in an endless cycle of productivity improvements and long work hours, often at the cost of what they consider to be their basic rights such as freedom of movement, and natural access to resources such as air, food, and water.

Given the existence of contraception and powerful technology, many feel that such sacrifices are unnecessary and the system should be better managed – at least that is the conclusion to be drawn from several millennial-futurists' blogs that this intrepid journalist blundered into.

And, just like the baby boomers before them, this generation has a great confidence in its ability to change the world and aligns its fortunes to technological advancement (another strong narrative).

<u>Carbon super-cycle exhausted</u>

With the growth benefits of the oil super-cycle now exhausted, many are pinning their hopes on the green transition to keep the economic wheels turning.

But how much productivity can the world take? And at what cost?

The whole premise of modern monetary theory is that supply in the West and many parts of Asia already outpaces demand. And let's not forget the demand-sag associated with ageing populations.

A range of social solutions has been proposed for this situation, including a universal basic income: we all get $200 when we "pass Go". Sound familiar?

Corporations will be offered stimulus, lent to them by the people to provide jobs for the people and to clean up the environment. This is the social contract. Trillions are being lent and breaches are unlikely to be taken lightly.

Law suits are already rising for breaches of the ESG mandate. German banking giant DekaBank, for example, is being sued for misleading retail investors over both the social and environmental impacts of its fund. I think the emphasis here has to be on "retail" investor and its implications.

Emerging economies may also offer greater demand elasticity.

And, just like Monopoly, the winners of the oil supercycle may have to waive a few debts from people landing on their hard-won assets if the game is to continue.

At the moment, society appears to be borrowing from itself and banking on the prospect of future rises in productivity; which many say can only come from the green transition.

So everyone is invested. Supposedly.

Narratives are critical for gaining support

Financially people may be invested. Psychological investment is another thing.

The image of the curtain being drawn on the supposedly omnipotent Wizard of Oz is the archetypal symbol for the role of narratives in our society.

The ESG and green transition narratives are considered to be an important part of the “social” solution and they work on several levels.

ESG appeals to the younger generation’s social conscience, ambitions and sense of progress; with the promise of raising the “poor” out of poverty and improving general living conditions for all, including animals.

On the environmental level, it appeals to their instinctive understanding of their connectedness with the natural world. Like Dorothy, everyone wants to “go home”.

As a narrative, it also carries the concept of sacrifice and belt-tightening now for the sake of the environment and broader society, which is useful. The covid narrative is also now intertwined with this concept.

And it contains a quest: the prospect of circularity, which to many translates to living happily ever after.

When it is combined with the climate change narrative, the very future of humanity is at stake – the narrative becomes existential.

But as we see in the Wizard of Oz, like all narratives, it has to gain consensus and is vulnerable to reality checks.

Enter Rio, BHP and indigenous rights

The incursions over the past year, while suitably mobilising the media and chattering classes, have also weakened both the social and environmental narratives, given the lack of material consequences

The Oak Flat transfer even undermined the circularity narrative. Humans are often prepared to make sacrifices for a quest, but generally not if they are the only ones; and not if they do not believe the quest will end within their lifetime.

While the occasional setback to a quest is permitted, progress is critical to maintaining a narrative’s momentum – and perhaps this is the best lens through which to view the BHP and Rio incursions.

A 15-year lead-in to the biggest copper mine is not inspiring to a generation used to instant gratification.

The narratives are unlikely to sustain too many such disappointments, so it is telling that the US government stepped in to reverse the Apache land transfer.

There are several months to go before the matter is resolved; but all eyes will be peeled to the outcome as a test of the social narrative; and as a potential indicator to the likely pace of disruption in the electrification market.

ESG is more than just a story

ESG is more than just a narrative. The financial investment from all parts of society is indisputable; and government is weighing in

Big capital is in play.

It will wreak profound physical effects on society, and the decisions governments and institutions take today will either feed or sap the narrative - and will either feed or sap investors' funds.

As Goldman Sachs said to mining.com:

*"Covid is ushering in a new era of policies aimed at social need instead of financial stability [which] will likely create cyclically stronger, more commodity intensive economic growth, that should create the elusive upswing in demand.*

*"Spending on green infrastructure could be as significant as the BRIC investment boom of that decade while the redistributive push in developed markets is likely to lead to a large boost to consumer spending, comparable to the lending-fuelled consumption increase in the 2000s."*

<u>Funds also flowing to social investments</u>

Back to the "social" component?

While not as strongly supported as green investing, "social" funds under management are rising sharply.

A recent MSCI investor survey notes that more than one third (36%) wanted the social component to comprise a larger proportion of the mix in 2021.

This makes sense given the focus on the covid stimulus-led recovery.

This increased to 50% and 48% in the UK and US respectively, where respondents cited covid-19 coinciding with a reassessment of inequality in society as a driving factor," says MSCI.

But how does one assess inequality for investment purposes?

And amidst the political noise and media chatter arising from incidents like Juukan Gorge and Oak Flat, what information can ESG investors rely on?

<u>Investors need to sharpen their focus on materiality</u>

Russell Investments advises ESG investors to focus on materiality, with environmental priorities foregrounded over social priorities.

"The demand for ESG is going to broaden – E is going to be the biggest focus but we do expect the social and governance aspects are going to become a greater focus for investors as well," says Russell Investments in *Investor Daily*.

The analyst advised that, rather than adopt a one size fits all approach, investors should focus on the small number of sustainability issues that have the biggest impact for that company – the old 20:80 rule.

As Juukan Gorge and Oak Flat show, indigenous rights in even transition-critical industries are increasingly proving to be material issues for investors.

Previously, it had become clear that incursions on indigenous and community rights were proving to be a material issue for a vulnerable carbon producer. Australian coal producers have already lost several legal battles – Gloucester Resources being just one example.

<u>Watch supply chains and living wages</u>

In terms of best-in-class stocks, investors are also likely to be evaluating progress on metrics such as ensuring employees have a living wage, supply chains, modern slavery, health & safety and on-shoring.

Modern slavery is already in the spotlight for a number of geopolitical reasons, particularly Sino-relations, and it might be wise for investors to prioritise this issue.

*Responsible Investor* (*RI*) uses the Uighurs as a classic example, noting that the Chinese state has conscripted more than one million civilians into its workforce. Analysts and academics note that China is using its supply chain power as a tool of aggression with trading partners, who are less than impressed, especially given the state-sponsored use of slave labour allows China to muscle out its competitors.

The West's argument may be: what the "Lord" giveth, the "Lord" can taketh away.

"This is an opportune time for investors to clarify whether they need to be funding China's dictatorship," writes Heather White in *RI*. "If one wishes to avoid complicity in slavery and gross human rights abuses, a continued presence in China seems incompatible with even the most lenient ESG standards."

She adds that factory management cannot be relied upon to disclose they are using forced labour. "In fact, they never admit to it, even when challenged directly."

Like all social imperatives, cleaning up supply chains will come at a cost, but given the implications for international security, one suspects the issue of modern slavery and supply chain management is swiftly rising in priority.

If not China, then where? Investors will be keeping a keen eye peeled.

In the United States at least, there is a strong push for investment in on-shoring, which would require considerable infrastructure spend. Many nations are also eyeing India.

Social concerns, such as health & safety, are already recognised as factors that have the potential to destroy long-term shareholder value, as has been the case with various mining disasters.

But even treatment of contractors is in the spotlight.

Cimic Group ((CIM)), for example, has fallen foul of "social" expectations for its factoring practices and supplier and contractor payment practices. Assuming the infrastructure boom arrives, it is possible that time-pressed suppliers and contractors might deprioritise them.

Much will depend on labour supply post-covid but Australia is generally short of skilled tradespeople.

Lendlease ((LLC)), meanwhile, is being examined by the Australian Tax Office. Some sources say that tax is going to be a "social" issue going forward.

One of the company's developments in the Macarthur region was recently downsized after a battle with locals over land clearing that threatened the local koala population, which related not only to a green theme but the social theme, given the campaign was led by the community:

"Experts have warned property developer Lendlease that its reputation as one of the most sustainable housing companies in the world could be damaged if it proceeds with a controversial development on the outskirts of Sydney," said the ABC.

<u>Social bond issuance</u>

Companies may be able to issue social bonds for the purpose of reorganising supply chains or domiciling operations, for example, giving them an advantage over those who have been unable to secure support.

The social bond issuance market may provide signals to the winners on this front, given companies will need to define key spending areas and performance metrics to attract stimulus funds.

In terms of growth/impact stocks, many investors are opting for ready-to-market biotech companies with several years of development under their belts and a proven technology with a competitive advantage; or health-tech companies in markets such as telehealth with ready-to-market software and hardware.

These generally have low risks associated with manufacturing, such as on-shoring, and energy and water use; while dovetailing into UN Sustainability Goals of improving human health and reducing energy consumption by transferring interactions on-line.

Meanwhile, EuropeanIssuers, which represents more than 70% of European public companies is lobbying against legislation that will require company directors to take into account the interests of all stakeholders, including local communities and the environment, in addition to mandatory supply chain due diligence.

Without such legislation, it would be difficult for investors to have a sufficiently firm foundation upon which to take the "social" component of investing seriously at all. It would all boil down to a game of information and nous.

<u>Regulation is a key social investment theme</u>

From a social-risk perspective, interesting industries to watch will be the "wages of sin" sextet: weapons, alcohol, gambling, tobacco, pornography and nuclear power (although the latter industry has a considerable degree of backing for it in some quarters as a substitute for fossil fuels).

The SIX Swiss Stock Exchange, for example, recently launched ESG indices in the Swiss equity and bond markets. For a company to be included in one of the 20 bond indices or two equity indices, it must secure an ESG Impact Rating of C+ and generate no more than 5% of its revenue from "critical" sectors, including coal and tobacco.

Education campaigns and media documentaries to wean people away from these industries are already on the rise.

All face the very real prospect of regulation, although history shows that regulation typically just sends many such markets underground.

Still, regulators can make life very uncomfortable and unpredictable for investors with a bit of tweaking here and there.

Fossil fuels are also considered a social risk, and may face regulation – although this is generally viewed under the broader green transition risk.

<u>Business model resilience</u>

Russell Investments also advises that one way investors can engage in ESG forecasting is by monitoring Business Model resilience and evaluating how a company is preparing for transition.

This will include making social reform in return for social stimulus and ESG capital (which might include employing more people to enable a pivot to circularity where necessary).

Amundi, for example, has launched two early-stage "Improvers" funds, a take on the "best-in-class" concept, that contain companies that progress and continue to progress on ESG matters.

Corporate governance is also expected to have a material focus by improving transparency and accountability, and board and management remuneration and accountability.

However, this particular metric also takes a fairly regular battering. *Michael West Media* notes that only two Crown Resorts ((CWN)) directors resigned after the not inconsiderable scandal arising from the Bergin Report, which found several executives and directors should be considered unfit to continue. West also notes that Woodside Petroleum ((WPL)) dodged a massive clean-up bill in Bass Strait.

As has been the case in the past 30 years, the level and regularity of scandals, and their general lack of consequences, makes even covering such incursions tiresome and an unrewarding job for those tasked with maintaining any kind of narrative.

Something will have to change fast for the new narratives to gain credibility. Covid was the first shock. The world's biggest copper mine has been knocked back. What will be next?

<u>Social materiality</u>

It is difficult to ascertain how the “social” is going to fit in from a materiality aspect, and one suspects it could easily be deprioritised in the first instance as businesses rush to prepare for the green transition.

Ensuring a living and gender-equal wage, removing slavery from supply chains, and on-shoring will come at a cost, and will only prove material in the sense that institutions are likely to penalise offending companies by withdrawing capital, as they are doing with carbon producers.

Although now, the Oak Flat reversal suggests governments may also be willing to step in and regulate on social issues when self-regulation fails: another issue for investors to beware.

However, there is a considerable amount of literature about the long-term financial benefits to corporations from staff retention and low churn rates, and perhaps now is the time that investors will take these issues seriously.

Social scorecards monitoring performance against a range of social criteria are likely to proliferate.

As tools to estimate materiality grow, difficult-to-weigh social criteria are likely to be first out the window; and staff retention and satisfaction are easily-weighed low-hanging fruit.

<u>The old hoary chestnuts – transparency and accountability</u>

Apart from these standard metrics, determining materiality can be challenging, particularly for the social aspect of ESG, given the lack of ESG transparency in corporate reporting and the complexity of the area.

What is materially relevant can differ from company to company and industry to industry; carbon being a more material issue for an airline than a biotech, for example. And a service company will have different social issues to a resources company.

Multinational corporations also operate in many different jurisdictions so global standardisation is needed.

Sustainability mapping should help with this.

The US Sustainability Accounting Standards Board (SASB) has merged with the International Integrated Reporting Council to create a global reporting standard. The first brush is expected to be available within about two years.

The metrics chosen should provide investors with a standardised view into an organisation’s performance against sustainable criteria. Until that time, institutions are likely to direct capital to corporations they believe they can trust to carry out the social imprimatur.

Still, many less well-known quantities are jostling for funds, as Friends Provident Foundation, the Joffe Trust and Blagrave Trust discovered when fielding applications for their "ESG Olympics".

The three published a "state of the sector" report based on the pitches received and noted many of the funds disregarded social criteria, investing in sectors with high social risk, or which have been in the news for fostering poor working conditions, according to *RI*.

Several pitches did not mention social issues at all, and many did not include social risk in their exclusions.

A foundation representative said that "... there are also risks to the credibility of ESG as a concept if the approach taken is too piecemeal or tokenistic."

SASB materiality maps will be accessible to even small investors, as the numbers will eventually just be inputs in a spreadsheet, easily extractable by simple software. The cost of advanced software should also fall.

Once in place, investors will soon be able to access corporate governance scores, social scores and open-sourced environmental data from multiple providers, including forecasting tools.

For now though, they will have to use their nous and check sustainability highlights in annual reports.

Measuring circularity

The initial transfer of Oak Flat may have raised serious questions over the pace of circularity, (and circularity appears to be going nowhere fast in Australia, despite China's refusal to process Australian plastic) but it remains a key policy agenda for the next three decades.

But the reversal puts the narrative back in the spotlight.

It is one of the strongest investment lenses for ESG given that, all things being equal, circularity comes with that coveted "sustainability premium".

Meanwhile, the Global Reporting Initiative (GRI) has developed a tool to help measure a corporation's progress towards circularity, which will also be critical to estimating a corporation's business model's resilience during the transition.

"GRI 306: Waste 2020 is the first globally applicable reporting standard for companies to provide a complete picture of waste impacts along their value chain," says the Initiative.

The tool maps these waste disclosures against relevant Circulytics indicators, allowing companies to assess their performance towards achieving circularity.

"Circulytics from the Ellen MacArthur Foundation – the global thought leader for the circular economy – is a tool that enables any business to assess circular economy performance in its operations," says GRI.

The tool is free for organisations to help inform their strategy in the transition to a circular economy.

Elsewhere, JSS Sustainable Asset Management has rebadged a water fund as a "Green Planet" fund, according to *RI*. The fund continues its focus on ecosystems while launching investments in the circular economy, green energy and electric vehicles. It was among the top performing funds in its Morningstar peer group in 2020 and the shift recognises the shift in focus to "green" investing in 2021.

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

ESG FOCUS

# ESG Focus: Materiality Matters - Part 1

***FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:***
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ESG Focus: Materiality Matters - Part 1

The highly coveted "sustainability premium" is the holy grail of ESG investors globally, and determining materiality is the key to attaining this. First Sentier shares some of its preferred metrics.

**-Materiality meets "social licence" and outcomes**
**-Certain SDG indicators - the low-hanging fruit - come first**
**-Grappling with the materiality of social themes in the supply chains of emerging economies**

By Sarah Mills

It is early days yet for ESG but we at FNArena are always trying to determine the more material ESG metrics to investors.

We also like to follow the money trail: where, why and when institutions are allocating their funds.

Speaking to these issues, First Sentier Investors has published a paper and held a webinar titled *Navigating Investment in a Post-Covid World.*

The paper discusses material indicators for broad sustainability, renewable energy, biodiversity, modern slavery, mental health and gender.

It also provides an interesting insight into the focus and approach of fund managers in the ESG investment space, as well as insightful information on the link between materiality and the social theme.

Part 1 of this series examines First Sentier's approach to materiality and the challenges of investing in emerging economies.

Part 2 will examine materiality in mental health, gender and modern slavery.

Part 3 will examine the environmental materiality: biodiversity, climate change, water, and oceans.

Where materiality meets outcomes

First Sentier says it focuses on both materiality and on a company's "social licence to operate" when allocating funds.

Or, as First Sentier responsible investment specialist Kate Turner puts it: "the space where materiality intersects with outcomes."

The social licence premise is that a company has a "right" to do business so long as they accept the basic rights of others to receive a living wage, breathe clean air, and drink fresh water, for example.

Social licence is becoming an increasingly material factor, and a sustainability issue, as the threat of regulation looms.

"We only invest where management operates the business effectively and in the interests of all stakeholders," says Turner.

"Those that don't look after their customers, employees, suppliers and larger community are unlikely to be rewarding long-term investments," she asserts, noting corporate failures are often indicators of low sustainability in these areas.

Social issues are also becoming increasingly material as funds pivot to invest in emerging economies with a clear growth path (as opposed to developed economies with ageing populations but reasonable working conditions).

This is particularly important given that raising standards and sustainability in emerging economies is also a focus of the UN's Social Developemnt Goals (SDG), meaning a large proportion of institutional funding will be funnelled into these economies - another revenue source for shareholders.

Given this is the case, investors are grappling with understanding the materiality of social outcomes to a company's longevity in these regions.

As an example, FSSA Investment Managers investment analyst Angus Sandison notes that the crippling of many large Indian corporations over the past few years, in particular, can be sheeted back to "social" themes.

Not only did direct investors in these companies suffer, but those with supply chain exposures to these organisations were also burnt.

So institutional focus on supply-chain management is intensifying globally.

Targeting UN Sustainability Goals

First Sentier ties its investment decisions to the United Nations' 17 SDGs, which contain 169 targets and 231 unique indicators.

The fund has chosen a handful of SDGs and then focuses on the targets and indicators upon which it feels it can have the greatest influence.

Using gender as an example, Turner notes that institutions have minimal influence over SDG indicator 5.1.1, which refers to legal frameworks to prevent sex discrimination; but it can wield strong and immediate influence on indicator 5.2.1, which relates to the percentage of women in management.

In this manner, the institution ensures its efforts are both focused and incentivised.

It rates a company according to both its negative and positive contributions to the chosen indicators.

"Every institution is likely to have its own starting points [for ESG investment]," says Turner.

"It's about seeking real world outcomes with targets and indicators."

For First Sentier, biodiversity; modern slavery; mental health; green energy and infrastructure; electrification; decarbonisation and progression to net zero are key areas of interest and areas in which the materiality-outcomes nexus features strongly.

It views biodiversity as mutually dependent with climate change themes.

Low hanging fruit on the SDG chart

First Sentier believes it can immediately influence the following SDG target indicators.

**SDG 5: Achieve gender equality and empower all women and girls Indicator**
**5.5.2:** Proportion of women in managerial positions

**SDG 8: Decent Work**
**Indicator 8.7.1:** Proportion and number of children aged 5-17 years engaged in child labour, by sex and age (this is difficult for them to directly measure but they are working towards it)

**SDG 7: Affordable and Clean Energy**
**Indicator 7.2.1:** Renewable energy share in the total final energy consumption.

**SDG 8: Decent Work**
**Indicator 8.7.1:** Proportion and number of children aged 5-17 years engaged in child labour, by sex and age (this is difficult for them to directly measure but they are working towards it).

**Indicator 8.8.1:** Frequency rates of fatal and non-fatal occupational injuries, by sex and migrant status (particularly in the fund's diversified infrastructure fund portfolio)

**SDG 12: Responsible Consumption and Production**
**Indicator 12.6.1:** Number of companies publishing sustainability reports.

Given the ease of measurement, the number of women on boards is a key metric for institutions globally.

Norges Bank Investment Management, for example, has advised it will vote against the nomination committees of companies without at least two women on the board, unless they have clear plans and targets.

Last year, the investor voted against the committees of 16 European and US companies will all-male boards.

Of course, being on the board doesn't guarantee a voice, but it is a start.

Materiality of indicators

It is notable that First Sentier points out that one of its targets is, at present, difficult to measure.

The SDG indicators, are tiered as I, II and III.

**Tier 1 indicators** are those with an established methology and regular global data production across at least 50% of countries.

**Tier II indicators** have an established methodology but no regular data production.

**Tier III indicators** have no internationally established methodology or available standards. Which means, of course, they are, at present, ineffectual.

Given the SDGs are constantly under review and it is proposed that if no progress is made against improving measurement of Tier III indicators, those indicators will be dropped.

So investors seeking impact need to ensure their corporate investments are focused on Tier 1 indicators, particularly given they are measurable and can be used to demonstrate success, which should attract institutional funding.

Tier II indicators are generally considered satisfactory at present, but not overly material.

For example, only 34% of gender-related indicators sit in Tier 1, which means the balance is not really material.

A potential guide to greenwashing is the corporate promotion of Tier III indicators.

Tracking progress towards the SDGs

First Sentier also rewards corporate progress against SDG timelines to ensure progress towards, and accountability against, long-term ambitions.

While most SDGs are long-term goals; they include many shorter-term milestones, such as 2023, 2025, 2030, and so on.

"It's about ensuring management teams are aligned and accountable [over the timeline]," says First Sentier.

The institution also attempts to assess how a corporation's present actions will affect future outcomes; and then which tools are available to institutions to ensure progress.

Supply chains and the China problem

As noted above, there is a general shift to diversifying manufacturing operations out of China, in particular, and this will have serious implications for global supply chains.

This reflects in part on the nation's continued state-sponsored human rights incursions, growing militarism, and expansion ambitions in South-East Asia.

These include the enslavement of ethnic minorities such as the Uighurs; and the murder and extraction of organs from dissidents and religious dissenters such as the Falun Gong (which has earned China a reputation as the global organ superhighway).

As mentioned in previous articles, slavery has broad economic implications; but when labour (not to mention organs) is sourced from ethnic minorities and dissidents, combined with expansionary military policies, it becomes a matter of geopolitical security.

It echoes of the rise of Hitler in Germany in the 1930s in which the nation subsumed and enslaved surrounding sovereign nations.

Many recall that that resulted in an extremely "material" war, in which vast amounts of capital were destroyed and the world order was rewritten.

In the ensuing chaos, communism extended its influence to create the Soviet bloc; China raised the bamboo curtain; the atomic bomb was dropped; and the Cold War created an uneasy balance of power that lasted nearly 40 years.

It also reflects a shift in focus to latent opportunity in lagging economies.

Investing in emerging economies

The United States has expressed a clear preference for corporations with onshore operations, and may regulate to this effect.

Corporations meanwhile, are considering their options in India, and Latin America.

But investing in emerging economies is increasingly a risk issue for investors as growth in developed economies tapers off and geopolitical tensions rise.

Weaknesses in supply chains due to slavery and poor treatment of staff and the resulting affects on quality control and secure supply are all material issues.

Sandison points to other risks of investing in India, and uses the generic pharma industry as an example.

"India is well known for its generic drug making industry, and is often dubbed 'the world's pharmacy'," says Sandison.

"In our expectations, a lot of these companies have failed to meet international expectations in terms of quality control."

"They are truly global corporations but meeting India's manufacturing standards did not necessarily translate to those desired by the US/Europe."

"As you can imagine, the consequences (for human health and shareholders), of poor quality control is devastating in pharmaceuticals."

Sandison says this is indicative of the general mismatch between Indian and Western manufacturing standards that occur in other Indian industries; and pose high risks for investors in the region.

Sussing out sustainability in India

"As a general comment on India; there is a long-standing phrase in India about family businesses: 'the first generation builds it, the second generation grows it and the third generation destroys it'," says Sandison.

"Hence, when investing in India, we have always paid attention to management changes, the corporate culture, and the morale of various stakeholders.

"Perhaps more than any of the other markets in which we invest, India is where we wish to spend the most time on the ground - getting to visit businesses, speaking to management teams and network with the promoters.

“What we typically look for are companies where sustainability and stewardship is part of the DNA. “

“A good indicator for this is where we find companies which have successful transitioned to a professional management team whilst maintaining the crucial stability offered by a family’s ownership and influence.”

“It is a fine balance but can lead to great outcomes if achieved.”

As an example, Sandison points to Godrej Consumer, a 122-year-old Indian consumer goods business.

“We have regular calls with Nisa Godrej, the chairperson, and have seen our conviction increase as the company has demonstrated its responsiveness and willingness to be a leader around sustainability matters,” says Sandison.

“After expressing to us their desire to become leaders in environmentally friendly packaging solutions, we introduced Godrej to an innovative biodegradable packaging company in late 2018.

“By the time we met management again in May 2019, the company had commissioned a pilot study of alternative biodegradable packaging, signed up to the Plastic Pact and were increasingly using refillable containers, which lowered prices for customers and generated higher margins for the company.

“There are plenty of challenges ahead for Godrej, but the company's transparency, awareness and willingness to learn helps us build confidence in their ability to navigate the various business and sustainability challenges India faces.”

Social materiality

The next instalment in this series examines First Sentier’s approach to defining materiality and extracting the “sustainability premium” - as Blackrock’s Larry Fink describes it - for the social themes of gender, mental health, and modern slavery.

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WEEKLY REPORTS

# Weekly Ratings, Targets, Forecast Changes - 05-03-21

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

By Mark Woodruff

***Guide:***

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

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

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

***Summary***

*Period: Monday March 1 to Friday March 5, 2021*
*Total Upgrades: 7*
*Total Downgrades: 6*
*Net Ratings Breakdown: Buy 52.49%; Hold 39.78%; Sell 7.73%*

For the week ending Friday 5 March, there were seven upgrades and six downgrades to ASX-listed companies by brokers in the FNArena database.

Orica received three downgrades from separate brokers. A litany of woes included China's ban on Australian thermal coal imports, FX headwinds, lack of visibility on earnings as well as a CEO transition.

Wagners had the largest percentage rise in forecast target price for the week. As mentioned last week broker forecasts were significantly exceeded in the first half and volume growth helped in lifting margins, particularly in construction materials and services.

Reece was next after first half earnings exceeded forecasts while good cost control led to earnings margin expansion. Ord Minnett upgraded its rating to Hold from Lighten and felt housing activity in both ANZ and the US looks supportive for earnings growth for the remainder of the calendar year.

Given their intertwined businesses, it was not surprising Synlait Milk and a2 Milk had the two largest percentage falls in forecast target prices for the week. The latter also headed the same table last week after brokers aggressively downgraded earnings to largely reflect lower FY21 guidance.

This week Morgans downgraded its rating for Synlait Milk to Reduce from Hold after assessing significant uncertainty and volatility is impacting the business. A slide in infant formula sales volumes is expected to reduce overhead recovery and increase production of lower-margin ingredient products.

On the podium for leading forecast earnings downgrades last week were the two leading BNPL stocks in Afterpay and Zip Co.

Citi expects Afterpay's growth will be negatively impacted by slowing e-commerce and sees competition as a risk to medium-term margins. In the prior week, UBS pointed out over $2bn in capital raisings since last July "vindicates our view that the market continues to mis-price or ignore how much capital is required to fund the company's growth".

Regarding Zip Co, Macquarie warned the market may only be focussing on customer growth and pointed out the risk of elevated sector multiples. While largely positive on the stock, Citi alluded to risks from competition and lack of scale internationally.

Another high PE stock in NextDC was wedged between the BNPL players on the table for the biggest percentage downgrades to earnings. As mentioned last week, Credit Suisse expects a slower ramp-up over the next couple of years with costs largely unchanged, while Macquarie cautions on the impact of rising bond yields. On the other hand, Citi enthuses that near-term earnings are already contracted and customer expansion underpins the broker's medium-term forecasts.

There was caution around forecast earnings for Fineos Corp as FY21 guidance implies to UBS a material slowdown in the second half for organic services revenue. Several brokers, as mentioned last week, found counterbalancing positives including organic subscriber growth of 35% and the signing of a small though strategically significant cloud claims deal in Australasia.

Qantas and Flight Centre also appeared on the list for significant percentage downgrades to earnings for the week by brokers on the FNArena database. While Qantas is doing a good job managing costs, Ord Minnett notes the balance sheet is feeling the impact of a huge hit to revenue with net debt rising to $6.1bn and above target.

Last week Flight Centre suffered some broker downgrades triggered mainly by valuation concerns with a recovery seemingly already factored into the share price.

Finally, Orica also had material forecast earnings downgrades, which dovetails with the earlier explanations for ratings downgrades.

Karoon Energy was atop the table for percentage earnings upgrades by brokers last week. The reasons put forward by Macquarie last week were solid production and cash metrics which are expected to continue in FY21.

Coronado Global Resources was next on the table. Morgans believes the around -15% discount to fair value looks overdone and upgraded its rating to Add from Hold. Meanwhile, UBS forecasts positive free cash flow in 2021.

Galaxy Resources received a boost to forecast earnings after UBS forecasted 10-50% higher lithium prices in 2021 and Citi expects a return to positive gross margins in 2021 driven by higher prices and lower unit costs.

Material forecast earnings upgrades were also received by road warriors Transurban Group and Atlas Arteria last week. For the former Macquarie highlighted a rebound in Australian traffic and registration growth, while management of Atlas Arteria cited French traffic resilience and recovery potential this year.

The recently updated 2020 financial performance for Nickel Mines showed Macquarie better-than-expected metrics and the Angel Nickel acquisition is expected to underpin a doubling of nickel production by 2023.

Finally, Wagners forecast earnings upgrades are consistent with commentary above relating to the big uptick in estimated price target for the company.

Total Buy recommendations take up 52.49% of the total, versus 39.78% on Neutral/Hold, while Sell ratings account for the remaining 7.73%

**Upgrade**

**ARB CORPORATION LIMITED ((ARB)) Upgrade to Accumulate from Hold by Ord Minnett** .B/H/S: 2/2/0

Ord Minnett expects ARB Corp to benefit from an improvement in new vehicle sales along with strong demand in the Australian aftermarket sales and growth from the export markets. Also, favourable currency movements have led to better gross profit margins.

The broker believes these factors will drive above-average growth in the medium term.

Looking at the recent pull-back in the share price, Ord Minnett upgrades its rating to Accumulate from Hold with the target rising to $36.50 from $35.

**AUSTAL LIMITED ((ASB)) Upgrade to Outperform from Neutral by Credit Suisse** .B/H/S: 3/1/0

Austal's first-half revenue was below Credit Suisse's expectations although the result beat the broker's operating income forecast ($70m versus Credit Suisse's estimated $62m). The beat was primarily driven by stronger-than-expected margin expansion in the US business.

Management has downgraded FY21 revenue guidance to $1.65bn from $1.8bn while leaving the operating income guidance unchanged at $125m, hinting at better productivity levels and cost control, in the broker's view.

The broker has reduced its FY21 revenue estimate by -11% to $1.69bn on fx headwinds and lower sustained throughput due to the US Navy's decision to cease LCS dockings.

Rating is upgraded to Outperform from Neutral with the target rising to $2.75 from $2.70.

**CORONADO GLOBAL RESOURCES ((CRN)) Upgrade to Add from Hold by Morgans** .B/H/S: 4/0/0

Morgans believes the around -15% discount to fair value looks overdone and upgrades the rating to Add from Hold. The target decreases to $1.27 from $1.35.

The 2020 result was well flagged by quarterly reports. The broker describes guidance as mixed with higher-than-expected costs driving a downgrade to forecasts.

The analyst says the company will benefit in the second half from fleet sale-and-leaseback and the potential for both property sales and the sale of Greenbriar.

**EVOLUTION MINING LIMITED ((EVN)) Upgrade to Buy from Neutral by Citi** .B/H/S: 3/3/1

Citi believes nominal gold prices have peaked this cycle and downgrades gold price forecasts by -5% in 2021 to US$1,800/oz while the long term gold price remains unchanged at US$1,400/oz.

With the Fed tightening being priced-in, Citi thinks the opportunity cost of holding gold will increase. The broker's key picks are stocks positioned to generate cash through the cycle and expect upcoming news flow.

Evolution Mining is upgraded to Buy from Neutral with a target price of $4.80.

**ORICA LIMITED ((ORI)) Upgrade to Outperform from Neutral by Credit Suisse** .B/H/S: 2/5/0

Credit Suisse thinks Orica's earnings downgrade stems from a mix of external factors likely to normalise in time plus some fundamental factors.

The broker highlights the progression of downgrades over the years indicates rising cost pressures, surplus industry capacity and operational delays with key assets.

On the bright side, the broker finds the market structure attractive and expects technology to drive further consolidation. In the broker's view, the reduction in Orica's share price is an opportunity for investors to get exposure to the leader in a market likely to remain attractive.

Credit Suisse upgrades to Outperform from Neutral with the target dropping to $16.84 from $16.99.

See also ORI downgrade.

**PANORAMIC RESOURCES LIMITED ((PAN)) Upgrade to Add from Hold by Morgans** .B/H/S: 1/1/0

In the wake of half year results, Morgans increases the rating to Add from Hold after updating commodity and FX assumptions and taking into account sale proceeds from the Panton PGM project. The target price is increased to $0.16 from $0.15

Based on strong commodity prices, the broker believes the board will approve a production re-start mid-year. There's also considered upside from more efficient, lower cost mining and processing than previously estimated.

**REECE LIMITED ((REH)) Upgrade to Hold from Lighten by Ord Minnett** .B/H/S: 0/1/2

Ord Minnett upgrades to Hold from Lighten and raises the target price to $16 from $13.50 after first half earnings (EBITDA) exceeded forecasts by 2.4%, while earnings margins increased 41 basis pointss to 11.4%.

Financing costs of -$66.6m were significantly higher than the broker's -$44 forecast due to a foreign currency loss on derivative instruments.

The broker feels housing activity in both ANZ and the US looks supportive for earnings growth for the remainder of the calendar year. It's considered there will be a rebound in capital expenditure, particularly in the US, where further opportunities for expansion exist.

**Downgrade**

**DAMSTRA HOLDINGS LIMITED ((DTC)) Downgrade to Equal-weight from Overweight by Morgan Stanley** .B/H/S: 0/1/0

While Damstra Holdings' revenue at $12m missed Morgan Stanley's forecast by -10%, the operating income beat the broker's estimated $1.3m. Also, the broker expected a net loss of -$1.5m but the company surprised with a net profit of $0.9m.

The broker finds the strategic vision of Damstra platform play to be compelling. Even then, there is a near-term lack of visibility that makes the broker think the earnings will be skewed to the downside versus Damstra's August guidance.

Morgan Stanley lowers its revenue forecasts by -8% in FY21 and -11% in FY22.

The rating is downgraded to Equal-weight from Overweight with the target dropping to $1.25 from $2. Industry view: In-line.

**ORICA LIMITED ((ORI)) Downgrade to Neutral from Buy by UBS and Downgrade to Hold from Add by Morgans and Downgrade to Neutral from Outperform by Macquarie**.B/H/S: 2/5/0

UBS is disappointed with the trading update, noting there are several factors that drove a reduction to the first half earnings outlook. Orica has indicated a 180,000t reduction in global ammonium nitrate volumes is likely in the first half, given the slump in thermal coal demand.

UBS reduces FY21-23 estimates sharply. Rating is downgraded to Neutral from Buy.

The broker still believes Orica will provide leverage to a global recovery and the normalisation of mine production, but increasing coal trade dislocation, increased investor concerns and the risk of a re-set under the new CEO will weigh on the short-term performance, the broker predicts.

Target is reduced to $13.50 from $19.40.

Orica’s first half update was materially weaker than Morgans had expected due to covid impacts and China’s ban on Australian thermal coal imports. Also, FX headwinds and issues with transitioning to a new SAP system were considered to play a part in the weak result.

Though operating conditions have improved, the broker believes some first half issues will continue to impact the second half. Thus, Morgans downgrades FY21-23 profit (NPAT) forecasts by -33.9%, -16.8% and -16.4%, respectively.

The rating is moved to Hold from Add and the target falls to $13.97 from $18.95. Morgans forecasts growth will resume in FY22 reflecting a recovery from covid and the implementation of five strategic growth initiatives.

Macquarie downgrades to Neutral from Outperform, given the lack of visibility on earnings as well as the CEO transition and tighter balance sheet metrics.

The company has made a significant downgrade in its update, with first half earnings affected to the tune of -$105-125m and only partially affected by the pandemic. Macquarie highlights the impact of lower mining demand, while FX and Burrup costs also contribute.

The broker's first half estimate for operating earnings (EBITDA) is reduced by -22%. Target is reduced to $13.65 from $18.46.

See also ORI upgrade.

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

In the wake of the recent downgrade from The A2 Milk Co ((A2M)), Synlait Milk has flagged significant uncertainty and volatility is impacting its business. The company has now withdrawn FY21 guidance.

Morgans makes material forecast downgrades, lowers the rating to Reduce from Hold and the target price is decreased to $2.78 from $4.18. Balance sheet risk is considered to be heightened and an equity raising not ruled out.

The broker highlights a slide in infant formula sales volumes will reduce overhead recovery and increase production of lower-margin ingredient products.

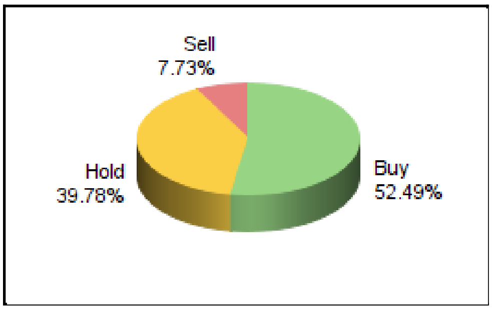
**VICTORY OFFICES ((VOL)) Downgrade to Hold from Buy by Ord Minnett** .B/H/S: 0/1/0

Victory Offices reported a net loss of -$14.2m on the back of weaker than expected revenue of $6.6m (Ord Minnett expected $7.2m). This along with an impairment of receivables led to the first half cash burn exceeding guidance, notes the broker, implying a limited funding runway.

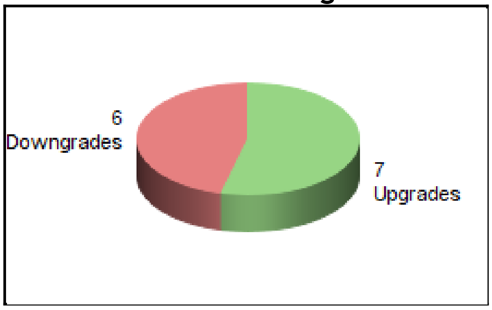
In the long term, Ord Minnett believes covid will offer positive tailwinds as the industry demands a high level of workplace flexibility. For now, the broker expects the negative impacts to prevail.

Ord Minnett downgrades to Hold from Buy with the target dropping to $0.33 from $0.71.

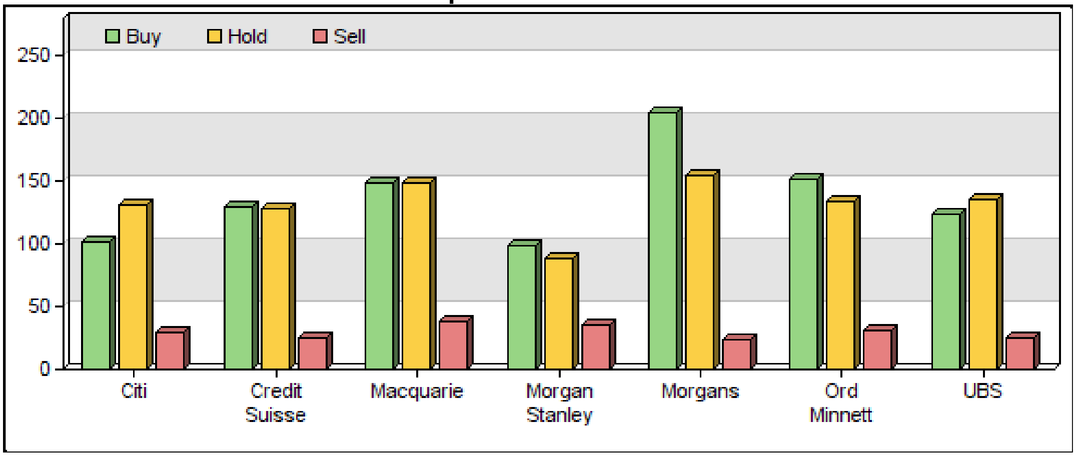
### Total Recommendations




### Recommendation Changes




### Broker Recommendation Breakup




# Broker Rating

| Order | Company | New Rating | Old Rating | Broker |
|---|---|---|---|---|
| Upgrade | | | | |
| 1 | ARB CORPORATION LIMITED | Buy | Neutral | Ord Minnett |
| 2 | AUSTAL LIMITED | Buy | Neutral | Credit Suisse |
| 3 | CORONADO GLOBAL RESOURCES | Buy | Neutral | Morgans |
| 4 | EVOLUTION MINING LIMITED | Buy | Neutral | Citi |
| 5 | ORICA LIMITED | Buy | Neutral | Credit Suisse |
| 6 | PANORAMIC RESOURCES LIMITED | Buy | Neutral | Morgans |
| 7 | REECE LIMITED | Neutral | Sell | Ord Minnett |
| Downgrade | | | | |
| 8 | DAMSTRA HOLDINGS LIMITED | Neutral | Buy | Morgan Stanley |
| 9 | ORICA LIMITED | Neutral | Buy | Morgans |
| 10 | ORICA LIMITED | Neutral | Buy | Macquarie |
| 11 | ORICA LIMITED | Neutral | Buy | UBS |
| 12 | SYNLAIT MILK LIMITED | Sell | Neutral | Morgans |
| 13 | VICTORY OFFICES | Neutral | Buy | Ord Minnett |

# Recommendation

## Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New Rating | Previous Rating | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | WGN | WAGNERS HOLDING COMPANY LIMITED | 100.0% | 33.0% | 67.0% | 3 |
| 2 | CRN | CORONADO GLOBAL RESOURCES | 100.0% | 75.0% | 25.0% | 4 |
| 3 | ASB | AUSTAL LIMITED | 75.0% | 50.0% | 25.0% | 4 |
| 4 | WTC | WISETECH GLOBAL LIMITED | 10.0% | -10.0% | 20.0% | 5 |
| 5 | ALX | ATLAS ARTERIA | 60.0% | 40.0% | 20.0% | 5 |
| 6 | TPG | TPG TELECOM LIMITED | 67.0% | 50.0% | 17.0% | 6 |
| 7 | REH | REECE LIMITED | -67.0% | -83.0% | 16.0% | 3 |
| 8 | EVN | EVOLUTION MINING LIMITED | 29.0% | 14.0% | 15.0% | 7 |
| 9 | ARB | ARB CORPORATION LIMITED | 38.0% | 25.0% | 13.0% | 4 |
| 10 | APX | APPEN LIMITED | 20.0% | 10.0% | 10.0% | 5 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New Rating | Previous Rating | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | FLT | FLIGHT CENTRE LIMITED | -14.0% | 21.0% | -35.0% | 7 |
| 2 | NIC | NICKEL MINES LIMITED | 67.0% | 100.0% | -33.0% | 3 |
| 3 | ORI | ORICA LIMITED | 29.0% | 57.0% | -28.0% | 7 |
| 4 | SM1 | SYNLAIT MILK LIMITED | 25.0% | 50.0% | -25.0% | 4 |
| 5 | A2M | THE A2 MILK COMPANY LIMITED | 21.0% | 43.0% | -22.0% | 7 |
| 6 | BGA | BEGA CHEESE LIMITED | 83.0% | 100.0% | -17.0% | 3 |
| 7 | WOW | WOOLWORTHS LIMITED | 60.0% | 67.0% | -7.0% | 5 |
| 8 | SKI | SPARK INFRASTRUCTURE GROUP | 29.0% | 33.0% | -4.0% | 7 |
| 9 | BEN | BENDIGO AND ADELAIDE BANK LIMITED | -17.0% | -14.0% | -3.0% | 6 |

# Target Price

### Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | WGN | WAGNERS HOLDING COMPANY LIMITED | 2.383 | 1.417 | 68.17% | 3 |
| 2 | REH | REECE LIMITED | 14.333 | 11.517 | 24.45% | 3 |
| 3 | FLT | FLIGHT CENTRE LIMITED | 17.571 | 14.970 | 17.37% | 7 |
| 4 | NIC | NICKEL MINES LIMITED | 1.600 | 1.467 | 9.07% | 3 |
| 5 | BGA | BEGA CHEESE LIMITED | 6.783 | 6.250 | 8.53% | 3 |
| 6 | ARB | ARB CORPORATION LIMITED | 38.688 | 37.900 | 2.08% | 4 |
| 7 | WTC | WISETECH GLOBAL LIMITED | 27.750 | 27.690 | 0.22% | 5 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | SM1 | SYNLAIT MILK LIMITED | 2.780 | 4.180 | -33.49% | 4 |
| 2 | A2M | THE A2 MILK COMPANY LIMITED | 9.200 | 12.170 | -24.40% | 7 |
| 3 | ORI | ORICA LIMITED | 14.909 | 17.921 | -16.81% | 7 |
| 4 | ASB | AUSTAL LIMITED | 2.850 | 3.425 | -16.79% | 4 |
| 5 | ALX | ATLAS ARTERIA | 6.258 | 6.700 | -6.60% | 5 |
| 6 | CRN | CORONADO GLOBAL RESOURCES | 1.393 | 1.488 | -6.38% | 4 |
| 7 | APX | APPEN LIMITED | 22.230 | 23.280 | -4.51% | 5 |
| 8 | TPG | TPG TELECOM LIMITED | 8.035 | 8.352 | -3.80% | 6 |
| 9 | WOW | WOOLWORTHS LIMITED | 42.790 | 43.075 | -0.66% | 5 |

# Earning Forecast

### Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | KAR | KAROON ENERGY LTD | 1.867 | -2.867 | 165.12% | 3 |
| 2 | CRN | CORONADO GLOBAL RESOURCES | 6.527 | -16.701 | 139.08% | 4 |
| 3 | GXY | GALAXY RESOURCES LIMITED | -0.459 | -3.820 | 87.98% | 6 |
| 4 | ALX | ATLAS ARTERIA | 27.603 | 14.875 | 85.57% | 5 |
| 5 | TCL | TRANSURBAN GROUP | -1.757 | -5.223 | 66.36% | 6 |
| 6 | NIC | NICKEL MINES LIMITED | 11.802 | 7.441 | 58.61% | 3 |
| 7 | WGN | WAGNERS HOLDING COMPANY LIMITED | 6.357 | 4.063 | 56.46% | 3 |
| 8 | SYD | SYDNEY AIRPORT HOLDINGS LIMITED | -3.271 | -4.967 | 34.15% | 7 |
| 9 | NUF | NUFARM LIMITED | 13.521 | 11.441 | 18.18% | 7 |
| 10 | HT1 | HT&E LIMITED | 9.243 | 7.993 | 15.64% | 3 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | APT | AFTERPAY LIMITED | -10.643 | 14.323 | -174.31% | 7 |
| 2 | NXT | NEXTDC LIMITED | -2.064 | -1.065 | -93.80% | 7 |
| 3 | Z1P | ZIP CO LIMITED | -22.460 | -11.880 | -89.06% | 5 |
| 4 | FCL | FINEOS CORPORATION HOLDINGS PLC | -3.558 | -2.468 | -44.17% | 4 |
| 5 | QAN | QANTAS AIRWAYS LIMITED | -72.433 | -54.323 | -33.34% | 6 |
| 6 | ORI | ORICA LIMITED | 55.996 | 81.716 | -31.47% | 7 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 7 | FLT | FLIGHT CENTRE LIMITED | -143.100 | -113.171 | -26.45% | 7 |
| 8 | RRL | REGIS RESOURCES LIMITED | 35.439 | 43.799 | -19.09% | 7 |
| 9 | A2M | THE A2 MILK COMPANY LIMITED | 33.622 | 39.767 | -15.45% | 7 |
| 10 | AFG | AUSTRALIAN FINANCE GROUP LTD | 14.600 | 16.933 | -13.78% | 3 |

**Technical limitations**

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

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WEEKLY REPORTS

# Uranium Week: European Nuclear Decision Pending

While the spot uranium price has declined nearly -20% in the last eight weeks, the market awaits an important decision by the European Commission on radioactive waste.

**-Nuclear defined as transition fuel or polluter?**
**-China's Five Year Plan nuclear targets**
**-Spot uranium slides over -10% during 2021**

By Mark Woodruff

A decision to be made this month could have implications not only for private investment in nuclear power but also the extent to which European Union member countries could sponsor and/or underwrite their domestic nuclear programs.

The European Commission's internal research body, the Joint Research Centre, is set to release a report that could ultimately recognise nuclear power as a "transition fuel" under the EU's "green finance" rule book. Alternatively, it may irreversibly regard it as a polluting form of energy that does "significant harm" to the environment.

A review is currently underway focusing on the safe handling of radioactive waste. Industry consultant TradeTech highlights results of the review could prove pivotal in a decision on whether to include nuclear power as a sustainable energy option for the EU in the future.

In a broad sense, Taxonomy is the science of classification and EU Taxonomy is a classification tool that specifically defines the types of activity that will be considered environmentally sustainable.

EU taxonomy also aligns with the European Green Deal policy that has the dual aim of establishing carbon neutrality by 2050, and supporting the regional economy through green investment.

By pre-qualifying sustainable activities, its expected support can be channelled into the most appropriate areas. Examples of support include investment, grants, low interest debt, and underwriting.

According to figures released by the International Energy Agency, global nuclear power output increased slightly in 2020, despite covid-19 having a significant effect on energy demand worldwide. Nuclear plants supplied 2,600 terrawatt hours (TWh) of emissions-free electricity in 2020 (2,586 TWh in 2019), accounting for 10% of global electricity and nearly one third of the world's low-carbon electricity production.

The resilience of nuclear power, hailed as one of its key benefits, has been clearly demonstrated by its 2020 performance in the face of both pandemic-related supply challenges and reduced electricity demand in many countries.

Country News

China released its 14th Five Year Plan (2021-2026) last week, setting a five-year growth target for its nuclear power program as part of a commitment to be carbon neutral by 2060.

According to the plan, China aims to have 70GW of nuclear generation capacity installed by 2025, compared to about 48GW at year-end 2020. Brandon Munro, Co-Chair of the World Nuclear Association's Nuclear Fuel Demand Working Group explains, "China's 2025 target of 70GW of installed nuclear capacity sits mid-way between the WNA's Reference Scenario and Upper Scenario. China will require six to seven new reactors to commence construction in 2021 for this goal to be achieved."

The country will also continue advancing its domestically developed Hualong One reactor design, consistent with its core strategy of technology independence.

To build a green economy and pave the way for achieving a long-term carbon emissions goal by 2030, the plan calls for lowering energy consumption per unit of Gross Domestic Product by -13.5% and cutting CO2 emissions by -18%.

Although the plan is a measurement of China's commitment to tackling climate change in the near term, the country's detailed intentions, including the targeted rate of reactor construction starts during the period, will be presented in the coming months.

Uranium Pricing-During the week

TradeTech's **Weekly Spot Price** Indicator is US$27.40/lb, down -US$0.35/lb from the week before.

The Spot Price Indicator has declined nearly -20% in the last eight weeks and over -12% from a year ago and is down nearly -10% in 2021.

The average weekly spot price in 2021 is US$29.29/lb, US$0.43/lb above the 2020 average.

Almost 1m lbs U3O8 traded hands in spot deals last week.

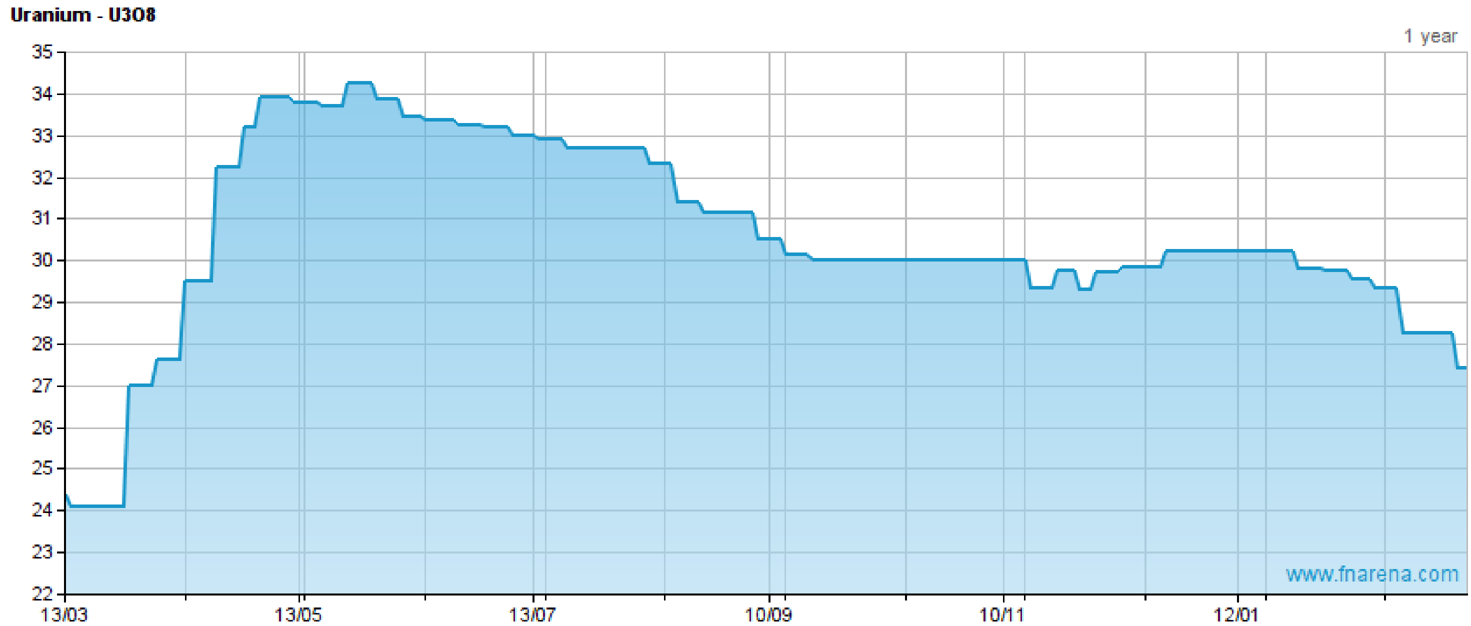
TradeTech's **term price** indicators are US$31.25/lb (mid) and US$35/lb (long).

Currently, a limited number of sellers in the mid-term uranium space have access to attractive financing and are able to offer prices significantly below those required by primary producers to sustain or bring forth new production.

This has resulted in sellers attempting to gain a competitive edge against parties with low-priced material in the mid term by expressing a willingness to accept lower prices for the earlier portion of a long- term commitment. However, this is only in exchange for additional significant volumes over the life of the contract, explains TradeTech.

Uranium Pricing-During the month

TradeTech's **monthly spot price** for February 28 is US$27.75/lb. This is down -US$2 from the January 31 Exchange Value.

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WEEKLY REPORTS

# The Short Report - 11 Mar 2021

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

**Summary:**

Week ending March 4, 2021.

A three-week chart of the ASX200 looks much like the mouth of a shark who would do well to see an orthodontist. But despite a series of sharp moves, mostly in opposite directions each day, the index has managed to go a whole lot of nowhere over the period. Last week was no exception, and nor has this week been.

Stock market volatility has been driven almost entirely by bond market volatility, and on that front it appears things may just be ready to settle down a bit. But nothing, yet, has managed to rouse the short sellers. Last week's action was even more benign than the week before.

What's more, most of the stocks I highlighted last week as moving up the table – not that there were many – have moved back down again.

Two stocks did see moves of more than one percentage point or more last week – both short reductions, both biotechs, and both relating to fresh funding. Neither is covered by FNArena database brokers.

Skin restoration specialist Avita Medical ((AVH)) successfully closed a capital raising last week, and its shorts fell to 7.0% from 8.3%. Shorters were no doubt using the raising to cover positions, although the stock price did take off on the day.

There was little market response to news stem cell specialist Mesoblast ((MSB)) had received a surprise capital injection from a US investor group, led by surgery clinics business SurgCenter Development. Mesoblast shorts fell to 6.7% from 8.9%, with shorters likely frustrated their hopes of a lower price were now stymied.

Otherwise we note the share price of network-as-a-service provider Megaport ((MP1)) has been in a steep downward slide since the company disappointed with its earnings result a month ago. Last week it was announced Megaport has partnered with Philippine-based PLDT Enterprise to deliver a multi-cloud service platform that aims to bridge enterprise networks to major public cloud service providers in different countries.

Little in the way of excitement ensued. Megaport has appeared at the bottom of the 5%-plus shorted table.

No Movers & Shakers this week.

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

**10%+**
TGR 13.0
WEB 11.9

No changes

**9.0-9.9**

No stocks, no changes

**8.0-8.9%**

RSG, ING

Out: MSB, AVH, SSM

**7.0-7.9%**

SSM, FLT, MTS, WSA, MYR, AVH

In: SSM, AVH, MYR

**6.0-6.9%**

A2M, BVS, FNP, MSB, IVC

In: MSB, BVS Out: MYR

**5.0-5.9%**

ALK, EOS, TPW, JBH, Z1P, MP1, CUV

In: MP1 Out: BVS, BOQ, PNV, TYR

**Movers & Shakers**

See above.

**ASX20 Short Positions (%)**

| Code | Last Week | Week Before | Code | Last Week | Week Before |
|---|---|---|---|---|---|
| ALL | 0.1 | 0.1 | MQG | 0.5 | 0.5 |
| ANZ | 1.2 | 1.1 | NAB | 1.2 | 1.2 |
| APT | 1.4 | 1.3 | NCM | 0.4 | 0.4 |
| BHP | 3.6 | 3.6 | RIO | 0.3 | 0.3 |
| BXB | 0.2 | 0.3 | TCL | 0.8 | 0.9 |
| CBA | 0.7 | 0.6 | TLS | 0.3 | 0.4 |
| COL | 0.4 | 0.5 | WBC | 1.1 | 1.1 |
| CSL | 0.2 | 0.2 | WES | 0.5 | 0.5 |
| FMG | 0.4 | 0.4 | WOW | 0.4 | 0.3 |
| GMG | 0.4 | 0.2 | WPL | 1.0 | 1.0 |

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

**Guide:**

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

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

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

***IMPORTANT INFORMATION ABOUT THIS REPORT***

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

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

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

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

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

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

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

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

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SMALL CAPS

# Time To Revisit Infomedia?

After the pandemic caused a slump in earnings in the first half, heavily impacting the share price, brokers suggest it may now be time to revisit Infomedia

**-Next Gen platform continues to gain traction**
**-Prospect of further acquisitions over 6-12 months**
**-High level of recurring revenue from parts & service**

By Eva Brocklehurst

Automotive software specialist Infomedia ((IFM)) remains on track to record modest growth, after lockdowns and restrictions prevented sales from being converted to revenue and earnings in the first half.

The slump in earnings heavily impacted the share price and brokers suggest this was undeserving as, understandably, the pandemic brought installations to a standstill. The company was also unable to fulfill new dealership licences in Europe and the US.

Bell Potter suspects the drop in the share price was framed by a weaker outlook for the second half than many had expected. Still, the broker believes the reaction was overdone as the business is performing well despite a challenging operating environment.

Service revenue was up 9% in the first half while parts revenue was down -6%, contributing to an operating earnings (EBITDA) decline of -2%. Increased capitalised development costs caused a -16% decline in cash operating earnings.

Nevertheless, over the medium term, management expects growth will be sustained and has **an aspirational target for revenue of $200m by 2025**. While restrictions are still affecting sale conversions this situation should now start to improve.

Credit Suisse points out the Next Gen platform continues to gain traction amid several small additional contracts. Major deals should add a sustainable 6-7% to revenue going forward, in addition to new opportunities, while the historically more difficult Americas could benefit from a leveraged sales model.

The broker believes it is time to revisit the stock, noting benefits of acquisitions will eventually materialise, and retains an Outperform rating with a $2.30 target. UBS, with a Buy rating and $2.10 target, incorporates reduced rolling out of licences in FY21 and a recovery in FY22.

UBS suspects the benefits from the subscription model will take a while to recover prior momentum. Nevertheless, the long-term outlook is unchanged and there is a strengthened product offering after the Next Gen platform is completed. The broker assesses this should deliver revenue growth that will translate to around 15-20% in terms of operating earnings.

Acquisitions

Bell Potter believes there is reasonable prospect of acquisitions over the next 6-12 months and assumes acquisitions worth $25m will materialise in each of FY22 and FY23, and be accretive to earnings. The balance sheet is net cash, although a capital raising during the last year is diluting forecast earnings per share. Still, Bell Potter expects double-digit growth in EPS in FY22 and FY23.

The broker re-evaluates its modelling and upgrades to Buy from Hold, retaining a target of $1.75, highlighting that all products are sold on subscription and as a result there is a high level of recurring revenue. The main risks to the business generally are the loss of license agreements and key customers along with product obsolescence.

TREASURE CHEST

# Treasure Chest: Rates Key To Computershare

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. As rates on US 10-year Treasuries start to turn around is there a brighter outlook for Computershare's mortgage servicing?

**-US conventional mortgage rates have started to increase**
**-Main unknown is duration of forbearance programs**
**-And growth in high-margin business likely to be slow**

By Eva Brocklehurst

Mortgage servicing, particularly in the US, has hit an interesting juncture and the growth path for Computershare ((CPU)) may well hinge on developments in mortgages.

Computershare has material leverage to global rates, which affect the level of new mortgages and refinancing, and 10-year US Treasuries are the bellwether indicator for the mortgage servicing segment. Hence, Goldman Sachs believes the market may be overlooking the degree to which movements in rates can be reflected in growth, cash flow and valuation.

Following a lift in 10-year Treasury rates, conventional mortgage rates in the US have started to increase. This is good news for Computershare as, from a mortgage servicer perspective, lower rates have been driving increased pre-payments and refinancing.


Lower mortgage rates may trigger elevated levels of new lending but, as the broker explains, the drag on the company's cash flow in any growth scenario is always greater for an equivalent level of earnings in a heightened early-payment or paying-down environment.

Hence, pre-payments are one of the most sensitive inputs into the valuation. Computershare lowered the useful life assumption on its mortgage service ratio to eight years from nine years at the FY20 results.

Goldman Sachs suspects management is not keen to make such adjustments regularly but can envisage **some upside over the medium term should US rates continue to rise and pre-payment rates return to more normal levels**. The debate, therefore, centres on whether the risk of elevated pre-payments is receding and the broker considers the latest indications on this front encouraging.

Morgan Stanley finds underlying revenue resilient and looks for 7% growth in FY22, despite a step-down in margin income, expecting US mortgage servicing can recover to 24% revenue growth in FY22, as foreclosure fees catch up.

Mortgage servicing went into loss-making territory in the first half, affected by the moratorium on foreclosures. Credit Suisse is more cautious and suspects the accelerated run-off in mortgages because of lower US mortgage rates is unlikely to turn around soon.

As cost reductions are largely leading the recovery, the broker believes this a lower quality item compared with a revenue-led recovery and anticipates a larger rebound in mortgage servicing will not occur until FY23. Ord Minnett concurs, noting gearing is at the top end of management's target and, while cost savings efforts are progressing, expenses are still rising.

Forbearance

The main unknown, Goldman Sachs concedes, is the timing of the cessation of forbearance programs. As a result of the pandemic the US allowed for a period of relief from bankruptcy filings and mortgage stress, and these programs have recently been extended.

**A moratorium on foreclosures will continue restricting Computershare's ability to collect fees**. Citi also points out mortgage servicers are incentivised in the US to modify loans, given the one-off fee income on offer. Loan modification fees are unlikely to be earned when a loan is in forbearance.

The company's guidance assumes minimal recovery in foreclosure-related revenue so the broker assesses the adverse impact of extensions to mortgage foreclosures on revenue is likely to be modest. The bankruptcy administration business was up strongly in the first half and there is potential for further improvement over the next two years as this tends to be counter-cyclical.

Citi notes issuer services are the highest margin business and have proven resilient in terms of revenue despite the loss from US mortgage services. On the other hand, growth is expected to take time to eventuate. Moreover, the level of mortgage originations is likely to soften from recent peaks, although the company is proactively attempting to retain more of its mortgages on the servicing book.

If some of the loans on forbearance convert to true non-performing loans then this should present Computershare with more opportunities for higher margin work. All up, Citi believes there is a lot priced into the shares and has a Sell rating.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, believes the outlook now has more clarity and maintains a Buy rating with a $15.38 target. The database has the lot, three Buy ratings, two Hold and two Sell. The consensus target is $14.54, suggesting -1.1% downside to the last share price. Targets range from $10.75 (Ord Minnett) to $16.45 (Macquarie).

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TREASURE CHEST

# Treasure Chest: Can Tyro Accelerate Growth?

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. A key issue for Tyro Payments is whether the acquisition of new merchant customers is gathering pace

**-Terminal outage impact less than feared**
**-New merchant applications key to the outlook**
**-Margins to improve from changes in card mix**

By Eva Brocklehurst

Can Tyro Payments ((TYR)) accelerate its merchant acquisitions and return rates of growth to peak levels? The volume of downloads in the Tyro Payments mobile app for merchant customers has risen in recent weeks, recovering to the levels seen before a terminal outage in January caused a major disruption to the company's business.

Morgan Stanley notes this data coincides with new merchant application growth and estimates the Tyro Payments mobile app has a 30-40% penetration rate amongst its merchant customers.

Hence, weekly app downloads are considered a useful indicator of new merchant acquisitions and critical to the broker's Overweight thesis.

The company provided no explicit guidance at its half-year results, although indicated the impact of the terminal connectivity issue on customer loyalty was generally less than feared.

Costs in the second half are higher as a consequence, yet Goldman Sachs is reassured by the guidance for remediation costs of around $15m. Importantly, churn in January was in line with the average and there may not be a long-lasting impact on future growth.

Moreover, the **revenue growth profile could accelerate through 2021 as Victoria and the hospitality vertical return to normal**. Revenue and customer growth trends, while lower in January-February than the averages of July-December 2020, are not the signs of a business that is losing market share, Goldman Sachs asserts.

For Macquarie, the main issue is whether new merchant applications are still running substantially below peak levels. The broker notes 599 new applications were made in the first three weeks of February, implying a monthly growth rate of 800-850, which remains -32% below the peak seen in October 2020 and -24% below the pre-pandemic average.

Should this monthly number remain below 1000 in the period ahead of June 2021, Macquarie suspects it will disappoint bullish expectations and signal a more permanent reduction in merchant growth rates.

So, while incrementally more optimistic, the broker continues to envisage risks to merchant growth and retains an Underperform rating. Until the full year results, Macquarie believes weekly total transaction value (TTV) updates are the catalyst and should this data set improve it would provide the upside risk necessary to change its view.

In contrast, Ord Minnett has renewed confidence that the impact of the January outage has been contained and merchant acquisitions are starting to get back on track, lifting its recommendation to Buy from Accumulate.

The outage was significant in that it affected around 30% of the company's merchants but the broker points out other merchant acquirers have had similar issues over the past five years so this event was not unique to Tyro Payments.

Ord Minnett assesses the offer is compelling for small and medium-sized enterprises and market share growth should continue. Moreover, elevated merchant-acquiring margins are expected to improve as a result of the change in card mix.

**Debit cards now account for around 60% of transactions and international cards are decreasing to less than 1%**. Amid restrictions on international travel and a broader trend to debit cards, Ord Minnett expects the trend towards debit cards will continue to the end of FY21 before normalising.

Goldman Sachs, too, acknowledges it underestimated the earnings benefit from the mix shift to debit cards and this is a structural trend that is unlikely to abate. Debit card volumes are the company's most profitable payment units and as a result of the structural migration the broker believes the impact on profit margins is likely to be sustainable.

Goldman Sachs has upgraded to Buy from Neutral and, not one of the seven stockbrokers monitored on the FNArena database, maintains a target of $3.70.

Morgan Stanley notes risks to the upside include another deal similar to the one with Bendigo & Adelaide Bank ((BEN)) along with expansion into new verticals. Pre-integration activities are on track for this alliance and commercial completion is expected by the end of the second half.

On the other hand, further terminal failures or a failure to take market share from the large four banks are risks to the downside. The database has two Buy ratings and one Sell (Macquarie). The consensus target is $3.75, suggesting 16.5% upside to the last share price. Targets range from $2.65 (Macquarie) to $4.50 (Ord Minnett).

RUDI'S VIEWS

# Rudi's View: Will The Fed Tame The Beast?

In today's Weekly Insights:

**-Will The Fed Tame The Beast?**
**-Conviction Calls**
**-FNArena Talks**

**Will The Fed Tame The Beast?**

By Rudi Filapek-Vandyck, Editor FNArena

In a share market as bifurcated as the ASX, leading indices such as the ASX200 or the All Ordinaries no longer show investors the true picture of what is going on.

On a three-month view, share market indices have shown increased volatility but on balance the direction has remained upwards, with the ASX200 moving away from 6600 as many times as it was able to, only to be pulled back towards it an equal number of times, sometimes in quite a violent manner.

On Monday, Australia's leading index closed at 6739.60, which is pretty much in the middle of the 6600-6900 trading range that has kept the local market in check since late last year.

Underneath all that day-to-day volatility, however, lays a gamut of portfolios and market positions that are bleeding profusely and in a lot of pain as share prices for companies including Cochlear ((COH)), Nanosonics ((NAN)), Altium ((ALU)) and Coles ((COL)), to name but a few, are trading well below levels witnessed last year.

The easy explanation that roams the internet these days is "rising bond yields", oft with an extra reference to previously bloated valuations and, in some cases, a disappointing operational performance revealed in February.

It is why shares in Magellan Financial ((MFG)) are now down more than -36% from last year's high, and the damage has even been greater for Bravura Solutions ((BVS)), or for Appen ((APX)), while the likes of Afterpay ((APT)) and Zip Co ((Z1P)) are rapidly catching up, so to speak.

The easy explanation, however, is only part of what is inflicting so much pain on market segments outside of this year's re-opening and reflation trades. While many an expert had been reflecting upon the likelihood of higher bond yields for 2021 and possibly beyond, very few would have anticipated we'd be witnessing the 10-year bond in Australia aiming for 2% by the end of February (the RBA temporarily put a stop to it).

In the US, the world's largest market for government bonds by a long stretch, the yield on the 10-year loan has now nearly tripled from below 0.60% to now 1.55%, with the occasional attempt to move above 1.60%. Back in 2012, the most recent reference to bond yields rising and weighing upon equity markets, those yields rose from 1.5% to 3%, which was a level much higher in absolute terms.

But a similar rise today would represent a near quadrupling in yields from the bottom, while 2012 saw merely a doubling. Context is all that matters in finance, and relative values and movements are more important now than in the preceding decades since yields are at ultra-low levels and debt at an unprecedented high.

Many a market analysis has put central banks in the global control room, keeping liquidity flowing and bond yields low, allowing equities and other assets to remain in bull-market mode. No surprise thus, many on Wall Street are looking at the Federal Reserve to stop this year's bond market shenanigans from inflicting so much pain on REITs, healthcare stocks and technology-driven business models, but so far, no intervention a la RBA has ensued.

For this to happen, policy makers at the world's most dominant central bank would need to become a lot more worried that selling of US Treasuries (yields rising) might become unruly, possibly out-of-control and thus a negative influence on market stability and the central bank's ultimate policy goals, which now includes allowing inflation to sustainably run above 2% for an undetermined period of time.

As with the RBA, the Federal Reserve will only intervene when it feels market stability is in danger, which might impact on the strength of the nascent economic recovery, thus weakening the labour market and finances of the US government and the average US household. While rising US bond yields are seen as the natural correction from exceptionally low yields in response to covid-19 and last year's global recession, central bankers need to be careful they communicate well and their messages are not being misconstrued or misunderstood.

Most importantly, market participants need to remain fully confident Phillip Lowe, Jay Powell & Co know what they are doing and they remain in full control over what is happening in divergent corners of the financial world. One of the narratives, I feel, that is currently read differently from the Fed's intention is that, longer-term, letting inflation run past 2% means bond yields can run a lot higher in the meantime.

This looks like the first mis-communication that needs to be addressed and Jay Powell might well make the extra-effort after the upcoming FOMC meeting, scheduled for March 16-17. But from an economist's viewpoint, let alone from the world's most watched central bankers, there doesn't seem to be a lot to be overly worried about just yet.

Yes, some share prices are down, but others are up, and the economy seems to be humming quite nicely, adding more jobs each month. While things have become a lot more volatile over the first two months of the fresh calendar year, they are a far cry from the mayhem and the emergencies that kept on popping up twelve months ago.

While the RBA felt it had to show its hand when domestic bonds rallied past 1.9% in a hurry, the Federal Reserve will be very reluctant to follow suit. Theoretically, it could go down the policy path of Japan, and the RBA in Australia, and put an effective yield control policy in place, or increase its own bond buying program, but the Fed prefers to use such options only when its communication with market participants fails.

And so the speculation can run rife in the meantime. What is he going to say? Will he say anything? I remain with the voices who believe central bankers will hold on to their communication that inflation, underlying and in trend terms, still has a long way to go until it reaches the current goal of 2% and beyond, but this year might, temporarily, see a bit of a spike because of the economic recovery.

Whether such communication will be enough to keep the bond market in check remains anyone's guess, but we will find out, soon.

The Other Factor: Portfolio Disruption

It remains true, rising bond yields put pressure on higher valued stocks and until recently parts of equity markets, both in Australia and overseas, were showing all the signs of ultra-exuberance, with parts of the investment community acting as if there is no such thing as a valuation and prices can continue to rise no matter what.

But share prices of many quality companies that released excellent results in February, accompanied with ongoing buoyant guidance, are falling virtually every day, leaving valuations derived from analysts' forecasts 25%, 30%, or even 40% higher. Surely, even if fundamental models need to incorporate higher yields, valuations for the likes of Charter Hall ((CHC)), NextDC ((NXT)), and Hub24 ((HUB)) will still remain significantly above where share prices trade?

The answer is yes, but that won't necessarily mean present market dynamics cannot last for longer. One important part of the puzzle can be explained by how most investment portfolios where positioned at the start of 2021, which was still Overweight technology and growth, while financials and cyclicals are the ones outperforming.

So what investors are experiencing in the first quarter of 2021 is, essentially, portfolio disruption, explains **Morgan Stanley's US-based equity strategist, Michael J Wilson**. Hence shares in CSL ((CSL)), Goodman Group ((GMG)), Afterpay and the like need to be sold to purchase shares in, say, Orocobre ((ORE)), Bank of Queensland ((BOQ)) and Downer EDI ((DOW)), and this is what creates this big swing in market momentum between divergent parts of the market.

Wilson thinks this process still has further to run, as portfolios need more recalibrating towards Value and cyclicals. Equally important, before long banks and miners and other cyclicals will look great on technical charts, while the technical picture for share prices under pressure is breaking down, which will further widen the gap as short-term traders (and others) will continue to feed the momentum.

On my observation, recurring chatter among traders is how the Nasdaq is forming a reverse head-and-shoulders on price charts, which is widely interpreted as the harbinger of much weaker index levels.

Ultimately, predicts Wilson, "Growth stocks can rejoin the party once the valuation correction and repositioning is finished", but one can sense this can still take a while, irrespective of whether the Fed calms the market next week, or not.

Active Managers January Survey

Meanwhile, the latest update on **active funds managers in Australia by JP Morgan** shows average cash weightings continue to trend down with January the tenth consecutive month of cash draw-downs; cash is now at a new record all-time low of 2.2%. According to the survey, cash levels fell by a further -27bp in January and are now -147bp below the two year-average.

In February last year average cash rose to 4.5%, the same level where it was in the first half of 2019. BHP Group ((BHP)) and other iron ore miners have been the trade du jour in January with the survey indicating some 70% of local active managers own BHP as a top holding in their portfolio. Another popular come-back stock has been Westpac ((WBC)).

The number of technology stocks dropped in January with the sector only representing 3.2% of major positions in portfolios; the lowest percentage point in six months. The most popular domestic tech stock among active managers remains Xero ((XRO)).

**Conviction Calls**

When it comes to **consumer-related exposures** in Australia, Macquarie recently communicated its favourites with Woolworths ((WOW)) most preferred among supermarket operators, while Harvey Norman ((HVN)) is preferred over JB Hi-Fi ((JBH)), with special mention for Domino's Pizza ((DMP)) and Flight Centre ((FLT)) in other categories.

Over at stockbroker Morgans, retail sector analysts have published their five key picks post February as Lovisa Holdings ((LOV)), Universal Store Holdings ((UNI)), Baby Bunting ((BBN)), Breville Group ((BRG)), and Adairs ((ADH)).

Goldman Sachs' most favoured consumer stocks, as published on Monday, are Super Retail ((SUL)), Coles, Domino's Pizza, Wesfarmers ((WES)), Metcash ((MTS)), and Woolworths. The broker has a Sell rating on Premier Investments ((PMV)), ahead of the release of its interim report.

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Market strategists at **Wilsons** made two changes to their selection of **Conviction Calls** post the February reporting season, with both Integral Diagnostics ((IDX)) and Appen ((APX)) removed from the list.

Whereas Integral Diagnostics' removal follows a 55% appreciation since the stock was added to the list, Appen's share price went in the opposite direction and Wilsons now refers to diminishing confidence in the company's growth trajectory ahead.

Stocks that have kept their inclusion are ARB Corp ((ARB)), Collins Foods ((CKF)), Telix Pharmaceuticals ((TLX)), ResMed ((RMD)), Whispir ((WSP)), ReadyTech ((RDY)), and Plenti ((PLT)).

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Over at **Ord Minnett** (and JPMorgan), a monthly review of what is happening in equity markets, and why (all roads lead to the US bond market) has led to a repeat of the **Super 7**; those stocks most preferred to cope with the changing landscape in 2021.

Those Super 7 are Charter Hall Group, James Hardie Industries ((JHX)), National Australia Bank ((NAB)), Rio Tinto ((RIO)), Santos ((STO)), Super Retail, and Transurban ((TCL)).

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**Tech sector analysts at Credit Suisse** remain undeterred in their view that each of Altium ((ALU)), WiseTech Global ((WTC)) and Xero remain well-positioned, and able, to outperform the broader market on a 12-month view.

Irrespective of the market rotating into most preferred financials and resources companies, Credit Suisse reiterates investment theses for all three remain "alive and well".

The one exception in the sector is Appen, for which the analysts continue to see downside risk to consensus estimates.

Credit Suisse has also lined up three preferred tech exposures outside of the large caps, defined as outside the ASX-100 index. Here the three sector favourites are Audinate Group ((AD8)), Life360 ((360)) and Infomedia ((IFM)).

Elsewhere colleagues at the healthcare desk have nominated ResMed, Ansell ((ANN)), and Sonic Healthcare ((SHL)) as their three sector favourites.

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Looking back at February, Macquarie believes it was a "good" reporting season for **building companies** in Australia. Market forecasts have risen for most in the sector during the month, the broker has noted.

Macquarie's three stock picks for the sector are James Hardie, Reliance Worldwide ((RWC)), and CSR ((CSR)).

**FNArena Talks**

On Wednesday last week (3rd March) I participated in a Special broadcast on the February reporting season by

Elio D'Amato's Spotee on TickerTV and the result can be viewed here:

https://youtu.be/POPg8L1QwX4

This week, on Thursday (11th March) I am scheduled to appear on AusbizTV's The Call, midday-1pm.

**(This story was written on Monday 8th March, 2021. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).**

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**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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RUDI'S VIEWS

# Rudi's View: Qantas, AMP, Infomedia And Lovisa

Favourite theme-exposures and sector top picks from stockbrokers post the February reporting season.

By Rudi Filapek-Vandyck, Editor FNArena

Portfolio recalibration. We don't often hear about it, but we can be 100% certain that's what is happening, a lot, behind the curtains of the 2021 share market volatility.

Assuming the bond market is not yet ready to lay low, but the economic recovery goes on uninterrupted, this year's momentum trade should continue to favour:

-Cyclicals over Defensives
-Cheap & Value over Quality and Growth
-Small Caps over Large Caps

Of course, the above switch in market momentum has already been in place since late last year. The public debate will therefore concentrate on how long this aberration from the past five years or so will/can/should last? The answer probably lays with how quickly portfolio re-adjustments can be executed, and how much damage this will/can inflict on last year's winners.

The dilemma for investors thus becomes: do I hold on to last year's winners, in the knowledge there is not necessarily anything wrong with the underlying companies I hold, and as certain as day follows night, portfolio switching will eventually have run its course? Or do we abandon losers and join the bandwagon of this year's new momentum trade?

The answer, I believe, probably lays somewhere in the middle. In particular given many a quality stock is already down -25% or more over the past few weeks. Conviction and an iron stomach may be needed for longer, though.

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Those investors looking to re-calibrate their own portfolio, partially or otherwise, might take some inspiration from **UBS**'s recent strategy update. In it, UBS strategists revisited the investment themes they believe are most dominant in this year's landscape, with favourites and best-to-avoid suggestions included.

<u>Theme: Value stocks</u>

Most preferred: Qantas ((QAN)), Downer EDI ((DOW)) and GrainCorp ((GNC))
Negatively viewed: Air New Zealand ((AIZ)), Scentre Group ((SCG)) and Vicinity Centres ((VCX))

<u>Theme: Housing market</u>

Most preferred: James Hardie ((JHX)), Boral ((BLD)), Super Retail ((SUL)), Adairs ((ADH))
Negatively viewed: JB Hi-Fi ((JBH))

<u>Theme: Mining Services</u>

Most preferred: Downer EDI
Negatively viewed: none

Theme: Defensive Growth

Most preferred: Charter Hall ((CHC)) and ResMed ((RMD))
Negatively viewed: Ramsay Health Care ((RHC)), Fisher & Paykel Healthcare ((FPH)) and Cochlear ((COH))

Theme: Income Stocks

Most preferred: APA Group ((APA)), Telstra ((TLS)) and Charter Hall
Negatively viewed: Atlas Arteria ((ALX)), ASX ((ASX)), Scentre Group, Vicinity Centres

Theme: Offshore Earners

Most preferred: James Hardie, Sims ((SGM)), Boral, Aristocrat Leisure ((ALL)) and ResMed
Negatively viewed: Domino's Pizza ((DMP)), Atlas Arteria, Brambles ((BXB)), Ramsay Health Care and Cochlear

Theme: Vaccine & Demand Rebound

Most preferred: Super Retail, Aristocrat Leisure and Nine Entertainment ((NEC))
Negatively viewed: InvoCare ((IVC)) and Atlas Arteria

Theme: Vaccine & Demand Rescue

Most preferred: Qantas
Negatively viewed: Air New Zealand, Scentre Group and Vicinity Centres

Theme: Covid & Demand Boost

Most preferred: ResMed and Collins Foods ((CFK))
Negatively viewed: Domino's Pizza, Ramsay Health Care, JB Hi-Fi and Fisher & Paykel Healthcare

Theme: Covid & Structurally More Demand

Most preferred: Charter Hall
Negatively viewed: none

Theme: China

Most preferred: IGO ((IGO)) and Sims
Negatively viewed: Western Areas ((WSA)) and Rio Tinto ((RIO))

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Another route to find inspiration is by looking back at the February reporting season. It's now well and truly behind us, but this year's script, blurred and ripped apart by rising bond yields and an appreciating Aussie dollar, has not necessarily rewarded the best performers with the most solid outlook.

Strategists at **stockbroker Morgans** have selected four major themes for the year ahead, including with best exposure suggestions:

Theme: Resilient Structural Growth

Most preferred: NextDC ((NXT)), Breville Group ((BRG)), ResMed, Magellan Financial ((MFG)), Universal Store Holdings ((UNI)), and Zip Co ((Z1P))

Theme: Global Reflation

Most preferred: Santos ((STO)), Macquarie Group ((MQG)), Ansell ((ANN)), Aristocrat Leisure, Incitec Pivot ((IPL)), Nufarm ((NUF)), and Lovisa Holdings ((LOV))

Theme: Key Vaccine Beneficiaries

Most preferred: Sydney Airport ((SYD)), Corporate Travel Management ((CTD)), Alliance Aviation Services ((AQZ)), and Baby Bunting ((BBN))

Theme: Income Upside

Most preferred: Westpac ((WBC)), BHP Group ((BHP)), Aurizon Holdings ((AZJ)), Coles Group ((COL)), and Aventus Group ((AVN))

Morgans has also updated its list of Best Ideas, now comprising of 43 ASX-listings (too much to repeat here) with all of the above mentioned names included. A few that might not necessarily be on investors' radar include: QBE Insurance ((QBE)), TPG Telecom ((TPG)), Eagers Automotive ((APE)), Redbubble ((RBL)), Booktopia Group ((BKG)), Jumbo Interactive ((JIN)), Volpara Health Technologies ((VHT)), Mach7 Technologies ((M7T)), Acrow Formwork and Construction Services ((ACF)), People Infrastructure ((PPE)), Strandline Resources ((STA)), Ramelius Resources ((RMS)), and HomeCo Daily Needs REIT ((HDN)).

An interesting observation was made by Morgans strategists in that favourite picks performed overall well throughout the February reporting season, but in most cases share price gains were made before the actual results release occurred.

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Small cap analysts at **UBS** have done the hard yakka, comparing earnings forecast adjustments with valuations, growth projections, dividend yield and balance sheet health, and ultimately decided their top three stocks for most upside post February consists of Adore Beauty ((ABY)), Infomedia ((IFM)) and Imdex ((IMD)).

Their least preferred top three (most downside) lists Japara Healthcare ((JHC)), InvoCare ((IVC)) and Servcorp ((SRV)).

UBS prefers to refer to small cap stocks as Emerging Companies and its recommended exposures are (apart from the three already mentioned): Adairs, Autosports Group ((ASG)), Bapcor ((BAP)), Breville Group, Collins Foods, Eclipx Group ((ECX)), EML Payments ((EML)), GrainCorp, IDP Education ((IEL)), NextDC, Select Harvests ((SHV)), Super Retail, TechnologyOne ((TNE)), United Malt Group ((UMG)), and Virtus Health ((VRT)).

The team also highlighted a number of names that underperformed in reporting season, but which should see a better operating environment over the next 6-12 months: Infomedia, Altium ((ALU)), NRW Holdings ((NWH)), and Perenti Global ((PRN)).

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Post February all investors have on their mind is rising bond yields and what it possibly means for their portfolio and the world tomorrow, but a number of brokers has nevertheless made the effort to publish specific sector reports.

Diversified Financials analysts at **Citi** this week grabbed that opportunity to make a non-consensus call on Link Administration ((LNK)) with the fresh Buy rating heavily reliant on the company realising value from its equity stake in PEXA. Citi continues to see rather tepid growth for the years ahead, albeit there should be "growth".

Over at **Credit Suisse**, sector analysts prefer Afterpay ((APT)) most among diversified financials, while Perpetual ((PPT)) is the number one favourite among asset managers and with IOOF Holdings ((IFL)) beating Hub24 ((HUB)) and other financial platform operators.

The team at **UBS**, however, retains a clear preference for Challenger ((CGF)) in the sector with AMP ((AMP)) still least preferred.

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**Goldman Sachs** sees an improving background for mining services providers and its top three Buy rated companies are ALS Ltd ((ALQ)), Orica ((ORI)) and Emeco Holdings ((EHL)).

Sector analysts at **Macquarie** point out February has been a tough reporting season for the sector, with many still reporting weak performances, but Macquarie agrees with the awakening momentum that should put this sector firmly in the basket of covid losers turning into winners this year.

Macquarie's sector favourities, in order of preference, are Downer EDI first, followed by Worley ((WOR)), Monadelphous ((MND)), and Cimic Group ((CIM)).

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**JP Morgan** has nominated Transurban ((TCL)) as its top pick among infrastructure exposures and Qantas as most preferred in the transport sector.

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When it comes to listed property owners, **Macquarie** continues to prefer the funds managers in the sector most (Goodman Group ((GMG)) and Charter Hall), followed by Dexus ((DXS)) and Mirvac ((MGR)).

Over at **Morgan Stanley**, property sector analysts have come to the view that listed owners of retail malls might be a great way to play the snapback in the domestic economy. Most preferred for this strategy is Scentre Group, while Shopping Centres Australasia ((SCP)) is most preferred among smaller mall owners.

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One of the stand-out performing sectors in February were the retailers, discretionary retailers in particular, with stockbroker **Morgans** observing the market has remained quite rational in its response to many great operational performances by not fully pricing in what have most likely been peak-conditions for many.

While the sector is likely to continue enjoying multiple consumption headwinds, the broker believes the sector will somewhat remain under pressure as investors are trying to assess what follows next for the sector. Top picks for the sector, according to Morgans, are Lovisa Holdings, Universal Store Holdings, Baby Bunting, Breville Group, and Adairs.

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The most unusual observation throughout the recent reporting season is that healthcare stocks for once were not among the best performers, despite the fact most large cap companies in the sector once again forced analysts to lift earnings estimates for the years ahead.

The second unusual observation is that CSL ((CSL)), for once, did not force analysts to lift forecasts (though its result was much better than expectations; it was all about the medium-term impact from less plasma collection).

**Credit Suisse**'s healthcare sector analysts believe the general weakness in share prices is opening up great opportunities for investors who can look through short-term momentum, which remains negative for the sector.

Credit Suisse three large cap sector favourites are ResMed, Ansell ((ANN)), and Sonic Healthcare ((SHL)).

Healthcare analysts at **Macquarie** saw most companies reporting in-line with expectations, but no changes occurred to the list of sector favourites which has Cochlear on top, followed by Ramsay Health Care and Integral Diagnostics ((IDX)), Healius ((HLS)), and Estia Health ((EHE)). The latter is an aged care services provider, which is not always included in the sector at other brokerages.

**(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions.)**

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