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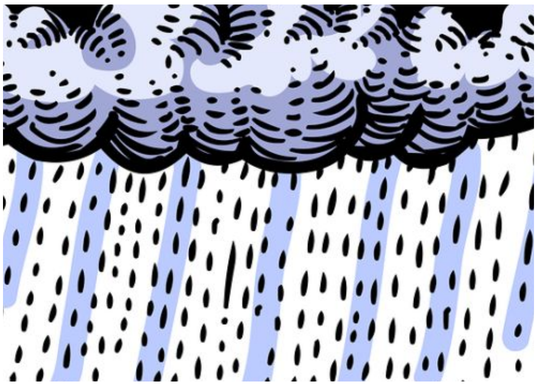

Recession: For And Against

Can Institutional Banking Spur Growth At ANZ?

On Dividend Alert

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FNArena
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INTERNATIONAL

Recession: For And Against

Market analysts put forward their views on the risk of US (and thus global) recession in the near term.

-Fed response too late?
-China feeling the pain
-Earnings must justify valuations
-Stock selection critical

By Greg Peel

The US Federal Reserve's track record in using rate cuts to avoid a recession is mixed, note the analysts at Guggenheim. And this time around, a combination of limited policy space globally – rates are already historically low – and numerous other headwinds suggest it's a close call as to whether the Fed has cut early enough (twice this year ahead of this week's meeting) to help extend the US economic expansion, as is its intent.

The odds of a US recession increased in the September quarter, when the US manufacturing PMI fell into contraction and the US yield curve inverted, while the Chinese economy continued to slow with manufacturing also feeling the pain. Guggenheim's Recession Probability Model at the time suggested a 58% of recession by mid-2020 and 77% within 24 months. The trend continued at the beginning of the December quarter.

History shows that when this particular model reaches such levels, only aggressive policy action can delay a recession, but not avoid it.

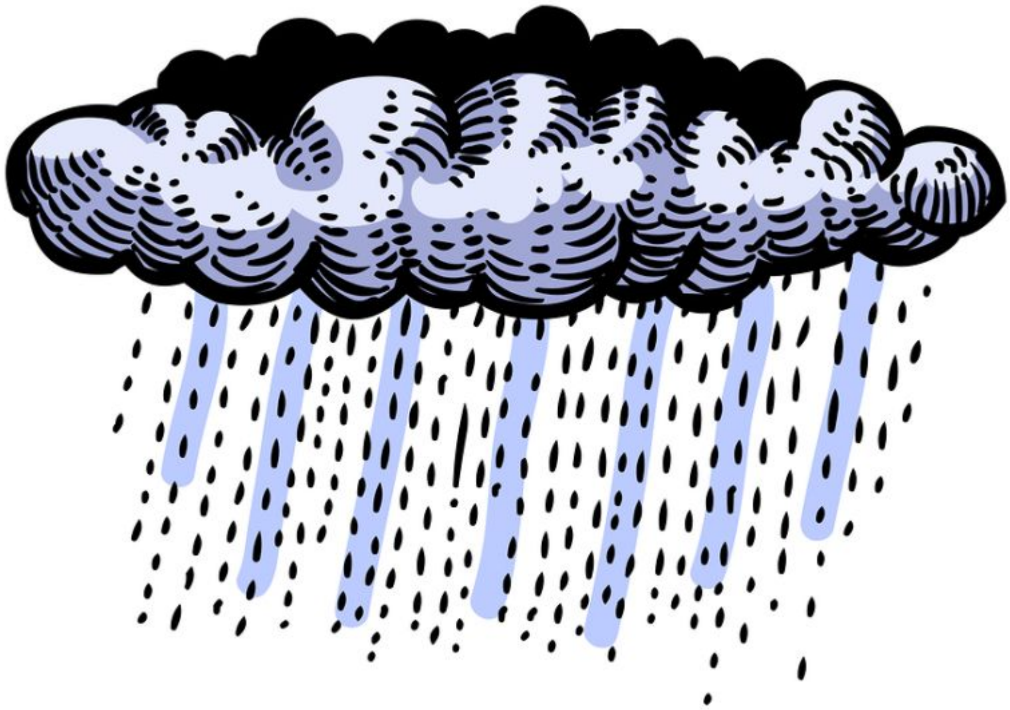
Since Guggenheim published its September report, signs in the US have improved slightly. Manufacturing has crept back and the yield curve has swung back into the positive, albeit mildly. It is important to note that the question of whether or not there will be a recession is always one of *when* not *if*. Every period of growth must be followed by a period of contraction at some point.

At this point in history, the defining factor in all economic forecasting is the trade war. If the trade war is to escalate (which could include Trump's December tranche of new tariffs being implemented) then the chances of a recession increase. If a "deal" can be reached, even a small one, then the opposite is true.

Right now talk is of a small "deal" being reached, as part of a larger process. But we have been here many times before in the past two years. There is little doubt President Trump had expected the war would have been run and won by now when he started the process, even though he did from the outset warn of short term pain for long term gain. But not only is the war ongoing, every attempt by Trump to force a resolution by upping the ante has failed up to now.

Trump blames the Fed for not cutting aggressively. The Fed is now cutting, mostly due to the impact of the trade war. Guggenheim expects Trump to use easier monetary policy as the green light for more aggressive trade policy.

In other words, a dangerous feedback loop may eventuate.



Playing Chicken

However, Trump has an election to win next year, and a failure to secure any sort of trade breakthrough and worst still a recession before November next year will make that task that more difficult. To that end, Russell Investments believes an easing of the trade war seems likely, if only temporary.

It may come down to just how much pain China can bear.

Beijing has come right up to the line on several occasions in the past two years and then baulked, resulting in more or increased tariffs from an incensed Trump. Right from the outset it was assumed Beijing would play a "long game", attempting to wear down Washington into making concessions that would allow President Xi to "save face". For some time it has been expected Beijing would try to string things out right up to the election to force Trump into a corner.

Given a "phase one" deal will not be signed until December, if at all, and the critical factor of intellectual property policy is not addressed until phase two and/or phase three, at the pace things are moving it's hard to see negotiations not running right up to the election. And impeachment proceedings will only have steeled Beijing's resolve. But they might also backfire, steeling the resolve of wavering Trump supporters.

To date it appears a decidedly left wing candidate may become the Democratic nominee, with the veteran Joe Biden struggling for traction. This may not be sufficiently palatable for US voters, and thus upset Beijing's "long game" strategy. But moreover, president-for-life Xi does not by default have the support of all of China.

China's pain threshold may be higher, notes Russell Investments, but job losses and the threat of social instability provide an incentive to de-escalate trade tensions and pursue domestic policy stimulus. Cutting to the chase, trade war escalation will result in more stock market volatility in both camps and this, suggests Russell, may prod both sides into action.

To that end the analysts believe the global economy can recover in 2020 on a balance of trade war resolution and policy stimulus.

Importantly, both will provide a lifeline for the European economy. Otherwise the ECB's relaunch of QE and cutting of interest rates into ever more negative territory is unlikely to provide any further stimulus, Russell Investments believes.

For the US the outcomes are asymmetrical. Failure on trade would likely lead Wall Street into a bear market. Success provides for limited upside from all-time highs. Russell is thus cautious.

And let's not forget Brexit. Even after the developments of the past couple of weeks it appears a Never Ending Story that will ensure uncertainty and investment constraint for some time. Russell is tipping another referendum.

The trade war has also led other central banks around the Asia-Pacific region to cut rates, which should provide some support, Russell believes. But while **easier monetary policy from the Reserve Bank of Australia has provided a boost to the Australian equity market, the analysts suggest any upside is limited given soft fundamentals.**

The analysts at investment manager Loomis Sayles are expecting a further weakening in global economic data in the near term but expect the manufacturing-driven slowdown to reverse course later in the December quarter without recession.

Loomis expects the Fed to cut this week and in December, while the ECB and Bank of Japan have indicated signs of continued easing until growth and inflation approach targets. Global growth forecasts have begun to stabilise and absolute levels of real GDP look "decent" for 2020-21. The analysts see labour market strength and rising wages but do not believe these will lead to a blowout in CPI inflation as has been the case in past expansion cycles.

One risk highlighted by Guggenheim is the possibility of US core inflation reaching back up to 2%, leading some FOMC members to forcefully resist any further policy easing.

Loomis does fear the risk of recent weakness in manufacturing bleeding through to service-oriented sectors, but for now notes limited indications of such an outcome.

Earnings Critical

As for the US stock market, the issue here is that any further strength will need to come from earnings, given price/earnings multiples have already expanded over 2019 from very low levels, when the Fed was tightening, to levels which many see as "expensive" today, regardless of the implications of low interest rates on discounted cash flow valuations. To justify high PEs, earnings must rise in accordance. The outlook for corporate earnings and global growth remain critical, Loomis suggests, in helping to drive equity market performance.

Loomis was writing ahead of this month's US earnings season which to date has proven positive, in the sense that forecasts already deemed to be too pessimistic heading into the season are being beaten by (at the time of writing) around 80% of S&P500 companies. The S&P has hit a new all-time high as a result, along with ongoing confidence in a trade deal if at least some sort.

But most agree, as Loomis believes, any resolution on trade, however small, would be an upside catalyst, while escalation would evoke downside risk.

Possibly severe downside risk, one assumes.

Of course, the trade war is not the only geopolitical hotspot at present. There's Brexit, and US conflicts with Iran and other nations. Plenty of scope elsewhere for downside risk.

But put it all together and Loomis believes US economic expansion should continue through 2020.

Choose Wisely

American Century Investments nevertheless advises, and is not alone, that given expectations for ongoing volatility investors should take a more defensive stance without deviating from their long term strategic asset allocations. However, beware of crowded trades, the analysts warn, especially in traditionally low volatility sectors that may have become risky due to lofty valuations.

Into this group we can place the likes of utilities, REITs and consumer staples – the traditional "defensives" – which have been bought up heavily in the US in particular but also in Australia.

Adopting a defensive posture in equity portfolios could mean complementing growth-oriented holdings with higher-quality companies with histories of paying dividends, American Century suggests. The late stage of the economic cycle continues to favour companies that can use their competitive advantages to drive profit growth regardless of economic conditions.

In the case of utilities, REITs and other bond proxy-type asset (infrastructure funds, toll roads, airports…), the allure has not just been "defensiveness" but yield in a little-to-no yield paying environment. Aside from having been pushed beyond typical valuations due to demand, these assets are at risk of any decision by central banks to hold off on or even reverse further easing.

Which might be the case, say, were the trade war to be resolved.

Consumer staples tend to pay reliable if not as spectacular yields but are truly “defensive” in that even in a recession consumers will still have to eat, drink, wash etc. The big US names have been the go-to trades for most of this year but unfortunately for Australia it is the same US labels that grace our supermarket shelves, leaving the supermarkets themselves as the mega-cap staples, which are far from a risk-free proposition in Australia’s supermarket wars.

This leaves “companies that can use their competitive advantages to drive profit growth regardless of economic conditions” as a rather select group locally. In Australia’s case, “size” is not the simple answer, particularly when the ASX top 20 represents over half of total market capitalisation and is dominated by banks/insurers and resource companies.

But that is not to dismiss all large caps.

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AUSTRALIA

Gwalia Extension Key To St Barbara Outlook

Expansion activities weighed on the performance of St Barbara's Gwalia mine in the September quarter but increased production is likely from mid 2020.

-Removal of ventilation constraints an important catalyst
-Ventilation should effectively double once extension completed
-Softer near-term outlook but increased production from Gwalia likely beyond March quarter

By Eva Brocklehurst

St Barbara ((SBM)) has provided a positive outlook for its newly-acquired Moose River mine while expansion activities weighed on the Gwalia performance in the September quarter. As a result, St Barbara has reduced FY20 production guidance for the Gwalia operation by -11% to 175-190,000 ounces. This comes with slightly higher costs (AISC), now expected at $1390-1450/oz.

A step-change in production at Gwalia, Macquarie suggests, will be important in demonstrating improved operations following the removal of ventilation constraints. Existing mining and the extension activities are currently competing for limited ventilation.

Credit Suisse acknowledges the full details on the September quarter may help understanding, but suspects overly ambitious forecasts for the mine's capacity to cope with the constrained ventilation system have cause the production downgrade. While a constraint will be removed when the upgrade is delivered during the March quarter it leaves insufficient time to catch up on the shortfall, in the broker's view.

While acknowledging this is not a great start to FY20, Ord Minnett points out the extension, when completed in the March quarter, will set the mine up for its current life to 2031.

St Barbara has a competitive platform, in the broker's view, with visibility to 2030 for two 200,000ozpa mines, and one potential 100,000ozpa mine. The Gwalia extension project is effectively doubling underground ventilation and Ord Minnett expects a 25% rebound to around 220,000ozpa when completed.

Volume growth once the extension is completed could push the mine back up to 250,000 ozpa while grades are sustained. As this is a high-quality orebody it comprises more than half of the broker's valuation.

Moose River

Production and costs for Moose River, Nova Scotia, have been provided for the first time. Production guidance is broadly in line with broker estimates, with 95-105,000 ounces expected, although costs are higher. Macquarie now expects costs of $936/oz at Moose River, noting the company intends to spend $11-13m on exploring the tenements in FY20.

Ord Minnett remains positive on the prospectivity of the region and expects St Barbara to entrench its position in the operations over the next 12 months, confirming medium-term production targets and de-risking the permitting of future pits.

Added costs probably reflect an increase in sustaining capital to improve the operation but may also reflect an upward revision to unit cost assumptions, Credit Suisse suggests. If the latter turns out to be the case, this will need explanation, as projections are relatively recent.

The company has retained FY20 guidance for Simberi, PNG, at 110-125,000 ounces at costs of $1285-1450/oz. Ord Minnett awaits further drilling outcomes and the release of the sulphide strategy. Already, with 1.4m ounces in reserves, the broker believes the sulphides have potential to unlock value, as current oxide operations will wind down in FY21.

FNArena's database has three Buy ratings and one Hold (Citi, yet to comment on the quarterly). The consensus target is $3.23, signalling 25.5% upside to the last share price. The dividend yield on FY20 and FY21 forecast is 4.5% and 4.9% respectively.

AUSTRALIA

ARB Corp Decelerates

A depreciating Australian dollar and soft vehicle sales have caused ARB Corp to decelerate, with first half net profit likely to be weaker.

-Turnaround in vehicle sales/change in offshore outlook required
-Flexibility from owning much of the manufacturing value chain
-4x4/SUVs sales an important impetus in the Australian aftermarket network

By Eva Brocklehurst

Vehicle component manufacturer/distributer ARB Corp ((ARB)) is experiencing extended downside risk to earnings although, as the chairman remarked at the AGM, "it's not all doom and gloom". First quarter sales revenue rose 5% but the depreciation of the Australian dollar against both the Thai baht and US dollar means will be difficult to offset by price increases or cost reductions.

Moreover, there have been further declines in new vehicle sales. Hence, **first half net profit is likely to be below the same period last year**. However, ARB Corp has pushed through three small price increases, the latest in early October, although Baillieu points out it will take time for these to take effect.

Ord Minnett acknowledges the company's track record of profit growth has been remarkable, averaging 12% over the past 15 years. The business is high-quality but there is a lack of material upside for the share price, in the broker's view, particularly given the downside risk to near-term earnings.

Credit Suisse also believes, for outperformance beyond this point, a meaningful turnaround in vehicle sales and/or a change in the outlook for the offshore businesses is required, although hastens to add the weakness is not structural.

New vehicle sales continue to trend down and declined -6.7% in the September quarter. Hence, Baillieu assesses the fact ARB Corp managed to sustain sales growth of 5% is favourable, and driven by a large growth in export markets.

Uncertain Economy

The company has highlighted uncertain economic conditions, which could affect sales and earnings. As with many automotive parts suppliers and retailers in Australia, price increases are required to offset cost inflation.

ARB Corp has flexibility, as it owns much of the manufacturing value chain, but achieving cost reductions from suppliers is hard and the depreciation in the Australian currency has not helped. The Australian dollar has depreciated against the Thai baht by around -30% over the past five years, Ord Minnett calculates.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, is not deterred by the prospect, upgrading to Overweight with an $18.75 target. The broker assesses sales growth is robust and the recent price increases should neutralise FX headwinds.

Structural Shift

Moreover, along with Baillieu, the broker considers long-term growth drivers remain compelling, including further structural shift to 4x4 and SUVs (sports utility vehicles). The company is also making significant investment in product development and distribution.

While passenger vehicle sales declined -7.5% over FY19, 4x4 and SUV sales continued to outperform, declining a more modest -1.6%. Given the company's exposure to this end of the market, Baillieu believes this category will be an important impetus for sales in the Australian aftermarket network.

Wilsons expects sales growth to accelerate in the second half, on the back of new OEM (original equipment manufacturer) contracts and the acquisition of Beaut Utes in New Zealand. The latter has around $15m in sales of 4x4 accessories in the NZ market and distributes ARB products.

The acquisition is expected to be positive for earnings per share in FY20. **The company is also developing an increased focus on the emerging mid-sized truck market in the US**. Credit Suisse highlights the fact ARB Corp does not often expand via M&A, albeit its track record in this area is very strong.

The stock has underperformed the Small Ordinaries index, while the shares have fallen -14% since the peak in mid-September, and Baillieu, also not one of the seven, upgrades to Buy with a target of $18.90.

Reasons for the upgrade including weakness in the share price, amid a long-term growth profile that remains intact. Strong returns continue on invested capital and the company has a strong financial position. Meanwhile, the FNArena database has four Hold ratings. The consensus target is $17.43, suggesting 2.3% upside to the last share price.

AUSTRALIA

Painful Adjustment For IOOF Still Looms

Bell Potter is critical of wealth manager IOOF Holdings, which is yet to provide updated details on earnings and synergies from its reinvigorated ANZ P&I transaction.

-Approval from APRA still outstanding for ANZ P&I transaction
-Growth prospects may be limited beyond the initial step up from ANZ P&I
-IOOF likely to sustain remediation shortfall

By Eva Brocklehurst

Wealth manager IOOF Holdings ((IFL)) appears reluctant to divulge too much detail about the changes to its business as it adjusts to the restructuring that is occurring across fund management platforms and adviser groups.

Bell Potter is sharply critical of the company when it comes to providing information. Details for the reinvigorated ANZ OnePath P&I (pensions and investment) transaction have been scant, other than a lower agreed price that was announced on October 18. The revised price was $850m, a -$125m reduction from the original sale price announced in October 2017, and warranties have changed - apparently.

ANZ Bank ((ANZ)) agreed in July 2018 to transfer a partial economic interest in its OnePath P&I business and the legal ownership of its aligned dealer group (ADG) to IOOF from October 1, 2018 but completing the deal has faced hurdles ever since, including court action by APRA (Australian Prudential Regulatory Authority).

This deal is still technically at risk, as approval from APRA remains outstanding. **Bell Potter suspects the metrics have deteriorated and the synergies on offer are not the same as originally conceived**. After two years of waiting, the broker suspects APRA may not approve the transaction. IOOF has received a no-objection notice from OnePath Custodians.

The company will need to successfully integrate and deliver on $65m (original) in expected synergies, Macquarie emphasises, and the source of upside will be if the ANZ ADG can be returned to break even. The broker believes flows are holding up well considering the tough industry backdrop.

Credit Suisse has a view that no news is good news, noting "these beaten up wealth players" are trading at a significant discount to the market. The broker believes the ANZ P&I acquisition is more likely to go ahead now, and this should support strong earnings growth and a re-rating of the share price.

Citi agrees IOOF faces major hurdles, such as the need to restructure the economics of its advice business, but believes the added scale and associated cost synergies from the ANZ P&I deal should provide some flexibility.

September quarter net inflows of $165m beat Morgan Stanley's forecasts and compare with $75m in net inflows in the prior corresponding quarter. Funds under administration and management in the quarter were up 3% to $142.7m largely, brokers note, on the back of supportive markets. Excluding ANZ ADG, net outflows were -$124m in the September quarter. Morgan Stanley expects this to be offset by the opportunity to capture displaced bank-aligned advisers.

IOOF may be enjoying greater stability in funds under administration versus its major peers but only its platform division has experienced positive net flows in the past year, UBS points out, and suggests growth prospects after the initial step up related to the P&I are limited.

<u>Shadforth</u>

Citi considers the fund flows reasonably resilient in the context of the current market and competitive offerings from peers. The company has highlighted the benefits from the increased capture of Shadforth inflows following its platform investments (Project Evolve) in late 2018.

The Shadforth service appears to be slightly cheaper than BT Panorama for higher balances and this contributed strongly to flows in the March and June quarter. The broker envisages this offering, while likely to be lower margin, should at least provide a solution to maintain adviser-sourced funds within IOOF rather than have these leak to external platforms.

The advice segment flows and the recently-acquired ANZ ADG flows were minimal albeit positive in the quarter. Citi found this respectable, given the disruption affecting the whole adviser industry.

Still, Bell Potter questions how the IOOF platform, which consistently rates in the bottom quartile in the Strategic Insights platform report, can be viewed as the best option for the Shadforth and Bridges network. Margin pressure continues in the platform and advice businesses and, while the advice business is being restructured, cost metrics are yet to be provided.

<u>Remediation Shortfall</u>

Moreover, Bell Potter assesses the company's review of client remediation falls significantly short of expectations, as IOOF's costs are a sixth of the average of the major banks on a per-adviser basis. Hence, the broker suspects a further $1bn to cover the shortfall may be required.

Bell Potter is incredulous when it comes to the insufficient provisions, as the company has not checked back beyond seven years, nor with all advisers that have ever worked for IOOF. Details will be hard to avoid, the broker suspects, when the company has to publish its first half results.

Citi acknowledges **clarity on a new strategy is unlikely until 2020** and suggests, while the new advice model is likely to require capital, the company is not in a position to quantify the amount.

Bell Potter sums up its view that the company is stuck in the "old world model" whereby it buys advice distribution and utilises its products to maximise returns, and this is likely to become harder to achieve.

Bell Potter, not one of the seven monitored daily on the FNArena database, has a $4 target and Sell rating. Ord Minnett has the single Sell rating on the database, with three Hold and two Buy making up the remainder.

The consensus target is $6.90, signalling -7.8% downside to the last share price. This compares with $5.40 ahead of the October 18 update. Targets range from $4.95 (Morgan Stanley) to $8.45 (Credit Suisse). The dividend yield on FY20 and FY21 forecasts is 4.3% and 5.3% respectively.

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AUSTRALIA

Cleanaway Banking On Better Second Half

Cleanaway Waste is now relying on cost reductions and price increases to deliver growth in the second half of FY20, guiding to a flat first half.

-More exposed to external forces than previously expected
-Brokers cautious about any meaningful recovery in the second half
-Options for cost reductions and price increases the main hope

By Eva Brocklehurst

Cleanaway Waste Management ((CWY)) remains confident all operating segments will perform and has reiterated FY20 guidance for growth. Yet the company's first half result is now forecast to be flat, with softness driven by a combination of weak economic activity, no growth in customer volumes and weak commodity prices.

This reliance on second half growth is somewhat disconcerting, Morgans asserts, as the latest update follows the broker's positive conference briefing earlier this month. Other brokers are disappointed too, as the company should be experiencing incremental cost benefits from the acquisition of Toxfree, and the new joint venture with ResourceCo was expected to contribute as well.

UBS believes the business should be able to work through the issues but acknowledges Cleanaway Waste is a little more exposed to external forces than previously anticipated. Ultimately the broker suspects China's National Sword policy (restricting imports of solid waste as raw materials) will provide further opportunities but wants evidence that headwinds are easing before turning more positive.

Credit Suisse suspects the short timeframe between the August outlook and this downgrade means prior guidance was slightly optimistic. The broker upgrades to Neutral from Underperform on valuation grounds and reduces FY20 net profit estimates by a further -5%, having cut forecasts by -14% at the results. Credit Suisse would not be surprised if there is another downgrade to FY20 before the year is out.

The company still considers FY20 will provide improved earnings. Yet, brokers envisage any growth will probably stem from incremental synergies resulting from the Toxfree acquisition. Ord Minnett suspects the market will be sceptical about the delivery in the second half on cost saving initiatives and assertive price action, given a poor FY19 result and the weak FY20 outlook provided in August.

The broker remains cautious about a meaningful recovery in earnings in the second half but positive on the medium-term structural trends for large-scale operators in Australia's waste management industry. This view is underpinned by potential public policy and regulatory changes.

Historically, Morgans points out Cleanaway has indicated whether it is comfortable with consensus estimates. However, this year such assurance has been absent. The broker notes the company would be required to notify the market if earnings are expected to miss expectations by more than 5% and takes the opportunity to adjust assumed effective tax rates to align to recent history.

This partly offsets a downgrade to operating earnings estimates of -4-5% for FY20-22. Morgans expects operating earnings growth in FY20 of 3% and believes it too early to factor in the proposed waste-to-energy facility into forecasts.

Queensland Landfill

Macquarie was also surprised by the weakness in the first half outlook, having previously expected 8% growth. The most pertinent deviation from forecasts appears to be in Queensland landfill. The company has blamed lower local Queensland landfill volumes post the implementation of the levy.

The introduction of the Queensland landfill levy from July 1 has affected volumes, Citi notes, expecting this to impact operating earnings by up to -$10m in the first half. Credit Suisse, too, assesses Cleanaway has taken a significant hit to its pricing for landfill in Queensland, most of which will be felt in the first half.

Ord Minnett points out Cleanaway should have been able to mitigate this impost to some degree, or at the very least not be surprised by the impact, as a levy was flagged well in advance. Over the past decade, landfill levies in most markets have helped put inflation into the value chain.

Recyclables Pricing

Citi also flags the price for recycled materials has been volatile and under pressure since the China National Sword policy was implemented. The most pertinent exposure for Cleanaway is old corrugated cardboard (OCC). Citi estimates prices of OCC have halved since the first half and end markets remain under pressure.

Still, the broker highlights options resulting from cost reductions and price increases and a stabilisation in the commodity markets that could flow through from the second half. There is also Cleanaway's ability to benefit from industry consolidation, given the strength of the balance sheet.

Citi encourages investors to look through the recent volatility and focus on the quality of the balance sheet, as well as the operating leverage to be derived from price increases.

Macquarie suspects domestic economic growth reached a trough in the second quarter of 2019 and growth will recover, along with the further improvement expected in 2020, factoring in the lagged effects from easier monetary policy and the recent turnaround in real house prices.

FNArena's database has three Buy ratings and two Hold. The consensus target is $2.13, suggesting 19.2% upside to the last share price.

see also Cleanaway Waste Still On Top Of Recycling on August 19, 2019.

AUSTRALIA

Will ResMed's Growth Rates Taper?

While ResMed has recovered its lead in the sleep disorder market, several brokers suspect stellar growth rates may taper.

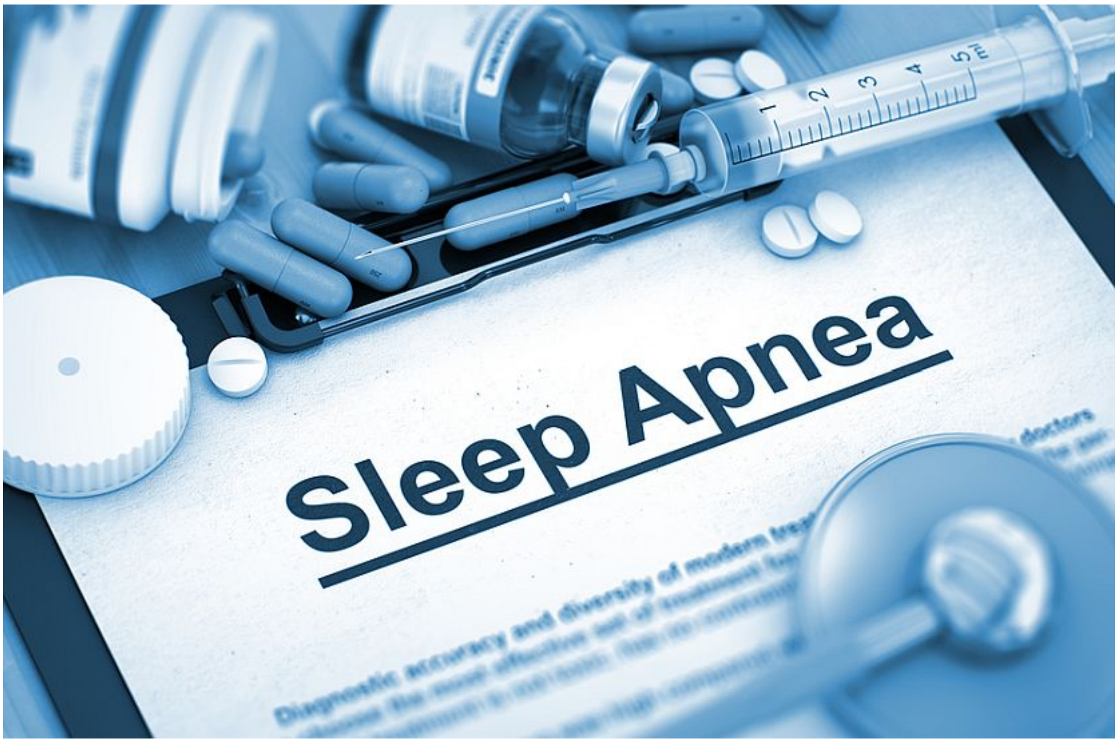
-Exceptionally strong first quarter unlikely to be repeated
-US Medicare changes underpin medical device business
-To soon to know when Propeller Health will be profitable

By Eva Brocklehurst

Brokers continue to laud the prospects for sleep disorder specialist ResMed ((RMD)), which has sustained strong revenue growth in the first quarter. Masks grew 19% and, outside of the US, recorded the best quarterly growth since 2011, while devices were cycling high comparables but still grew 8%.

The overall sleep business grew 11%. ResMed continues to gain market share at the expense of both Phillips and Fisher & Paykel Healthcare ((FPH)). Ord Minnett suggests the company has re-established a leading position in masks after a period where it was challenged. It is also the undisputed leader in devices with the AirSense range.

Credit Suisse agrees **the company is benefiting from having the broadest product portfolio**. Both the breadth of its product portfolio and continued re-supply should enable consistent strong growth in mask sales. Moreover, the company is best placed in devices because of its AirView data platform.



Morgans suspects the exceptionally strong first quarter is unlikely to be repeated but the company should maintain good momentum across its core business and the evolving connected-care offering. Saturation is unlikely to occur in the market in the short to medium term, UBS agrees, as recent mask launches appear to be adding to overall category growth.

The main downside issue for Ord Minnett is the likelihood that sales will slow because of lower market growth. The broker remains hopeful the software business can provide a boost, although warns a prolonged period of uncertainty created by the latest round of competitive bidding may weigh on sentiment.

Management has expressed confidence growth will lift to double digits and the broker considers this achievable in light of the recent collaboration with Cerner, which should open up the prospect of a large number of new customers in need of an out-of-hospital solution.

The outcome of 2021 competitive bidding is the key downside risk, in Citi's view. In contrast with the company's goal for double-digit growth the broker forecasts high single-digit revenue growth in FY21 and beyond. ResMed has guided for an FY20 gross margin of 59.5%. Morgan Stanley differs from the market in that less gross margin pressure is envisaged as US re-imbursement is stable.

One of the issues for Citi is the role price is playing and whether the market may be, temporarily, growing faster than usual. The launch of four new masks in the last 12 months probably explains some of the market share gains, in the broker's view.

It is also possible that as public discussion around sleep and obstructive sleep apnoea becomes more mainstream and products improve, previously-diagnosed patients could return to the system and growth rates accelerate, although this is not the broker's base case.

Devices

Credit Suisse expects US device sales to grow above market, at 9% in FY20, supported by a growing trend towards in-home sleep testing. As the company has increased its investment in data, the broker is upbeat about the ability of this to be directed towards improving the quality of care in the home setting and increasing the penetration rate within the sleep and chronic obstructive pulmonary disease (COPD) markets.

ResMed has an enduring advantage in its medical device business and customers will find incentives to prefer those devices that share treatment data, Wilsons believes. This supports the company's strategy and provides potential upside to forecasts, driven by US Medicare changes that necessitate the implementation of enterprise software in the skilled nursing sector and among home care providers.

UBS suspects, with key providers now covered, such as nursing homes, hospices and durable medical equipment (DME) providers, that a period of consolidation in this area is more likely. Morgan Stanley on the other hand anticipates a recovery in devices once FY20 has passed and a high-growth period has been lapped.

Mask Share

Citi points out that **the impact of new mask launches has diminished over time**, largely because of the rising share of masks being sold through re-supply programs, particularly in the US. The broker estimates the 70-80% are sold in the US are dispatched through a re-supply program.

Hence, there are few incentives for DME providers to sell new masks to existing customers, and manufacturers are competing for the just the 20-30% of the US market that is not on the re-supply chain.

The broker finds it too soon to assess when Propeller Health will become profitable. ResMed is expected to publish results from studies to prove the value of Propeller Health to payors and pharmaceutical companies. Macquarie, too, notes the company has highlighted a large COPD comparison sponsored by Novartis featuring Propeller Health that is expected to start in January 2020. This will compare Propeller Health plus COPD standard of care to COPD on its own.

Morgan Stanley envisages upside in the COPD market from both portable oxygen concentrators and Propeller Health and long duration growth is being supported by a large installed base, stable US reimbursement and the connected care strategy.

Macquarie, on the other hand, while assuming robust growth over the rest of FY20, believes the risk/reward profile is skewed to the downside. The broker believes the share price is ascribing limited risk in relation to reimbursement/regulatory changes and/or the impact of competing technologies over the medium to longer term.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, has an Overweight rating and $23.15 target. The database has four Buy ratings, two Hold and one Sell (Macquarie). The consensus target is $20.54, suggesting -2.8% downside to the last share price.

See also Connected Care Working Well For ResMed on July 29, 2019.

AUSTRALIA

Retail Fuel Competition Still Dogs Viva Energy

Despite higher refining margins, the focus is on Viva Energy's retail fuel offering, which is likely to remain pressured by competition.

-Retail fuel margins likely to remain weak
-Recovery in industry dynamics likely to be delayed
-Strong balance sheet provides scope for further M&A or capital management

By Eva Brocklehurst

Refining margins surged for Viva Energy ((VEA)) in the September quarter, which reported a Geelong refining margin of US$8.80/bbl. This was driven by improved regional refining margins, although offset partly by downtime from planned maintenance.

Improved retail fuel pricing, loyalty program redemptions and joint marketing campaigns with Coles ((COL)) helped volumes at Coles Express rise 1.4%. This was a pleasing outcome and remains the basis for growth, Ord Minnett asserts.

Importantly, retail fuel volumes are lifting in the alliance network, and Morgan Stanley assumes 5% volume growth in 2019, while expecting retail fuel margins will be flat. The broker suspects the market will be prepared to look ahead a number of years, given Viva Energy has lost -40% of its volumes in the past five years because of a high-price strategy in conjunction with Coles.

UBS suggests the company is now making progress on retail volumes, consistent with its intention to grow by competing on price. Credit Suisse increases assumptions for refiner margins that more than offset a weaker retail fuel margin and ultimately drive an 11% upgrade to earnings forecasts.

Retail Margins

Retail fuel margins are likely to remain pressured by competition. Ord Minnett assesses lower costs and a different priority for profit and returns from the independents, as well as a more price-focused approach from EG, which now owns Woolworths ((WOW)) petrol, could cause retail fuel margins to stay weak.

Margins have not continued the upward trend of the past decade over 2019 and competition remains intense. Retail earnings guidance is for a flat second half and the broker suspects the step-up in Coles Express volumes has probably been incorporated at the first half result when guidance was provided.

Ord Minnett agrees a recovery in industry dynamics may not be as quick as many had hoped. Still, the broker retains an Accumulate rating given the company's strong industry position.

UBS believes the market is under-appreciating the operating leverage that comes with improving alliance volumes. While commentary on retail margins was softer, the broker does not believe the trend has stepped down materially compared with the first half. UBS suggests the market should have more confidence in the company's ability to lift alliance volumes to its target of 70-75m litres per week.

The broker underscores several reasons for retaining a Buy rating including a favourable earnings outlook, a recovery in refiner margins from multi-year lows and a strong balance sheet, which provide scope for further M&A or capital management. Macquarie, on the other hand, is cautious about the medium-term and sticks with a Neutral rating, despite the stock offering a premium to its 12-month forward price target.

There are three Buy ratings and three Hold on FNArena's database. The consensus target is $2.29, signalling 9.3% upside to the last share price. There is a 2.8% dividend yield on 2019 forecasts and 4.0% for 2020.

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AUSTRALIA

Lovisa's Expansion Captivates Brokers

Jewellery retailer Lovisa Holdings continues to expand and invest in new markets, now operating 33 stores across the US, considered its main opportunity.

-Like-for-like sales growth moderated in recent weeks
-Price increases likely to provide only partial offset to currency headwinds
-Significant premium factored into the stock

By Eva Brocklehurst

The long-term growth outlook for jewellery retailer Lovisa Holdings ((LOV)) is robust and intact, underpinned by the expansion offshore. Margin pressure from currency is considered temporary while investment in new markets is acknowledged as essential for setting up a strong base.

Morgans points out that obtaining exposure to a significant global roll-out is rare in the Australian retail sector, albeit the stock is far from cheap. Operating expenditure is likely to remain elevated as this global expansion progresses but leverage should flow through in coming years.

Like-for-like sales growth for the first 17 weeks FY20 was 2.3% but this indicates a slowdown from the first 6-7 weeks, which were in the 3-5% growth range. Hence, there is some disappointment relative to expectations. Still, Morgans points out this is still firmly in positive territory and the base being cycled will become easier.

Gross Margin

Lovisa Holdings continues to invest in support structures, particularly in the US and currency headwinds have been flagged. Gross margin pressures have materialised, driven by Australian dollar weakness.

Citi forecasts gross margins will fall in FY20 because of currency pressures and this may only be partially offset by price increases, reduced discounting and better gross margins in new markets. The broker calculates every -US1c decline in the AUD/USD results in a -35 basis points decline in gross margins and only a third of this decline is likely to be offset.

Macquarie continues to factor in 3% same-store sales growth and captures the full extent of the FX headwinds in gross margin estimates. While the broker accepts price increases are likely to provide only a partial offset, other options are cited such as management of sourcing and input costs.

Store Numbers

Bell Potter assesses growth in the year to date reflects price increases, as volumes are roughly flat. There has been an increase of 31 stores since July and this brings total store count to 421. The company expects to open more new stores in FY20. There were 64 new stores opened in FY19.

There are 33 stores now operating across the US, in five states. This remains the largest market opportunity for the company. Bell Potter believes **Lovisa Holdings has reached an important inflection point, where key US landlords now embrace the concept**. The broker, not one of the seven monitored daily on the FNArena database, retains a Buy rating and $15 target.

No guidance was provided, given the spring racing and Christmas periods are still to come and this has a significant bearing on the company's performance, hence Macquarie cautions about extrapolating recent trends. Yet, the broker is least concerned about same-store sales growth, believing the **rolling out of stores is the main driver of the investment case**.

Citi expects further upside if issues in Spain can be fixed and the company enters a new market, which appears likely over a 6-24 month timeframe. The broker notes that 71% of new stores opened over the last two years have been skewed to the first half and considers it too early to be upgrading assumptions for the roll-out in FY20.

Both strong like-for-like sales momentum and store roll-out are essential, in Morgan Stanley's view. The broker remains cautious into the crucial Christmas trading period and, while acknowledging the appeal of a global roll-out, considers this balanced by the significant premium factored into the stock.

FNArena's database has three Buy ratings and one Hold (Morgan Stanley). The consensus target is $13.53, signalling 2.9% upside to the last share price. Targets range from $11.40 (Morgan Stanley) to $14.50 (Macquarie).

AUSTRALIA

Alacer Gold Promises More From Copler

Alacer Gold's oxide resource expansion at Copler holds significant promise while the sulphide plant pleased brokers with steady production throughout the September quarter.

-Sulphide plant now routinely at, or above, nameplate capacity
-Further upside from ongoing exploration success around Copler
-Free cash flow yield and mine life stand out among gold peers

By Eva Brocklehurst

Alacer Gold ((AQG)) has defied the pessimists and managed the transition to its sulphide project, while still upgrading production forecasts at the established Copler oxide resource.

The oxide business was supposed to be in decline but exploration targets have revealed potential for further ore, both sulphide and oxide. UBS points out, based on historical grades and recoveries, instead of declining the oxide production contribution may indeed hold up.

Meanwhile, the sulphide plant has ramped up and delivered sustainable production throughout the September quarter. Credit Suisse lauds the progress with the sulphide transition, as an endorsement of its quality as well as management's capability and execution.

Year-to-date 161,500 ounces have been produced at a cost of US$613/oz and the plant is now routinely at, or above, nameplate. It was not that long ago that investors were concerned about the risk of a production hiatus, as oxide reserves depleted and sulphide permitting was delayed.

However, additional discoveries outside of reserves have provided over 50% of the 2019 oxide gold production. These new discoveries appear almost certain to underpin a long life for Copler. Work is underway on near-mine prospects as the expansion of heap leaching occurs. Credit Suisse suggests the potential now appears stronger than when Copler initiated oxide mining.

Moreover, **sulphides are present beneath all of the subsequent oxide discoveries** and this indicates an opportunity to enhance the profile and extend life beyond the current 20 years. Management's strategy is to sustain oxide and sulphide gold production from Copler for 10 years at 300-400,000 ounces.

Oxide Extends

Alacer Gold has lifted oxide guidance for 2019 citing positive reconciliation, in-pit exploration and successful blending strategies. September quarter production of 101,300 ounces was well ahead of Macquarie's expectations. Upgraded guidance at the oxide project is the main positive for the outlook, in the broker's view, as regional drilling adds to inventory.

UBS has lifted oxide production forecasts for 2020 and envisages further upside from ongoing exploration success and the stacking of oxide ore. While the company's plans are not yet fully formed, the broker assesses it may be possible to stack and leach around 5-6mtpa for several years and, depending on grade and recovery, potentially maintain the oxide production at 100-150,000 ounces per annum.

The Ardich prospect revealed strong intercepts that support a materially larger metal endowment compared with the current resource. Mineralisation is open in all directions. An updated interim resource is anticipated for Ardich, 6km to the north east of Copler's processing centres. Ardich has indicated resources of 639,000 ounces at 1.5g/t along with 96,000 ounces of inferred resources at 1.16g/t.

Credit Suisse considers Ardich the most exciting growth opportunity and success will almost certainly require additional heap leaching capacity. If Ardich grows proportionate to the mineralised trend then it could be a multi-million ounce endowment, the broker adds, supporting its own gold recovery infrastructure.

Another oxide growth prospect, adjacent to Ardich, is Cakmaktepe where a review is underway to better understand the system. Phase 1 mining was completed in the quarter, with strong positive grade reconciliation. Credit Suisse also highlights Copler Saddle, which borders the western flank of the mine and has also demonstrated highly economic grade intersections over favourable widths.

The Alacer Gold share price has risen 149% in the year to date as the company passed certain milestones, and UBS suspects more is to come. The broker considers the stock a stand-out in the gold sector, with a free cash flow yield for 2019-20 of over 15%, vs peers on 3-5%, and with a mine life of more than 20 years vs peers at 5-10 years.

FNArena's database has three Buy ratings for Alacer Gold. The consensus target is $7.28, signalling 6.0% upside to the last share price.

AUSTRALIA

Blackmores: Hopes Pinned On Restructuring

Blackmores' first half profit warning has sent analysts into a scramble to downgrade forecasts, but turnaround potential has been boosted by a shift in strategy.

-Big first half downgrade for Blackmores
-Improvement expected in second half
-Brokers like new business strategy
-But it will all take time

By Greg Peel

Dietary supplement purveyor Blackmores ((BKL)) has seen its share price fall -36% since January amidst tough conditions in the company's premier sales destination of China. Yesterday management warned first half FY19 profit will be flat on the second half FY18, representing a material downgrade to consensus forecasts.

Blackmores's troubles began when Beijing implemented complex new e-commerce laws in January, aimed at tightening up a loosely regulated market and requiring operators to satisfy a certification process. At the same time, the company has suffered increases in product input costs and the cost of bedding down its recent Catalent acquisition.

A cost-out program underway is tracking to expectation and Blackmores introduced significant product price rises on October 1. However, two-thirds of cost-out savings will be used to reinvest in revenue growth while price hikes always present the risk of lower sales.

But the new CEO has a cunning plan, and it is this plan that drew the attention of analysts and sent the share price higher on the day when it otherwise should have tanked. A new Business Transformation Plan targets five goals: (1) Lead with purpose; (2) Rejuvenate Australia; (3) Deliver a sustainable growth model in Asia; (4) Products and services to be powered by education; and (5) Drive operational excellence.

Which all sounds a bit "motherhood", but backed up by management restructuring and the appointment of new executives with health sector experience and, perhaps most importantly, a Chinese managing director of the China operation with impressive e-commerce experience.

The most important of the strategy's five goals, as analysts see it, is point (3), which is to be achieved through pursuing strategic partnerships in China. Brokers agree the potential for a Chinese partnership or joint venture would be a positive share price catalyst.

Citi believes a Chinese partner could potentially improve China distribution, tailor marketing and new development for Chinese consumers and improve regulatory capabilities.

But at this stage it is all about potential, while conditions remain challenging. Morgans echoes consensus in suggesting the business transformation program makes strategic sense and should drive solid top and bottom line growth, but given said short term challenges and a lack of actual financial targets, converting a strategic plan into earnings forecasts is rather difficult.

Thus, as is typically the case with potential turnaround stories in any industry, it all sounds good but the proof of the vitamin pill will require actual evidence.

The new CEO, in outlining the plan, pointed out Blackmores' gross profit margins are some -500 basis points below the competition, which suggests improvements can be made. Credit Suisse notes a lot of this gap is due to product mix, implying innovation will be key to lifting margins and "that's not a sure thing".

Credit Suisse also notes Chinese consumers are increasingly holding off purchases – of anything presumably – until retail holidays in which deep discounts are offered, such as Singles Day – the creation of "China's Amazon" Alibaba – June 18 – the creation of Alibaba competitor JD – and Valentine's Day. And the new kid taking on Alibaba and JD is Pinduoduo.

Pinduoduo organises consumers into groups for the purpose of making bulk purchases at better prices than retail.

Thus competition in Blackmores' space is fierce. Credit Suisse at least sees enough potential to move its recommendation on the stock to Neutral from Underperform.

Management is highlighting price increases, cost-outs and the benefits of the Catalent acquisition in expecting a materially better second half, but analysts see this as a big ask. Morgan Stanley retains Equal-weight but sees full year earnings at risk.

Citi is sticking with Sell, while noting an aforementioned Chinese partnership is the main risk to this recommendation.

Morgans retains Hold, but despite cutting earnings forecasts alongside other brokers, Morgans stands out in lifting its price target to $80.00 from $66.10. Ex-Morgans, the consensus target among FNArena database brokers (bearing in mind two are yet to update) is $67.20.

The broker attributes the big jump to applying a lower risk free rate (consistent with falling interest rates) and rolling forward its forecast period to FY21, which will be the first full year under the new CEO.

As to whether Blackmores can turn the ship as early as FY21 is still a point of contention among brokers.

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AUSTRALIA

Can Institutional Banking Spur Growth At ANZ?

ANZ Bank's FY19 result confirmed the challenges faced by a banking sector that needs to find new areas of growth while grappling with narrowing interest margins.

-Cost reduction targets is likely to require more investment
-Difficulties persist with Australian loan growth
-Franking on dividends reduced to 70%

By Eva Brocklehurst

As the first of the three major banks to report its financial results this month ANZ Banking Group ((ANZ)) encompassed the broad scope of market concerns and will face another difficult year. Further investment is considered likely in order to sustainably reduce the bank's cost base.

Morgan Stanley forecasts underlying revenue to fall -3.5% in FY20, with negative operating leverage driving a -10% decline in pre-provision profit. The broker also forecasts a -10 basis points decline in margins.

Regulatory costs are likely to remain elevated, in Credit Suisse's view, while the **pick-up in housing finance applications may not flow through to overall credit growth because of a higher paying down of mortgage debt by borrowers.**

FY19 cash earnings were $6.47bn, below most expectations, driven by lower net interest margins. Morgans actually found the results better than feared as costs, asset quality and capital were all pleasing elements.

On a mildly positive note too, softer revenue was offset by lower-than-expected bad debts and Credit Suisse points out earnings quality was enhanced by a higher effective tax rate, albeit affected by declining provision coverage.

The bank has confirmed its medium-term (FY22 exit) cost base target of $8bn which UBS considers positive, provided cost reductions are undertaken in the correct manner and do not disrupt the franchise.

Morgan Stanley believes the cost target will require more investment and also a material reduction in the bank's footprint as well as a reshaping of the workforce. This could then create a risk of further losses in market share if peers do not take the same path.

Macquarie agrees that it will be difficult for ANZ Bank to materially outperform peers on costs without damaging the franchise. This view is reinforced by the first half FY20 expense guidance of around 4%, ahead of possibly more remediation and restructuring costs.

The bank is lowering its hurdle rate to increase growth opportunities, particularly in institutional banking as this will offer potential for faster growth. Citi considers this the right strategy, as institutional banking was already growing at 7% and offers high single-digit returns, not too dissimilar from the front-book (new customer) mortgages that peers were chasing.

Sector Implications

Morgans assesses investors are adopting negative views on net interest margins for the other major banks as a result of ANZ Bank's disappointing performance. This may be unjustified, as the broker calculates the retail net interest margin in Australia actually increased in the second half, with positive implications for more retail-oriented banks.

Morgans believes the main problems for ANZ Bank lie with the institutional and New Zealand divisions, and more specifically the compression being generated in margins on deposits in these divisions. The broker suspects official rate reductions, both domestically and offshore, pose a greater problem for ANZ Bank because of the nature of its markets business.

While the FY19 results may be partially a reflection of specific issues related to ANZ Bank, Macquarie still asserts the underlying pressures on the sector remain broad-based. The broker suspects ANZ Bank will need to raise capital levels by around $4bn over the medium term, given pending rules changes from the Reserve Bank of New Zealand, and despite what appears to be a robust pro forma CET1 ratio of 11.5%.

Mortgages

The bank has warned that loan growth is unlikely to materially increase, despite a housing recovery, stating "volume growth is going to be close to zero".

ANZ Bank has lost market share in mortgages recently, Bell Potter notes, with the mortgage portfolio declining by -$7bn in FY19. The bank has moved to rectify the issue through increasing transparency on policy and risk settings and improving processing and turnaround times.

Bell Potter, not one of the seven monitored daily on the FNArena database, was underwhelmed by the results and has reinstated a Hold rating with a target of $28, given the 12-month return is expected to be less than 11% amid ongoing regulatory and operating headwinds.

Dividend

The second half dividend was maintained at $0.80 but the bank has cut the franked portion to 70%. UBS believes ANZ Bank is likely to hold its dividend at current levels, if asset quality remains benign and rates do not fall much further.

Franking should not be an issue for other major banks, Morgans suggests, as these derive a greater proportion of their statutory earnings from Australia and have healthier surplus franking credit balances. Citi is of a similar view and expects ANZ Bank will retain this level of franking for a while. The benign credit environment should allow for a stable dividend and provide some valuation support.

Morgan Stanley disagrees and expects a dividend reduction is more likely in 2020, lowering its full year estimate to $1.40. The broker cites the fact ANZ Bank has previously described a 60-65% pay-out ratio as providing a conservative, sustainable and fully franked dividend base for the future. This would imply a -20-25% cut to the dividend, although the broker suspects the bank will aim to remain above this level, even with lower franking.

Ord Minnett points out while the valuation of 12.5x FY21 estimated earnings looks cheap compared with other major banks, the discount is justified given the number of challenges and significant execution risk facing ANZ Bank.

FNArena's database has six Hold ratings and one Sell (Credit Suisse). The consensus target is $26.31, suggesting -0.3% downside to the last share price. Targets range from $24.80 (Morgan Stanley) to $28.00 (Citi). The dividend yield on FY20 and FY21 forecasts is 5.8%.

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COMMODITIES

Material Matters: Oil, Nickel, Iron Ore & Coal

A glance through the latest expert views and predictions about commodities. Oil; nickel; iron ore; metallurgical coal; and thermal coal.

-Are Russia/Saudi Arabia on the same page for oil production cuts?
-Nickel ore exports from Indonesia appear to be abruptly ceasing
-Iron ore price unlikely to be sustained into 2020
-Supply reductions required to lift coking coal price substantially
-Fundamentals brighten somewhat for thermal coal

By Eva Brocklehurst

Oil

Saudi Arabian officials have indicated a desire to stem growth in **oil** inventories in 2020. Given the backdrop of weakening global economic growth, Citi suggests OPEC et al can easily rationalise a deeper cut to production, although Russia and Saudi Arabia appear to be drifting apart.

Hence, the Saudis may need to consider deepening production reductions, along with United Arab Emirates and Kuwait, if Russia abstains. Russia's energy minister has indicated it is too early to state what might be required by the market in 2020.

Meanwhile, the Russian oil industry tsar, Igor Sechin, has raised doubts about Saudi Arabia's reliability as an oil supplier. Citi points out the Russian industry has been arguing that production caps were reducing the long-term growth potential of the country's oil companies.

Mr Sechin has also asserted the US is exercising more control over the oil market than Russia and Saudi Arabia, through sanctions that have reduced targeted country exports significantly as well as from rapid growth in shale output.

He also stated that the US has a privileged position in financial markets which should end and his company, Rosneft, will now conduct all oil and gas sales in euros. The Saudi currency is tightly pegged to the US dollar while the Russian rouble floats.

Citi acknowledges the overlap between Saudi and Russian interests in the energy sector has been imperfect yet both countries retain an interest in their mutual ability to affect prices. This makes the Sechin comments significant regarding the potential future direction of bilateral ties.

Nickel

UBS flags press reports which indicate the Indonesian government and the country's Nickel Mining Association have agreed to cease **nickel** ore exports immediately. To UBS, this appears to be an agreement rather than a decree or changing regulation.

By laws enacted in August, exports were to cease in January 2020. This appears to have the unintended consequence of nickel miners preferring to export to China rather than supply domestic smelters.

The industry agreement cited in reports appears to indicate pricing for domestic ore will be on parity with China's spot prices, with freight netbacks. The nickel price has rallied around 60% in the year to date, mostly because of the shift in Indonesia's export policy.

The bringing forward of the ore export ban without offsets has led to a temporary loss of around -8% of global supply. UBS believes the risks are mostly priced into nickel and nickel equities and maintains a forecast for US$7.50/lb.

However, price risk lies to the upside from the shifting policy and the consolidation of metal inventory. Nickel inventory on the London Metal Exchange has halved in just a month because of buying from Tsingshan on a view that supply will be tight in 2020.

Iron Ore

UBS notes unprecedented volatility in **iron ore** has occurred this year. First half news was dominated by supply-side shocks and, along with record productivity from Chinese **steel** mills, induced prices to rise 70% by the end of June.

Prices have drifted lower for much of the second half as major producers return from outages, with spot iron ore now at US$87/dmt. Nevertheless, the recent closure of Vale's Itabirucu dam serves as a reminder that a return to full capacity will not be smooth.

UBS considers current prices are necessary, as non-conventional high-cost supply has lifted. China's steel output is on track for a record year and remains supportive of the iron ore price as well.

Beyond 2019, the market is expected to come back into balance and such price levels are likely to be unsustainable. Hence, the broker prefers **BHP Group** ((BHP)) and **Rio Tinto** ((RIO)) over pure iron ore plays which are more exposed to a decline in prices, such as **Fortescue Metals** ((FMG)).

Metallurgical Coal

Morgan Stanley expects a partial recovery in the **metallurgical (coking) coal** price, to US$165/t, based on seasonal demand improving in India, China's import quota being re-set for deliveries in 2020 and the US cutting back exports.

As expectations for a near-term recovery in demand fade, the broker would require more meaningful supply reductions to lift prices further. Metallurgical coal is more exposed to steel weakness outside of China than iron ore, in Morgan Stanley's view. With the marginal cost of seaborne hard coking coal hovering in line with the spot price there is little incentive for significant reductions to supply.

The main risk to the upside, in the broker's view, is a chance of disruptions to Australia's concentrated supply base during the November to April wet season.

Thermal Coal

Macquarie observes production cuts have materialised in **thermal coal**. While coal remains uncompetitive against **gas** in Europe, spreads have improved since the northern summer, pointing to a much more balanced Atlantic market. Observable thermal coal inventory has stabilised, or started to decline, at all major consuming hubs in China, India and Europe.

A bearish factor has been removed, namely China's port restrictions, which are not materialising as previously expected. Macquarie suspects port authorities may have been instructed to "go soft" on coal imports to avoid the risk of sudden spikes in prices. Moreover, it appears likely India's imports will need to rise to offset a slump in production during the monsoon.

Strong demand growth is also flagged from Vietnam amid a surge in power generation and falling local production. This is likely to be a source of relief for high-ash Australian coal, in the broker's view, which has have struggled to sell in China.

All up, Macquarie suspects the fundamentals for thermal coal have brightened somewhat and reiterates a view that spot prices have bottomed. However, for a compelling price rally to take place a clear catalyst is required, and coal is likely to struggle as long as the **LNG** market remains stuck in such deep oversupply.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 25-10-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday October 21 to Friday October 25, 2019
Total Upgrades: 8
Total Downgrades: 6
Net Ratings Breakdown: Buy 38.03%; Hold 45.49%; Sell 16.48%

Amidst a lot of portfolio switching going on -from "Growth" and "Quality" into "Value" and "Cyclical" and back- stockbroking analysts monitored daily by FNArena issued eight upgrades for ASX-listed securities, but only three moved to (an equivalent of) Buy. Maybe this illustrates the current state of affairs?

One positive observation is that the week ending Friday, 25th October 2019 only generated six downgrades from the same seven stockbroking firms, with only two of those shifting to a Sell. Equally noteworthy is that mining stocks hardly feature among the downgrades, but they do among the upgrades.

Very little is happening in terms of changes to valuations and price targets. This might change as more out-of-season financial earnings reports are being released this week and in November.

For the record: Steadfast Group enjoyed the largest increase to consensus target during the week, ending up with a 2.5% gain. On the flip side, Bank of Queensland, having delivered yet another disappointing financial performance and dividend cut, saw its target decline by -4.5%.

More action can be observed in the tables for positive and negative adjustments to earnings estimates. On the positive side, the week's show was stolen by Superloop and Western Areas, both enjoying gains in excess of 20%. The numbers on the negative side look decidedly larger led by lithium miner Orocobre, followed by St Barbara, Oil Search and Bank of Queensland.

Here, it has to be noted, the table for negative adjustments carries an overweight in resources companies.

Upgrade

CIMIC GROUP LIMITED ((CIM)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/3/0

The company has reaffirmed net profit guidance of $790-840m for 2019. Credit Suisse upgrades forecast to the lower end of guidance and raises the target to $36 from $35. Rating is upgraded to Neutral from Underperform.

Operating cash flow was down -29% in the September quarter while operating earnings conversion was 52% vs 54% in the prior quarter.

Credit Suisse suspects this was because of a reversal in the build up of payables and a higher proportion of alliance-style contracts, as well as completion and delays for some large infrastructure projects.

CALTEX AUSTRALIA LIMITED ((CTX)) Outperform by Macquarie .B/H/S: 3/3/0

Caltex reported strong regional refiner margins in the Sep Q driven by supply reductions in the Middle East. The Dec Q outlook is softer but the volume skew will be material due to planned turnaround and inspection (T&I). The broker sees margins as stabilising in Dec before improving in 2020.

Headwinds remain for Convenience but the company is taking action to defend its return on investment which the broker sees as positive. The broker increases earnings forecasts, and target to 27.97 from $24.78. Outperform retained, with a preference over Viva Energy ((VEA)).

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Hold from Lighten by Ord Minnett and Upgrade to Neutral from Sell by Citi.B/H/S: 1/4/1

Ord Minnett models both the high end of production and costs at the Tropicana operation and suspects that, while the company is on track to meet guidance at the Nova mine, costs could remain a little high.

The broker envisages a strong outlook for nickel prices and expects a positive outcome from new offtake negotiations. Rating is upgraded to Hold from Lighten. Target is steady at $5.70.

The share price has pulled back in the last month as the nickel price has eased and Citi upgrades to Neutral from Sell on valuation.

The broker envisages downside risks to nickel from global growth risks and the disconnect between prices and exchange tightness. However, for Independence Group these factors are partly offset by the appeal of gold as a macro portfolio hedge.

INGHAMS GROUP LIMITED ((ING)) Upgrade to Neutral from Sell by UBS and Upgrade to Buy from Neutral by Citi .B/H/S: 1/5/0

Following the underperformance in the share price, UBS upgrades to Neutral from Sell. The strategy briefing provided little quantitative guidance but the company has signalled that the business will move to a customer-led focus amid new revenue streams.

There is no material lift in capital expenditure intentions and the company is still targeting growth in FY20, although oversupply from poultry export bans will put pressure on earnings in the first half.

UBS reduces estimates for earnings per share by -3%. Target is steady at $3.10.

Citi upgrades to Buy from Neutral on the view that Inghams share price has now fallen too far post the release of a disappointing financial performance report in August. Target price remains unchanged at $3.40.

The analysts also believe the implied yield looks rather attractive in the current low yield environment. On top of all that, the analysts seem confident that management will be able to steer this ship around successfully.

The company is organising a Strategy Day on 22 October 2019.

NEWCREST MINING LIMITED ((NCM)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/3/3

Credit Suisse notes the September quarter was sequentially much weaker as all operations underperformed other than the now less-relevant Gosowong. Political changes in PNG have resulted in indefinite delays at Wafi Golpu.

Key areas of focus include reliability at Cadia and Lihir and Red Chris drilling results. The broker upgrades to Neutral from Underperform on valuation. Target is unchanged at $31.80.

THE STAR ENTERTAINMENT GROUP LIMITED ((SGR)) Upgrade to Add from Hold by Morgans .B/H/S: 5/0/1

The trading update was ahead of expectations. The company is forecasting first half operating earnings of $300-310m on the back of domestic revenue growth and cost reductions.

With the stock offering 17% upside to the revised target price Morgans upgrades to Add from Hold. The broker also notes the current dividend yield of 4.5% is attractive in the current environment. Target is raised to $5.48 from $4.17.

See also SGR downgrade.

<u>Downgrade</u>

AUSTRALIAN PHARMACEUTICAL INDUSTRIES ((API)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/1/1

FY19 results were difficult to reconcile, in Citi's view. Benefits accrued from a low tax rate. Reported underlying earnings (EBIT) of $94m were -1% below guidance. However this included the Sigma dividend income and a $17m fair value benefit from Clearskin Care.

Citi downgrades to Neutral from Buy on valuation and reduces the target to $1.50 from $1.60. FY20 estimates are reduced by -17%.

OROCOBRE LIMITED ((ORE)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 3/3/1

Ord Minnett reduces realised price expectations further for FY20 and lowers production estimates for both FY20 and FY21.

The broker remains attracted to the lithium sector and the company's assets in the long-term but notes excess inventory in the supply chain, along with majors keen to maintain market share, means prices could stay weak for some time.

Rating is downgraded to Hold from Buy. Target is lowered to $2.30 from $2.90.

QANTAS AIRWAYS LIMITED ((QAN)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 3/2/0

Qantas will provide a first quarter trading update on October 24. Credit Suisse estimates capacity in the domestic airline market was up 0.4%. Forward schedules indicate flat market capacity in the second quarter.

Credit Suisse suspects the market is expecting large capacity cuts from Virgin Australia ((VAH)) which will be of significant benefit to Qantas.

While the broker acknowledges this is possible, there is limited evidence this is occurring and cuts may be smaller and take longer to materialise. Rating is downgraded to Neutral from Outperform. Target is steady at $6.40.

STOCKLAND ((SGP)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/3

Macquarie downgrades to Underperform from Neutral, as a more demanding valuation has already priced in future residential upside. Residential deposits were up 36% quarter on quarter but down -11% on the prior September quarter.

The company expects net deposits to improve over FY20 and FY21 revenue should benefit from settlement volumes. Target is steady at $4.46.

THE STAR ENTERTAINMENT GROUP LIMITED ((SGR)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 5/0/1

Credit Suisse notes positive momentum so far and updates numbers to reflect this. Earnings per share have been upgraded 7-8% over the forecast period.

Still, with Crown Resorts ((CWN)) opening its Sydney casino in January 2021 the FY21 and FY22 earnings profile is less exciting for the broker.

Credit Suisse downgrades to Underperform from Neutral, suspecting the stock has run too hard.

The company has submitted a proposal to the Queensland government to upgrade the Gold Coast convention centre and the Sheraton Mirage. This proposal is not included in the broker's modelling. Target is raised to $4.00 from $3.75.

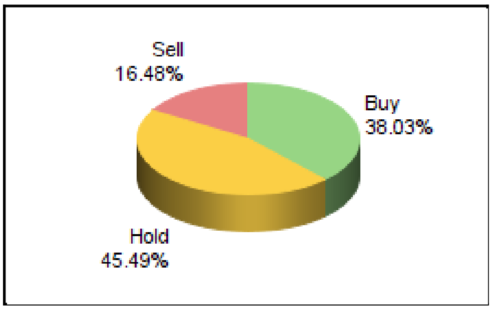
See also SGR upgrade.

WESTPAC BANKING CORPORATION ((WBC)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/4/1

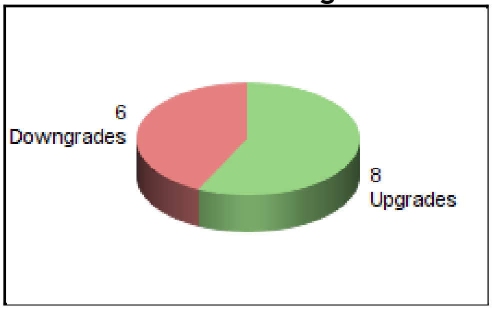
Westpac has announced further customer remediation and Citi downgrades FY19 cash earnings estimates by -4.5%. From here the broker considers the prospect of further outperformance is difficult and expects the bank will reduce the dividend at the FY19 result.

Capital appears tight post further remediation and the rating is downgraded to Neutral from Buy. Target is unchanged at $31.25.

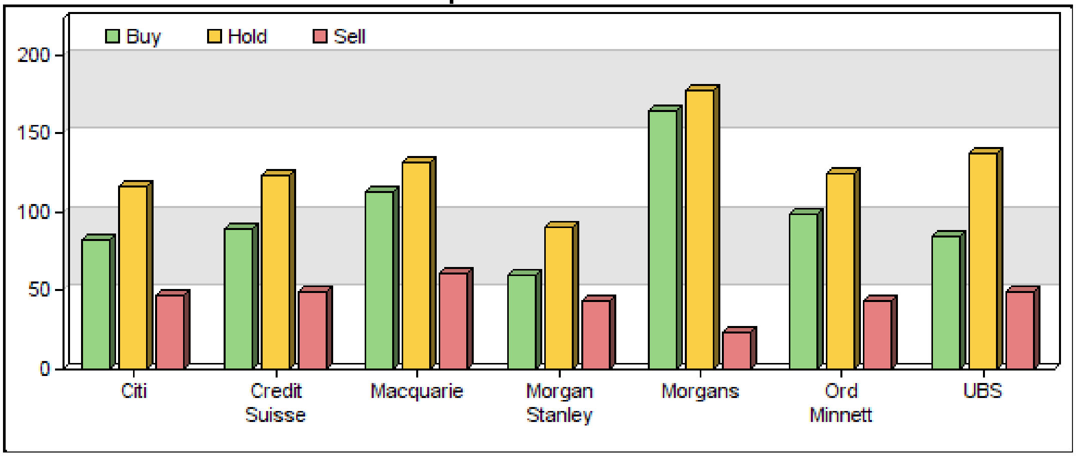
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	CALTEX AUSTRALIA LIMITED	Buy	Neutral	Macquarie
2	CIMIC GROUP LIMITED	Neutral	Sell	Credit Suisse
3	INDEPENDENCE GROUP NL	Neutral	Sell	Citi
4	INDEPENDENCE GROUP NL	Neutral	Sell	Ord Minnett
5	INGHAMS GROUP LIMITED	Buy	Neutral	Citi
6	INGHAMS GROUP LIMITED	Neutral	Sell	UBS
7	NEWCREST MINING LIMITED	Neutral	Sell	Credit Suisse
8	THE STAR ENTERTAINMENT GROUP LIMITED	Buy	Neutral	Morgans
Downgrade				
9	AUSTRALIAN PHARMACEUTICAL INDUSTRIES	Neutral	Buy	Citi
10	OROCOBRE LIMITED	Neutral	Buy	Ord Minnett
11	QANTAS AIRWAYS LIMITED	Neutral	Buy	Credit Suisse
12	STOCKLAND	Sell	Neutral	Macquarie
13	THE STAR ENTERTAINMENT GROUP LIMITED	Sell	Neutral	Credit Suisse
14	WESTPAC BANKING CORPORATION	Neutral	Buy	Citi

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	ING	INGHAMS GROUP LIMITED	17.0%	-17.0%	34.0%	6
2	SDF	STEADFAST GROUP LIMITED	83.0%	50.0%	33.0%	3
3	CTX	CALTEX AUSTRALIA LIMITED	42.0%	25.0%	17.0%	6
4	IAG	INSURANCE AUSTRALIA GROUP LIMITED	-14.0%	-29.0%	15.0%	7
5	NCM	NEWCREST MINING LIMITED	-50.0%	-64.0%	14.0%	7
6	STO	SANTOS LIMITED	33.0%	29.0%	4.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	CRN	CORONADO GLOBAL RESOURCES	67.0%	100.0%	-33.0%	3

2	SGP	STOCKLAND	-60.0%	-40.0%	-20.0%	5
3	QAN	QANTAS AIRWAYS LIMITED	60.0%	80.0%	-20.0%	5
4	BOQ	BANK OF QUEENSLAND LIMITED	-79.0%	-64.0%	-15.0%	7
5	WBC	WESTPAC BANKING CORPORATION	14.0%	29.0%	-15.0%	7
6	ORE	OROCOBRE LIMITED	29.0%	33.0%	-4.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	SDF	STEADFAST GROUP LIMITED	4.050	3.950	2.53%	3
2	CTX	CALTEX AUSTRALIA LIMITED	26.937	26.402	2.03%	6
3	SGP	STOCKLAND	4.250	4.170	1.92%	5
4	IAG	INSURANCE AUSTRALIA GROUP LIMITED	7.606	7.520	1.14%	7
5	WBC	WESTPAC BANKING CORPORATION	29.057	28.957	0.35%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	BOQ	BANK OF QUEENSLAND LIMITED	8.300	8.693	-4.52%	7
2	NCM	NEWCREST MINING LIMITED	31.563	32.451	-2.74%	7
3	ING	INGHAMS GROUP LIMITED	3.317	3.375	-1.72%	6
4	CRN	CORONADO GLOBAL RESOURCES	3.253	3.300	-1.42%	3
5	QAN	QANTAS AIRWAYS LIMITED	6.490	6.570	-1.22%	5

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	SLC	SUPERLOOP LIMITED	-4.800	-6.500	26.15%	3
2	WSA	WESTERN AREAS NL	37.357	31.040	20.35%	6
3	SDF	STEADFAST GROUP LIMITED	15.933	15.100	5.52%	3
4	IAG	INSURANCE AUSTRALIA GROUP LIMITED	39.357	37.871	3.92%	7
5	PRU	PERSEUS MINING LIMITED	3.240	3.143	3.09%	3
6	JHX	JAMES HARDIE INDUSTRIES N.V.	114.118	112.521	1.42%	6
7	SGR	THE STAR ENTERTAINMENT GROUP LIMITED	26.327	25.963	1.40%	6
8	CRN	CORONADO GLOBAL RESOURCES	48.679	48.063	1.28%	3
9	MP1	MEGAPORT LIMITED	-22.367	-22.550	0.81%	3
10	SGP	STOCKLAND	36.300	36.180	0.33%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	ORE	OROCOBRE LIMITED	-0.678	1.347	-150.33%	7
2	SBM	ST BARBARA LIMITED	29.023	36.390	-20.24%	4
3	OSH	OIL SEARCH LIMITED	31.901	36.758	-13.21%	7
4	BOQ	BANK OF QUEENSLAND LIMITED	70.114	78.843	-11.07%	7
5	S32	SOUTH32 LIMITED	18.074	20.060	-9.90%	7
6	NCM	NEWCREST MINING LIMITED	160.778	170.555	-5.73%	7
7	QAN	QANTAS AIRWAYS LIMITED	61.580	65.278	-5.67%	5
8	WPL	WOODSIDE PETROLEUM LIMITED	171.476	180.420	-4.96%	7
9	SFR	SANDFIRE RESOURCES NL	78.902	82.583	-4.46%	6
10	STO	SANTOS LIMITED	55.650	58.229	-4.43%	6

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: Selling Accelerates

The uranium market remains in a state of flux due to policy uncertainty. Sellers became more anxious last week.

-Iran waiver deadline looms
-Sellers jumping over each other
-Paladin moves forward on Langer Heinrich restart

By Greg Peel

Industry consultant TradeTech sums it up succinctly in suggesting the uranium market is currently "frozen by uncertainty". Last week was the fifth in succession in which the uranium spot price fell, this time notching a less incremental fall than prior weeks on slightly greater volume than has been the case recently during this period of demand stasis.

TradeTech reports six deals concluded in the spot market last week totalling 750,000lbs U3O8 equivalent. Each deal traded at a lower price than the last, resulting in a -US75c drop in the consultant's weekly spot price indicator to US$24.10/lb. Sellers have clearly become more anxious.

It isn't helping that the Nuclear Energy Institute is this week hosting its International Uranium Fuel Seminar in Nashville. Such market gatherings, which are quite numerous in the nuclear industry, typically lead to reduced volumes during the period. But the real issue remains that which has hung over the market for a seemingly interminable period – US government policy uncertainty.

At the risk of "broken record" reporting, this extract from last week's report highlights the most immediate issue:

When the US dropped out of Obama's deal with Iran with regard its nuclear program, sanctions were applied but waivers were also granted to those companies already invested in supporting Iran with its nuclear power objectives. If these waivers are not reinstated, sanctions would apply to said companies, jeopardizing some 20% of US nuclear fuel supply.

The effects of secondary sanctions could reverberate through the global nuclear fuel market by isolating some major suppliers from customers in Western Europe and beyond. Should the US levy sanctions on countries providing nuclear fuel products and services to Iran, these restrictions would likely include certain Russian, Chinese, and European companies, thereby disrupting nuclear fuel imports into the US.

Throw in President Trump's yet-to-report Working Group and a review of the Russian Suspension Agreement underway, and it is understandable that demand commitments simply cannot be made with any confidence at this juncture, notwithstanding there is as yet little evidence of desperation on the part of still well-stocked utilities.

Perhaps this week might bring some break in the drought. The aforementioned Iran waivers are set to expire tonight.

There are nevertheless tenders for delivery contracts out in term markets at present, albeit no action as yet. TradeTech's term price indicators remain at US$27.00/lb (mid) and US$31.00/lb (long).

Rapid Restart

One company that remains confident uranium prices can ultimately recover is Australian listed miner Paladin Energy ((PDN)), which has completed phase one of a prefeasibility study into restarting the Langer Heinrich mine in Namibia. The mine has been under care & maintenance since August last year due to uncommercial uranium prices.

The phase one study suggest improved financials and production capacity, confirming the mine is ready for a "rapid" restart within twelve months of securing adequate financing. One presumes adequate financing may itself hinge on the uranium price outlook.

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

WEEKLY REPORTS

The Short Report - 31 Oct 2019

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

Summary:

Week ending October 24, 2019

Ongoing US-China trade optimism and positive US earnings reports had the ASX200 rallying choppily last week. There was a bit more action in terms of short position changes last week but only a couple of particular note.

Firstly I'll note shorts in Kirkland Lake Gold ((KLA)) fell to 10.1% last week from 14.5%, which does not detract from my theory US hedge funds sold the stock in Australia to get ahead of sellers in the US.

Bank of Queensland ((BOQ)) shorts jumped to 12.1% from $10.9%. See below.

Nearmap ((NEA)) shorts rose to 10.3% from 8.4%. This should thus qualify as a "Mover & Shaker", but for the fact it is unclear why the shorters are putting the boot in. There has been no news out of the company recently and no updates from FNArena database brokers. As a tech stock Nearmap tends to move with the Nasdaq, but selling took hold last week in the midst of the WiseTech Global controversy, which has nothing to do with Nearmap.

We might simply note that tech high-flyers – pardon the pun in this case – do occasionally fall into holes following a period of over-exuberance.

One stock to note ahead of next week's Report is Costa Group ((CGC)). Last week Costa shorts fell to 8.6% from 9.1% ahead of this week's profit warning and announcement of a heavily discounted capital raising, which saw the stock drop -28%. Someone went a little early there.

And we might also note this week has seen some big rallies for lithium miners, due to protests in Chile. Short-covering would explain a lot of it, given two of them are numbers one and two on the table.

Weekly short positions as a percentage of market cap:

10%+
SYR 17.6
GXY 16.9
ORE 14.5
ING 13.8
NXT 13.6
GWA 12.5
JBH 12.3
BOQ 12.1
SDA 10.7
DMP 10.6
HUB 10.3
NEA 10.3
BIN 10.2
KLA 10.1

In: NEA Out: BKL

9.0-9.9

BKL, IVC

In: BKL Out: NUF, CGC, PPT

8.0-8.9%

PPT, NUF, MTS, CGC, WEB, BGA, RWC, SAR, DCN, BWX, IFL

In: PPT, NUF, CGC, WEB, SAR Out: NEA, HVN, SUL

7.0-7.9%

MIN, HVN, BAL, SUL, CLH, CGF, A2M, OML, SGM, MYR

In: HVN, SUL Out: WEB, SAR, PLS

6.0-6.9%

NCZ, PLS, SLR, AMP, RSG

In: PLS Out: CSR

5.0-5.9%

CSR, RFF, ADH, CLQ, COE, CUV, NWL, NEC, PGH, CTD, GEM, LNG, GMA, CMW, KAR, SEK

In: CSR, KAR Out: FMG, SFR, GUD, KGN

Movers & Shakers

Bank of Queensland's FY19 earnings result, released last week, disappointed brokers who had already expected weakness. The bank also cut its dividend, but that came as no surprise, with further cuts on the cards.

The result highlights the difficult position the regionals now find themselves in thanks to the indiscretions of their mega-cap peers. More onerous post-RC regulation applies to regionals as well, despite much smaller capital bases. Brokers agree the outlook is challenging, and requiring of Bank of Queensland to seriously rethink its entire strategy. This will cost money, and result in earnings rebasing and more pressure on capital.

Six of seven FNArena database brokers have a Sell or equivalent rating on the stock. The shorters are moving in for the kill, taking their positions up to 12.1% from 10.9%.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.7	0.7	RIO	4.4	4.6
ANZ	0.6	0.6	S32	1.4	1.3
BHP	3.3	3.3	SCG	0.4	0.6
BXB	0.3	0.2	SUN	0.5	0.6
CBA	0.7	0.7	TCL	0.3	0.3
CSL	0.1	0.2	TLS	0.2	0.2
GMG	0.2	0.1	WBC	0.8	0.8
IAG	0.5	0.5	WES	0.6	0.7
MQG	0.3	0.3	WOW	0.9	0.9
NAB	0.6	0.7	WPL	1.0	0.8

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

Guide:

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

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

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

Summary:

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.7	0.7	RIO	4.4	4.6
ANZ	0.6	0.6	S32	1.4	1.3
BHP	3.3	3.3	SCG	0.4	0.6
BXB	0.3	0.2	SUN	0.5	0.6
CBA	0.7	0.7	TCL	0.3	0.3
CSL	0.1	0.2	TLS	0.2	0.2
GMG	0.2	0.1	WBC	0.8	0.8
IAG	0.5	0.5	WES	0.6	0.7
MQG	0.3	0.3	WOW	0.9	0.9
NAB	0.6	0.7	WPL	1.0	0.8

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations.

Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

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

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

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

WEEKLY REPORTS

The Wrap: Oz Wealth, Banks & Insurers

Weekly Broker Wrap: Australian wealth; banks; insurers; and BNPL.

-Per capita, Australian gross wealth has dropped in the last six months
-Downside pressure continues for banks
-Front to back book variations a growing concern for general insurers
-BNPL appears to have minimal impact on credit or consumption growth

By Eva Brocklehurst

Australian Wealth

How wealthy are Australians? Attempts to measure this have frequently looked at income, or tracked debt, while others have assessed assets. Now, Roy Morgan's Wealth Report 2019 adds more colour to the picture.

The report offers detailed data on Australian Net Wealth by calculating personal assets and subtracting personal debt. The report suggests this information matters because wealth and the way it is distributed is linked to economic resilience.

From its long-running and extensive study of consumer financial behaviour Roy Morgan has found well-established links connecting overall wealth and the distribution of wealth to national well-being.

So, the report reveals Australian per capita gross wealth increased in real terms between 2007 and June 2019 by 20.9% but has stagnated in the last six months. Per capita gross wealth dropped by around -1.4% from the first to the second quarter of 2019.

Although debt is growing, it is growing more slowly than the growth in assets. In real terms, over the 2007-19 period per capita debt increased 13.7% while assets grew 20.9%.

The richest 10% of a population hold 47% of the wealth globally and this is matched, almost perfectly, in Australia, Roy Morgan highlights. Around 50% of the population, the lowest five deciles, have just 3.6% of net wealth and inequality has increased rather than decreased over the period.

Banks

Over the medium term, Macquarie expects margin benefits of 3-5 basis points from mortgage re-pricing will be competed away if the front book (new customer) rates of the banks remain competitive. Despite mortgage re-pricing benefits, the broker continues to envisage downside earnings pressure from lower interest rates and the narrowing of the front to back (existing customer) book spread.

Following the June and July official rate cuts, the price gap between the front to back book widened round 50 basis points for the major banks and this gap is likely to extend further after the October 2019 re-pricing. Among the major banks, Macquarie believes **Commonwealth Bank** ((CBA)) is the most affected while **ANZ Bank** ((ANZ)) is the least.

The broker also points out the sector, ex CBA, is facing a -$13bn capital shortfall, and capital is likely to increase from current levels or banks will look to optimise portfolios. **Westpac Bank** ((WBC)) is expected to cut its dividend, supplemented by an underwritten dividend reinvestment plan at the upcoming result while **National Australia Bank** ((NAB)) is likely to raise capital with an underwritten DRP.

JPMorgan finds the impact of the federal government's First Home Loan Deposit Scheme is modest, noting that major banks will be limited in the extent of their participation in the scheme. Although one would expect the scheme to drive higher house prices, it appears to the broker to be more targeted than previous first home buyer assistance programs.

The scheme will remove the need for lenders mortgage insurance for home loans written between 80% and 95% of the loan-to-value ratio. Hence, the government will effectively guarantee up to 15% of the property purchase price. The scheme will be limited to 10,000 such loans per annum and commence January 1 2020. It will apply to owner occupiers paying principal & interest loans and house price caps will also apply.

Insurance

Bell Potter observes the general insurers have weathered the Hayne Royal Commission better than the banks, probably because of a cleaner record in dealing with, and ultimately settling, customer claims. Underlying fundamentals are also much stronger.

Risk management is relatively stronger, including the use of capital efficient reinsurance arrangements and fewer operating constraints. There is also no correlation between unemployment and premium growth.

The broker retains a positive view of the general insurers, noting little dependency on wholesale funding and much stronger capital levels, which are likely to lead to capital returns and remains overweight on the general insurance sector.

Still, front to back book variance remains a large and growing concern for general insurers and a challenge that is not diminishing. Hence, Macquarie believes **Insurance Australia Group** ((IAG)) and **Suncorp** ((SUN)) are most at risk, as most of the variance resides with them.

Issues highlighted by the ESLIM Report on insurance pricing in NSW underline the broker's concerns. The data from ESLIM shows average base premiums for renewals are tracking higher than for new business.

The monthly spread of 34.6% for December 2018 was the widest at any point during the data collection period. Macquarie estimates, if only 10% of back-book customers were re-priced at front book levels, this could remove -$150-250m in gross written premium from the Australian insurance market.

The insurance industry is looking to the technology to streamline the acquisition of customers and the supply chain and, the broker notes, increased attention is being given to blockchain.

Benefits of technology appear weighted towards larger commercial risks, while supply chain solutions are primarily addressed by existing technology. Should the industry pursue blockchain options, Macquarie suggests a most efficient solution can be generated with brokers at the centre.

This may not be enough to change the complexion of an insurer's overall cost base and the broker suspects the benefits and returns could be limited to the likes of home and motor insurers, particularly in developed markets

QBE Insurance ((QBE)) is a potential beneficiary, given a global customer base and supply chain as well as involvement in the reinsurance market. However, Macquarie suggests the "holy grail" is many years down the track, with much investment considered likely.

Buy Now Pay Later

The boom in Buy Now Pay Later (BNPL) purchasing is having a material impact on core retail businesses but, UBS suggests, is insignificant for consumption or credit growth.

By 2021 expenditure via BNPL as a share of total nominal consumption is set to double, to 1% and more significantly, to almost 4% of retail sales. For core retail, excluding food and eating out, use of BNPL is set to lift to around 8% of sales.

UBS has evidence that 64% of customers consider BNPL credit but yet this is not counted in household debt data. Nevertheless, even assuming these receivables are debt the current $1bn outstanding is a tiny percentage of household liabilities or personal credit.

SMALL CAPS

Gas Ramp Sets Senex Energy On Growth Path

Senex Energy continues to evolve as a key east coast gas producer, with an extensive drilling program planned across the Surat Basin assets.

-Material upside once Roma North and Project Atlas are at plateau rates
-Accelerated capital investment program in the Surat Basin
-First sales from Project Atlas expected by year end

By Eva Brocklehurst

The ramp-up of CSG production at Roma North was the highlight of the September quarter for Senex Energy ((SXY)), offsetting a decline in Cooper Basin oil production. A key milestone was the commissioning of the Roma North gas processing facility with output topping a daily rate of 11 TJ/d.

Production of gas in the quarter was up 28%, largely from the ramp up of Roma North, which supports Morgans' view that existing production wells have reached desorption levels that allow for the majority of gas to be produced. The broker increases forecast Roma gas output to 11.6 TJ/d for FY20 and lowers debt load assumptions.

While this is not tier 1 ground, the broker believes it holds good supporting economics with all-in costs of around $5/gigajoule. Moreover, given the advanced pace of development, the financial performance should start to become clear to the market over the next 1-2 years.

Senex Energy's revenue was lower than Macquarie forecast for the quarter because of lower average realised sales prices although the production trend is still heading in the right direction as Roma North ramps up and Project Atlas readies for start-up in the next quarter.

Sales revenue and production were to the downside of Citi's estimates as well. The broker describes the ramp-up of CSG as "noisy and error prone" and assesses the value of assets lies in plateau production not dewatering. Citi acknowledges it over-estimated gas deliverability because of some operating issues related to water handling. These are being resolved and stronger production is expected in following quarters.

Credit Suisse points out no guidance has been provided because of the uncertainty associated with the ramp-up of gas production, although envisages material upside once Roma North and Project Atlas are at a plateau, targeted for the end of FY21, and assuming sustainable cost structures are achieved.

The broker also suggests **the company's prized uncontracted gas supply position is likely to benefit from higher prices post 2021** while acquisition of new acreage adds to the growth potential.

In the near term, nevertheless, risks during the ramp-up could bolster negative sentiment and reduce the upside. There is also little in the way of guidance on well workover frequency and costs. The main drivers of value, in Credit Suisse's view, include oil prices, and the risks and costs at Roma North in particular, as this appears to have a less prolific subsurface area.

Senex Energy has committed to an accelerated capital investment program within the Surat Basin, including completing 110 wells and Bell Potter is now more positive about Roma North, noting the expansion opportunities. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $0.48 target, supported by a positive outlook for the Australian east coast gas and global energy markets.

Project Atlas

First sales from Project Atlas are expected by the end of the year and the drilling campaign should be completed by mid 2020. Macquarie calculates this should lead to an 18 PJ/annum initial production plateau by the end of FY21. Gas is currently being flared prior to commissioning of the Jemena processing plant next month to deliver into sales agreements from January 1, 2020.

Substantial earnings and free cash flow growth are expected over the next two years for Senex Energy. Morgans assesses **the business has long held value appeal through the potential of the gas assets** and this is now becoming a reality as drilling campaigns accelerate.

FNArena's database has two Buy ratings and three Hold. The consensus target is $0.45, suggesting 24.4% upside to the last share price.

See also, Senex Outlook Fuels Re-Rating Hopes on July 24, 2019.

RUDI'S VIEWS

On Dividend Alert

The story below was written on invitation by the Australian Shareholders' Association (ASA) and was published in this month's edition of ASA members magazine Equity.

Weekly Insights shall resume its normal format next week.

On Dividend Alert

By Rudi Filapek-Vandyck, Editor FNArena

I am still amazed, every single time, but with the year 2020 but a whisker away, there are still investors who use backward-looking data as the main support source for their investment strategy and portfolio. On my assessment, these investors are at risk of significant disappointment in the year ahead.

Firstly, before I explain what I see as one of the key sources for potential disappointment from here onwards, I'd like to recount a recent anecdote because it's not just inexperienced amateur investors who rely on (false) security from the past.

Two months ago I upset a rather well-known economist employed by a large financial institution for putting up a table online with implied dividend yields that were significantly different from what my forward-looking indicators were suggesting as the most plausible outcome.

The explanation that followed was the information had simply been copied from data-provider Iress. What could possibly be wrong with that? Well, the numbers are from the prior financial year. To illustrate why this can be important, I referred to one of my observations from about half a dozen years ago.

At that time, one of the national newspapers published a double spread story on dividends in the share market, accompanied by a table with backward looking, highly attractive looking dividend yields. Twelve months later, only one company from that table had not cut its dividend.

Looking back at past dividend statistics for the Australian share market, that story must have been published after FY14, with the subsequent year delivering the first year post-GFC when total dividends paid out to shareholders went backwards in Australia. My advice to shareholders today is: pay attention, because all the signals are suggesting the current financial year will become the second year post-GFC when total dividends go backwards.

In practice this means companies are finding it increasingly difficult to pay out more than they did the previous year. Already, the August reporting season provided plenty of signals and indications about escalating pressures on shareholder rewards and returns. Only twelve months earlier total dividends paid out in Australia to shareholders grew by 14% from the year prior.

In August this year, the total dividend gain was still more than 4%, but exclude the specials and the extras from asset sales and the underlying payout was actually lower than in August 2018. No less than 23 members of the ASX200 either reduced or scrapped their dividend altogether during the August reporting season.

On my assessment, this number can potentially double by February next year, when companies including Caltex Australia ((CTX)), G8 Education ((GEM)), Spark Infrastructure ((SKI)), and OZ Minerals ((OZL)) are likely to pay out less than they have in the past. Miners and energy producers have been among the better dividend payers these past few years, but that's about to change. It would take an incredibly large amount of investor optimism to not anticipate that companies such as Alumina ltd ((AWC)), BHP Group ((BHP)), Fortescue Metals ((FMG)), Whitehaven Coal ((WHC)) and New Hope Corp ((NHC)) will no longer enjoy the steadily growing cash flows that have supported unusually large payouts in recent years past.

As per usual, the weakest and the most vulnerable are the first to succumb to the operational squeeze from a two-speed, if not three-speed domestic economy, on top of slowing international growth. The August reporting season had barely finished before profit warnings followed from Incitec Pivot ((IPL)), Sims Metal Management ((SGM)) and CYBG ((CYB)). Be prepared for dividend cuts from peers including AGL Energy ((AGL)), CSR ((CSR)), Graincorp ((GNC)), Inghams Group ((ING)), South32 ((S32)), and others.

Many of these companies do not feature as a Go-To destination for most income seeking investors, but Australian banks do and apart from CYBG, dividends from Bank of Queensland ((BOQ)), Westpac ((WBC)) and Bendigo and Adelaide Bank ((BEN)) are equally considered as being "under threat". Some answers shall be provided when a number of banks releases financial results in the coming weeks.

Even if some of the dividend cuts may not turn out to be overly dramatic, the real message for investors should be that companies do not wish to disappoint shareholders until they can no longer avoid it. There is potential for a whole lot more negative news the longer the operational squeeze remains "on".

This new trend change in dividend payments can potentially also provide investors with an important signal regarding the outlook for the broader Australian share market. According to research released by analysts at Citi earlier this year, it appears there is a close relationship between dividends paid out to shareholders and the underlying direction for equities.

Historically, suggests Citi's analysis, equity markets can temporarily get panicky and volatile, but as long as dividends keep on growing, the market will eventually find its footing and resume its uptrend, in line with growing dividends. But this also implies the outlook might not be as solid when dividends go backwards.

As stated earlier, the last time dividends went backwards in Australia was in 2015. Once banks and similar yield stocks peaked in May of that year, there was not much joy to be had from most parts of the share market until February the following year. Assuming that correlation hasn't changed since, it might be wise to not have overly optimistic expectations for the months ahead. Unless the underlying dynamics for corporate profits and cash flows changes dramatically, of course.

In the meantime, be aware that risks are rising. A review of the portfolio and its constituents might be appropriate.

FNArena offers self-managing investors proprietary tools and insights, including forward looking estimates. The service can be trialled for free at www.fnarena.com

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