WEEK 45

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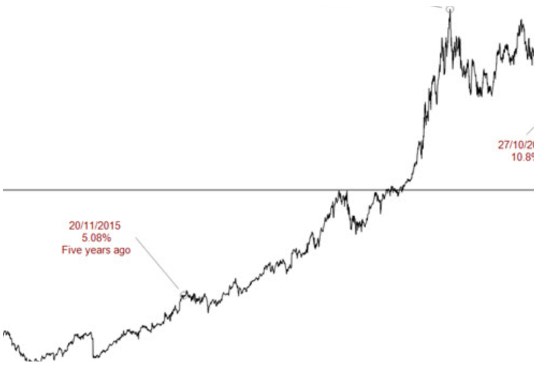
Friday, 4 November 2022

Security Blanket For Lynas

Material Matters: Base Metals; Resources Shares; Iron Ore & China Zero Covid




Rudi's View: Technology's Moment Of Truth

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AUSTRALIA

# Security Blanket For Lynas

The security of non-China rare earths supply and an above-market view on EV growth has UBS re-initiating on Lynas Rare Earths with a Buy, although not everyone is so enthused.

**-Lynas volumes and sales up, prices down**
**-NdPr price stabilising**
**-Kalgoorlie processing key**
**-UBS re-initiates with Buy**

By Greg Peel

Lynas Rare Earth's ((LYC)) September quarter update revealed stronger than expected production and sales but weaker realised prices. This, notes Macquarie, was due to a lower volume of benchmark neodymium/praseodymium (NdPr) in the sales mix.

Aside from NdPr, Lynas produces yttrium, lanthanum, cerium, promethium, samarium, europium, gadolinium, terbium, dysprosium, holmium, erbium, thulium, ytterbium, and lutetium, in case you were wondering.

The sales mix saw net realised pricing fall quarter on quarter, but due to increased volumes revenue actually grew above expectation.

Lynas had forewarned about a weaker quarter for margins and cash flow due to water outages at its Malaysia processing plant, which have since been sorted. The company is building a water recycling facility and progress on that front provides a catalyst.

Meanwhile over at the Kalgoorlie processing plant, capex guidance has been increased by 15%. While Ord Minnett suggests this is "immaterial", particularly given the company has a $1bn capital buffer, the plant remains a major stumbling block for the broker.

Ord Minnett remains sceptical that the project is "on time and on budget". Being "on time" for July 1, 2023, is essential to comply with Malaysian regulations.

A change in the Malaysian government has meant Lynas has been given until that date to shift its processing, and its resultant radioactive waste, to home soil before its licence will be revoked.

Capital Management

Lynas has a development and funding partner in the form of Japan Australia Rare Earths which provided a loan facility that initially came with capital management restrictions – no dividends or buybacks. That restriction has now been lifted, to be replaced by standard financial covenants such as debt-equity and debt service coverage ratios.

Good news for shareholders.

Pricing

The NdPr price is down -31% year to date and has nearly halved from its 2022 high, due to weaker demand and concerns over China's 25% lift in rare earth production quota.

Macquarie remains bullish on the rare earth pricing outlook, while UBS sees limited further downside risk to NdPr prices and is bullish on the longer term outlook. Ord Minnett agrees NdPr prices appear to have stabilised.

UBS has this week re-initiated coverage of Lynas with a Buy rating, and readily admits to being most positive on the outlook for global EV penetration, forecasting 50% by 2030 against consensus of 35%.

Ord Minnett is more focused on the near term, noting that while the NdPr price is down -31% year to date, Lynas' share price is only down -19%, despite an historically strong correlation. Valuation currently implies a long term NdPr price of US$100/kg, compared to US$79/kg presently, and the broker's forecast of US$68/kg.

Hence, Ord Minnett retains a Sell rating. And stands out with a $4.95 target compared to Macquarie's $9.50 and UBS' $9.95. Macquarie has an Outperform rating.

Security

China is the world's leading rare earth producer by a margin. In 2021 China produced 168,000mt, up from 140,000mt in 2020, before a quota was set at 162,000mt. Bizarrely, this led to China having to import rare earths.

But as noted, that quota has since been increased by 25%.

The US produced 43,000mt in 2021 and Australia 22,000mt. In between was Myanmar (26,000mt), but enough said.

The US was slow to realise the importance of rare earths in a new age of not just EVs, but everything from magnets for wind turbines to LED screens on smart phones, as well as military applications. China was the global supplier.

Now there is a sense of urgency for the US to shore up supply of all “strategic” metals. Hence, the Department of Defense has provided Lynas with US$120m in funding to build a Heavy Rare Earth separation facility in Texas.

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AUSTRALIA

# Investors Remain Attached To IGO's Lithium Story

A mixed bag from IGO’s first quarter update, with strong production from Greenbushes somewhat overshadowed by a significant capital expenditure upgrade for Cosmos.

**-Strong quarterly production was led by an impressive result from Greenbushes**
**-Updates on Cosmos project and associated capital expenditure largely disappointed**
**-Lithium pricing provides upside potential**

By Danielle Austin

A strong start to the year saw IGO ((IGO)) report record quarterly spodumene production from its Greenbushes project of 361,000 tonnes, while group earnings lifted 54% quarter-on-quarter to $396m. Greenbushes is expected to deliver a similar production and cost performance in the December quarter, while costs are likely slightly higher at Nova and production higher at Forrestania.

Less pleasing to analysts was an update on the Cosmos project, and a sizeable increase to the capital expenditure forecast when the asset was acquired. Total expenditure for the project now looks set to reach $810m, double initial estimates and leaving a $400-425m spend in FY23.

A revised development plan for the project includes an expansion of the processing plant to 1.1m tonnes per annum from 0.75 tonnes, as well as modification works to the shaft and further mine development to support a higher mining rate. First concentrate is anticipated in the first quarter of FY24.

Lithium outlook allows investors to overlook cost increase

While analysts largely agreed that Greenbushes performance was the highlight of the quarter, outlooks present a more mixed bag. Three equivalent Buy ratings, one Neutral and two equivalent Sell ratings were offered from database brokers, with an average target price of $15.06 ranging from $10.50 to $20.00.

First quarter production was a sizeable beat to Macquarie’s (Outperform, target price $20.00) assumptions. Spodumene production from Greenbushes beat expectations by 14%, while nickel and cobalt from Nova beat by 5% and 3% respectively. This broker found IGO’s first quarter strong, and the financial performance solid.

Credit Suisse (Outperform, target price $16.50) flagged that only 80% of spodumene sold in the quarter achieved the pre-set chemical price, and while it anticipates the December quarter will be better it expects technical grade will continue to drag on realised prices.

Citi (Neutral, target price $15.20) liked that earnings from Greenbushes more than doubled quarter-on-quarter, and that net debt reduced -$137m to $396m in the period. However, Citi assumes nickel prices will decline and lithium prices will remain steady in the near term. With the stock price lifting 16% in the last six months, and the broker taking a cautious view on nickel pricing, Citi sees better value elsewhere in the lithium sector.

While describing Greenbushes as the world's best spodumene mine, UBS (Neutral, target price $15.70) finds downstream processing still coming together. The broker expects the setting of second half spodumene pricing will prove a key upcoming announcement for the company. Although UBS recently downgraded its rating, it did so given the share price is approaching its target price.

At the other end of the spectrum, Morgan Stanley (Underweight, target price $12.45) found the sizeable increase to capital expenditure for Cosmos hard to overlook, anticipating it will drive a significant hit to net present value. Ord Minnett (Lighten, target price $10.50) similarly described the increased expenditure as an explosive cost blowout, but also noted investors seem willing to overlook risk given the lithium business cash generation.

AUSTRALIA

# October In Review: Banks Lead In Strong Rally

The ASX200 gained 6.0% in October after a strong contribution from the banking sector buoyed by a decline in the 10-year bond yield.

**-The ASX200 gained 6.0% (total return) during October**
**-Growth marginally outperformed Value; Financials and Energy were best**
**-Consumer Staples and Metals & Mining were the worst performers**
**-The Australian 10-year bond yield fell by -13bps to 3.76%**
**-Commodity prices continued the downward trend from April**

By Mark Woodruff

The ASX200 gained 6.0% (including dividends) in October, which largely recovered the -6.2% lost in September, thanks largely to a buoyant Banking sector.

Banks were supported by a more-dovish-than-expected 25bps interest rate hike to 2.60% by the Reserve Bank of Australia. In early November the RBA again raised rates by 25bps to 2.85%.

Apart from the boost provided to Financials by the banks, the Energy, Real Estate and Discretionary sectors were also significant contributors to market performance in October.

Consumer Staples was the worst performer, largely due to a sell-off in Staples Retail, while Metals & Mining was the second worst sector.

Global share market sentiment lifted on speculation that central banks are nearing the peak of policy tightening, explains UBS. The S&P500 in the US rose by 8.1% in local currency terms and the MSCI Developed Markets Index rose by 7.5%.

In Australia, the 10-year yield moved down by -13bps to 3.76%, while US 10-year yields rose by 28bps to 4.07%, despite speculation of a potential pivot in the Federal Reserve's policy path (since dashed).

While underperforming share market gains in the US over October, Australia continues to lead in terms of year-to-date performance.

Growth outperformed Value in Australia by 0.2% for the month though Value has outperformed Growth globally in the year-to-date.

Value outperformed by 6.6 percentage points in the US and, given the **ongoing risk of a US recession in 2023**, there was also a bias to Defensives over Cyclicals, explains Macquarie.

The broker believes a further rise in corporate credit spreads in Australia is reflective of this increasing risk of a US recession. **Corporate spreads are now higher than the peak during the initial covid shutdowns in 2020.**

Mid-caps outperformed large and small cap counterparts over the month in Australia, while Industrials outperformed Resources across all size indices, performing best in mid-caps.

Morgan Stanley detects from consensus earnings expectations **a significant shift in earnings mix towards Industrials and away from Resources.**

More broadly, based on all the central bank rate hikes in 2022, **Macquarie continues to think we are at the start of a long downgrade cycle that may last through 2023.**

Oil prices rose, while iron ore and gold prices declined in a mixed performance for the commodities complex in October.

On a wider perspective, commodity prices have weakened since April, points out Macquarie, due to concerns about global growth and China lockdowns.

While the US Dollar continues to strengthen, as investors see a relatively hawkish US central bank and rising global uncertainty, the Australian dollar remained relatively flat over October.

The importance of the future direction of the Australian dollar on the ASX has been highlighted by recent Ord Minnett research. It’s estimated 12% of revenues emanate from the US, with the figure climbing to 45% when US dollar-denominated sales are included, as for mining and energy stocks.

All else being equal, should the Australian dollar fall a further -US5c, the broker sees considerable earnings upside potential for the likes of Alumina Ltd ((AWC)), Aristocrat Leisure ((ALL), Incitec Pivot ((IPL)) and Origin Energy ((ORG)).

On the other hand, should the currency appreciate by US5c, Qantas Airways would be a key beneficiary, according to Ord Minnett.

## ASX100 Best and Worst Performers of the month

| Company | Change | Company | Change |
|---|---|---|---|
| DMP - DOMINO'S PIZZA ENTERPRISES LIMITED | 23.74% | MPL - MEDIBANK PRIVATE LIMITED | -19.02% |
| CGF - CHALLENGER LIMITED | 20.00% | FMG - FORTESCUE METALS GROUP LIMITED | -12.60% |
| WBC - WESTPAC BANKING CORPORATION | 16.81% | OZL - OZ MINERALS LIMITED | -6.25% |
| QAN - QANTAS AIRWAYS LIMITED | 16.33% | NXT - NEXTDC LIMITED | -5.67% |
| VUK - VIRGIN MONEY UK PLC | 15.79% | ASX - ASX LIMITED | -5.66% |

## ASX200 Best and Worst Performers of the month

| Company | Change | Company | Change |
|---|---|---|---|
| NVX - NOVONIX LIMITED | 52.27% | SBM - ST. BARBARA LIMITED | -31.08% |
| TLX - TELIX PHARMACEUTICALS LIMITED | 46.51% | BRN - BRAINCHIP HOLDINGS LIMITED | -25.86% |
| LTR - LIONTOWN RESOURCES LIMITED | 26.51% | MP1 - MEGAPORT LIMITED | -21.82% |
| CXO - CORE LITHIUM LIMITED | 25.34% | MPL - MEDIBANK PRIVATE LIMITED | -19.02% |
| DMP - DOMINO'S PIZZA ENTERPRISES LIMITED | 23.74% | ABC - ADBRI LIMITED | -14.40% |

## ASX300 Best and Worst Performers of the month

| Company | Change | Company | Change |
|---|---|---|---|
| PNV - POLYNOVO LIMITED | 53.85% | EML - EML PAYMENTS LIMITED | -49.38% |
| NVX - NOVONIX LIMITED | 52.27% | AMI - AURELIA METALS LIMITED | -47.50% |
| TLX - TELIX PHARMACEUTICALS LIMITED | 46.51% | CDA - CODAN LIMITED | -31.75% |
| SYR - SYRAH RESOURCES LIMITED | 45.73% | SBM - ST. BARBARA LIMITED | -31.08% |
| 360 - LIFE360 INC | 39.60% | CXL - CALIX LIMITED | -29.58% |

## ALL-TECH Best and Worst Performers of the month

| Company | Change | Company | Change |
|---|---|---|---|
| CTT - CETTIRE LIMITED | 118.12% | EML - EML PAYMENTS LIMITED | -49.38% |
| ELO - ELMO SOFTWARE LIMITED | 107.14% | DUB - DUBBER CORPORATION LIMITED | -44.14% |
| NVX - NOVONIX LIMITED | 52.27% | AMS - ATOMOS LIMITED | -39.39% |
| 360 - LIFE360 INC | 39.60% | WSP - WHISPIR LIMITED | -38.46% |
| BTH - BIGTINCAN HOLDINGS LIMITED | 36.45% | CDA - CODAN LIMITED | -31.75% |

Australian Banks

The average total shareholder return of 14.2% for the major banks in October materially outperformed the 6.0% gain for the ASX200.

All the banks outperformed, with a 16.8% return for Westpac ((WBC)) leading the way for the majors. The regionals also performed well with Bank of Queensland ((BOQ)) and Bendigo & Adelaide Bank ((BEN) gaining 16.8% and 15.7%, respectively.

Among the other major banks, CommBank ((CBA)), National Australia Bank ((NAB)) and ANZ Bank ((ANZ)) each gained 15.4%, 12.5% and 12.1%, respectively, as the average price earnings multiple increased over October after de-rating in the previous two months.

Since the start of the current RBA tightening cycle, the broker points out the major banks' share prices have fallen by an average of -1%.

Based on consensus estimates, Morgan Stanley notes the average major bank one-year forward dividend yield is around 5.3%, which compares with a post-2010 average of circa 6.0%. It’s felt banks are no longer cheap when comparing this yield to that for ASX Industrials ex-banks.

Ord Minnett notes the major banks raised advertised rates on full-feature home loans by 25bp in October, whereas a few smaller banks chose to hold back a portion of the rate increase on new lending.

This broker estimates CBA offers the best interest rate leverage from among the majors, followed by NAB and Westpac, while ANZ has the least leverage owing to its Institutional tilt.

Australian Financials Ex-Banks

Morgan Stanley observes Australian Financials Ex-Banks mostly outperformed the ASX200 in October.

Several companies outperformed on more stable earnings and/or flows.

Challenger ((CGF)) and Macquarie Group ((MQG)) gained 20% and 11%, respectively, while Pendal Group ((PDL)), Insignia Financial ((IFL)) and Janus Henderson ((JHG)) just fell short of 10% gains.

Suncorp Group ((SUN)) and Insurance Australia Group ((IAG)) gained 14% and 7%, respectively, after a Federal Court of Australia judgement into covid-related business interruption claims.

Shares of the ASX ((ASX)) fell by -6% on lower volumes for interest rate products, according to Morgan Stanley, and ongoing concerns surrounding the CHESS replacement project.

REITs

Credit Suisse detected a potential mindset change by investors toward the REIT sector, which achieved a gain of 9.91% for October, compared to a global return of -1.8%.

While lower bond yields boosted the performance, the broker saw a lot more investor interest in the second half of October, based on emerging value for the sector.

However, many investors await some price discovery from direct markets and continue to discount most REITs, apart the fund managers.

For the 12 months ending October 31, REITs have delivered a total loss of -14.06%, under-performing the broader ASX200 by -12.05%. The around -14% loss in Australia compares favourable with losses of -25.7% globally.

JP Morgan highlights specialist REITs were outperformers for the month and included Arena REIT ((ARF)) which gained 18%, National Storage REIT ((NSR))17%, Centuria Industrial REIT ((CIP)) 17%, Shopping Centres Australasia Property ((SCP)) 15.7% and Waypoint REIT ((WPR)), which gained 15.2%.

On the flipside, Lendlease Group ((LLC)) lost -2.6%, GDI Property ((GDI)) -1.9%, while small gains were registered for HealthCo Healthcare & Wellness REIT ((HCW)) 1.4%, RAM Essential Services Property Fund ((RAM)) and Centuria Office REIT ((COF)) gained 3.4%.

In general, office-exposed REITs underperformed, notes JP Morgan including Dexus ((DXS)), Cromwell Property Group ((CMW)) and Mirvac ((MGR)).

For the shorter-term, Credit Suisse suggests pure-play Retail names should continue to hold up relatively well. In addition, the fund managers Charter Hall Group ((CHC)) and Goodman Group ((GMG)) are considered attractive with capital flexibility and strong balance sheets.

The broker recommends Outperform-rated Mirvac Group and Stockland ((SGP)) on a longer-term view for those investors willing to look beyond the current Residential cycle.

On the residential front, Morgan Stanley noted national house prices fell by -1.1% in October, the sixth consecutive month of decline but a moderation in pace from the prior month. Nationally, prices are now down -6.5% from April 2022 peak levels.

Commodities

The CRB Commodity Index rose by 2.2% to 274 in October.

Brent crude oil rose by 7.8% to US$94.8/bbl, amid European Union trade embargos lowering supply and production, explains UBS.

The iron ore price fell by -19% to $US81/t on seasonally lower steel demand, notes the broker, and higher supply levels.

The gold price decreased by -1.6% to US$1,633.60/oz on US dollar strength and as higher real rates continue to weigh, according to UBS.

Hard coking coal prices rose by 18.3%, while thermal coal fell by -17.8% during October.

Foreign exchange

The US dollar Index (DXY), a measure of the value of the US dollar relative to a basket of foreign currencies, declined by -0.5% to 111.53.

The Australian dollar remained relatively flat from the end of September and closed at US$63.97.

COMMODITIES

# Material Matters: Base Metals; Resources Shares; Iron Ore & China Zero Covid

A glance through the latest expert views and predictions about commodities: Lower base metal price forecasts; recommended resource shares; a greater iron ore surplus in 2023 and signposts for an easing of China's zero-covid strategy.

**-The odds of a synchronised 2023 global recession sit at 50%**
**-Citi's resource stocks for a hard and soft landing**
**-An even greater iron ore surplus in 2023**
**-Identifying first signs of an easing in China's covid zero strategy**

By Mark Woodruff

Dire base metal price forecasts

Citi's weekly take on commodities appears under the headline: a global recession could quickly spook the bulls.

**The odds of a synchronised 2023 global recession sit at 50%**, according to the broker. A series of "rolling recessions" is expected, with measurable downturns in the EU and UK this northern winter and in the US by mid-2023.

Investors are reminded that commodities post negative returns during recessions, while positive returns coming out of a recession occur largely in the first six months. The demand for commodity-intensive goods increases with a rebound in economic activity, explain the analysts.

**Citi expects the worst is yet to come for base metal demand** as economic activity deteriorates further, and forecasts price declines of up to -20% by the first quarter of 2023, varying by metal.

This sell-off would be consistent with industrial metals price returns heading into and during a global recession, point out the analysts.

For **gold**, Citi sees a struggle for the bulls in the short term, but also notes signs of price stabilisation. Price support is evident at US$1,575-1,600/oz.

The broker is more bullish on **palladium**, with current prices presenting a potential dip-buying opportunity. It's felt US$2,250-2,300/oz may be reached in the next three to six months, as global auto production continues to recover on improved microcontroller chip supply.

Precious metals tend to outperform during recessions, says Citi, as investors turn to less risky assets, and prices may also be assisted by central bank policy easing.

In the case of **uranium**, a 9% price increase in October is supported by increasing appetite for nuclear energy globally, according to the analysts. Recent delays in closures for European nuclear reactors represents a stabilisation of Western uranium demand.

As a result of this stability, Citi now believes nuclear power growth in Asia will provide positive incremental demand growth, as opposed to a mere shifting of demand from West to East.

Recommended resource stocks for hard and soft landings

Citi recommends different Resource sector (mining, oil & gas) stocks for each of its base level, hard-landing and soft-landing scenarios for 2023 global GDP.

In the case of a soft-landing, the broker sees clear upside to the miners (especially those in the second tier) with lower margins and higher operating leverage such as South32 ((S32)) and Fortescue Metals ((FMG)). Newcrest Mining ((NCM)), 29Metals ((29M)) and Mineral Resources ((MIN)).

The likes of Santos ((STO)) and Woodside Energy ((WDS)) should be eschewed if a soft landing arises but would be the most preferred under a hard landing, explain the analysts.

While miners, especially mid-caps, will underperform the overall market due to materially lower earnings during a hard landing, Oil & Gas sector exposures would be relatively defensive, according to the broker, given the current Ukraine crisis and its expected impact on Asian gas markets.

**The analysts point out the Oil & Gas sector has outperformed the ASX300 Metals and Mining index by 25% over the last six months** due to events in the Ukraine.

Least favoured by Citi in a hard landing include the soft-landing favourites of South32, Fortescue Metals and 29Metals, as well as Sandfire Resources ((SFR)).

Sticking for now with the broker's base case, both Mining and Oil & Gas sectors offer value, with large cap mining cheaper than large cap oil & gas. Here, Rio Tinto ((RIO)), South32, Santos, Mineral Resources and Allkem ((AKE)) are preferred, while Whitehaven Coal ((WHC)), New Hope ((NHC)) and Pilbara Minerals ((PLS)) should be avoided.

Citi points out key oil & gas names are at a different point in the earnings cycle to other Resource sector stocks, with brokers raising gas price expectations given the European Union gas crisis.

Earnings momentum for Santos has largely remained positive since mid-2020, while Woodside's earnings momentum has been positive since late October 2021.

Citi sees a greater iron ore surplus during 2023

Iron ore prices are now trading at their lowest levels since 2020, driven by a downturn in sentiment following disappointing policy emanating from China's recent 20th Congress, explains Citi.

The broker cuts its (up to) three-month iron ore forecast to US$70/t from US$95/t and lowers its 2023 forecast to US$95/t from US$110/t, due to a gloomy outlook for demand globally.

Intensifying curbs at Chinese steel mills and a lack of a clear exit path from zero-covid policy are weighing upon iron ore demand, according to Citi. Also, as 'houses are for living in, not for speculation' according to the Chinese government, sentiment is considered poor for the property sector, which accounts for around 40% of steel demand.

**Citi sees the iron ore market surplus building during 2023, driven by declining steel output globally.** China's steel production is expected to fall by -3.5% year-on-year in 2022 and be broadly flat in 2023.

Outside of China, production during 2022 will decline by -4.5% year-on-year, forecast the analysts, as the consumer recession takes hold. It's noted European iron ore demand has already taken a hit due to curtailed operations at blast furnaces.

While the nadir for apparent steel demand ex-China should be the fourth quarter of 2022, Citi doesn't expect demand to return to 2018/2021 levels before 2024. Recovery is likely to be tepid with the broker forecasting 1.5% year-on-year growth in apparent steel demand in the ex-China world in 2023.

Some recovery in iron ore prices may occur upon a major vaccine roll-out or major easing in China, concludes Citi.

Potential signposts for an easing of China's zero covid strategy

Morgan Stanley believes time needs to pass before any macroeconomic implications can be drawn from China's 20th Party Congress.

As global growth slows into next year and inflation peaks, one key question, according to the broker, is whether China can provide support to the global economy. Also, will China rekindle inflationary pressures?

Both before and after the Party Congress, Morgan Stanley felt the answer to these two questions lay in how China negotiates covid zero polices and how it handles the property sector.

There was no substantive news on the property sector at the Congress, so the analysts see a continuation for the current policy of meting out support when needed to keep delivery of homes going but hold very little prospect of a surge in residential investment.

An unchanged covid strategy leaves the broker still seeing little scope for a rapid exit from covid zero. However, as spare fiscal reserves in China will be depleted by early next year, urgency levels are expected to rise, and some changes will likely occur over coming months.

The drain on reserves has been exacerbated by weaker exports to a slowing global economy and the continuing drag from the property sector, point out the analysts.

Signposts of a pivot in covid strategy will include rising vaccination rates for the elderly and greater availability of treatment facilities and medications, according to Morgan Stanley. Also, less government fear mongering about the virus may be another indicator.

The broker forecasts a modest recovery for China from the second quarter of 2023, which aligns with a three-to-six month lag for a pivot in the covid strategy after evidence of the above signposts emerges.

Once this private consumption-led rebound commences, the demand-pull for the rest of the world will likely be relatively muted, suggests Morgan Stanley, and unlikely to be an inflationary event, as some market pundits fear.

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RUDI'S VIEWS

# Rudi's View: Technology's Moment Of Truth

In this week's Weekly Insights:

**-Technology's Moment Of Truth**
**-Conviction Calls**
**-Research To Download**

By Rudi Filapek-Vandyck, Editor FNArena

**Technology's Moment Of Truth**

Big Tech on Wall Street has fallen off its pedestal in October with share price weakness following the release of Q3 financials.

For some, like Meta (formerly known as Facebook) the latest disappointment simply added more pain for loyal shareholders who have now witnessed the share price tanking by some -70% from last year's peak.

While the consequences for the likes of Amazon, Apple, Alphabet (Google), Microsoft and Tesla have been less severe, they are making big headlines nevertheless and have started to sow the seeds of doubt among investors.

Maybe Big Tech is not immune from the global slowdown; might it pay the price for being over-owned by investors across the globe?

For investors in Australia, there are multiple important points of interest to consider.

The first is the observation that positive market sentiment will not be deterred - at least not by disappointments from individual companies, no matter how big their size or marketweight.

This could well turn out to be all-important (in the short-term) as market observers had formed doubts about the outlook for Big Tech and how markets might respond to upcoming "misses" and downgrades.

Even after recent sell-offs, the marketweight of the so-called FAANMG stocks still represents around 11% of the FTSE World Market cap, so it would not be much of a stretch to think where goes Big Tech, there follow global indices.

Apparently not so. Market sentiment post the general weakness in September is now firmly focused on central banks slowing down the pace of rate hikes - a global trend that started with the RBA pre-Melbourne Cup day meeting.

Previous rallies in US equities have run out of puff once the 50 or 60 day moving average or the 200DMA came in sight, so investors will be keeping a close watch on what happens next over the weeks ahead.

Currently, the 60DMA, while trending downwards, seems only another positive day away while the 200DMA, also trending south, is below 4100 for the S&P500.

Headaches building for the largest companies on earth also lends credence to forecasts for the Aussie share market to outperform international peers, in particular US indices.

If investors were to assume Big Tech's marketweight is now reverting back to pre-pandemic level, this implies either Big Tech share prices must fall by a further -25% or other equities combined must outperform by some 33%, according to calculations published by Longview Economics.

Let us assume the actual outcome will be somewhere in the middle of those two scenarios. This still implies large US indices have a natural headwind to overcome, which the ASX200 doesn't have.

FAANMG market cap as a % of total world market cap (daily data)


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This month's newfound vulnerability for the world's corporate giants also shines a light on current trends in corporate earnings; trends that equally affect businesses in Australia.

Even without disappointments from Meta et al, statistics and trends for corporate profits in the US had started to look bleaker in comparison with previous quarters this year. But despite a general expectation that analysts' forecasts for corporate profits remain too high, and estimates need to fall by -15%-20%, the outcome thus far is less unified, much more polarised.

In simple terms: companies that were badly hit by covid, and are currently enjoying the re-opening recovery, seem to be performing better-than-expected. Others are facing emerging headwinds from inflation, rising rates and bond yields, and from down-shifting consumer spending.

Companies like Alphabet and Meta, for example, are essentially offering an insight into global trends in paid advertising. With economic recessions on the horizon for the UK, Europe and elsewhere, who should be surprised businesses are spending less on promoting products and attracting fresh customers?

Australia has the added benefit of a relatively oversized skew to miners, energy producers and financials. In particular the latter two sectors have witnessed positive revisions to earnings forecasts recently, which is in stark contrast to this year's overall trend, and again makes the Australian market a positive stand-out on the global platform.

Australia doesn't have a quarterly results season, but this year's AGMs, quarterly updates and out-of-season reporters combined fulfill a similar function for local investors. Macquarie, upon checking 76 AGMs to date, concludes the underlying balance has shifted in favour of downgrades and "misses".

More worryingly, perhaps, is that market responses to any negative updates have become a lot larger too - a phenomenon that is equally visible in the US. Could this be a direct result from lower liquidity on the back of central banks' tightening and companies no longer buying in their own stock?

On Macquarie's assessment, earnings disappointments in Australia are mostly blamed on high freight and energy costs, the weak Aussie dollar and bad weather. And while 74% of companies to date have stuck with their guidance for FY23, it is also Macquarie's view that it's too early yet, both into the new financial year and into the global economic slowdown, for a true and accurate assessment of what lays ahead.

Meanwhile, the polarisation between covid-winners and -losers is also taking shape in Australia.

The recent weeks have seen sharp contrasts in market updates from Qantas Airways ((QAN)), the recently renamed EVT Ltd ((EVT)), Auckland International Airport ((AIA)), as well as from Super Retail ((SUL)), JB Hi-Fi ((JBH)) and Unibail-Rodamco-Westfield ((URW)) against disappointments from Coles Group ((COL)), Endeavour Group ((EDV)), Woolworths Group ((WOW)), as well as from Australian Clinical Labs ((ACL)), Healius ((HLS)) and Sigma Healthcare ((SIG)).

Market updates by CSL ((CSL)), ResMed ((RMD)) and Macquarie Group ((MQG)) have resulted in slightly lower price targets.

In contrast, banks, energy producers Santos ((STO)) and Woodside Energy ((WDS)), and local coal producers are enjoying positive market updates and upgrades this month. Though, it has to be pointed out, smaller cap mining companies equally delivered their share of disappointments and misses, as have the likes of Adbri ((ABC)), ARB Corp ((ARB)), Codan ((CDA)), Reliance Worldwide ((RWC)), and Step One Clothing ((STP)).

Following on from current trends, maybe extra caution seems but appropriate ahead of upcoming market updates from the likes of Boral ((BLD)), CSR ((CSR)), Domino's Pizza ((DMP)), James Hardie ((JHX)) and Downer EDI ((DOW)) - at least for the short term.

On the same logic, maybe companies including Best & Less Group ((BST)), Flight Centre ((FLT)), Monash IVF ((MVF)), Lovisa Holdings ((LOV)), and Universal Store Holdings ((UNI)) are in the short term poised to perform better-than-expected?

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If investors are ready to rethink their exposure to Big Tech in the USA, this could potentially have negative consequences for the sector locally, even if direct comparisons look rather spurious and manufactured.

Sure, a direct link exists between less advertisements for Google and Meta and services required from Appen ((APX)), but virtually nothing links with Audinate Group ((AD8)), Carsales ((CAR)), Life360 ((360)), Pro Medicus ((PME)), Seek ((SEK)), TechnologyOne ((TNE)) or WiseTech Global ((WTC)).

Yet, during the good times of the pre-2022 bull market, often no such questions were being asked as local share prices simply attracted buyers in the slipstream of gains made in the US.

In similar vein, investors who witnessed the aftermath following the Nasdaq meltdown in 2000 will still remember there was no more appetite left for anything online, technology or telecom - worldwide, for years.

Within this context, recent price action for local stalwarts including Altium ((ALU)), Audinate Group, Pro Medicus, TechnologyOne and WiseTech Global should be very encouraging for investors in Australia as it signals that local companies can break free from general market sentiment on the strength of their specific qualities and outlook.

I do note also that when UBS recently selected its ten stocks for the decade ahead, WiseTech was included.

The team of technology sector analysts at Morgan Stanley is equally positive about WiseTech, arguing the company is increasingly trending towards the broker's bull case scenario for the years ahead.

Morgan Stanley also decided to add ten more local technology companies to its coverage, which makes for some interesting reading, to say the least.

First conclusion: only few companies in the sector possess a sustainable competitive advantage. Even fewer are profitable and/or scalable into new markets.

The team ultimately decided to prefer Hansen Technologies ((HSN)), Megaport ((MP1)), and Pexa Group ((PXA)) - none are free of risks or criticism.

Megaport might be building global domination on the back of technological leadership, but the cash register is still bleeding, there are no profits and more than one growth hiccup has shown up in recent market updates; which is also why the share price has been so volatile.

Pexa, partially owned by very troubled Link Administration ((LNK)), operates from an extremely solid market position in most of Australia, but housing activity is expected to slow down and the fresh expansion into the UK will be a costly drag in the short term.

Hansen Technologies has just about been every analysts favourite throughout the past two decades, until realisation sinks in that loyal clients do not guarantee wealth creation for shareholders.

Investors only have to look back over the past decades, both through financial metrics like profits and dividends as through the share price to see this company relies on acquisitions to decisively move the dial.

Hansen has made 30 acquisitions in 30 years.

Key reasons as to why analysts tend to like this company include sticky customers (Hansen does billing software, churn is less than 2% annually), strong cash conversion of stable revenues, and family and senior management ownership.

Morgan Stanley's research and projections confirm my own observations and scepticism, with only minimal organic revenue growth expected, unless more acquisitions follow. Also, after all those years, and 30 acquisitions, annual revenues are still only expected to reach $300m this year.

Call me biased, but another software provider on the ASX, TechnologyOne ((TNE)) has an even lower customer-churn but it grows without the need for acquisitions, the past two decades showcasing one of the most consistent and resilient track records on the ASX (possibly worldwide).

Morgan Stanley's gripe is that TechnologyOne's ERP software is not that special, while it competes with larger multinationals including Workday, SAP and Oracle. Also, TechOne's business approach is very much based on strong relationships in Australia; a model that doesn't scale up when entering additional markets, such as the UK.

However, the analysts do concede if management achieves its targets in the years ahead, including $500m Annual Recurring Revenues (ARR) by FY26 at a 35% gross profit margin, the share market will likely re-rate the stock.

Morgan Stanley analysts are equally positive on oOh!media ((OML)) and hipages Group ((HPG)), but cannot get excited because of too much competition and no clear moat.

Four fresh initiations all received a negative Underweight rating (essentially an Avoid) as Morgan Stanley sees too many vulnerabilities and risks on the horizon for Appen, AirTasker ((ART)), Aussie Broadband ((ABB)) and Macquarie Telecom ((MAQ)).

I think the key message to take away from all of the above is that the Great Party is over for young gun Growth and Technology stocks.

Successful investing in these companies is now dependent on the same characteristics and requirements that have been necessary in other segments of the market throughout time and cycles; cashflows, dependable revenues, defendable moats, not too much debt, and successful execution.

Questions will be asked and narratives put to the test as economies slow down or face recession. Next year will separate the pretenders from the deliverers.

As for US Big Tech, there's a valid argument this is simply the end of a cycle, but with exact fall-out as yet unknown.

## Conviction Calls

**UBS equity strategists** Richard Schellbach and Akash Biradar have outlined a number of reasons as to why the Australian share market might possibly be poised for relative outperformance vis-a-vis international equities throughout the decade ahead.

Reasons to support that premise are the faster population growth, the concentrated industry structure (supporting higher profit margins), the world-beating dividend yield and the fact most companies in Australia sell to local customers, which to an extent insulates them from troubles and headwinds elsewhere.

Once upon a time in the 1990s foreign investors used to make up 55% of ownership of ASX-listed companies, but this has been replaced with percentages fluctuating between 35%-40% in the past two decades. UBS predicts if the above thesis proves correct, that percentage of foreign ownership might be poised for a revival in the years ahead.

An important part of the thesis is based upon the prediction the world shall return to a low-growth environment and Australian equities, also carried by the resources industry, should be able to shine in such an environment, including when inflation sticks around for longer.

The duo has also selected its **ten best ideas for the next ten years**, or in their own words: "ten stocks to put in the bottom drawer for the next ten years".

The selection will raise a few eyebrows, no doubt about it: BHP Group ((BHP)), CommBank ((CBA)), IDP Education ((IEL)), REA Group ((REA)), Suncorp Group ((SUN)), Transurban ((TCL)), The Lottery Corp ((TLC)), Wesfarmers ((WES)), Worley ((WOR)), and WiseTech Global.

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**Strategists at Wilsons** prefer to remain cautious on equities as far as the next six months or so are concerned, mainly because inflation is not yet deflating and central bankers thus feel the need to continue tightening.

They also believe Australian equities might outperform on the international stage over the year ahead.

**Specific opportunities** identified include Aristocrat Leisure ((ALL)), Santos, Insurance Australia Group ((IAG)), Macquarie Group, National Australia Bank ((NAB)), Cleanaway Waste Management ((CWY)), Qantas Airways, Allkem ((AKE)), and Goodman Group ((GMG)).

Elsewhere, **Wilsons' Research Ideas** have identified the following opportunities: OFX Group ((OFX)), Aroa Biosurgery ((ARX)), Nanosonics ((NAN)), Select Harvests ((SHV)), Collins Foods ((CKF)), Ridley Corp ((RIC)), Nick Scali ((NCK)), ReadyTech Holdings ((RDY)), PeopleIn ((PPE)), Pro Medicus, and Immutep ((IMM)).

Still at Wilsons, the **Model Portfolio** made the following changes in September/October: adding Nine Entertainment ((NEC)) and NextDC ((NXT)) while buying more of ResMed while selling out of Judo Capital ((JDO)) and News Corp ((NWS)) and reducing exposure to BHP Group.

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**Retail sector analysts at Jarden** remain cautious on consumer-oriented companies in general. Investors are advised to look for companies with a clear value proposition, pricing power and scale.

Thus Woolworths Group, Metcash ((MTS)), Treasury Wine ((TWE)) and Costa Group ((CGC)) are preferred for their "defensive" business model, while Flight Centre ((FLT)) and Premier Investments ((PMV)) are preferred for their growing return on invested capital (ROIC).

The likes of Universal Store Holdings ((UNI)), Accent Group ((AX1)) and Premier Investments are favoured because of their defensive consumer clientele, with Treasury Wine shining in the premium section.

Three retailers are looked favourably upon for their 'value' proposition; The Reject Shop ((TRS)), Domino's Pizza, and Collins Foods.

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**JP Morgan**'s monthly insights into positioning and sentiment among local institutions becomes available at one month's delay, but the September update still contains a few snippets that provide us mere mortals with some useful insights.

For starters, sentiment remains downbeat, which also feeds into unchanged high levels of cash holdings.

September saw the return of staples becoming the defensive asset to own and JP Morgan reports Coles Group in particular enjoyed the come-back of institutional flows.

Overall exposure to the energy sector has been wound back, but just about everyone continues to favour Santos over Woodside Energy.

Macquarie Group fell out of favour in September. The other remarkable insight is that while retail investors continue to embrace ownership of local bank shares, domestic and offshore institutions are now markedly underweight the sector.

At least such was the situation in September.

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As mentioned above, **Morgan Stanley** has tried to spice up its coverage of **ASX-listed technology stocks** with the addition of ten new names, but only three start a with fresh Overweight rating: Pexa Group, Megaport and Hansen Technologies.

The decision to slap an Underweight rating (let's call them an Avoid/Sell) on four others has been inspired by intense pressure from competition and no obvious moat or defence against it. Stocks starting off on a negative note are Appen, Aussie Broadband, Macquarie Telecom and AirTasker.

Three companies sit in the middle with an Equal-weight rating: oOh!media, TechnologyOne and hipages Group Holdings.

## Research To Download

Research as a service (RaaS) on:

-Millennial Services ((MIL)):
https://www.fnarena.com/downloadfile.php?p=w&n=B4DEF51F-0CFB-844E-7A1CCFFBE4136EBF

-X2M Connect ((X2M)):
https://www.fnarena.com/downloadfile.php?p=w&n=B4E20607-E608-2DF0-D2CEE652615F40EB

-Kinatico ((KYP)):
https://www.fnarena.com/downloadfile.php?p=w&n=B4DC1EF2-C1CF-71D7-C6F4E137CF908E59

**(This story was written on Monday, 31 October, 2022. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).**

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

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

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SMALL CAPS

# Cash Is King For Small Caps

Tim Boreham notes small caps with cash on the balance sheet are the safer bet compared to 'pre-revenue' companies, and highlights several examples.

**-'Pre revenue' plays without enough cash will wither away**
**-Capital raised pre rate hikes a benefit**
**-Valuation de-rating offers opportunity**

By Tim Boreham

Charles III might be Britain's new reigning monarch, but in the realm of small caps cash is very much king in the harsh fund raising climate.

Put simply, 'pre revenue' plays without enough cash will wither away, no matter how compelling their story may be. That's the circle of life in the perennial pattern of bull and bear markets.

Fortunately, many companies took advantage of the amenable capital raising conditions and have stored some nuts away for winter. At the same time, declining valuations mean that many stocks are trading only modestly above – or even below – their cash backing or net tangible assets.

Here are a few that have caught your columnist's eye. Bear in mind that investors fundamentally are rational, so there might be a good reason for the steep discounts.

**The Agency Group Australia ((AU1))**

From its Perth stronghold the listed realtor has expanded into the eastern states - northern Sydney's leafy 'burbs and – more recently Launceston (by way of acquisition).

The Agency is seeking to shake up the old agent franchise model with a more direct hiring approach that confers more generous commissions on the individual agents.

The thinking is that the current franchises interpose too many management layers and costs, including unrequired office space.

The Agency reported a net profit of $1.59 million for the year to June 30 2022, compared with a previous $1.85 million loss. Adjusted underlying earnings gained 26%, to $3.85 million.

Revenue surged 24% to $72.7 million, with gross commission income rising 27% to $102.5m. The firm sold 5709 properties worth $5.9 billion.

The Agency's balance sheet has improved markedly, with a previous $12 million debt to Macquarie now whittled down to $5 million. Taking the $8.2 million cash into account, the company had net cash of $3.2 million- a handy war chest for more agent acquisitions or investing in organic growth.

The company conservatively estimates the 'real' value of these assets at $22.8 million, compared with the recognised value on balance sheet of $10.1 million.

The dampener on the valuation is five million $1 convertible notes held by Peters Investments, which are repayable in January 2026 or exercisable at 2.7 cents per share (depending on certain conditions).

Still, with a market cap of a little over $15 million, this one's a true renovator's delight.

**Orexplore Technologies ((OXT))**

Orexplore develops hardware and software allowing miners to scan orebodies and samples in situ and thus more efficiently and effectively.

The company listed in January this year, having demerged from Swick Mining.

The company's turnover was a modest $237,000 in the 2021-22 year, but in July the company won a $2.35 million contract with OZ Minerals to assay 30,000 metres of historic core samples at one of its mines.

On a bum note, gold mining client Wiluna Mining entered voluntary administration in July, with Orexplore recognising $162,067 of non-recoverable income in the 2021-22 accounts.

Orexplore posted a -$3.7 million loss, up from -$1.1 million so that's one likely reason the stock is out of favour.

The company's trading at a -17% discount to its net cash of $10.6 million (as of June 30 2022).

On another metric, the company's net tangible assets of 12 cents compares with the share price (at last glance) of 8.5 cents.

**Pharmaxis ((PXS))**

The fibrotic diseases specialist offers extraordinary bang-for-one's-buck as it pursues treatments for conditions including Parkinson's disease, myelofibrosis and skin scarring.

The company already sells Bronchitol, an approved treatment for cystic fibrosis although most investor interest lies with its emerging clinical programs.

Recently the company struck a deal with Parkinson's UK, by which the organisation funds a Parkinson's disease trial to the tune of $5 million over 18 months.

Carried out at sites in Australia, South Korea, Taiwan and the US, a 24 patient phase II myelofibrosis study began dosing in March last year and initial results are promising.

The company also has a promising clinical trial underway for burns scarring, overseen by legendary Perth burns surgeon Professor Fiona Wood at Perth's Fiona Stanley Hospital.

After a $10 million placement this month, the company has cash of $30 million and a $37 million market cap. The company made an underlying loss of -$1.3 million last year, but reckons it should be profitable this year as cystic fibrosis clincis open post pandemic.

Our only objection is the company has been around for a long time and so it's been a slow burn, if you'll pardon the pun.

Still on life sciences, **Universal Biosensors ((UBI)**) specialises in portable finger prick blood test devices, to manage conditions such as diabetes and coagulation.

The company is also developing tests for cancer and viral biomarkers and has launched an all-in-one wine assay platform for vignerons to test six elements – including sulphur dioxide and malic acid levels - in their barrels.

Universal Biosensors has $28.4 million in net cash and is currently valued at $54m. We hasten to add the company lost -$5 million in the September quarter on $679,000 of sales, so this one's a play on some decent top-line growth coming through.

**Spacetalk ((SPA))**

The dreaded founder's syndrome has struck again, with the board "terminating the employment contract" of CEO and 21-year veteran Mark Fortunatow.

Formerly known as MGM Wireless, the company focused on schools communications systems, such as for recording absences. It then pivoted to its kids' wearable tracking devices, Spacetalk and changed its name to such.

Spacetalk has made great progress on the top line with last year's revenue climbing 37% to $20.7 million, $18m of which is attributable to the wearables growth.

Spacetalk is now under the interim stewardship of former Urbanise CEO Saurabh Jain and we're guessing the cost cutting will be a numero uno priority.

Valued at less than $10 million, the company ended the year with $5.6 million of cash but lost -$6.57 million, compared with -$1.79 million previously.

At that run rate, the company won't be cash rich for much longer.

**Senetas Corporation ((SEN))**

Similarly, the high-speed encryption specialist and erstwhile market darling lost a cool -$10.8 million in the 2021-22 year, which on paper would wipe out its $10.7m cash kitty if repeated.

But there are some intricacies to consider beyond the reported bottom-line number. One is that the core Senetas business was profitable to the tune of $1.6 million, with the red ink attributable to the -$12.7m loss incurred by the Votiro Cybersec business.

Senetas holds 61% of the Israel-based Votiro, which is a leader in "disarm and reconstruction". This is not a military term but refers to taking apart digital documents and then reassembling them without any viral nasties, which sounds like something hacking victims Optus or Medibank Private should have been doing.

Excluding non-cash items, Senetas's 'real' loss was a more palatable -$2.7 million.

Senetas last week said that Votiro had increased its new customer pipeline by 60% since July this year, with annual recurring revenue expected to double in calendar 2022. What's more, the business is expected to be cash flow break even by July 2023.

Overall, Senetas' revenue is humming along nicely, up 9% to $25.1 million in 2021-22. Votiro is the growth engine that will determine whether the company should be worth more than its beaten-down $49 million market cap (albeit circa 20% higher over the last week).

**This story does not constitute financial product advice. You should consider obtaining independent advice before making any financial decisions.**

SMALL CAPS

# Poor Production Won't Rain On Coronado's Parade

Despite a weaker production result in its third quarter, Coronado Resources has benefitted from strong price realisation.

**-Third quarter production from Coronado Resources missed expectations**
**-Production at Curragh was slowed by rainfall volumes three times the norm**
**-Weaker volumes were offset by high price realisation**

By Danielle Austin

Weather continues to plague coal producer Coronado Resources ((CRN)), with the company's third quarter production and sales disappointing analysts. Managing the impact of adverse weather at its Curragh project remains a key issue for the company, with three times the usual rainfall slowing production capabilities in the quarter.

Quarterly coal production missed consensus forecasts by -16%, and sales by -19%, leading the company to downgrade full year coal production to 16.9-17.1m tonnes. Mining cost guidance was also lifted to US$81.00-83.00 per tonne, from US$79.00-81.00 per tonne, attributed to both adverse weather and inflationary impacts.

More positively lagged first quarter prices were realised in the quarter, benefitting Coronado. The company looks to generate strong free cash flow on the favourable met coal price outlook. Coronado Resources announced a special dividend of US13.4 cents per share, or US$225m, alongside an offer to repurchase up to US$200m in Senior Unsecured Notes.

Hopes for wet weather to ease by the March quarter

Macquarie, Credit Suisse and UBS were all disappointed by the September quarter production update. Between them, these brokers have an average target price of $2.50 ranging from $1.70 to $3.30.

Strong realised pricing saw revenue beat Macquarie's assumptions by 27%, while costs year to date are 12% higher than anticipated. While this broker (Outperform, target price $3.30) had anticipated a guidance downgrade, it was surprised by the extent of the decrease.

Higher realisations drive a 15% increase to Macquarie's earnings per share guidance for 2022. Looking ahead, Macquarie has lowered its production guidance -5% from 2023 onwards, and lifted cost assumptions.

Credit Suisse (Outperform, target price $2.50) highlighted Coronado Resources' production guidance downgrade was already largely reflected in consensus forecasts. Following the special dividend announcement, Credit Suisse anticipates the dividend announcement in February will yield 10%.

The broker was pleased by the completion of US domestic price negotiations, noting contract pricing looks to cover around 90% of US operational costs in the coming year. The company estimates 40% of FY23 output will be contracted at US$201 per tonne.

UBS (Neutral, target price $1.70) was encouraged by December quarter cost guidance of US$68.00-70.00 per tonne, which it believes may suggest peaking costs. This broker also sees potential for weather risks to ease by the March quarter.

Outside of core coverage, Bell Potter (Buy, target price $2.10) and Goldman Sachs (Buy, target price $2.20) both highlighted strong performance from Coronado's US operations, despite disappointment from the domestic operations.

Bell Potter notes downgraded production guidance still suggests a strong final quarter, and continuing wet weather impacts could pose risk to this. Goldman Sachs remains positive the met coal market will prove supportive in the coming year, and sees upside risk to forecasts on benchmark price assumptions.

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

TREASURE CHEST

# Treasure Chest: NextDC

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts.

By Rudi Filapek-Vandyck

**Whose Idea Is It?**

Analysts at Macquarie

**The subject:**

It's often one of the eternal enigmas of the public forum that is the share market: if it's such a great company, how come the share price is sliding backwards?

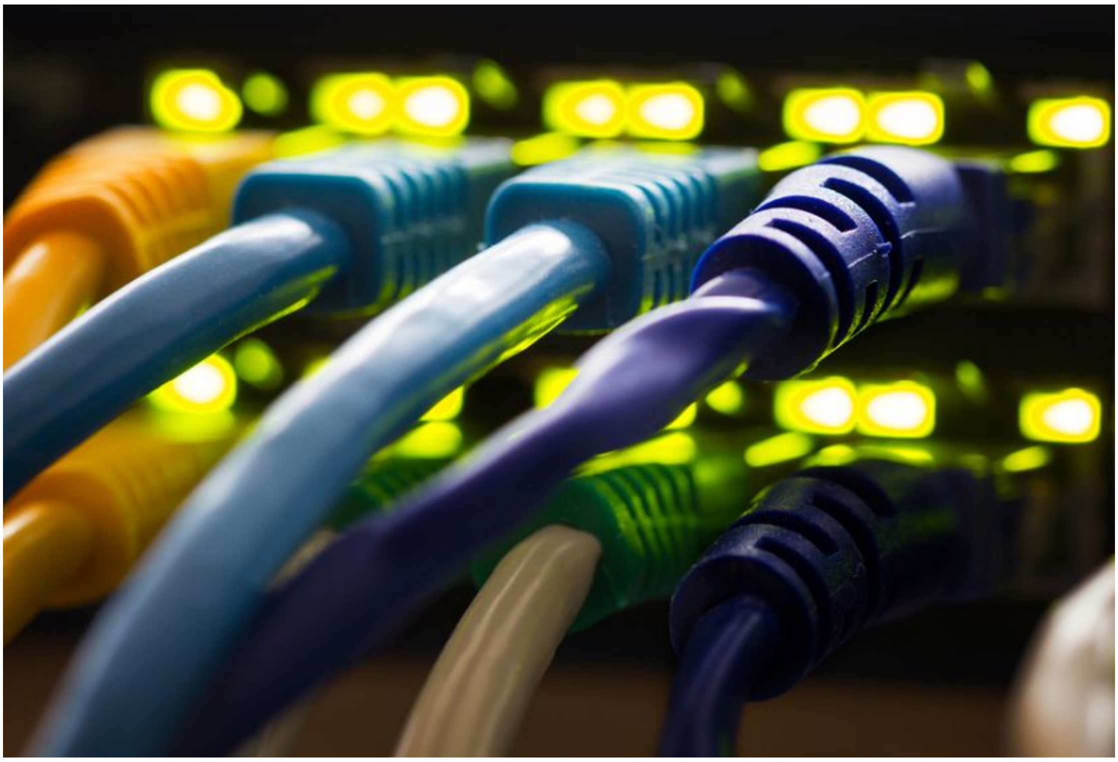
Why aren't buyers lining up to get on the register?

The Germans have a great term for it: *hineininterpretierung*. In share market terms it means: when a stock falls, we find a reason to justify it by reasoning-in a fitting narrative. It's what we humans do best.

So why exactly is the share price of data centres operator NextDC ((NXT)) in a downtrend? Why does the share price continue to fall post the release of FY22 financials in August?

Observing NextDC shares have now underperformed the ASX200 by no less than -18% since that market update in August, the persistent weakness has also caught the attention of Macquarie analysts.

Their conclusion remains NextDC shares by now represent "deep value" while the business overall has not lost its "defensive" character.



**The Explanation?**

Digging deeper into the NextDC investment proposition, Macquarie does acknowledge higher bond yields do increase debt financing costs for the business. It is estimated a 1% increase in interest rates could raise finance costs by 14% and lower FY25 EPS by some -34%.

But Macquarie is also of the view NextDC shares are not genuinely valued on the forecast EPS; the broker suggests EBITDA instead.

Macquarie observes the shares are currently trading on 23x forecast FY23 EV/EBITDA multiple, which is at a substantial discount to implied transaction multiples in the sector of 33x-38x.

The broker has revised its price target on lower forecasts, to $11.40 from $12.60 - the new target implies that multiple lifts to 30x FY23 EV/EBITDA.

Other potential concerns, such as more customer incentives, the risk of a capital raising and the challenge of cost inflation have been casually wiped off the table.

**More Info:**

Macquarie is keeping its eyes open for the AGM on November 18 or any update on the sale process of London-based Global Switch, for which NextDC has expressed interest too.

Meanwhile, the broker retains its Outperform rating, in support of the fact NextDC shares are trading at a significant discount to international peers.

FNArena's consensus price target of $12.75 -more than 53% higher than yesterday's closing share price- suggests other analysts share Macquarie's view, in general terms. Indeed, six of the seven stockbrokers monitored daily by FNArena rate the stock positively.

The one exception is Credit Suisse whose Neutral rating and $10.90 (31% above the share price) is taking guidance from the fact that new contracts are slower in ramping up.

If we expand the coverage with Wilsons and Goldman Sachs, we simply add two more positive views.

TREASURE CHEST

# Treasure Chest: AMP

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Today's idea is AMP.

**Whose Idea Is It?**

Jefferies.

**The subject:**

AMP ((AMP)).

AMP shares reportedly joined the Australian Stock Exchange in 1998 at around $18.70 a piece but shareholders soon enjoyed a share price trading above $20. Early this year they traded at 85c, and closed yesterday at $1.26. That's a 48% rally from the low, but hardly inspiring in the wider context.

Stockbroker Jefferies last week initiated coverage of the stock with a Buy rating, foreseeing a "less dramatic AMP". The broker has set a $1.43 price target.

Jefferies notes the wealth manager has had a chequered history since listing in 1998, resulting in reputational damage (No more so than the Royal Commission of 2018.) This is evidenced by adjustments to its business model that have resulted in retained losses of -$3.3bn on the balance sheet.

But following a series of divestments, AMP has exited businesses responsible for prior earnings shocks, or others that present the potential for increased earnings volatility through investment market exposure. Combined with changes to its wealth management business, Jefferies believes the company will be less exposed to significant negative attention in the future.

AMP's wealth brands (Australia & New Zealand) are benefiting from cost initiatives, the broker notes. The decrease in adviser numbers post Royal Commission has already improved revenue per adviser and should also allow the company to recalibrate its cost base.

In the meantime, the "North" wrap platform continues to attract inflows and remains competitive, evidenced by the increase in net cash inflows from independent financial advisor channels.

There have been reservations about AMP's banking business, but Jefferies suggests digital-only offering and narrow product set should see good returns.

Cost-outs are one thing, but the broker is also keen on AMP's planned capital management initiatives equivalent to 29% of the company's market cap (subject to shareholder approval).

Jefferies forecasts assume $850m in on-market share buybacks completed by FY24. Combined with decreases in controllable costs, the broker's FY24 earnings forecast implies a 21.7% compound annual growth rate over FY22-24.


**More info:**

Last week AMP provided a September quarter update. The assessment from FNArena database brokers covering the stock was that the banking business outperformed expectations, but weak growth trends persisted in other divisions.

Ord Minnett (Hold) noted Australian Wealth Management funds under management dipped -3% due weak markets, but net outflows more than halved year on year. Although the broker expects the loss of the Australia Post contract could affect Master Trust flows.

Ord Minnett has a $1.20 target.

Citi and Credit Suisse are both advising in a takeover of Collimate Capital which is an AMP subsidiary, and are currently restricted from providing a recommendation.

Updating for AMP’s August earnings result release, Morgan Stanley (Equal-weight) saw it as critical that AMP re-invests to stay competitive, with AMP Capital to be mostly divested. Yet $1.1bn is expected to be distributed by capital return, special dividend, or on-market buybacks, with no dividend declared in August.

UBS questioned margin contraction in the banking business at the time, although the September quarter clearly saw improvement. UBS has not altered its Sell rating, having declared AMP as "expensive" compared to peers.

*Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.*

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

WEEKLY REPORTS

# Weekly Ratings, Targets, Forecast Changes - 28-10-22

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

By Mark Woodruff

***Guide:***

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

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

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

***Summary***

*Period: Monday October 24 to Friday October 28, 2022*
*Total Upgrades: 16*
*Total Downgrades: 16*
*Net Ratings Breakdown: Buy 55.97%; Hold 36.53%; Sell 7.51%*

For the week ending Friday October 28 there were sixteen upgrades and sixteen downgrades to ASX-listed companies covered by brokers in the FNArena database.

While ratings changes were evenly split, there were more material earnings downgrades to broker forecasts than upgrades, and half (five) of the earnings downgrades in the table below relate to the Resources sector.

Three of those five downgrades were gold-related after Ramelius Resources, Newcrest Mining and OZ Minerals issued September quarter results.

While results for Ramelius came in slightly lower than Ord Minnett's expectations, the broker believes six-month upside more than outweighs perceived deliverability risk and upgraded its rating to Buy from Accumulate.

Citi also managed to look through a "mixed" quarterly for Newcrest and upgraded its rating to Buy from Neutral following a severe share price fall over the course of the general Gold sector de-rating. The US dollar is expected to peak over the next six months and gold is forecast to bounce back to US$1900oz in the second half of next year.

Over at OZ Minerals, gold production exceeded Neutral-rated Credit Suisse's forecast, but management downgraded gold guidance for Prominent Hill by -9% due to lower stockpile processing and higher group costs.

Morgan Stanley (Equal-weight) also observed copper production at Prominent Hill is below year to date run rates, and an improvement will be needed in the December quarter if full-year guidance is to be met.

South32 and Iluka Resources were the other two Resource sector stocks appearing in the earnings downgrade table.

While South32's first quarter numbers for coal, alumina and nickel underwhelmed, Morgans still maintained the business remains in "robust" shape and kept its Add rating, while its target fell to $5.30 from $5.40.

Overweight-rated Morgan Stanley observed sales now need to play catch-up to meet FY23 forecasts though considered this feat achievable.

After a hiatus on coverage of Iluka for 18 months, UBS set a Neutral rating and $10.25 target and its new earnings forecasts lowered the average in the FNArena database.

While rare earths are important for Iluka and command most attention, noted the analyst, 60% of its valuation for the company is linked to the mineral sands business.

Other brokers noted an agreement with ASX-listed rare earths junior Northern Minerals for the supply of rare earths concentrate. Iluka will invest an initial $20m to support the development of Northern Minerals' Brown Range project through to a definitive feasibility study.

Of all the downgrades to earnings forecasts last week in the database, Appen received the largest in percentage terms after Morgan Stanley became the fourth covering broker and initiated coverage with an Underweight rating and $2.25 target price.

The broker felt competition has intensified from a number of global players (including Amazon and Sagemaker), which are creating more sophisticated platforms. The analyst noted the company's software is not built on proprietary technology that would give it a distinctive competitive advantage.

The second largest downgrade to broker earnings forecasts went to Redbubble, which also registered the largest percentage fall in average price target in the FNArena database, following a first quarter update.

UBS downgraded its rating to Neutral from Buy and lowered its target to $0.60 from $1.55. Positive June quarter trends (like margins and improved channel mix) reversed in the September quarter, while the analyst noted free shipping and marketing spend more than offset recent price rises.

Add-rated Morgans was more forgiving around near-term margin headwinds and customer acquisition cost pressures, and noted the company is in an investment-phase with additional brand spend/headcount. The broker’s target price was reset to $1.00 from $1.65.

Next on the table was Aussie Broadband after Ord Minnett lowered its target to $3.61 from $4.03, despite an AGM trading update that revealed ongoing market share growth in the September quarter and reiteration of earnings guidance.

The broker’s EPS forecasts fell by around -3% to reflect a higher cost of capital, courtesy of rising interest rates.

Later in the week, Morgan Stanley (Underweight) issued its inaugural research on Aussie Broadband and became the fourth broker in the FNArena database covering the stock. In setting a $2.10 target price, the analyst lowered the average database target to $3.14 from $3.66.

This broker noted downside risks to consensus forecasts as upside has already been factored into the outlook. Intensifying competitive pressure in consumer broadband were also noted, which will potentially suppress average revenue per user and kick operating costs higher.

The average target price in the FNArena database for Medibank fell to $3.24 from $3.76 last week on impacts from the recent cyber security breach.

As part of a first quarter update, the company withdrew FY23 policyholder growth guidance in reaction to the event and initially assessed costs in the range of -$25-35m, though Morgans felt significant uncertainty remains for both costs and outcomes.

Ord Minnett felt the greatest immediate risk to earnings would derive from a loss of policyholders due to reputational risk, while regulatory imposts may be added at a later date.

While UBS retains its Sell rating and $0.45 target price for Zip Co following a first quarter trading update last week, Ord Minnett lowered its target to $0.70 from $1.10 and downgraded its rating to Hold from Accumulate, despite a positive trend for bad debts.

Ord Minnett had hoped management would have sold off the international operations by now though management stated the strategic review of the Rest of the World segment is “well advanced”.

It was a busy time for Pilbara Minerals with two ratings downgrades by separate brokers and also heading up the table below for the largest percentage increase in target price. These moves followed September quarter results.

While lithium production outpaced peers, operational expenditure came in at the lower end of guidance, and Citi raised its target to $4.60 from $4.30, the broker’s rating was downgraded to Sell from Neutral following recent share price strength.

The broker expects a rise in spodumene prices of 40% and 60% across FY23 and FY24.

Ord Minnett marginally increased its target to $4.20 from $4.10, but also struggled to justify the current valuation given a lack of firm growth or margin expansion plans and lowered its rating to Lighten from Hold. It's thought a strong net cash position may lead to a positive capital management update later this quarter.

Returning to broker earnings forecasts, TPG Telecom's position atop the table below for positive change should be ignored due to a data glitch.

Karoon Energy received the only material increase in earnings forecasts last week, following first quarter results.

Management raised the bottom end of its guidance range due to a stronger-than-expected performance at the Bauna oil and gas field in Brazil, post-intervention.

Macquarie feels the company could beat full year guidance if the Patola field in Brazil comes online, but timing and initial rates will be a determining factor.

Following Patola, Karoon Energy will proceed with up to two wells at the Neon oil discovery in Brazil, which the broker expects could be a material catalyst for a share price re-rate.

Total Buy recommendations comprise 55.97% of the total, versus 36.53% on Neutral/Hold, while Sell ratings account for the remaining 7.51%.

**Upgrade**

**AMPOL LIMITED ((ALD)) Upgrade to Outperform from Neutral by Credit Suisse** .B/H/S: 4/1/0

Credit Suisse believes Ampol's share price has been unfairly marked-down following 3Q results and upgrades its rating to Outperform from Neutral.

Earnings (EBIT) came in at $266m compared to the analyst's forecast for $338m, due to underperformance in Fuels and Infrastructure on a number of trading-related factors and adverse movements in freight.

The target price falls to $30.49 from $31.93 after the broker downgrades FY22 and FY23 EPS estimates by -6.2% and -7.6%, respectively.

**BENDIGO & ADELAIDE BANK LIMITED ((BEN)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 5/1/0

Since August 9, Bendigo & Adelaide Bank has underperformed peers by -17- 29%. While Macquarie continues to expect the bank to be impacted by intense mortgage competition and its community banking revenue-share arrangement, there appears to be light at the end of the tunnel.

Improved saving deposit spreads and rising swap curves should offset margin pressures and rising expenses. Macquarie's margin forecast for FY23 is 15 basis points ahead of consensus.

Target rises to $9.25 from $9.00, upgrade to Outperform from Neutral.

**CREDIT CORP GROUP LIMITED ((CCP)) Upgrade to Buy from Accumulate by Ord Minnett** .B/H/S: 3/0/0

Credit Corp has retained its full year earnings guidance and lifted the lower end of its purchased debt ledger guidance range. The update, alongside cash collections holding up, was well received by the market, particularly given recent industry cash collections.

Ord Minnett upgrades to Buy from Accumulate and the target price decreases to $28.00 from $28.50.

**COLES GROUP LIMITED ((COL)) Upgrade to Hold from Lighten by Ord Minnett** .B/H/S: 3/3/0

Ord Minnett now prefers Coles Group over Woolworths Group, and accordingly raises its rating to Hold from Lighten and lifts its target to $16.00 from $15.80.

By comparison to Woolworths, the analyst sees better sales momentum, less downside risk to consensus earnings forecasts and a fairer current valuation multiple.

Mind you, the broker is cautious on the overall outlook for the grocery space, despite believing risks are now more reflected in valuations. There's considered to be some downside risk to consensus earnings, following an inflection point reached in the FY22 reporting season.

**ESTIA HEALTH LIMITED ((EHE)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 1/1/0

Improved occupancy as covid cases decline should benefit Estia Health according to Macquarie, driving near-term upgrades to the broker's earnings assumptions.

The recently announced $62m acquisition of four residential aged care homes looks to be accretive. Coupled with expectations of improved occupancy, Macquarie's earnings forecasts lift 5%, 3% and 7% through to FY25.

The rating is upgraded to Outperform from Neutral and the target price increases to $2.50 from $2.15.

**INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Upgrade to Add from Hold by Morgans** .B/H/S: 4/1/2

Morgans raises its rating for Insurance Australia Group to Add from Hold after management left FY23 guidance unchanged at the AGM.

Also, the company recently announced it will lower its business interruption (BI) claims provision and will undertake a share buyback.

With the BI claims outcomes looking decidedly more favourable and following an investment mark-to-market exercise, the broker increases its target to $5.24 from $4.95.

**KOGAN.COM LIMITED ((KGN)) Upgrade to Neutral from Sell by UBS** .B/H/S: 0/1/1

It is UBS's view that Kogan's Q1 update still does not reflect a turning point in top line sales. The remainder of FY23 is seen as roughly EBITDA break-even while excess stock should be cleared by December.

UBS thinks margins remain at risk depending on what the competition does. Ultimately, however, the broker does see margins recovering, providing a more positive outlook from FY24 onwards.

As the share price is not far off from the $3.60 price target (up from $3.15), UBS has upgraded to Neutral from Sell.

See also KGN downgrade.

**MOUNT GIBSON IRON LIMITED ((MGX)) Upgrade to Neutral from Underperform by Macquarie** .B/H/S: 1/1/0

Despite a 1Q result weaker than Macquarie expected, with shipments impacted by fire damage, management at Mount Gibson Iron maintained FY23 guidance.

The broker upgrades its rating to Neutral from Underperform on valuation, given recent share price weakness. While operations and cash generation are expected to be stronger in the 2H of FY23, commodity price headwinds are forecast.

The $0.40 target price is unchanged.

**NEWCREST MINING LIMITED ((NCM)) Upgrade to Buy from Neutral by Citi** .B/H/S: 4/3/0

Citi sees an opportunity for investors as the Newcrest Mining share price has been hit hard throughout the general gold sector de-rating.

The broker expects the USD to peak over the next six months while the in-house view is for gold to bounce back to US$1900/oz in the second half of next year.

Arguably, says the broker, Newcrest Mining has the highest quality assets in Australia while its share price is at a 5-year low.

Against all of the above, the company released a rather "mixed" quarterly, with operations at Lumberjack suspended and grades disappointing at Lihir, but with material movement at the latter setting a new record.

The rating has been upgraded to Buy from Neutral. Target price remains $21.

**NOVONIX LIMITED ((NVX)) Upgrade to Speculative Buy from Hold by Morgans** .B/H/S: 1/0/0

Morgans lifts its rating to Speculative Buy from Hold and increases its target by 47% to $3.11 following news Novonix is in negotiations to secure a grant.

The US$150m grant from the US Department of Energy (DOE) is for a 30ktpa facility for the manufacture of battery anodes, which is potentially expandable to 75ktpa.

The DOE announcement includes an estimate for total spend of just over -US$1bn for the next facility, which the analyst believes partly allows for an expansion.

While the capital intensity is greater than expected, the broker also expects stronger anode pricing in the long term.

**PANORAMIC RESOURCES LIMITED ((PAN)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 2/0/0

Given results were pre-released, Panoramic Resources' first quarter production was in line Macquarie's expectations. All-in sustaining costs were 4% higher than the broker had assumed, while C1 costs were -4% lower.

The first of three shipments slated for the second quarter has already departed, with the others scheduled for mid-November and mid-December.

The rating is upgraded to Outperform from Neutral and the target price increases to $0.20 from $0.17.

**REGIS HEALTHCARE LIMITED ((REG)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 1/1/0

Macquarie raises its rating for Regis Healthcare to Outperform from Neutral on valuation grounds after AGM commentary highlighted an improving occupancy trend.

The analyst considers the medium-and longer-term outlook is favourable due to attractive industry fundamentals and increases longer-term growth assumptions.

The target slips to $2.15 from $2.20.

**RAMELIUS RESOURCES LIMITED ((RMS)) Upgrade to Buy from Accumulate by Ord Minnett** .B/H/S: 3/0/0

Ramelius Resources posted a "decent" quarterly result, slightly lower than Ord Minnett's expectations. Importantly, the broker believes Ramelius is at an inflection point at which six-month upside more than outweighs perceived deliverability risk.

With covid cases easing significantly and haulage improving, the broker has gained further comfort in the company’s ability to deliver to plan over FY23.

On a valuation basis Ord Minnett upgrades to Buy from Accumulate. Target rises to $1.25 from $1.15.

**STEADFAST GROUP LIMITED ((SDF)) Upgrade to Buy from Accumulate by Ord Minnett** .B/H/S: 4/0/0

Steadfast Group's annual general meeting and September-quarter earnings update impressed Ord Minnett.

The broker raises earnings forecasts to reflect management's observation of improved market conditions.

Ord Minnett considers the company's earnings to be highly defensive, appreciates its strong free cash flow, and expects EPS growth could exceed 10% in the short to medium term.

Rating upgraded to Buy from Accumulate. Target price is steady at $5.50.

**WHITEHAVEN COAL LIMITED ((WHC)) Upgrade to Buy from Neutral by UBS** .B/H/S: 6/0/1

UBS upgrades its rating for Whitehaven Coal to Buy from Neutral following AGM approval for a buyback of around 25% of issued capital.

Should the buyback be fully implemented, the analyst estimates the total return yield (dividend and buyback) will rise to
45% and 27% for FY23 and FY24, from 22% and 12%.

The $10.00 price target is unchanged.

**XERO LIMITED ((XRO)) Upgrade to Neutral from Sell by UBS** .B/H/S: 4/2/0

Off the back of a -22% share price decline since mid-August, UBS has lifted its rating on Xero. The broker attributes the de-rating to Xero flagging lower UK subscriptions driven by a delay of the second phase of Making Tax Digital, but UBS finds this to be a timing issue rather than a structural one.

The broker lifts its revenue forecasts an average of 3% between FY23 and FY25, reflecting expected better UK subscriptions following Making Tax Digital compliance.

The rating increases to Neutral from Sell and the target price increases to $80.40 from $70.00.

**Downgrade**

**AURELIA METALS LIMITED ((AMI)) Downgrade to Hold from Buy by Ord Minnett** .B/H/S: 1/1/0

Aurelia Metals' Sep Q was a bad as forewarned and Ord Minnett sees a long road back to redemption. Whilst there is a glimmer of hope at Peak, the fact is that the key value lies in Federation, the broker notes, which is now stalled due to a lack of funding.

The key question for the broker is have the operational cash losses stopped? If not, Ord Minnett does not believe a focus on Federation is possible.

After increasing the risk factor on the project, the broker cuts its target to 30c from 50c and downgrades to Hold from Buy.

**AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED ((ANZ)) Downgrade to Equal-weight from Overweight by Morgan Stanley**.B/H/S: 4/3/0

Morgan Stanley expects modest upgrades to consensus forecasts for ANZ Bank following FY22 results, which revealed a good exit margin and a supportive 1H FY23 margin outlook. Higher cost growth guidance provided a partial offset.

However, the analyst downgrades the rating to Equal-weight from Overweight on less scope for further EPS upgrades and given a 15% share price rally since mid-July. Margins are expected to rise materially in FY23, but a reinvestment burden is expected to weigh.

Cash profit was a beat of around 3% and 6%, respectively, by comparison with forecasts by the broker and consensus. The impairment charge of -$52m was significantly lower than the -$205m forecast by the analyst.

The target price falls to $25.50 from $26.90. Industry view: In-line.

**CODAN LIMITED ((CDA)) Downgrade to Neutral from Outperform by Macquarie** .B/H/S: 0/1/0

A guidance update from Codan has disappointed Macquarie's expectations, with the company targeting first half net profits of $25-30m. Guidance was well below what the broker had expected, largely driven by the Metal Detection segment which is yet to stabilise.

The company is anticipating first half sales from Metal Detection of $75-80m, compared to $138m in the previous comparable period. The Communications segment expects a more positive $123-135m for the period, compared to $118m in the previous comparable period.

The rating is downgraded to Neutral from Outperform and the target price decreases to $4.10 from $9.75.

**CAPRICORN METALS LIMITED ((CMM)) Downgrade to Neutral from Outperform by Macquarie** .B/H/S: 0/1/0

Capricorn Metals has reported strong drilling results from both Mt Gibson and Karlawinda which will inform a resource update in the second quarter. Ahead of the resource update Macquarie has lifted its expected mine life across both projects by an average 1.5 years.

The company particularly highlighted that results at Mt Gibson should allow a significant portion of the inferred resource to be upgraded to an indicated resource.

The rating is downgraded to Neutral from Outperform and the target price increases to $3.50 from $3.30.

**CARNARVON ENERGY LIMITED ((CVN)) Downgrade to Neutral from Outperform by Macquarie** .B/H/S: 1/1/0

Macquarie has highlighted a lack of visibility over Carnarvon Energy's pathway to a final investment decision on its Dorado project given approval delays and cost and design uncertainty.

While the broker remains attracted to both Dorado's and Pavo's resources, it could take time and more capital to unlock potential.

With $105m in cash at the end of the third quarter, Macquarie sees Carnarvon Energy funded for at least several quarters but considers another equity raise before a final investment decision on Dorado is reached a possibility.

The rating is downgraded to Neutral from Outperform and the target price decreases to $0.16 from $0.24.

**INTEGRAL DIAGNOSTICS LIMITED ((IDX)) Downgrade to Underperform from Neutral by Credit Suisse** .B/H/S: 1/2/1

Integral Diagnostics has terminated its agreement to buy Exact Radiology.

Credit Suisse says the $37.5m cash payment will improve the company's FY23 debt position but the broker says the termination reflects a challenged industry.

The broker lowers margin forecasts given the weakness of the company's covid recovery.

EPS forecasts fall -10.8% to -22.7% across FY23 to FY25.

Rating is downgraded to Underperform from Neutral, the broker spying material risks to consensus forecasts given likely profit falls in New Zealand, margin pressure as cost inflation outpaces indexation, weak volumes and an overestimation of the FY23 contribution for Peloton and Horizon purchases.

Target price falls to $2.63 from $3.

**KOGAN.COM LIMITED ((KGN)) Downgrade to Underperform from Neutral by Credit Suisse** .B/H/S: 0/1/1

Kogan's gross sales declined -39% year on year and the business made an earnings loss of -$0.3m for the September quarter. With sales declining and no profit, it is increasingly problematic to value the business, Credit Suisse suggests.

The broker downgrades earnings forecasts to reflect the materially lower sales, but assumes gross margin improvement post inventory clearance. Given poor business trends and valuation uncertainty, the broker downgrades to Underperform from Neutral.

Target falls to $2.73 from $3.66.

See also KGN upgrade.

**MEDIBANK PRIVATE LIMITED ((MPL)) Downgrade to Neutral from Buy by Citi** .B/H/S: 3/4/0

The full impact of Medibank Private's data breach remains uncertain, and the company has withdrawn its full year policy holder guidance amid uncertainty. Citi expects the reaction of consumers will be key to Medibank Private's outlook, but notes this is hard to predict.

Marking to market, Citi has pulled back its policyholder growth assumptions -6%, -10% and -12% through to FY25. The broker anticipates some policyholder contraction in the coming two years, before recovery in FY25.

The rating is downgraded to Neutral from Buy and the target price decreases to $3.00 from $4.00.

**PILBARA MINERALS LIMITED ((PLS)) Downgrade to Sell from Neutral by Citi and Downgrade to Lighten from Hold by Ord Minnett.**B/H/S: 1/0/3

Pilbara Minerals' September-quarter trading update pleased Citi, lithium production outpacing peers and operational expenditure falling at the lower end of guidance.

Management observes prices are rising across all chemicals and says customer inquiries remain extremely robust.

Cash rose $784m on the June quarter to $1.4bn, excluding $132m in letter of credit and debt fell to $160m, leaving net cash of $1.2bn. The company plans to announce a capital-management framework in December.

Citi predicts a sharp rise in spodumene prices of 40% and 60% across FY23 and FY24.

The broker downgrades to Sell from Neutral given recent share-price strength. Target price rises to $4.60 from $3.60.

Ord Minnett highlights a broadly in line operational result from Pilbara Minerals in its September quarter, and impressive final net cash of $1.2bn. The broker expects this net cash position to set the scene for a positive capital management update later this quarter.

Despite strong leverage to lithium prices, the broker struggles to find justify the stock at current valuation given the lack of firm growth or margin expansion plans beyond 1m tonnes per annum.

The rating is downgraded to Lighten from Hold and the target price increases to $4.20 from $4.10.

**REDBUBBLE LIMITED ((RBL)) Downgrade to Neutral from Buy by UBS** .B/H/S: 1/2/0

Redbubble's September-quarter trading update sharply disappointed UBS's forecasts, triggering a sharp about-face.

Trends that were holding up in the June quarter (like margins and improved channel mix) sharply reversed in the September quarter, says the broker, and free shipping and marketing spend more than offset recent price rises.

Add to that rising balance sheet risk and the broker believes the company will have to cut operating expenditure to reduce cash burn.

Rating is downgraded to Neutral from Buy. Target price slumps to 60c from $1.55.

**REECE LIMITED ((REH)) Downgrade to Hold from Buy by Ord Minnett** .B/H/S: 0/3/2

Reece reported a strong Sep Q sales update, Ord Minnett notes, driven by significant price increases across its key regions and solid volumes. The US business performed exceptionally well and is a late-cycle beneficiary of housing completions.

While the US operations continue to be a significant platform for growth, given the current macroeconomic environment and rise in US mortgage rates the broker expects demand to moderate.

Target falls to $16.00 from $18.50, downgrade to Hold from Buy due to an elevated PE multiple.

**SOUTH32 LIMITED ((S32)) Downgrade to Hold from Buy by Ord Minnett** .B/H/S: 6/1/0

Ord Minnett has lowered forecasts post what the broker describes was a quarterly report that revealed several soft operations, if not "lacklustre", particularly regarding metallurgical coal.

The broker had already turned more cautious on the outlook for commodity prices earlier this month.

Higher operating costs remain a feature and Ord Minnett notes South32 is no longer experiencing cost relief from a lower AUD at the Worsley and Illawara operations.

The stock has been downgraded to Hold from Buy (two steps) while the price target falls to $4.10 from $4.40.

**SIMS LIMITED ((SGM)) Downgrade to Underperform from Neutral by Macquarie** .B/H/S: 1/4/1

Macquarie has downgraded its rating on Sims given ongoing deterioration of the global economic outlook, with Macquarie's economic team expecting recessions in both the US and Europe.

The broker also remains concerned about Sims' high leverage to volumes, noting margins are susceptible to a volume contraction. Macquarie is now expecting earlier than expected margin pressure to impact on FY23 and FY24.

The rating is downgraded to Underperform from Neutral and the target price decreases to $10.80 from $14.10.

**WESTGOLD RESOURCES LIMITED ((WGX)) Downgrade to Neutral from Outperform by Macquarie** .B/H/S: 0/1/0

Westgold Resources Q1 production report was 9% better than forecast, while keeping costs in line, comments Macquarie, though cash generation was the disappointment as higher capex/lease payments and working capital took their toll.

As market focus will now shift to cash generation, the broker believes, the rating has been pulled back to Neutral. Target price $0.90.

**ZIP CO LIMITED ((ZIP)) Downgrade to Hold from Accumulate by Ord Minnett** .B/H/S: 0/2/3

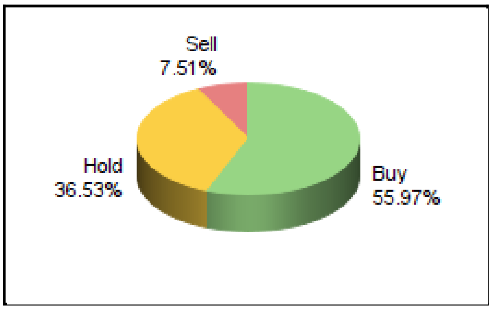
Bad debts are trending in the right direction, points out Ord Minnett, but then again, the broker had hoped management at Zip Co would have found a solution for the international operations by now.

That's analyst code for find a buyer and get rid of those ASAP.

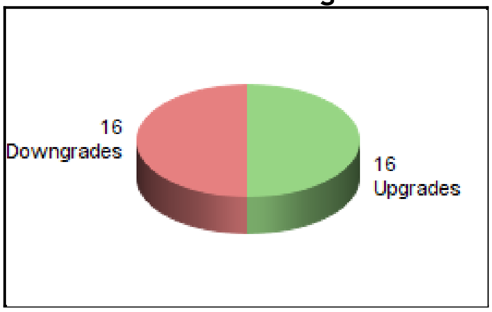
On current forecasts, Zip Co is forecast to reach cash EBTDA profitability in H2 of FY24. Ord Minnett has downgraded to Hold from Accumulate.

Price target declines to 70c from $1.10.

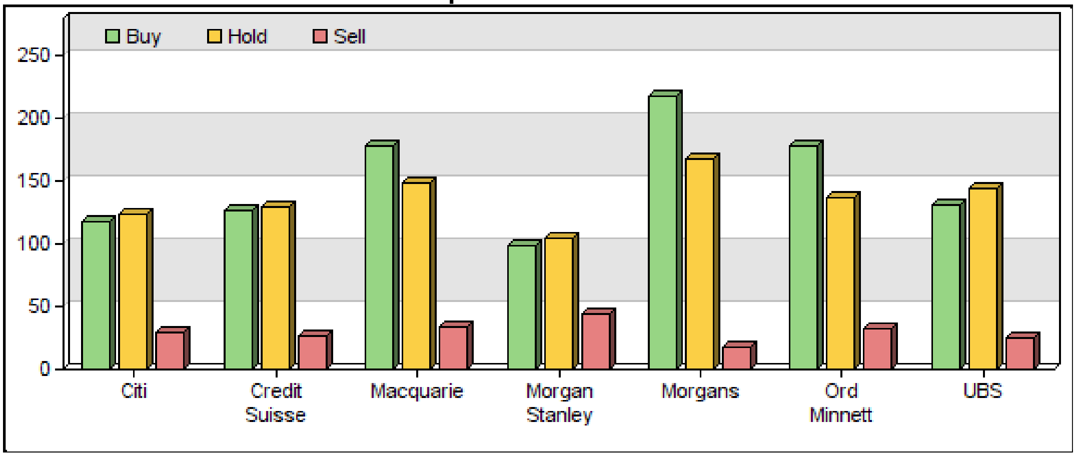
**Total Recommendations**




**Recommendation Changes**



Broker Recommendation Breakup




# Broker Rating

| Order | Company | New Rating | Old Rating | Broker |
|---|---|---|---|---|
| Upgrade | | | | |
| 1 | AMPOL LIMITED | Buy | Neutral | Credit Suisse |
| 2 | BENDIGO & ADELAIDE BANK LIMITED | Buy | Neutral | Macquarie |
| 3 | COLES GROUP LIMITED | Neutral | Sell | Ord Minnett |
| 4 | CREDIT CORP GROUP LIMITED | Buy | Buy | Ord Minnett |
| 5 | ESTIA HEALTH LIMITED | Buy | Neutral | Macquarie |
| 6 | INSURANCE AUSTRALIA GROUP LIMITED | Buy | Neutral | Morgans |
| 7 | KOGAN.COM LIMITED | Neutral | Sell | UBS |
| 8 | MOUNT GIBSON IRON LIMITED | Neutral | Neutral | Macquarie |
| 9 | NEWCREST MINING LIMITED | Buy | Neutral | Citi |
| 10 | NOVONIX LIMITED | Buy | Neutral | Morgans |
| 11 | PANORAMIC RESOURCES LIMITED | Buy | Neutral | Macquarie |
| 12 | RAMELIUS RESOURCES LIMITED | Buy | Buy | Ord Minnett |
| 13 | REGIS HEALTHCARE LIMITED | Buy | Neutral | Macquarie |
| 14 | STEADFAST GROUP LIMITED | Buy | Buy | Ord Minnett |
| 15 | WHITEHAVEN COAL LIMITED | Buy | Neutral | UBS |
| 16 | XERO LIMITED | Neutral | Sell | UBS |
| Downgrade | | | | |
| 17 | AURELIA METALS LIMITED | Neutral | Buy | Ord Minnett |
| 18 | AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED | Neutral | Buy | Morgan Stanley |
| 19 | CAPRICORN METALS LIMITED | Neutral | Buy | Macquarie |
| 20 | CARNARVON ENERGY LIMITED | Neutral | Buy | Macquarie |
| 21 | CODAN LIMITED | Neutral | Buy | Macquarie |
| 22 | INTEGRAL DIAGNOSTICS LIMITED | Sell | Neutral | Credit Suisse |
| 23 | KOGAN.COM LIMITED | Sell | Neutral | Credit Suisse |
| 24 | MEDIBANK PRIVATE LIMITED | Neutral | Buy | Citi |
| 25 | PILBARA MINERALS LIMITED | Sell | Neutral | Ord Minnett |
| 26 | PILBARA MINERALS LIMITED | Sell | Neutral | Citi |
| 27 | REDBUBBLE LIMITED | Neutral | Buy | UBS |
| 28 | REECE LIMITED | Neutral | Buy | Ord Minnett |
| 29 | SIMS LIMITED | Sell | Neutral | Macquarie |
| 30 | SOUTH32 LIMITED | Neutral | Buy | Ord Minnett |
| 31 | WESTGOLD RESOURCES LIMITED | Neutral | Buy | Macquarie |
| 32 | ZIP CO LIMITED | Neutral | Buy | Ord Minnett |

# Target Price

## Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | PLS | PILBARA MINERALS LIMITED | 4.070 | 3.670 | 10.90% | 5 |
| 2 | XRO | XERO LIMITED | 99.408 | 97.675 | 1.77% | 6 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 3 | OZL | OZ MINERALS LIMITED | 25.880 | 25.483 | 1.56% | 5 |
| 4 | IAG | INSURANCE AUSTRALIA GROUP LIMITED | 5.126 | 5.051 | 1.48% | 7 |
| 5 | WBC | WESTPAC BANKING CORPORATION | 25.997 | 25.659 | 1.32% | 6 |
| 6 | TNE | TECHNOLOGY ONE LIMITED | 11.343 | 11.265 | 0.69% | 3 |
| 7 | BEN | BENDIGO & ADELAIDE BANK LIMITED | 9.717 | 9.675 | 0.43% | 6 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | RBL | REDBUBBLE LIMITED | 0.717 | 1.250 | -42.64% | 3 |
| 2 | ABB | AUSSIE BROADBAND LIMITED | 3.137 | 3.865 | -18.84% | 3 |
| 3 | MPL | MEDIBANK PRIVATE LIMITED | 3.239 | 3.759 | -13.83% | 7 |
| 4 | ZIP | ZIP CO LIMITED | 0.672 | 0.752 | -10.64% | 5 |
| 5 | IDX | INTEGRAL DIAGNOSTICS LIMITED | 2.832 | 3.086 | -8.23% | 5 |
| 6 | S32 | SOUTH32 LIMITED | 4.757 | 4.964 | -4.17% | 7 |
| 7 | CCP | CREDIT CORP GROUP LIMITED | 25.750 | 26.733 | -3.68% | 3 |
| 8 | ALD | AMPOL LIMITED | 35.154 | 36.482 | -3.64% | 5 |
| 9 | OML | OOH!MEDIA LIMITED | 1.555 | 1.607 | -3.24% | 4 |
| 10 | REH | REECE LIMITED | 15.006 | 15.466 | -2.97% | 5 |

# Earning Forecast

### Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | TPG | TPG TELECOM LIMITED | 21.873 | 18.373 | 19.05% | 6 |
| 2 | KAR | KAROON ENERGY LIMITED | 60.305 | 51.391 | 17.35% | 3 |
| 3 | WHC | WHITEHAVEN COAL LIMITED | 460.243 | 421.117 | 9.29% | 7 |
| 4 | ANZ | AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED | 237.657 | 218.867 | 8.59% | 7 |
| 5 | SWM | SEVEN WEST MEDIA LIMITED | 11.393 | 10.568 | 7.81% | 5 |
| 6 | JBH | JB HI-FI LIMITED | 394.483 | 368.983 | 6.91% | 6 |
| 7 | SUL | SUPER RETAIL GROUP LIMITED | 94.133 | 88.967 | 5.81% | 6 |
| 8 | IAG | INSURANCE AUSTRALIA GROUP LIMITED | 30.667 | 29.233 | 4.91% | 7 |
| 9 | ZIP | ZIP CO LIMITED | -22.040 | -23.080 | 4.51% | 5 |
| 10 | PLS | PILBARA MINERALS LIMITED | 63.502 | 61.510 | 3.24% | 5 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | APX | APPEN LIMITED | -4.800 | -0.800 | -500.00% | 4 |
| 2 | RBL | REDBUBBLE LIMITED | -13.667 | -7.167 | -90.69% | 3 |
| 3 | RMS | RAMELIUS RESOURCES LIMITED | 3.067 | 4.233 | -27.55% | 3 |
| 4 | S32 | SOUTH32 LIMITED | 41.364 | 50.919 | -18.77% | 7 |
| 5 | ILU | ILUKA RESOURCES LIMITED | 120.860 | 144.780 | -16.52% | 6 |
| 6 | NCM | NEWCREST MINING LIMITED | 90.499 | 105.840 | -14.49% | 7 |
| 7 | WGN | WAGNERS HOLDING CO. LIMITED | 4.750 | 5.550 | -14.41% | 3 |
| 8 | ECX | ECLIPX GROUP LIMITED | 32.567 | 37.700 | -13.62% | 3 |
| 9 | ABB | AUSSIE BROADBAND LIMITED | 11.340 | 13.060 | -13.17% | 3 |
| 10 | OZL | OZ MINERALS LIMITED | 64.067 | 73.500 | -12.83% | 5 |

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WEEKLY REPORTS

# Uranium Week: Preparing For Volatility

The uranium spot market went quiet last week ahead of the Fed meeting and other crucial US events.

**-Spot U3O8 market quiet**
**-Term markets active**
**-Canada in the spotlight**

By Greg Peel

There was not a lot of interest in the uranium spot market last week, with only 300,000/lbs U3O8 changing hands in three transactions. Sellers were forced to drop prices to encourage any buyers, hence industry consultant TradeTech's weekly spot price indicator fell -US25c for the week to US$52.50/lb.

Given the spot market is beholden to general financial market volatility, it is likely the market went quiet ahead of this week's Fed meeting. It will be followed by the US October jobs report this Friday and the midterms and October CPI next week, so plenty of opportunity for more volatility.

By contrast, securing reliable longer term supply in an uncertain world is the priority for uranium end-users. Utilities are willing to pay higher prices for longer than average term contracts than is on offer from Russia, TradeTech reports, given (a) Russian imports could be banned by the US and/or Europe at any moment and (b) a desire to abandon Russia as a supplier.

Last week major producer Cameco reported quarterly earnings and revealed it had contracted 77mlbs U3O8 year to date in term contracts, mostly through off-market negotiations. Several utilities have indicated they will be entering the uranium market in coming weeks, TradeTech notes, through both formal channels and off-market discussions with suppliers.

TradeTech's term price indicators remain at US$50.50/lb (mid) and US$53.00/lb (long).

Positive Reaction

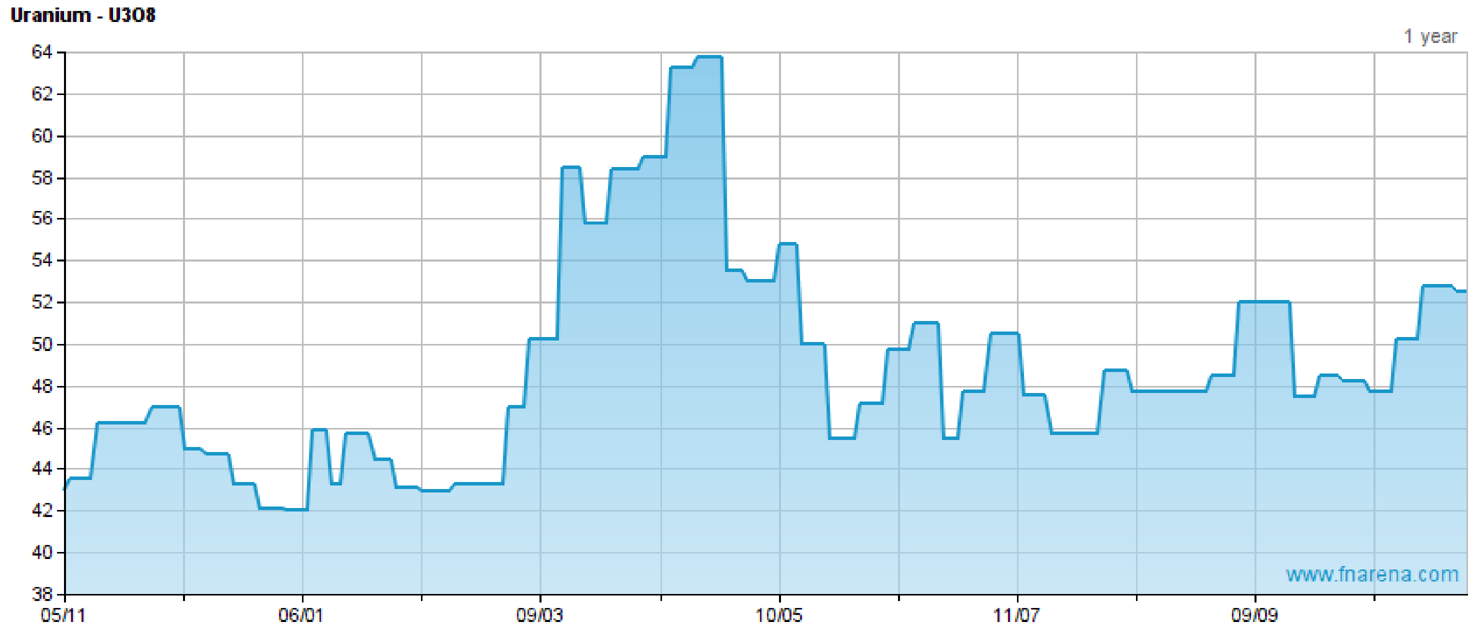
Haywood Capital Markets last week reported encouraging support for small modular reactor development in Canada, with the government-administrated Canadian Infrastructure Bank committing CA$970m in funding to build a 300MW SMR in Ontario over the next ten years.

Canada's Natural Resources Minister suggested the announcement "*…represents a significant step towards the development of a non-emitting electricity grid and a prosperous net zero future. The deployment of one of Canada's first small modular reactors…will further enhance Canada's leadership in nuclear technology, create sustainable jobs and reduce emissions*".

**Uranium companies listed on the ASX:**

| ASX CODE | DATE | LAST PRICE | WEEKLY % MOVE | 52WK HIGH | 52WK LOW | P/E | CONSENSUS TARGET | UPSIDE/DOWNSIDE |
|---|---|---|---|---|---|---|---|---|
| AGE | 31/10/2022 | 0.0520 | 0.00% | $0.12 | $0.04 | | | |
| BKY | 31/10/2022 | 0.2600 | ▼- 3.70% | $0.64 | $0.14 | | | |
| BMN | 31/10/2022 | 2.0900 | ▲ 1.95% | $2.49 | $0.15 | | | |
| BOE | 31/10/2022 | 2.6500 | ▲ 2.73% | $3.10 | $0.28 | | $3.300 | ▲24.5% |
| DYL | 31/10/2022 | 0.8200 | 0.00% | $1.25 | $0.55 | | | |
| ERA | 31/10/2022 | 0.2050 | 0.00% | $0.44 | $0.16 | | | |
| LOT | 31/10/2022 | 0.2300 | ▲ 6.98% | $0.46 | $0.19 | | | |
| NXG | 31/10/2022 | 6.4200 | 0.00% | $8.99 | $0.00 | | | |
| PDN | 31/10/2022 | 0.8550 | ▲ 3.03% | $1.03 | $0.53 | -149.4 | $1.100 | ▲28.7% |
| PEN | 31/10/2022 | 0.1700 | ▲ 3.03% | $0.31 | $0.14 | | | |

| | | | | | |
|---|---|---|---|---|---|
| SLX | 31/10/2022 | 2.9200 | ▲4.18% | $4.14 | $0.99 |

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WEEKLY REPORTS

# The Short Report - 03 Nov 2022

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

**Summary:**

By Greg Peel

Week Ending October 27, 2022.

Last week saw the ASX200 initially shoot up following a *Wall Street Journal* article suggesting the Fed was getting ready to pause. Incremental gains were made thereafter.

Last night the Fed once again debunked the notion, and the index is down -2.0% as I write.

Having been rather active the week before, shorters went quiet last week, with movements towards the bottom of the table representing only minimal bracket-creep.

There was one exception.

There was no news new from Inghams Group ((ING)) the week before when shorts fell to 6.2% from 7.6%, and no new news last week when they fell to 5.2%. The share price has done no more than follow the market in that period.

So far it seems the weather has not impacted on chook farming and feed, unless management is holding back the bad news. This is in contrast to fruit & veggie grower and consumer staples peer Costa Group ((CGC)), which has downgraded guidance due to adverse weather impacts.

Costa made an appearance at the bottom of the table last week at 5.0% shorted, and the rain keeps coming down.

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

**10%+**
FLT 14.8
BET 14.3
SQ2 12.1
MP1 11.5
DMP 11.1
PPT 11.0

No changes

**9.0-9.9**

No stocks

**8.0-8.9%**

BRG, NAN, TPW, LKE, ZIP

In: ZIP Out: SYA, MFG

**7.0-7.9%**

MFG, SYA, SBM, VUL, NXT, 92E

In: MFG, SYA, SBM Out: ZIP, KGN, PNV

**6.0-6.9%**

KGN, PNV, ASM, IEL, APX, AWC, BRN, CCX, BGL, CUV, PBH

In: KGN, PNV Out: SBM, ING, WEB

**5.0-5.9%**

WEB, BOQ,BLD, EVN, 29M, CHN, JBH, PDN, ADH, DEG, GOR, ING, PNI, CGC

In: WEB, ING, CGC Out: RRL

Movers & Shakers

Nothing this week.

**ASX20 Short Positions (%)**

| Code | Last Week | Week Before | Code | Last Week | Week Before |
|---|---|---|---|---|---|
| ALL | 0.9 | 0.8 | NAB | 1.0 | 0.9 |
| ANZ | 1.0 | 1.1 | NCM | 1.0 | 0.9 |
| BHP | 0.5 | 0.5 | RIO | 0.7 | 0.6 |
| CBA | 1.7 | 1.8 | STO | 0.5 | 0.6 |
| COL | 0.6 | 0.7 | TCL | 0.7 | 0.6 |
| CSL | 0.6 | 0.5 | TLS | 0.1 | 0.4 |
| FMG | 2.7 | 3.0 | WBC | 1.6 | 1.6 |
| GMG | 0.9 | 0.8 | WDS | 1.7 | 1.6 |
| JHX | 1.4 | 1.2 | WES | 1.6 | 1.6 |
| MQG | 0.6 | 0.5 | WOW | 0.6 | 0.4 |

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

**Guide:**

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

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

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

***IMPORTANT INFORMATION ABOUT THIS REPORT***

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

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

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

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

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

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

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

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

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WEEKLY REPORTS

# In Brief: Midterm Elections, Banks, Iron Ore, Telcos

Weekly broker wrap: US midterms drive higher returns, deposit pricing margins moderate, iron ore remains weak, fibre assets hold value.

**-US midterms likely to strengthen index returns, but not a primary performance driver**
**-With deposit spreads moderating, upside margin risk looks unlikely to last**
**-Weak iron ore outlook presents investor entry point**
**-Unlocking value in fibre assets a key focus for telcos**

By Danielle Austin

Equities likely to benefit from midterms

While Citi anticipates the midterm elections to carry tailwind risk for US equities, it does not expect the event to be a primary driver in the coming year.

Rather, the broker expects rate policy, inflation and recessionary risks to be determining factors, despite the S&P500 typically reporting strong returns growth of, on average, 20% in the year following a midterm. Notably, even in post-midterm years where an economic recession was experienced, returns were strong.

With polls pointing to the Republican party gaining control of both the House and Senate, some form of split government is anticipated, reducing the likelihood of large-scale policy reform and subsequent index level impacts.

Margin upside from high deposit pricing cannot last

Elevated deposit pricing has continued to provide meaningful upside to bank margins in the first half, and while deposit spreads are starting to moderate. Macquaire sees attractive liability spreads as providing scope for further margin upside in the second half.

Macquarie’s data suggests banks are gradually lifting deposit rates, and spreads are contracting. The broker expects the sector to be relatively defensive through an earnings upgrade cycle.

Among the majors, ANZ Bank ((ANZ)) reported the steepest housing book growth in September at 1.2x system growth, while National Bank ((NAB)) lagged its peers at 0.3x system growth, and regionals continue to struggle. National Bank and Commonwealth Bank ((CBA)) are Macquarie’s preferred picks among the majors, while Bendigo and Adelaide Bank ((BEN)) remains its preferred regional.

Iron ore looks weak near term, but offers investor opportunity

Citi expects iron ore pricing will remain weak near term, lowering its fourth quarter price assumption to US$70 per tonne from a previous US$95 and its 2023 average to US$95 per tonne from a previous US$110. Weak demand not only from China, but globally, has made Citi more cautious on the outlook for iron ore over the coming six months, and drives Citi's downgraded assumptions.

With share prices declining, the broker sees an attractive entry point for investors should its economic forecasts prove correct. While its updated price deck does not change its rating on any of the iron ore producers in its coverage, the broker has made target price adjustments.

Citi retains Rio Tinto's ((RIO)) target price of $115.00 but reduces earnings per share -16%, and similarly retains Mineral Resources' ((MIN)) target price of $86.00 and reduces earnings per share by -7%. Fortescue Metals Group's ((FMG)) target price decreases to $16.70 from $17.00 and earnings per share decline -31%, Champion Iron's ((CIA)) target price decreases to $6.70 from $7.50 and earnings per share decline -41%, and Deterra Royalties' ((DRR)) target price decreases to $4.70 from $4.80 and earnings per share decline -13%.

Fibre assets hold substantial value for telecoms

Unlocking value in fibre assets has been a key focus of domestic telcos recently according to UBS, which feels asset monetisation could offer substantial earnings upside to Telstra ((TLS)) and TPG Telecom ((TPG)).

The broker sees substantial value in Telstra's TLS InfraCo and TPG Telecom's Vision Networks, estimated the fibre assets could demand prices 15.7x and 13.0x FY23 earnings respectively, or $25.7bn and $722m.

The broker also expects both telcos to be beneficiaries of market share shifts, anticipating increased churn from Optus following its recent data breach. UBS expects Telstra will maintain its dominant mobile subscriber share, and that TPG Telecom will grow its share to 17.0% from 16.2%.

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