WEEK 48

STORIES TO READ FROM FNArena

Friday, 26 November 2021

ESG Focus: Huon Salmon Litmus Test for ESG M&A

Australian Banks: Worse Before Things Get Better

Rudi's View: The Secret Ingredient

CONTENTS

INTERNATIONAL

AUSTRALIA

COMMODITIES

ESG FOCUS

FEATURE STORIES

WEEKLY REPORTS

SMSFUNDAMENTALS

FNArena
Financial News, Data & Analysis

GPO Box 3145 - Sydney NSW 2001
info@fnarena.com

Your editor:
Rudi Filapek-Vandyck

Your dedicated team of journo's:
Greg Peel, Eva Brocklehurst & Sarah Mills

TREASURE CHEST

RUDI'S VIEWS

FNArena
Financial News, Data & Analysis

GPO Box 3145 - Sydney NSW 2001
info@fnarena.com

Your editor:
Rudi Filapek-Vandyck

Your dedicated team of journo's:
Greg Peel, Eva Brocklehurst &
Sarah Mills

INTERNATIONAL

Asia Attractions As Bright As Ever

By James Thom, Senior Investment Director, Asian Equities, abrdn

We see plenty of reasons for investors to be positive on the outlook for Asian equities in 2022 now that peak coronavirus appears to have passed and the region's economies are reopening.

Progress in the rollout of vaccinations allied to improved anti-viral treatments point to a policy transition from zero-covid tolerance to one of endemic coronavirus management.

We anticipate further easing of mobility restrictions and a resumption in travel. We also expect Asian exports to pick up as demand grows in the US and Europe. This promises to drive consumption and corporate earnings.

A key question globally concerns how transitory inflation really is, and we don't have a crystal ball. But unlike Western markets, we haven't seen much price pressure in Asia so far.

Investors should feel reassured that Asian central banks have more headroom to adjust monetary settings, having been more conservative with state policy tools in recent years.

The Bank of Korea has signalled a potential rate hike soon, but Asian policymakers on the whole continue to prioritise economic support. Asian balance sheets are also in a healthy state, with most of our holdings either meeting or exceeding earnings expectations in recent results.

Economic reopening will help to mitigate inflationary pressures tied to near-term bottlenecks in supply chains. This remains an area we will continue to monitor closely. We urge investors to diversify across markets and sectors and focus on firms with pricing power that can pass on cost pressures to protect their margins. We see many quality businesses doing exactly that.

While Asia experienced an equity market rally in the first half of this year, a regulatory reset in China and the prospect of US tapering led to a correction. Still, corporate Asia is well placed to withstand a cycle of a stronger dollar overall.

We expect China's property sector to remain under pressure, while China's zero-covid policy approach is likely to stay in place until after it has hosted the winter Olympics at least. Regulatory intervention will likely be at the forefront of investor thinking in the run-up to the Party Congress in November, when President Xi Jinping is expected to secure a third term.

Again, investors can rest assured that Beijing has levers to pull in the event that economic conditions become less stable. Bear in mind, much of China's growth slowdown is self-imposed via restrictions in property and energy sectors and the common prosperity push.

Investors need to be selective. But look carefully and they can find quality Chinese businesses on the right side of the policy agenda delivering strong growth. Structural drivers behind consumer spending in China remain intact. We predict rising disposable incomes and increasingly health-conscious citizens will drive demand for healthcare products and services.

Growth in domestic consumption remains a strategic priority for Chinese authorities, so we view quality consumer stocks as well placed to withstand regulatory headwinds.

We believe Southeast Asia will be the biggest beneficiary of economic reopening. Hit hard by covid, Indonesia and Vietnam are just emerging from the pandemic. They're working through supply-chain indigestion, with cyclical stocks long overdue a meaningful rebound.

India's stock market has been taking a breather of late, having rallied hard this year. But we're confident there's plenty of market upside to come given favourable demographics, low mortgage rates, rising household incomes and improving housing affordability.

After years of subdued economic growth, India looks primed for a rebound that should feed through to earnings. A brightening picture is boosting sentiment and company spending plans.

There's also excitement around India's tech sector. The nation has produced 100 unicorns and counting. Many are listing on exchange, transforming the corporate landscape. Our team has been wading through stacks of IPO information to cherry-pick likely winners.

Foreign direct investment continues to flow into the tech sector. As these businesses grow and harness new technologies, they will invest – creating jobs and lifting incomes.

Consumers will also benefit from better products and services.

India's government, too, is reforming the business environment, attracting foreign investment, incentivising companies via tax benefits and raising spending on key infrastructure projects. We expect a broadening of India's entire tech ecosystem, driving more growth in digitisation.

In terms of valuations, Asian stocks look reasonable relative to developed markets. The 12-month forward price-earnings ratio for MSCI AC Asia Pacific ex-Japan Index stands at 15.6x, versus 22.5x for S&P500, 16.2x for MSCI Europe and 20.3x for MSCI World.

Consensus earnings growth for Asia Pacific ex-Japan markets forecast to be in double digits for 2022.

We believe Asia's burgeoning middle class will fuel rising demand for health-care services and wealth management, while the region's urbanisation and infrastructure needs remain vast. At the same time, changes brought about by the pandemic could prove durable and reinforce existing trends – such as increased adoption of cloud computing and 5G networks.

Policymakers globally are also committing to a lower-carbon future and Asia is at the forefront of change. Investors can anticipate tailwinds for companies operating in renewable energy, batteries, electric vehicles, related infrastructure and environmental management.

As an investor we focus on quality firms with strong balance sheets and sustainable earnings prospects best-placed to capitalise on structural growth opportunities in the region. We see market corrections as an opportunity to add to our long-term quality holdings affordably.

In Asia, investors need to think long term. But Asia's attractions remain as bright as ever.

Important Information

Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance is not a guide to future results. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. We recommend that you seek financial advice prior to making an investment decision.

The details contained here are for information purposes only and should not be considered as an offer, investment recommendation, or solicitation to deal in any investments or funds and does not constitute investment research, investment recommendation or investment advice in any jurisdiction.

Any research or analysis used to derive, or in relation to, the above information has been procured by us for our own use, without taking into account the investment objectives, financial situation or particular needs of any specific investor, and may have been acted on for own purpose.

No warranty is given as to the accuracy, adequacy or completeness of the information contained in this document and no liability for errors or omissions in such information. Investors must make assessments to the relevance, accuracy and adequacy of the information contained in this document and make such independent investigations, as they may consider necessary or appropriate for the purpose of such assessments.

Any opinion or estimate contained in this document are made on a general basis. No information contained herein constitutes investment, tax, legal or any other advice, or an invitation to apply for securities in any jurisdiction where such an offer or invitation is unlawful, or in which the person making such an offer is not qualified to do so.

*Any data contained herein which is attributed to a third party ("Third Party Data") is the property of (a) third party supplier(s) (the "Owner") and is licensed for use by abrdn**. Third Party Data may not be copied or distributed. Third Party Data is provided "as is" and is not warranted to be accurate, complete or timely. To the extent permitted by applicable law, none of the Owner, abrdn** or any other third party (including any third party involved in providing and/or compiling Third Party Data) shall have any liability for Third Party Data or for any use made of Third Party Data. Neither the Owner nor any other third party sponsors, endorses* *or promotes the fund or product to which Third Party Data relates.*

***abrdn means the relevant member of abrdn group, being abrdn plc together with its subsidiaries, subsidiary undertakings and associated companies (whether direct or indirect) from time to time.*

Bloomberg data are for illustrative purposes only. No assumptions regarding future performance should be made.

This content is available in the following countries/regions and issued by the respective entities detailed below: Hong Kong: abrdn Hong Kong Limited. This document has not been reviewed by the Securities and Futures Commission.

Singapore: abrdn Asia Limited, Registration Number 199105448E.

****

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

AUSTRALIA

Nitro Software Into Global Top Three With Acquisition

Young gun electronic document provider Nitro Software is turning heads with its acquisition of Connective, making it a top global player and laying the foundation for a strong growth outlook.

-Nitro Software entered into a binding agreement for the acquisition of Connective
-The move cements the company as a global top three competitor
-Acquisitional activity and a strong FY21 make for a positive growth outlook

By Danielle Austin

A move by Nitro Software ((NTO)) to acquire Connective has been labelled a 'game changer' by industry analysts despite some associated risk.

The transaction is set to complete for US$81m, and Nitro Software has concurrently announced a US$105m equity raising to fund the purchase. The balance of raised equity will fund an additional US$5 in transaction costs and US$5m in integration costs, as well as providing additional working capital for the company.

Connective is the leading e-sign software as a service business in Belgium, with a growing France market share as well as customer bases in a further eleven European countries. Nitro Software highlighted that the transaction will allow it to assimilate e-signature capabilities into enterprise e-signing which it expects can increase the value of its total addressable market by US$11bn.

The deal itself, while in line with company strategy, is slightly more expensive than expected by some analysts. Further, the all cash upfront deal structure does not allow for much protection for Nitro Software if Connective does not perform to expectations.

The announced acquisition comes off the back of a year of strong organic growth for Nitro, which recently upgraded its FY22 revenue guidance to US$49-51m followed a robust third quarter that saw the company grow annual recurring revenue 50% on the year. Wilsons recently noted that given current growth, Nitro needs to only participate in, rather than dominate, business digitisation acceleration to retain its trajectory.

Adding capability to drive growth

Already guiding to strong organic growth, in recent months Nitro has faced increasing investor expectation to deliver more accelerated long-run growth, and the acquisition of Connective accelerates the company's ability to penetrate the market at a global level. Despite this, Shaw and Partners notes that while the acquisition adds a suite of services to its offerings, failure to reach annual recurring revenue expectations and deliver on potential would likely impact on share price.

The acquisition will allow Nitro Software to introduce Connective's enterprise e-signing capabilities to its customers, with Connective's full suite of services including high trust e-signatures, identification verification, workflow and automation, enhanced compliance and regulatory adherence, and private cloud functionality. Evans and Partners noted that the additional capability to Nitro Software's Contract Lifecycle Management is a step towards a holistic offering for document creation, signing and storage.

The addition of Connective also introduces an additional revenue stream for Nitro given Connective works on a volume-linked revenue model compared to Nitro's subscription-based model.

Solidifying its global status against sector leaders

According to Bell Potter the acquisition of Connective will confirm Nitro Software's position as the third global player in e-sign space, alongside dominant sector leaders Docusign and Adobe. With Docusign having a dominant hold on the e-signing market, and Abode holding a similar position in PDF productivity, Shaw and Partners notes that either competitor could aggressively match Nitro's product pricing if they perceive threat from the company. Currently, Nitro competes with Adobe's offerings at less than half the cost.

The choice of a European acquisition, as noted by Shaw and Partners, also provides confidence that Nitro is offering a world-leading platform given that it would meet stringent data regulation protection requirements in the region.

Bell Potter retains a Buy rating and target price of $4.50. Accounting for the impact of the Connective acquisition the broker upgrades revenue forecasts by 13% and 16% for 2022 and 2023 respectively, with a modest increase to underlying earnings in 2023 when the broker expects the acquisition to benefit.

Shaw retains a Buy rating and its target price reduces to $4.15 from $4.75 to reflect the dilution from the capital raising, with forecasts largely unchanged.

Evans and Partners retains a Positive rating and its valuation decreases -5% to $6.06 accounting for a higher share count. Revenue forecasts are increased by 18% and 15% for FY22 and FY23, with higher underlying losses given integration costs. The broker notes the transaction almost guarantees years of strong growth.

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

AUSTRALIA

APRA To Stem House Price Momentum

A 20%-plus price rise in house prices in major cities has made houses 'significantly over-valued' and APRA is poised to intervene to lower prices in 2022, says SQM Research

-20%-plus price appreciation in major Australian cities has made houses "significant over-valued"
-SQM Research predicts APRA stands ready to act to deflate house price momentum
-Apartments to rise in popularity as borders re-open

By Rudi Filapek-Vandyck

Australian capital city dwelling prices are forecast to peak in the first half of 2022, growth slowing sharply as the banking regulator, the Australian Prudential Regulatory Authority (APRA), intervenes to restrict home lending.

The base case in today's report from SQM Research is that property prices will slow rapidly from their annual 20%-plus growth rates.

Christopher's Housing Boom and Bust Report 2022 foresees a slower rate of price rises over the coming March quarter, followed by price falls as early as mid-2022.

Price falls are expected to be led by Sydney and Melbourne houses, which SQM Research describes as significantly over-valued.

SQM believes both cities are the most sensitive to even minor intervention by the banking regulator in home lending.

Christopher's Housing Boom and Bust Report 2022
Capital City Dwelling Price Change Forecasts

City/Region	ACTUALS	2022 Scenario 1 (Base case)	2022 Scenario 2	2022 Scenario 3	2022 Scenario 4
	12 months to 12-Nov-2021 - All Dwellings Source: Corelogic	• Cash rate remains unchanged • QE scaled back • Headline Inflation 3% to 5% • Further APRA action by June 2022	• 2nd half year cash rate rises to 0.25% - 0.50% • Headline Inflation 4-6% • QE scaled back • Further APRA Intervention by June 2022	• Cash rate remains unchanged • Headline Inflation 3-5% • No further APRA Action • QE scaled back	• Further APRA intervention by March 2022 • Headline inflation 4-6% QE Scaled back • Cash rate increase to 0.25%-0.5% first half of 2022
Perth	+16.4%	+3% to +7%	+2% to +6%	+5% to +10%	+1% to +6%
Brisbane	+22.3%	+8% to +14%	+8% to +14%	+9% to +16%	+3% to +6%
Darwin	+19.3%	-4% to +1%	-5% to 0%	-2% to +4%	-6% to +1%
Melbourne	+16.4%	-3% to +2%	-4% to +1%	-1% to +4%	-8% to -3%
Sydney	+25.2%	-2% to +4%	-3% to +3%	+3% to +8%	-7% to -2%
Adelaide	+20.1%	+4% to +8%	+4% to +8%	+6% to +11%	+1% to +6%
Hobart	+28.1%	-3% to +2%	-4% to +1%	+2% to +7%	-5% to +0%
Canberra	+25.5%	+5% to +9%	+5% to +9%	+7% to +12%	+1% to +6%
Capital City Average (weighted)	+20.6%	0% to +5%	-1% to +4%	+3% to +8%	-4% to +1%

Source: *Christopher's Housing Boom and Bust Report 2022*

SQM forecasts Brisbane will record the largest dwelling price rises over 2022 - between 8% to 14% - supported by expected strong interstate migration given relatively good housing affordability compared to Sydney and Melbourne. This gain will nevertheless represent slower growth than in 2021.

Melbourne and Sydney are likely to record house price falls from mid-2022 due to additional expected intervention by APRA to cool the market. Both cities were most affected by APRA's intervention in 2017 and, given very stretched valuations on SQM measurements, Sydney and Melbourne are considered "most susceptible” to any action that restricts home lending.

Melbourne could be further affected by migration to other states. However, this will likely be offset by a forecast rise in net overseas migration next year, suggests the report.

SQM expects unit rental markets in both Melbourne and Sydney will post a turnaround in 2022, and believes unit price growth could outperform that of houses.

With houses being overvalued, apartments are relatively affordable and are expected to benefit from the rise in net migration from interstate and overseas now Australia’s border are open.

According to Louis Christopher, Managing Director of SQM Research: “if the Australian housing market does not slow down by mid-2022, APRA will likely keep intervening in home lending until the market does slow down.

“We cannot afford another year of 20%-plus gains across the national housing market. And so, to ensure a soft landing for the market, it is best we see additional intervention sooner rather than later to reign in property valuations.”

[Note: APRA does not target house prices directly, it targets financial stability through restrictions on riskier mortgages and investment loans which lowers credit accessability and thus impacts on house prices.]

Other forecasts from *Christopher’s Housing Boom and Bust Report* include:

-Dwelling prices in regional Australia to correct, particularly for inland communities, as people return to the capital cities.

-Official interest rates are likely to stay on hold until at least late 2022.

-Further APRA intervention to occur as early as December 2021.

-Expected dwelling price corrections to be moderate unless exacerbated by aggressive monetary policy action involving rate rises earlier in the year.

-Ongoing rental rises for capital cities over and above the CPI change.

Technical limitations

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

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

COMMODITIES

Material Matters: Iron Ore, Copper, Coal, Lead & Nickel

A glance through the latest expert views and predictions about commodities: iron ore, copper, coal, lead and nickel.

-Morningstar's preferred iron ore exposure
-The US$1tr Infrastructure Bill's effect upon copper demand
-Significant volatility for the thermal coal price
-Macquarie's bullish stance on lead
-Nickel pig iron prices soften in China

By Mark Woodruff

Iron ore, copper and met coal

Following a significant softening in Chinese demand, Morningstar lowers 2021-24 assumptions for **iron ore** prices to US$116/tonne from US$133/tonne previously, and feels **BHP Group** ((BHP)) is the cheapest of the diversified majors. However, investors are cautioned the current share price offers little margin of safety should the downturn persist for China's economic activity and investment.

The iron ore impact is lessened for both BHP Group and **Rio Tinto** ((RIO)) by stronger near-term **copper prices** and for the former, higher metallurgical coal prices. Morningstar now assumes average copper prices for 2021-24 of US$4.44/lb up from US$3.70/lb, and an average US$205/tonne (US$155 previously) for **met coal** for the same period.

Morningstar makes a greater relative reduction to fair value for **Fortescue Metals Group** ((FMG)) due to a higher cost base and the discounts for lower-grade iron ore products that have widened.

Credit Suisse notes Australia's iron ore exports to September rose marginally year-on-year. The steel industry in the rest of the world is supporting iron ore prices now, given that China's demand has capitulated in the December half and is getting worse by the month, explains the broker.

In searching for a turnaround in pricing, the commodities team at Credit Suisse sees a December trough and anticipates China's 2022 budget may be a catalyst for a price recovery, when released next March.

Infrastructure stimulus will be needed to plug the growth gap from a crumbling property sector and to achieve the targeted 5% rise in GDP in the country's five-year plan, according to the broker. It's thought money allocated to Local Government Special Bonds for 2022 will far exceed that in either 2020 or 2021, and commodity prices should leap in response.

If the reader is looking for less exposure to the fluctuating iron ore price, Morningstar likes the quality of **Deterra Royalties** ((DRR)), which has a high moat and is essentially the equivalent of an iron ore toll road. The company's earnings are underpinned by a long-life iron ore royalty over BHP Group's Mining Area C, which is expanding to around 145m tonnes in 2023 from 60m tonnes in 2019. However, Morningstar notes the share price for Deterra Royalties is currently considered somewhat expensive.

Returning to copper, Credit Suisse estimates the additional demand impact from the US$1tr Infrastructure Bill in the US may be 50-250ktpa, which is almost 1% of global demand at the high end. On these figures, the broker feels the looming 2023-24 supply glut may turn out a lot less than feared by some.

Thermal coal

Macquarie notes **thermal coal** prices have experienced significant volatility over the past month.

The spot Newcastle price jumped to $254/t in mid-October, before falling to $150/t this week. The big change in price was primarily driven by an even more extreme move in China's domestic thermal coal prices.

While China doesn't buy Australian coal, not at the moment anyway, Newcastle is tracking other comparable grades which are influenced by China's moves, explains Credit Suisse.

China's domestic thermal coal prices have experienced a free fall (spot port prices more than halving) since mid-October, due to growing government intervention in the coal market, explains the broker.

The Chinese government has instituted several price ceilings for thermal coal, with the aim of helping power plants reduce losses, so that they can lift power generation during the upcoming winter. Interventions aside, Macquarie estimates a fundamental shift in the domestic supply demand balance in favour of lower coal prices.

Credit Suisse finds it difficult to weigh the effect of China's intervention upon export markets as such an arbitrary setting of the spot price is unprecedented. Traditionally, the government has tried to drive the spot price by controlling supply.

The broker wonders if China, in a move not seen for around 20 years, will exit the import markets and become self-sufficient. While not sure if China is a large enough importer, Credit Suisse also ponders whether the seaborne price will be dragged down to match China's domestic price.

Macquarie expects China's domestic thermal coal price to be US$115/t on average for 2022, slightly lower than the broker's previous forecast of US$123/t, with a year-end price of US$100/t expected. The broker explains the Chinese price cap had been anticipated, hence only a small downward adjustment is required to its price forecasts.

Lead

Macquarie has adopted a more bullish stance for **lead** demand over the next five years, based upon the broker's global auto forecasts.

As lead acid batteries will continue to be used for auxiliary functions in battery electric vehicles (BEVs), the broker thinks the global lead market should remain in a slight surplus, until the end of this decade.

Macquarie considers the future for lead is dependent on the overall fleet size, the speed of the transition to electric vehicles and the extent to which BEVs phase out lead batteries for auxiliary functions.

Given the relative cost and reliability of lead batteries, the broker downplays a risk that they are gradually phased out altogether.

It's thought China will have sufficient capacity to deliver an increase in secondary refined output to match the broker's stronger auto demand forecast. This will result in China becoming a net exporter of metal to the rest of the world unless new capacity is added elsewhere, notes Macquarie.

Lead demand is essentially battery driven, accounting for 85-90% of total demand. Autos account for around 55% of the total, of which replacement is normally around 40% and new vehicles are around 15%, points out the broker.

Nickel

After trending upwards for over a month due to robust stainless steel demand, Credit Suisse notes **nickel pig iron** (NPI) prices in China have softened after price decreases for **nickel** on exchanges.

After pandemic disruptions, the global nickel market is expected to swing into surplus as production recovers. The Chinese research house Antiake reported recently that prices are expected to fall from this year's multi-year highs.

Production next year is expected to rise in China and globally, though output of NPI (an input for stainless steel) will fall further, according to reports from Refinitiv, the provider of global financial data.

ESG FOCUS

ESG Focus: Huon Salmon Litmus Test for ESG M&A

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

ESG-Focus: Huon Salmon a litmus test for ESG M&A

The recent acquisition of Huon Aquaculture by Brazilian meat-packer JBS offers a great case study on ESG M&A, and an opportunity for investors to weigh impending global regulation on the world's oceans.

-A battle between two big SDGs – environment versus feed-the-world
-A good litmus test for ESG M&A
-A series of unfortunate events
-All food roads lead to Coles and Woolworths
-Global regulation to roll out this year

By Sarah Mills

JBS's acquisition this month of listed Tasmanian salmon farmer Huon Salmon ((HUO)) for $550m ($3.85 a share) threw the ESG spotlight onto the Australian aquaculture industry.

The fate of Huon will be a litmus test for the ESG credentials of not just of JBS and Australia's aquaculture industry, but for those of supermarkets Coles ((COL)) and Woolworths ((WOW)).

All ESG food roads lead to Coles and Woolworths, and outside of regulation, it is these two companies that will ultimately set the standards for the salmon industry (and other food industries) in an ESG world.

A battle between the "E" and "S" to see which will reign supreme

Food is one of the biggest ESG issues, and arguably the most controversial. We all have to eat.

One set of the United Nations' Sustainable Development Goals (SDG) demands the world be fed. These contradict another set of UN SDGs demanding improved environmental outcomes, including pollution and biodiversity.

Other SDGs focus on health, so one assumes the quality of food is also a combatant in the ESG ring.

So the pressure is on the world's food producers to feed a wealthier world demanding more protein while simultaneously improving environmental production standards and ensuring food is healthy.

Many assume that, push come to shove, feeding the masses will win out at the expense of environment and health (the latter being left to the pharmaceutical industry to manage the symptoms of poor nutrition). Or will it?

Investors are likely to view Huon's fate as an early guide to which of these SDGs will dominate going forward.

Ticking all the boxes for a good ESG story.

In one corner stands the environment. Salmon farming, like all farming, has an environmental impact, ruled by stocking densities, which has biodiversity impacts. And there's the carbon footprint.

In the other corner stands social concerns. Many workers objected to the takeover; and food is a health issue relating primarily to stocking densities and animal welfare.

Last but not least stands governance. Huon experienced a string of misfortunes, which brought the company to its knees.

It is also a great case study for ESG M&A

The Huon Salmon takeover should provide a good case study on the dynamics of ESG-driven takeovers as the world moves into a protracted period of ESG-driven M&A activity.

The Guardian reports that Federal Greens senator Peter Whish-Wilson expects JBS will ramp up its operations at a time when Huon will be subject to fewer reporting requirements as a private company, leaving Tassal Group ((TGR)) as the only publicly-listed Australian salmon farmer.

Will the takeover confirm environmentalists' fears of a large less-scrupulous predator snapping up a smaller operator with respectable environmental credentials, which are then reduced for profit. Or vice versa?

Twenty years ago, the former would have been a shoe-in (excluding brand considerations). But the plot is getting more interesting.

And there are other dynamics to consider.

It doesn't make sense for JBS to trash Huon.

Huon is a premium product and overstocking could harm not only the quality of the product but the brand. Few businesses wantonly destroy a strong premium brand on acquisition.

From a brand perspective, JBS is likely to seek to solidify Huon's position as a premium product in the global market. It can always establish a separate operation and brand for a cheaper product.

The inclusion of salmon farming might also reduce the beef producer's greenhouse-gas emissions as a percentage of revenue, given methane is clearly on the regulators' agenda post COP26.

It could possibly gain further forms of ESG leverage from the acquisition if the company is on its mark.

But let's start at the beginning, before going deeper into M&A.

A Series Of Unfortunate Events

Huon Aquaculture is the ESG jewel in the crown of Australia's aquaculture industry.

For decades, it has been carving a position as a leader in truly sustainable salmon farming, producing a premium, healthier product.

Those of our readers who care about the quality of their food will know that Huon Salmon is by far the best farmed salmon in Australia and possibly the world.

Huon went to market seeking suitors after a series of heavy knocks, which forced it to announce in August a -$128m loss, despite posting a 39% increase in production.

The hardest knock was covid, which triggered a -10% fall in salmon prices and a doubling of freight costs.

Huon suffered more than rival Tassal because its channel mix was skewed more to wholesale markets, and 44% of production was directed to tight-margin export markets.

It had also ramped-up production heading into covid which proved ill-timed.

Then followed three unfortunate incidents in quick succession, which raised more than a few eyebrows. In one incident, salmon escaped from nets; in another incident, the nets caught fire; and finally the company suffered a large theft of salmon shipments.

Whether these were simply misfortune, or the acts of an opportunistic criminal organisation, disgruntled employees, a would-be predator or a competitor will never be known, but such a coincidence is enough to raise the governance flag.

Analysts consider the company was well run. While the majority was family and fund-owned, which often creates a different oversight from alternative structures, Huon's governance and workplace measures were in line with industry standards.

The company would have most likely have had to increase its expenditure on security had it remained listed.

Meanwhile, Huon met with no shortage of suitors. Canadian aquaculture company Cooke and mining billionaire Andrew (Twiggy) Forrest both made a tilt, but neither at the price JBS was prepared to pay - $530m.

Observers suggest bidding may have been dampened by the general uncertainty surrounding covid, and upcoming ESG imposts.

Environmental regulation is only likely to increase, raising the ESG reputational, financial and operational risks for JBS and other industry operators.

But Twiggy Forrest did put up a fight and hoped to scarper rival JBS's bid on environmental concerns.

"Until JBS declares its unequivocal commitment to adopt the same animal welfare – including the principle of No pain No Fear – and environmental sustainability standards across their global operations, Huon shareholders have no certainty for the future of the company under JBS Group's control," said the mining magnate.

Naturally, JBS countered by saying it unequivocally supported the no-pain no-fear principle across its global operations.

It added that it was committed to the "highest standards of fish health and sustainable farming practices from water management to animal welfare, net zero emissions and stocking densities", establishing the board's understanding of the acquisition's ESG ramifications at the outset.

Forrest's campaign forced JBS to make a second "off market" offer for a smaller controlling interest in Huon if it received 50.1% support from shareholders, in the event Australian Super sided with Andrew Forrest.

Meanwhile, Andrew Forrest was able to leverage Huon's misfortune for his own benefit, building his industry brand as he prepares to invest in near-shore farming at Tattarang – a land-based finfish production facility -- at a cost of more than -$100m.

All farming has an impact and ocean salmon farming stacks up fairly well against other forms of farming.

Analysts observe that the environmental credentials of near-shore farming are less than for ocean farming, given carbon is needed to transport water (a service provided for free in the oceans).

Ocean salmon farming is also broadly considered a relatively environmentally friendly form of farming when compared with agriculture – given its lower greenhouse-gas footprint.

Then Brazilian meat giant JBS Food received approval in early November from the Foreign Investment Review

Board to buy the company, which was swiftly followed by majority shareholder approval, JBS gaining the minimum 75% support it needed to take full control.

Huon will constitute just 2.5% of JBS's $20bn global operations, so at this stage salmon farming is unlikely to prove much of an environmental offset, but it provides a base upon which to build.

M&A from an ESG perspective

Huon's takeover has a few parallels with MIRA's takeover of Bingo Industries in August: two companies in pivotal ESG industry positions are caught up in the covid bait-ball, then snapped up by opportunistic predators.

Both were at the end of a long investment period, which would position them well for the decade ahead within in an ESG environment, assuming good strategic execution.

Huon has 13 production sites and three-value-added product processing units and Bingo boasts its Recycling Ecology Park in the prime logistical position of Eastern Creek NSW.

FNArena's broker database suggests Huon was set to experience a strong earnings recovery across FY22 and FY23 thanks to higher prices and moderately lower operating costs.

Whereas MIRA's was something of a stealth attack, JBS's bid drew considerable controversy, thanks to workers, environmental concerns, and Twiggy Forrest's media attacks.

It is an example of a big company swallowing a small company with a good environmental record.

While salmon swim upstream, its hard to see how Huon's practices are likely to influence that of giant JBS, although it may perhaps set the standard for JBS's foray into a new industry.

Investors wary of regulation

Morgan Stanley covers aquaculture in its report titled *EU Sustainable Blue Economy: "No Green Deal without the oceans, no green recovery without the blue economy"* says that one in four seafood products consumed in Europe come from aquaculture.

Salmon's key environmental impact is that of biodiversity, which is expected to come under greater regulatory scrutiny after the authorities bed down decarbonisation.

In May, the EU Commission announced a coordinated approach for a blue economy covering shipping, offshore energy, biodiversity and sustainable food production (aquaculture and fishing).

By the end of this year, the EU is set to announce a plan to conserve fisheries resources and protect marine ecosystems.

The UN Convention on Biological Diversity published its draft framework in July and is to be discussed at the next COP meeting.

The EU plans to promote biodiversity by protecting 30% of marine space by 2030.

Of particular interest to investors will be Target 2 in the EU's Restoration of land and sea guidelines, which aims to ensure that at least 20% of degraded freshwater, marine and terrestrial ecosystems are under restoration.

It plans to design artificial reefs and restore seabed habitats – all potential opportunities for those operating in the aquaculture industry and beyond.

The battle will soon be on to see who will foot the bill for these restorations: aquaculture companies, major polluters or shareholders.

The EU has implemented guidelines to support growth in EU low impact aquaculture (low tropic, multitrophic and organic aquaculture).

The EU Commission also plans new marketing standards to improve consumer information on the environmental and social impact of seafood – and this could really sort the salmon from the sardines.

So perhaps JBS's takeover of Huon Aquaculture is well timed. Huon is generally ahead of the global salmon-farming curve.

It is in the hands of the supermarkets

But in the end, it is not JBS calling the shots but the world's supermarkets and their shareholders; and possibly the regulators.

Farmers will produce what supermarkets and their shareholders, and corrupted governments, are prepared to accept – that is why the Huon takeover will provide an ideal litmus test.

Supermarkets have their own ESG backs to guard, but the question is how savagely will investors hold the retailers to account.

At the moment, the supermarkets rely on the Aquaculture Stewardship Council (ASC) certification system but such a certification system yields considerable disparities in the quality of product and environments in which it is produced.

Woolworths ((WOW)) is reviewing its ASC certification after successfully implementing the system and finding it failed to protect from “adverse ecological outcomes” - no surprises there.

Certainly Coles ((COL)) and Woolworths combined have the power to transform the entire industry. All roads lead to Rome and it is likely that ESG pressures will rise on the retailers.

Given salmon represents such a small percentage of the retail giants’ inventory, alone, it is unlikely to shift the behemoths.

But the Tasmanian aquaculture activists have been very vocal.

Should they turn their campaign towards the supermarket giants, it is conceivable that investors might also take up the cause, particularly as biodiversity rises in importance over the next five years.

Industry review – under the regulatory spotlight

Salmon farming has become a national environmental issue, ironically thanks to the efforts of Huon’s founders.

The two major Australian operators are Tassal and Huon.

While both operate under the same regulator and regulations, Huon gained the environmental high ground after Huon co-founder Frances Bender blew the whistle on Tassal on the ABC a few years ago for creating excessive environmental damage in Macquarie Harbour.

Huon’s stocking densities also out-competed Tassal, the company producing a far superior product.

In the past nine years, Environment Tasmania and other groups lobbying contributed to a halving of Tassal’s expansion on Tasmania’s East Coast, preventing its encroachment into the Mercury Passage near the iconic Maria Island Marine Reserve.

It also successfully lobbied for the introduction of Go and No-Go zones for salmon farming, and pressured Australian Ethical to exit the industry.

It forced the ASC decertification of Tassal operations in Macquarie Harbour and prompted a review of ASC standards and changes to methodologies for measuring dissolved oxygen levels.

It lobbied the World Wide Fund for Nature to drop its endorsement of Tassal’s brand and worked with fishers to end the seal relocation plan.

Is there a big future for ocean-based aquaculture?

The Huon transaction attracted a great deal of focus on the aquaculture industry.

Some are billing land-based farming as a solution to the effects of ocean farming on local marine diversity.

But land-based farming is more difficult than ocean farming. It is incredibly expensive, has a higher carbon footprint and a generally a less optimal outcome for animal welfare.

On the flipside, its impacts are less visible and less recordable.

Analysts say that to date, no research has been made available outlining the net impact of both forms of farming.

One would expect stocking densities to become a key ESG metrics, given this would affect chemical and antibiotic usage, which affect both biodiversity and health outcomes.

Australian aquaculture density levels are low by global standards and the harvesting is relatively quick and humane.

These are big positives for investors seeking an exposure to aquaculture and for larger companies seeking to green their operations.

And as Tassal is the only remaining publicly listed company, this should provide some support for the share-price.

Investors will be keeping a keen eye to the regulatory environment; and predators will be weighing up the benefits of taking Tassal private, away from the glare of the public eye.

Meanwhile, the environmental battle is set to continue. *The Guardian* reports that an expert who quit a government panel in charge of Tasmania's salmon industry says no sound scientific evidence has been provided that might justify a planned doubling of production over the next decade.

The panellist also said many environmental concerns raised were persistently ignored, perhaps providing some insight into the political stance towards the industry.

Last but not least, Tasmania's old man of the pen, Richard Flanagan, has published a book on the subject titled *Toxic*, leaving little room for denialists to hide.

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

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

FEATURE STORIES

Australian Banks: Worse Before Things Get Better

Analysts agree FY22 will be another tough year for bank margins before sentiment begins to improve and the RBA eventually raises rates.

-Australian banks' net interest margins surprised to the downside
-Little relief apparent in FY22, but dividends not under threat
-RBA rate hikes will save the day
-Big retail banks to struggle more than smaller commercial banks

By Greg Peel

The bank reporting season has now wrapped with three of the four majors reporting full-year FY21 earnings and Commonwealth Bank ((CBA)) providing a first quarter FY22 update. Suffice to say, it was a disappointing season overall.

Yet there was a clear distinction between the performances of the two big mortgage-dominating banks, being Westpac ((WBC)) and CBA, and those of the two smaller, less mortgage-exposed ANZ Bank ((ANZ)) and National Australia Bank ((NAB)). While share price responses to the latter two's results on the day were fairly muted, Westpac dropped -7% and CBA -8%.

Analysts agree that CBA actually posted a relatively solid performance but not one that could justify the significant valuation premium it has long enjoyed over the other three banks. For Westpac, it was just a poor result.

Mortgage Pain

A near-zero RBA cash rate and historically low bond yields out to fifteen years does not provide banks with much opportunity to profit from their basic earnings driver – the difference between what they can borrow at and what they can lend at, known as the net interest margin (NIM).

While equally low global rates have meant the opportunity to borrow in corporate bond markets at low cost, with regard deposit rates – the other prime source of borrowing – banks have been backed up to a cliff. The current everyday deposit rate is 0.01%. That's as low as it can go unless banks decide they will charge *you* to deposit with them, which is not particularly attractive when inflation is running at 3%.

In other words, they can't.

What they can do is keep their mortgage and other lending rates higher to ensure margins are protected. This would work if there were only one bank. But there's four majors, two main regionals, and a host of other non-bank financials and fintech disruptors ready to take market share.

Competition has thus been fierce. Throw in a raging Australian housing market, and the need to retain market share if not increase it has meant rates on offer have been the battlefront, with margins the casualties.

Typically, Australians have paid more to lock into a fixed rate mortgage which removes upside interest repayment risk for at least two to four years. Standard variable rates (SVR), which shift up and down with the RBA cash rate, have usually been cheaper and more popular. But given the economic and employment uncertainty created by a pandemic that won't go away, banks decided in FY21 to offer fixed mortgages at lower rates than SVRs, thus removing some of the bad debt risk an RBA rate hike would represent.

But Australians aren't fools. With an RBA cash rate effectively at zero, what are the chances fixed rates could move lower still, after you've already locked yours in? What are the chances of rates moving higher? Confronted with this binary scenario, Australians rushed to lock in their mortgages on fixed rates – some 40% of new mortgages.

Which means it is the banks that will have to wait two to four years before they can adjust to any RBA rate hike in that period.

Analysts were surprised by the extent of NIM compression reported by banks, but not at all befuddled. Perhaps most surprising is that investors did not take the initial warning from Westpac's -10 basis point fall in NIM as a read-through to CBA – the biggest mortgage lender. Instead, investors saw further reason to maintain CBA's significant premium.

Until CBA reported a -7 point fall in NIM.

And this reduced revenue capacity is only one side of the equation. The astonishing acceleration of digital technology this century has led to new lending start-ups (including BNPLs) moving into the banks' traditional territory of tellers behind windows and five days to clear a cheque. If you can't beat them…

Westpac is the most glaring case in point of a bank which announced plans for substantial costs-outs at the beginning of the year, only to produce a result including cost increases due to necessary technology investment – more so than forecast.

Hence not only were bank revenues hit by weaker NIMs, earnings were hit again by increased costs. There was some saving grace in solid "market income" aka "trading income" amidst volatile financial markets (trading securities) but this is by definition a volatile source of earnings.

The question is: Have banks now seen the worst of it?

<u>Divergence in Prospects</u>

The good news is that despite negative earnings trends, bank capital positions have remained solid. The Australian economy has surprised all, including the RBA, with its resilience during the pandemic, largely thanks to super-easy RBA policy, solid government support from fiscal handouts and a relatively low impact from covid in a global context.

We may have been one of the most locked down countries in the world that has only meant saving up the pennies when there's nothing to spend it on and then unleashing as soon as the shops reopen. JobKeeper/Seeker have prevented a major increase in actual unemployment and a major surge in business failures (I say major – of course there have been plenty).

This has fed into a lower than expected, indeed much lower than feared, increase in bad debts and mortgage foreclosures (along with last year's mortgage payment furloughs offered by the banks) for which the banks provisioned (put aside earnings onto the balance sheet) when uncertainty was at its peak.

This means the banks still have retained earnings they can release, and this means solid dividends can be maintained and even share buybacks pursued.

The same thing happened in the GFC – banks put away vast amounts just for uncertainty only to find they didn't need them, and hence showered shareholders with dividends in subsequent years – something they came to regret when the Royal Commission came along. They are still paying remediation, and still have to spend on upgraded compliance.

The bad news is that until the RBA begins to hike its cash rate, shifting the banks back away from the cliff and allowing for higher NIMs, this financial year looks like being much the same as the last.

While the recent reporting season highlighted the distinctions between the banks (for example mortgage exposure versus business lending exposure), Credit Suisse notes underlying profit continues to be under pressure across the entire sector.

Despite strong bank balance sheets, competition and expense headwinds continue to dominate. Credit Suisse is Neutral on the sector given a still significant valuation premium to the rest of the market.

Citi suggests FY22 will be a "transition" year, as banks suffer from more of the same (low rates, competition, costs) ahead of the prospects of higher rates. However, the broker does foresee some abatement of FY21's difficult conditions, expecting "green shoots" in business lending and an easing off of fixed rate mortgage demand. Further bad debt provision releases are also anticipated, and solid balance sheets still allow for capital returns.

Yet Citi, too, sees current valuations as full.

Goldman Sachs also expects business lending to pick up amidst improvement in sentiment as we put lockdowns behind us (we hope) and the economy becomes a bit more normal, while mortgage growth will continue its positive momentum for now.

The banks are also focused on trying to reduce their absolute cost bases, although each bank is in a different stage of reaching this goal.

Ord Minnett concurs with the more-of-the-same theme in FY22 and also points out cheap funding provided by the RBA in light of the pandemic, through its Term Funding Facility, has expired. But the broker does see upside from rising rates.

While Ord Minnett's forecast is for the first RBA rate hike in the first half of 2023, the broker notes Australian short-end yields have been rising since September in anticipation the RBA will be forced to move earlier than its 2024 (*maybe* late 2023) insistence. Whether it is the market that proves to be right or the central bank, rising rates provide for higher bank mortgage rates.

Brokers mostly agree, and here we can add Macquarie's view to the list, that the FY22-23 outlook favours the commercial banks (NAB, ANZ) over the retail banks (CBA, Westpac). NAB is the biggest business lender, hence should have the best prospects, although Macquarie and Credit Suisse both point out ANZ will be the greater beneficiary among peers of rising rates.

Citi does not disagree with this thesis but has Westpac as its sole Buy among the four, as its weakest overall performance has led to a more realistic valuation.

As usual, everyone loves CBA, but no one wants to buy it at the price, even after its de-rating. The bank has always enjoyed the highest return on equity – the primary measure of bank valuation – but on that basis has been afforded a greater premium than is justified.

See: *CBA: On How The Mighty Have Fallen*
(https://www.fnarena.com/index.php/2021/11/18/cba-oh-how-the-mighty-have-fallen/)

Now, over to the RBA…

The divergence between the expected timing of the first RBA rate hike the market is currently pricing in and the RBA's own stoic guidance is stark. The market is pricing in no less than five rate hikes over the next 18 months, Jarden notes, reaching 1.25% by April 2023.

The RBA still foresees the first hike in 2024, or maybe late 2023. The board's dual target remains that of inflation above 2% (September quarter core CPI 2.1%) and wage growth of 3% (September quarter 2.2%). With inflation basically in place, it's all about wages.

As yet, inflation pressures have not meaningfully flowed into wage increases despite a shortage of labour. Clearly the market assumes this will eventually have to occur as we leave lockdowns behind and government support expires, and that price inflation will linger for longer than the RBA expects.

Typically, Jarden notes, the central bank raises rates when it is a strong economy leading to higher inflation. The last five rate-hike cycles since the 1990s show that while higher rates do have an impact on housing, credit and the economy, each time the impact was modest because of that strong economy underpinning the need for the RBA to cool things down.

But this time we are at the end of a decades-long structural decline in interest rates, and household debt is materially higher. And current inflation pressures are more about supply-side problems (supply shortages, delays, surging freight costs and labour shortages) than demand-side pressure on prices in a strong economy.

Jarden estimates that each one percentage point increase in mortgage rates, in line with increased cash rates, would imply -10-15% downside risk to house prices. But add in the "wealth effect", or positive feedback loop from solid house prices to consumer sentiment to the real economy, and the impact could be greater.

Note that average house prices are up 22% over 12 months so some sort of a blow-off would not be the end of the world. But as Jarden notes, elevated household debt at historically low rates imply households are much more sensitive to higher rates than previously, increasing the risk to the economy.

Jarden's base case is for the first rate hike to come in mid-2023. Jarden also suspects that were there to be an earlier hike and a big fall in house prices, APRA could respond by lowering the required mortgage "buffer rate" it has recently increased to cool runaway house prices and mortgage risk.

The buffer rate, or serviceability floor, is the rate a bank must stress-test a borrower's mortgage servicing capacity above that of the mortgage rate on offer, for when rate hikes eventuate. It's currently at 3%.

<u>But APRA's not done yet</u>

While forecasts vary in quantum, economists generally expect house prices to rise around 7-8% in FY22 before falling up to -10-20% in FY23 when the first rate hike is announced. Of course, if prospective buyers take heed of these forecasts, FY22 may not see demand as solid as assumed.

APRA does not specifically target house prices, it influences house prices indirectly by enforcing certain restrictions on housing loan risk. There are already various measures in place but with mortgages being the dominate part of elevated household debt and rate hikes looming, the regulator is now proposing further measures.

There are already limits on investor loans and interest-only loans, but APRA still has these in its sights for further restrictions. More notably, the regulator is proposing limits on loan sizes based on debt-to-income ratios above 4x, and above 6x, and loan-to-value ratios of above 80% and above 90%.

None of these proposals have surprised economists who have been tipping exactly such measures pretty much all year. However, while reaffirming its 3% buffer rate requirement, APRA has said this could vary from 2% and right up to 5% for certain loans.

Jarden estimates, at face value, a 5% buffer rate would reduce borrowing capacity by -19%. But Jarden expects any increase towards 5% would be a gradual process rather than an immediate one as the regulator monitors the impact.

(Note that so far these are only proposals, with industry responses due by February next year. Actual changes may not eventuate until mid-2022.)

Jarden also points out that a face value assumption is overstated because less than 10% of borrowers actually use their full capacity, and many customers borrow more than they need and leave the excess cash in offset accounts, which inflates their apparent debt.

The conclusion is that while further macro-prudential tightening, as such APRA measures are known, is clearly a risk, tightening will likely be modest in the near term, reducing the upside risk for credit growth.

The regulator will also be fully aware 2022 is an election year.

<u>The State of Play</u>

FNArena Major Bank Data					FY1 Forecasts				FY2 Forecasts			
Bank	B/H/S Ratio	Previous Close $	Average Target $	**% Upside to Target**	% EPS Growth	% DPS Growth	% Payout Ratio	**% Div Yield**	% EPS Growth	% DPS Growth	% Payout Ratio	**% Div Yield**
WBC	2/4/0	21.81	26.33	**20.57**	4.0	4.2	79.2	**5.6**	20.8	11.2	72.9	**6.3**
ANZ	2/4/0	27.27	29.46	**6.73**	- 1.3	3.1	68.3	**5.3**	8.3	7.6	67.9	**5.7**
NAB	2/4/0	28.47	29.47	**3.10**	2.0	8.4	69.9	**4.8**	8.8	8.5	69.8	**5.2**
CBA	0/1/5	96.82	87.25	**- 10.72**	- 14.2	7.0	76.0	**3.8**	5.7	6.2	76.3	**4.1**

Above is comparative table of bank consensus forecasts and ratings among FNArena database brokers.

The table initially ranks the banks based on number of Buy, then Hold, then Sell ratings first, before differentiating on upside risk to target.

As the above text noted, brokers concur that NAB and ANZ are better placed than CBA and Westpac in FY22, and that NAB's greater exposure to business lending puts it in the box seat, although ANZ's greater exposure to RBA rate hikes could put it in the box seat, while Westpac's de-rating now suggests value, and CBA's de-rating has not been sufficient to close the premium gap to a realistic level.

The result is CBA being placed in a fourth spot it has owned for a very long time, other than very brief periods. Thereafter, all of the other three attract the same ratings spread among Buy, Hold Sell and equivalents, which reflects the above mix of views.

The suggestion of Westpac now showing value is reflected in table-winning 20.6% upside to consensus target (based off yesterday's closing price). ANZ and NAB are close, but ANZ wins. Downside of -11% for CBA is very typical.

Of course what is also critical to investors is dividend yield, and again it's clear why Westpac is top of the table.

For those looking to invest in banks and are now scratching their heads about which one, longer term investors may be best served by just buying them all, or buying a bank ETF. Over time, performances and preferences come and go with the tides.

The one exception is CBA, which has outperformed the rest of the pack in significant fashion since the 1990s, but steadfastly carries the risk of losing its relative premium. That relative valuation premium only rarely disappears and thus far it has quickly re-appeared after each of the few de-ratings that has occurred over the past 2.5 decades.

Technical limitations

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 19-11-21

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

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday November 15 to Friday November 19, 2021
Total Upgrades: 5
Total Downgrades: 3
Net Ratings Breakdown: Buy 55.60%; Hold 37.80%; Sell 6.60%

For the week ending Friday November 19, there were five upgrades and three downgrades to ASX-listed companies covered by brokers in the FNArena database.

There are seven brokers updated daily in the database, and their combined research propelled Incitec Pivot to the top of the tables for both the largest percentage rise in forecast target price and forecast earnings. Following FY21 results, Credit Suisse believes consensus forecasts underestimated the impact of fertiliser pricing. Underlying profit rose 91% to $358.6m, well ahead of the consensus estimate for $296.6m.

UBS expects further benefits will accrue from a global recovery in agricultural conditions and fertiliser pricing, as well as tightening supplies of ammonia, phosphate and nitrogen. While the company's rating was downgraded to Accumulate from Buy by Ord Minnett, it was only in reaction to recent share price strength.

Macquarie is excited by the experience of the incoming CEO at Lovisa, who has previously grown brands and stores in both China and India. While a long term target of 1200 stores globally is already priced in, there's upside risk for over 1400 stores in China and India alone, according to the analyst. The broker lifted its target price to $25 from $17, thereby ensuring second place on the table for the largest percentage rise in forecast target prices.

Second place on the equivalent table for forecast earnings went to United Malt Group. This arose despite a FY21 profit result that missed the consensus forecast, largely due to covid restrictions and export disruptions, explains Morgans. Citi expects processing volumes will exceed pre-covid levels after the March quarter, as UK whisky exports hold and US on-premise beer consumption recovers.

Nufarm was next on the table after its FY21 profit result outpaced Macquarie's estimate and consensus forecasts. Strong cash, debt reduction and a return to dividend were considered the icing on the cake. UBS believes the turnaround is still evolving, and expects earnings growth driven by -$10m of cost-outs from the company's Performance Improvement Program. Organic growth is also anticipated, given the outlook for agriculture.

Finally, Orica's forecast earnings received a boost after a review of recent FY21 results by Ord Minnett. After combining an increased earnings outlook with a re-rating in the ASX200 Industrials Index, the broker lifted its 12-month target price to $15.25 from $13.00.

On the flipside, Afterpay received the largest percentage downgrade to forecasts earnings last week. While generating increased November app downloads in the US, Morgan Stanley noted competitor Affirm had a greater rate of increase.

Next up was Xero. Despite strong first half results, UBS finds the valuation is too high to offer fair reward for risk to investors. Macquarie agrees and sees A&NZ reaching maturity and slower than forecast overseas growth weighing upon revenue. Subscriber growth was -3% below the analyst's expectation for the first half and there may be difficulty in competing with the size of QuickBooks in the US market.

UBS lowered its FY21 EPS forecast by -7% for Eagers Automotive following revised FY21 guidance. However, demand is considered to remain strong despite recent lockdown impacts and management pointed to ongoing strong growth for Easyauto123. Morgan Stanley also remains upbeat as pent-up demand has led to a growing order book and believes the company is well placed going into 2022.

Finally, AGM commentary by Mineral Resources implied to Morgan Stanley that margins could come under pressure. Near-term production guidance was downgraded for Yilgarn and the economics at Ashburton are significantly worse than expected by the analyst. The broker remains concerned around significant growth and margin risk from the iron ore operations and growth projects and retains its $38.70 target price and Underweight rating.

This contrasts with the relatively unperturbed Macquarie which retained its Outperform rating and $72 target price. Elsewhere, Citi also retained it Buy rating and $55 target, while Ord Minnett kept its Hold rating and $47 target price.

Total Buy recommendations take up 55.60% of the total, versus 37.80% on Neutral/Hold, while Sell ratings account for the remaining 6.60%.

Upgrade

ATLAS ARTERIA ((ALX)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/1/0

Macquarie upgrades Atlas Arteria to Outperform from Hold, noting the company is trading slightly below fair value, and that the APRR concession and likely improved certainty towards Greenway should combine with the attractive dividend to spur desire.

Target price rises 35c to $6.87 to reflect improved cash flow and a -30 basis point cut in bond forecasts.

Macquarie tinkers with Atlas Arteria's earnings estimates, shaving -1.2% off FY21, adding 0.2% to FY22; and cutting -2.8% from FY24, expecting the improved Greenway traffic outlook will fall foul of the currency outlook.

The company's investor day met expectations, the 100% distribution policy intact, and the company continuing to adopt a legislation solution to the Greenway toll-road-to-concession settlement.

October inflation fell at 2.6%, compared to the broker's forecast 2.1%, which should boost toll revenue.

EAGERS AUTOMOTIVE LIMITED ((APE)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 5/1/0

Lockdowns in the second half of FY21 are set to cause up to an estimated -$25m impact on Eagers Automotive full-year earnings guidance of $390-395m, with Ord Minnett noting demand continues to exceed supply capabilities.

The company has grown its order bank for sixteen consecutive months, providing near-term earnings confidence with revenue to be recognised on the backlog upon delivery of vehicles, and some suggestion that supply chain congestion could ease in the next six months.

The rating is upgraded to Buy from Accumulate and the target price increases to $18.50 from $18.00.

CAPITOL HEALTH LIMITED ((CAJ)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 2/0/0

A trading update at Capitol Health's AGM suggested a solid result amidst lockdowns. Underlying growth exceeded Ord Minnett's forecast by 4%, with Victoria's 75% of the company's total sites performing better than expected.

Capitol Health's organic growth profile from clinic maturation, greenfield opportunities and demographic tailwinds should underpin earnings growth over the medium-term, the broker suggests. With $110m in unused debt facilities & negligible gearing, M&A continues to provide optionality.

Target unchanged at 43c, rating upgraded to Buy from Accumulate.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/4/0

Evolution Mining's $1bn deal with Glencore that will see it take ownership of the Ernest Henry operation gets the approval of Citi, supported by the broker's bullish view on copper.

Citi believes the deal is accretive to Evolution and should enable management to continue its track record of cost-out at a site previously owned by a major.

On that basis, Citi upgrades to Buy from Neutral. The target price gains 50c to $4.70.

Citi's in-house view is for a multi-year, electrification driven bull market for copper with long term prices of US$4.08/lb or US$9,000/t. Ernest Henry will lift Evolution Mining's copper output to circa 60ktpa, points out the broker.

LOVISA HOLDINGS LIMITED ((LOV)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/1/0

Macqurie notes Lovisa has a new CEO with experience in growing brands and stores in China and India, which will now be the focus. Together those markets exceed that of the US by 15%.

While a long term target of 1200 stores globally is already priced in, the broker suggests, upside risk is for another 1400-plus stores in China and India alone.

Greater confidence in store rollout in current markets drive earnings forecast upgrades, and a re-rating is warranted on store upside potential, leading the broker to upgrade to Outperform from Neutral. Target rises to $25 from $17.

Downgrade

AURIZON HOLDINGS LIMITED ((AZJ)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/2/1

Despite benefiting from current coal activity, Aurizon Holdings is repositioning group mix and supplementing coal income by increasing non-coal related assets in anticipation of coal decline, likely to occur from FY31 according to UBS.

The broker noted the acquisition of One Rail Bulk supports increased non-coal income, but expects the company will need to commit further capital investment of -$550-650m to achieve supplemented income targets.

The broker looks to the potential East Coast Rail sale or demerger for more certainty on the company's outlook. Coverage is reinstated with a Neutral rating and a target price of $3.50.

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 5/2/0

Following the released of Incitec Pivot's FY21 metrics and a strong earnings result, Ord Minnet has increased earnings before tax forecasts by 8% for FY21 and 35% for FY22.

The broker expects elevated fertiliser pricing to persist for at least another six months.

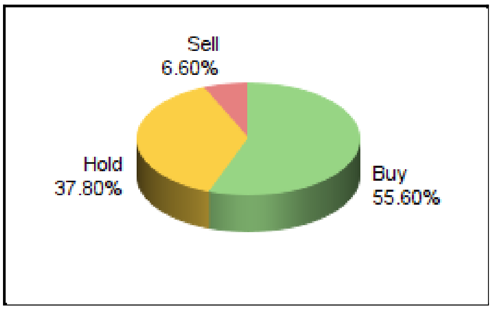
Given recent share pricing, the rating is downgraded to Accumulate from Buy while the target price increases to $3.50 from $3.20.

SEEK LIMITED ((SEK)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/3/0

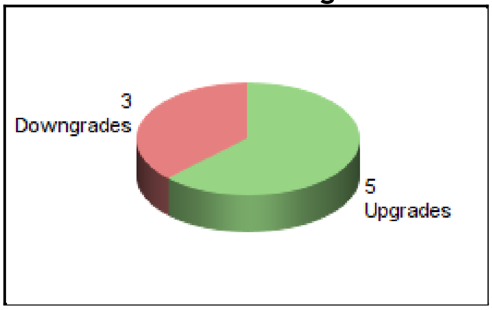
After reviewing Seek's "solid" trading update, UBS downgrades its rating to Neutral from Buy. It's thought $1bn of revenues in A&NZ over the next 5 years have already been priced in by the market. The target price rises to $36 from $35.

While admitting forecasting remains difficult, Seek management expects to achieve the top-end of the FY22 existing guidance range for underlying revenue, earnings (EBITDA) and profit.

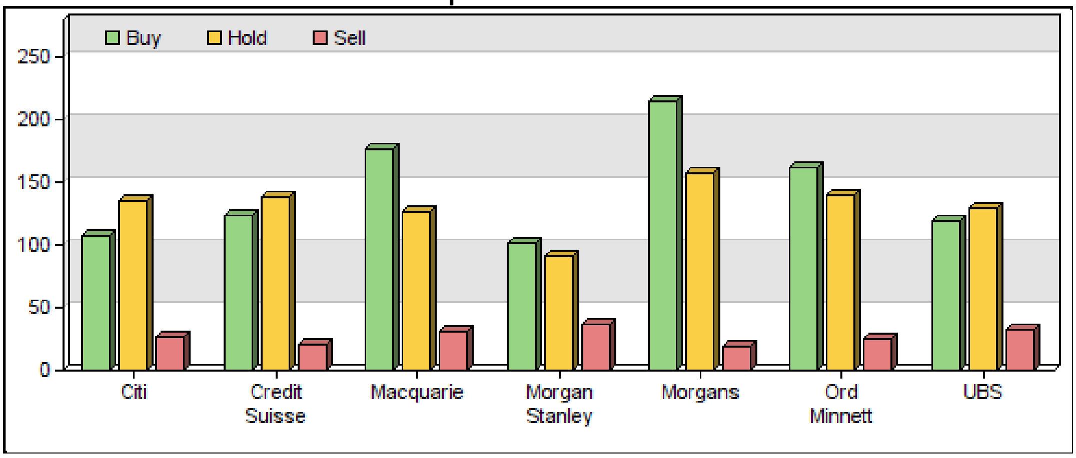
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ATLAS ARTERIA	Buy	Neutral	Macquarie
2	CAPITOL HEALTH LIMITED	Buy	Buy	Ord Minnett
3	EAGERS AUTOMOTIVE LIMITED	Buy	Buy	Ord Minnett
4	EVOLUTION MINING LIMITED	Buy	Neutral	Citi
5	LOVISA HOLDINGS LIMITED	Buy	Neutral	Macquarie
Downgrade				
6	AURIZON HOLDINGS LIMITED	Neutral	Buy	UBS
7	INCITEC PIVOT LIMITED	Buy	Buy	Ord Minnett
8	SEEK LIMITED	Neutral	Buy	UBS

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	XRO	XERO LIMITED	17.0%	-8.0%	25.0%	6
2	QUB	QUBE HOLDINGS LIMITED	63.0%	38.0%	25.0%	4
3	LOV	LOVISA HOLDINGS LIMITED	75.0%	50.0%	25.0%	4
4	ALX	ATLAS ARTERIA	80.0%	60.0%	20.0%	5
5	EVN	EVOLUTION MINING LIMITED	25.0%	8.0%	17.0%	6
6	COL	COLES GROUP LIMITED	43.0%	29.0%	14.0%	7
7	EBO	EBOS GROUP LIMITED	50.0%	40.0%	10.0%	6
8	APE	EAGERS AUTOMOTIVE LIMITED	83.0%	75.0%	8.0%	6
9	EDV	ENDEAVOUR GROUP LIMITED	-25.0%	-33.0%	8.0%	4
10	TWE	TREASURY WINE ESTATES LIMITED	40.0%	33.0%	7.0%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	CCX	CITY CHIC COLLECTIVE LIMITED	63.0%	88.0%	-25.0%	4
2	IPL	INCITEC PIVOT LIMITED	64.0%	86.0%	-22.0%	7
3	SEK	SEEK LIMITED	40.0%	60.0%	-20.0%	5

4	MTS	METCASH LIMITED	58.0%	75.0%	-17.0%	6
5	JBH	JB HI-FI LIMITED	17.0%	33.0%	-16.0%	6
6	ORI	ORICA LIMITED	29.0%	43.0%	-14.0%	7
7	RHC	RAMSAY HEALTH CARE LIMITED	8.0%	17.0%	-9.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	IPL	INCITEC PIVOT LIMITED	3.600	3.237	11.21%	7
2	LOV	LOVISA HOLDINGS LIMITED	21.885	19.885	10.06%	4
3	EVN	EVOLUTION MINING LIMITED	4.298	3.975	8.13%	6
4	XRO	XERO LIMITED	134.167	124.450	7.81%	6
5	ORI	ORICA LIMITED	15.969	14.979	6.61%	7
6	EBO	EBOS GROUP LIMITED	34.250	32.333	5.93%	6
7	SEK	SEEK LIMITED	35.046	33.528	4.53%	5
8	QUB	QUBE HOLDINGS LIMITED	3.378	3.308	2.12%	4
9	CCX	CITY CHIC COLLECTIVE LIMITED	6.900	6.763	2.03%	4
10	UMG	UNITED MALT GROUP LIMITED	4.834	4.748	1.81%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	APE	EAGERS AUTOMOTIVE LIMITED	17.808	18.350	-2.95%	6
2	RHC	RAMSAY HEALTH CARE LIMITED	68.880	69.475	-0.86%	6

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	IPL	INCITEC PIVOT LIMITED	31.250	16.500	89.39%	7
2	UMG	UNITED MALT GROUP LIMITED	20.725	12.288	68.66%	5
3	NUF	NUFARM LIMITED	24.829	17.130	44.94%	7
4	HDN	HOMECO DAILY NEEDS REIT	11.975	8.550	40.06%	3
5	ORI	ORICA LIMITED	68.853	50.601	36.07%	7
6	ALL	ARISTOCRAT LEISURE LIMITED	158.043	128.900	22.61%	7
7	GNC	GRAINCORP LIMITED	69.618	57.575	20.92%	4
8	EVN	EVOLUTION MINING LIMITED	18.055	16.505	9.39%	6
9	SEK	SEEK LIMITED	60.730	56.858	6.81%	5
10	SHL	SONIC HEALTHCARE LIMITED	261.817	246.900	6.04%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	APT	AFTERPAY LIMITED	-0.498	0.859	-157.97%	6
2	XRO	XERO LIMITED	6.945	20.534	-66.18%	6
3	TYR	TYRO PAYMENTS LIMITED	-1.540	-1.290	-19.38%	4
4	APE	EAGERS AUTOMOTIVE LIMITED	89.735	109.583	-18.11%	6
5	MIN	MINERAL RESOURCES LIMITED	193.100	231.100	-16.44%	4
6	ELD	ELDERS LIMITED	74.867	89.150	-16.02%	4
7	RHC	RAMSAY HEALTH CARE LIMITED	187.317	212.000	-11.64%	6
8	NHC	NEW HOPE CORPORATION LIMITED	67.938	73.718	-7.84%	4
9	NIC	NICKEL MINES LIMITED	6.661	7.190	-7.36%	4
10	ANN	ANSELL LIMITED	228.968	240.312	-4.72%	6

Technical limitations

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

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.

WEEKLY REPORTS

Uranium Week: US Infrastructure Bill Passed

As the spot uranium price stayed relatively flat last week, support for the nuclear industry comes from one of the largest infrastructure packages in US history.

-US infrastructure bill support for threatened nuclear facilities
-Kazatomprom moves joint venture forward
-Who will be Australia's next uranium producer?
-Uranium spot price rises less than 1% for the week

By Mark Woodruff

The US$1.2tr Infrastructure Investment and Jobs Act was signed into law last week.

The bill provides US$6bn in US Department of Energy funding to support nuclear facilities that are under economic threat of premature closures.

The new legislation also appropriates US$2.4bn of funding for micro reactors, small modular reactors (SMRs) and advanced reactors, while an additional US$3.2bn is authorised through to 2027.

Company news

Kazatomprom, the world's largest producer of uranium, has approved a Life of Mine plan for the 51%-owned joint venture Budenovskoye. As part of a move toward commercial production, the plan will be submitted to the Ministry of Energy in Kazakhstan.

The proposed 25-year plan (2021 - 2045) would entail a commercial ramp-up of up to 6.5mlbs U3O8, beginning no earlier than 2024, and the potential for a maximum annual production capacity of up to 15.6mlbs no earlier than 2026.

The joint venture's anticipated production from 2024-2026 is fully committed to Russia's nuclear power industry (Rosatom), under an offtake contract at market-related terms.

In further company news in Australia, stockbroker Bell Potter believes **ASX-listed Boss Energy ((BOE))** will be Australia's next uranium producer. Bell Potter has initiated coverage with a Speculative Buy rating and 12-month target price of $0.44.

The pending restart of operations at the company's Honeymoon project is thought to represent a comparatively lower-risk development opportunity in a tier-1 jurisdiction. The analyst estimates a 12 month lead time to first production and the potential to produce 2.45mlbs per annum within three years of the restart at a low level of capital intensity.

By locking in lucrative beginning-of-cycle contracts prior to additional supply entering the market, Bell Potter believes the company can attain first mover advantage. Moreover, nearby exploration potential is thought to lend potential for additional upside.

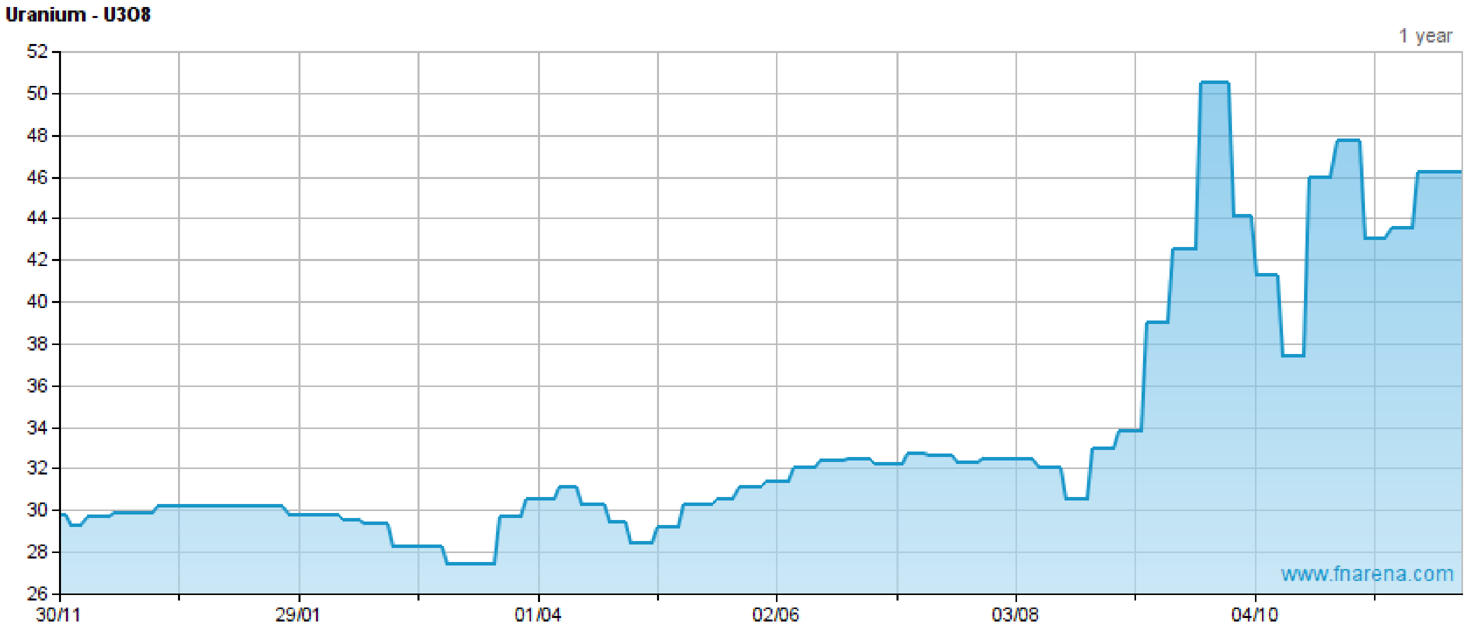
Uranium pricing

TradeTech's Weekly **Spot Price** Indicator ended last week at US$46.25/lb, up US$0.05/lb from the previous week.

The spot price has increased nearly 8% this month on notable transaction volumes, explains Tradetech. The weekly spot price is up 40% over the last three months, up 52% since the beginning of the year, and has risen 56% year-on-year.

The average Weekly Spot Price in 2021 is US$34.05/lb, US$4.34/lb above the 2020 average. Just over 2mlbs U3O8 were traded last week, compared to 2.5mlbs in the prior week.

TradeTech's **term price** indicators are US$43.75/lb (mid) and US$45/lb (long).



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

Silver Investors Should Be So Lucky

Silver investors should be so lucky as the grey metal emerges from the coat tails of its big sister

By Tim Boreham, Editor, The New Criterion

In the past, silver has been akin to younger brothers and sisters seeking to hang out with their older sibling – gold, that is and much to the yellow metal's annoyance.

As time goes by, the little kids develop their own confidence and forge their own career and persona.

In the past we've compared gold and silver with Kylie and Dannii, but in reality 'little' Dannii has long emerged from the coat-tails of the Singing Budgie.

The same thing is happening with the 'real' gold and silver.

For the last century metals have traded in sync with each other, as measured by the gold-silver ratio, or GSR.

On average gold has been worth 45 times more than silver.

In 2011 when silver hit a record US$46 an ounce, the GSR fell to around 30 times.

With gold currently trading at US$1845 an ounce and silver at US$24.80 an ounce, the GSR has blown out to 74 times and Kylie again is overshadowing Dannii (or Venus is eclipsing the more successful Serena, as measured by grand slam titles).

For those who believe that valuations will always revert to the average over time, either silver is undervalued - or gold is overvalued.

The investment thesis with both metals is they are hedges against rampant inflation and general financial or geopolitical tumult.

Given the inflation concerns both here and in the US, gold and silver should be on a roll. Indeed, they've rallied in the past month or so but have still fallen 12% and 14% from their recent peaks in early August 2020 and early February 2021.

One reason is that higher interest rates – usually part and parcel of inflation – are a negative influence, because they improve returns on other investments relative to the non-incoming producing metals.

But bear in mind that in nominal terms – that is, allowing for inflation - interest rates remain in negative territory.

The gold price has also been hit by the outflows from gold-backed exchange funds into cryptocurrencies, which are either the store of value of the future or a disaster waiting to happen.

For those still lured by gold and its long history as a store of value, silver actually might be a better option. There's certainly an argument for having a smattering of Kylie and Dannii in one's portfolio.

Silver's proponents argue that the demand profile around the grey-ish metal is superior because it is used in more industrial applications than gold.

Silver is used in electronics and in healthcare and food preparation (because of its antibacterial properties).

It's also part of the renewables revolution as a solar panel component, but we could swear that every mineral is a 'battery metal' these days.

About half of silver is consumed, while another 20% is used in jewellery and special occasion tableware.

"Silver wears two hats," says Ainslie Bullion director Paul Engeman. "It's got the monetary metal hat and the industrial metal hat. So if commodities boom on an inflation led reflation trade, then silver will enjoy that ride.

"The fact it's coinciding with inflation means the inflation hedging monetary side is going well for silver as well; it gets that double whammy."

He notes that more silver is consumed rather than hanging around in a vault, while supply is finite. China accounts for 22% of silver exports, but has imposed export bans in the same way it has constrained supply of magnesium, phosphate and rare earths.

Only about one-quarter of silver supply comes from primary production; the rest is a by-product of lead, zinc, copper and gold mining. If Chinese demand for these other metals declines as expected, silver output will also be affected.

Outside of China, silver production is dominated by Mexico, Peru, Russia and Bolivia – all of which are not exactly Top of the Wazir when it comes to stable mining jurisdictions.

As a much smaller market, silver trading is more volatile and more prone to manipulation, as evidenced by the Hunt Brothers - all three of them – who tried unsuccessfully to corner the market in the late 1970s.

In Engeman's words: "silver is both a smaller market and it's got more masters than gold has."

As with gold, there are several ways for investors to gain a silver exposure, ranging from owning the physical metal, exchange traded funds, digital tokens (more recently) and the listed producers.

Ainslie Bullion reports strong demand for its silver ingots and coins, usually as an adjunct to gold investment.

As far as ASX exposures go, there are no pure-play silver producers but there's a raft of early to mid stage players eyeing golden – er, silvery – opportunities.

The biggest producer by far is **South32** ((S32)) and its Cannington lead-silver mine in northwest Queensland, which accounts for 6% of global output. But the mine is a small part of the BHP offshoot that covers multiple commodities in multiple countries.

Having listed in July last year **Manuka Resources** ((MKR)) says it is on track to start mining its acquired Wonawinta project, in NSW's Cobar basin, by late 2022.

The project is rated at 38m tonnes with 51m ounces on contained silver, at an average grade of 41.3 grams per tonne.

Manuka is already producing gold from its nearby groovily-monikered Mt Boppy, generating revenue of $22.8m in the June quarter.

The company claims Wonawinta would be Australia’s “largest pure-play silver producer”.

The self-explanatory **Silver Mines** ((SVL)) is in the final stages of obtaining mining approvals process for its Bowdens project near Mudgee in NSW.

With a resource of 163m ounces including reserves of 66m ounces, the deposit is – in the company’s words - “the largest undeveloped silver deposit in Australia and one of the largest globally”.

Production plans assume a 16.5 year mine life, with life of mine output of 66m ounces of silver, 130,000 tonnes of zinc and 95,000 tonnes of lead.

Investigator Resources ((IVR)) is advancing to pre-feasibility stage with its Paris silver project, which is not on the rive gauche of the Seine but in south Australia’s Eyre Peninsula.

Given the guerre de paroles between Messieurs Morrison and Macron, that’s just as well.

The local Paris has 18.8m tonnes with 53.1m ounces of contained silver and 50,000 tonnes of contained lead, with the silver assaying a handy 88 grams per tonne.

For those seeking more oh la la than the Paris option, **Boab Minerals** ((BML)) is moving to definitive feasibility study stage at its 75% owned Sorby Hills lead-silver project, in WA’s Kimberley region.

At last report the deposit was scoped at 49.9m tonnes with 54m ounces of contained silver.

Silver explorers include **BBX Minerals** ((BBX)) in Brazil, **Argent Minerals** ((ARD)) and its Kempfield project in NSW and **Thomson Resources** ((TMZ)) with four silver projects in Queensland and NSW (two of them acquired from Silver Mines).

Indeed! The golden road to prosperity is lined with … silver.

Tim Boreham edits The New Criterion

WEEKLY REPORTS

The Short Report - 25 Nov 2021

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

Summary:

By Greg Peel

Week Ending November 18, 2021.

Last week was another weak one for the ASX200, as the Australian market failed to find any traction despite strength on Wall Street. There was some angst over RBA rhetoric, and the index is still struggling through this week.

A bit of shuffling of the deck chairs among stocks shorted 5% or more last week, with only two stocks posting changes in short position of one percentage point or more. One is Kirkland Lake Gold ((KLA)), and we recall from last week's Report:

"One exception is Kirkland Lake Gold ((KLA)), which jumped to 21.9% shorted from 9.3% and which we can completely ignored. The Canadian-based miner is listed in three countries, thus opening up occasional geographic arbitrage opportunities. It could well disappear off the table next week."

It didn't, but it did drop to 17.9%.

The other is online furniture & homewares retailer Temple & Webster ((TPW)), which saw its shorts rise to 7.6% from 5.9%. As a lockdown winner, T&W's share price started sliding on November 1 – the day Sydney was reopened, and then Melbourne was reopened soon after.

Are the glory days over?

Another stock to note is BHP Group ((BHP)), which has been quietly climbing the table and is now at an unfamiliar 7.1% shorted. It's not a play on the iron ore price, nor anything else sinister, but rather a reflection on BHP moving closer to the end of its UK dual listing as well as the de-merger of its Petroleum division in a scrip-swap with Woodside Petroleum ((WPL)).

Such share register disruptions provide opportunities to play a risk arbitrage. BHP will likely revert back to its low level of shorts once the whole ball game is completed.

We also welcomed a newbie last week, in the form of Appen ((APX)) at 5.4% shorted. See below.

Weekly short positions as a percentage of market cap:

10%+
KLA 17.9
FLT 12.7
KGN 11.7
RBL 10.8

No changes

9.0-9.9

EOS, Z1P

In: EOS Out: WEB

8.0-8.9%

WEB, MSB, COE

In: WEB Out: EOS, ING

7.0-7.9%

ING, TPW, PNV, BHP

In: ING, TPW, BHP

6.0-6.9%

MND, OBL, BET, A2M, MTS, AMA

In: OBL, AMA Out: BHP

5.0-5.9%

APX, TGR, BPT

In: APX Out: TPW, OBL, AMA, RSG

Movers & Shakers

Artificial intelligence company Appen saw its share price surge by 14% last week on a read-through of a strong earnings report from Canadian-based rival Telus International, which Citi noted pointed to improving trends for AI data projects from the major technology companies.

Alas, Appen has given a lot of that back this week on the gravitational pull the local tech sector is drawn into every time the Nasdaq has a tumble.

As was the case with Polynovo last week, there was no new news from Appen, but smaller, riskier stocks are typically the first to be jettisoned at the first sign of trouble.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.1	0.1	MQG	0.3	0.2
ANZ	0.6	0.6	NAB	0.7	0.7
APT	0.9	1.0	NCM	0.4	0.3
BHP	7.1	7.2	RIO	0.3	0.3
BXB	0.5	0.4	TCL	0.3	0.3
CBA	0.7	0.6	TLS	0.2	0.2
COL	0.5	0.5	WBC	1.0	1.1
CSL	0.2	0.2	WES	0.3	0.2
FMG	2.6	2.5	WOW	0.5	0.4
GMG	0.0	0.0	WPL	1.5	1.3

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.

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

In Brief: Shares Can Outrun Inflation, E-Commerce, China, Mortgages & REITs

Weekly Broker Wrap, In Brief: Shares can outrun inflation; e-commerce; China; mortgage stress and REITs.

- Shares can outrun inflation
- Aussies record spending via social media
- Asset price deflation for China?
- Record lows for mortgage holder stress
- Morgan Stanley on smaller-mall REITs

By Mark Woodruff

Shares can outrun inflation

Equities have the potential to perform well compared to bonds and cash in an inflationary environment, according to Ord Minnett. Both the Value style of investing and cyclical shares are generally favoured, while defensive sectors tend to lag.

Cyclical-oriented sectors include Consumer Discretionary, Materials, Energy and Financials, while examples of defensive sectors are Communication Services, Consumer Staples, Healthcare, Real Estate and Utilities.

Inflation is usually accompanied by the benefits of stronger economic conditions, and in addition, companies can often pass through higher prices to consumers. Moreover, costs can be managed down (for example via hedging or cost cutting) in order to boost earnings, explains the broker. This helps offset a decline in the market price/earnings (PE) multiple brought on by higher interest rates.

Ord Minnett feels some of the recent inflation spikes are pandemic-induced (e.g. labour shortages, supply bottlenecks and travel restrictions) and thus transitory, though could still take a year to retrace. However, it’s thought the recent cocktail of fiscal and monetary stimulus, along with pent-up demand, should combine to see inflation settle at a higher level than previously.

Interestingly, the broker says information technology has been a strong performer through past inflationary periods. However, this linkage may be somewhat weakened when taking into account the structural growth in the sector, which may have leapfrogged most hurdles.

Aussies record spending via social media

The average Aussie now spends $35/month via social media channels, a 40% year-on-year increase from 2020, according to PayPal's eCommerce Index.

The most popular platforms are Facebook (70%) and Instagram (42%), though Generation Z (9-24 years olds) shoppers have a preference for Instagram (62%). While they still shop on Facebook (61%), they are increasingly buying more through a broader range of social platforms including Snapchat, TikTok and Twitch.

One in five Australians are following their favourite brands on social media to keep on top of sales and discounts. Having spotted a bargain, two in five then prefer to go to the website to make a purchase.

Gen Z shoppers lead in both following brands and purchasing them online, and also have a higher rate of discovering new brands online than other age groups.

Peter Cowan, Managing Director of PayPal Australia notes “The incredible amount of time we all spend on social media, especially younger people, **is positioning social commerce as one of the biggest trends we will see in online shopping over the next few years”.**

Meanwhile Gen Zs, followed closely by Gen Ys, are contributing to a rapid uptick in consumer subscriptions. Little wonder then that one in six Australian businesses offer a subscription service, with nearly half of those launching a new subscription offering during the pandemic.

While movie and TV subscriptions were the top category across all age groups, it wouldn’t be a pandemic without mentioning 5% of Australians have subscriptions for the likes of toilet paper and mindfulness apps, as well as pet supplies and accessories.

Businesses with subscriptions say they saw revenues increase on average by a third after implementing a subscription model, points out Mr Cowan. However, the jury is still out on this trend with an equal number of subscription businesses expecting current levels to be maintained as those bracing for a reversion to pre-covid levels.

Asset price deflation for China?

Fresh from securing at least another five years of leadership, Chinese President Xi Jinping has little incentive to prove himself through GDP figures, according to ANZ Bank strategists.

Indeed, high quality development will be preferred, even if that is at the expense of growth. ANZ forecasts GDP growth of 4.6% for FY22, down from an estimated 8% for 2021.

More worryingly, ANZ believes **asset price deflation is a major macroeconomic risk** and points out headline inflation numbers (CPI and PPI) don't capture the outlook for property prices, which could potentially fall by -5%.

ANZ notes core CPI weakness has been persistent, reflecting the sluggish outlook for household incomes. Youth unemployment is still high compared with previous years, while household income per capita is growing at a slower rate than pre-pandemic levels. It's thought **the prospects for income growth will hinder consumption and property investment, potentially risking long-term economic health**.

As China's economy slows, ANZ suggests **investors should focus on property prices, as expectations of positive growth remain crucial for financial stability**. Following the slide in property prices in top-tier cities this year, the markets will be watching whether Chinese authorities are willing to relax property measures in 2022.

Record lows for mortgage holder stress

According to new research from Roy Morgan, mortgage stress today is less than half the level experienced during the GFC in 2008. Polling shows an estimated 584,000 or 15.8% of mortgage holders were 'At Risk' of mortgage stress in the three months to September 2021.

'At Risk' is defined as mortgage repayments exceeding a certain percentage of household income, depending on income and spending.

The current record-low level has been attained via a combination of record-low interest rates and record levels of government support, notes Michele Levine, Chief Executive of Roy Morgan. In addition, lenders have implemented measures to support mortgage holders during the pandemic.

Moreover, strong employment growth during 2021 has led to a record 13 million Australians being employed compared to less than 12 million at the beginning of the pandemic.

A similar downward trend has also emerged for those mortgage holders considered 'Extremely At Risk', which is when the interest only component exceeds a certain proportion of household income.

Smaller mall REITs

Following increased mobility as pandemic restrictions ease, Morgan Stanley feels the relative attractiveness of smaller mall REITs with regional exposure may lessen.

As a result, the broker lowers the rating for Charter Hall Retail REIT ((CQR)) to Underweight from Equal-weight, and its rating for Shopping Centres Australasia Property Group ((SCP)) to Equal-weight from Overweight.

Over half of their respective retail malls are located outside of capital cities and supermarket tenants are the largest contributors to rent.

While both should suffer from slowing regional migration, with less of a snapback trade on reopening compared to some other REITs and limited balance sheet capacity the analysts have a preference for Shopping Centres Australasia. This is because of a higher forecast three-year compound annual growth, explains Morgan Stanley.

SMSFUNDAMENTALS

SMSFundamentals: Super-Sized - Observations From A Private Investor

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals section on the website.

Super-Sized - Observations From A Private Investor

By Danielle Ecuyer

As a retail investor it is far too easy to become bogged down in the short-term stock price movements and the profile grabbing headlines in the financial media. Often, it is worthwhile for us to cast an eye over what is taking place in the big end of town and observe whether there are some large-scale trends.

This week I had the opportunity to observe the **AFR Super and Wealth Summit**.

Although I manage my SMSF and have done so for years, there were some notable trends and take away points for investors like you and me.

The wealth and superannuation industries, like many other industries are in a state of transition and restructuring. The flow on impacts of the Hayne Royal Commission continue to rumble through the industry.

Jeremy Cooper, Chairman, Retirement Income for Challenger highlighted that there are currently 15 alliances and mergers underway in the industry.

David Byrant, President Pacific Region and CEO of Mercer Australia observed that the structure and the shape of the industry will continue to change, with 140 funds currently available and in five years the number may well be reduced to 40 funds.

Byrant emphasized three broad categories from large funds that have eliminated the disadvantage of scale; purpose driven funds such as ‘industry, faith or service’ and lastly ‘challenger’ funds that offer an alternative be it an ESG slant or one more specific to a unique retail manager.

The fact is the Australian superannuation industry is large, very large and undergoing considerable change.

The Hon Jane Hume, Minister for Superannuation, Financial Services, and the Digital Economy reminded the summit that with $3.3trillion under management and 16 million members the industry now represents 150% of Australia’s GDP.

The median super is $125,000 and expected to grow to $460,000 in forty years.

The largesse of the savings and the position of the industry in the government's portfolio creates often disputed and awkward conversations politically as a possible place to access higher taxable income or in the case of the pandemic allow for 3million Australians to access $38 billion in savings.

The lack of housing affordability in Australia also raises the prickly question of should first home buyers be allowed to access their superannuation savings for a housing deposit?

It is unlikely the regulatory question marks will disappear as the size of the industry is forecast to grow to around 280% of GDP in 2061 according to Jeremey Cooper. That would equate to $34trn of superannuation savings and double the size of the Australian ASX today.

Size has its problems too. The Norwegian Sovereign Wealth Fund is unable to invest in the Norwegian economy for fear of overheating the economy or basically the fund is too large for the investible asset base.

Australian superfunds at the summit also cited the increasing need to invest overseas, in part because the opportunities in sectors such as renewable energy and decarbonisation were greater with a lower risk profile.

Debby Blakey, CEO of Hesta cited that every $1 invested in Australia is matched by $3 overseas in the decarbonisation space. Both Ms Blakey and Deloitte Access Economics Partner Chris Richardson concurred with the need for policy certainty over a 10-, 20- and 30-year time frame to drive positive and risk adjusted investment outcomes for members in the investing opportunities to tackle global issues like climate change.

The appetite for more private assets and infrastructure assets is also on the agenda.

One of the greatest changes for the superannuation industry is the transition from the 'accumulation' phase of the asset base to the 'de-accumulation' or retirement phase for members.

Sally Loane, CEO of the Financial Services Council and Paddy McCrudden, Head of Retirement Solutions and Data Science at Magellan Asset Management both raised the conundrum for product and service providers of meeting three objectives for retirees –

1. Providing a stable and reliable income in retirement
2. Avoid excessive risk taking to achieve the income streams
3. Access to capital

The golden egg of retirement products is still evolving and given the three objectives in what will predominantly be a lower growth environment according to Chris Richardson remains challenging.

The industry leaders emphasized throughout the summit the need for increased investment in the digitalisation and tech upgrades to the industry.

Deanne Stewart, CEO of Aware Super didn't pull any punches when she quoted the industry as being like a "dinosaur", trapped in a world of paperwork and the urgent need to embrace "technology, data and digital".

The retail segment of wealth market has been well covered post pandemic. The Gen Zs and the millennials have embraced the low-cost trading platforms and the crypto currency markets. My hunch is that they are here to stay and will continue to impact on how the industry shapes itself, but a market shake out might give some of them a nasty fright.

The hot topics, crypto and decentralised finance were embraced in varying degrees. Minister Hume stated the government would not seek to legislate against the market, but suggested investors should approach the asset class with “caution not fear”.

Joe Longo, Chair of the Australian Securities and Investment Commission (ASIC) made some great points, highlighting ASIC does not strive to eliminate risk, but maintain enforcement of regulations in combination with reducing red tape to provide for more affordable advice in a post covid world.

In his words crypto is “phenomenal and impossible to ignore” but substantial policy questions around DAOs or ‘decentralised autonomous organisations’ are in play.

How do you regulate an organisation that has no directors, normal company structure or annual accounts? In the simplest terms a DAO is an organisation working off a blockchain structure or in the words of Mr Longo the organisation engages by the “rule of code” replacing the “rule of law” in a virtual community.

Some 3% of SMSFs (not me) have money invested in crypto. For what it is worth Mr Longo said consumers should approach with great caution and “don’t put all your eggs in one basket”.

Looking at some of the other highlights; advice for Australians remains too expensive and the levels of engagement too low but improving. A handy reminder to all investors that we are all in a better financial position when we are more informed about where our savings (super) are invested.

The size of the industry will push funds to invest more offshore and into private markets.

For private investors, there is a risk that the global hunt for yield from global retirement funds and private equity has the potential to crowd out investors like you and me.

Think the removal of Sydney Airport from the ASX and this week KKR announced a US$37.5bn bid for Telecom Italia as another example.

My hunch is allocating some cash to listed infrastructure assets might prove savvy as the super funds will be on the lookout to grab the right asset at the right price.

But with so much change in sectors such as energy, I would always risk adjust my investment decision based on possible disruption from regulatory or global trends such as decarbonisation. In other words, if the yield on the asset/investment seems too good to be true (high in a low interest rate world) then proceed with caution.

If the 1990’s and the naughties were the decades for government privatisation of assets and infrastructure then the 2020’s marks the start of the re-privatisation of such assets as global savings target investable, stable and risk adjusted returns.

The summit also reinforced my opinion that the growth in the Cloud, Data and Digitalisation of one of Australia’s largest industries has a long runway. Investors could do worse than us maintaining an exposure to these secular trends as well.

Danielle Ecuyer has been involved in share investing in Australia and Internationally for over three decades, both professionally and personally and is the successful author of Shareplicity A simple approach to investing and Shareplicity 2 A guide to investing in US stock markets.

TREASURE CHEST

Treasure Chest: EML Payments

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

By Rudi Filapek-Vandyck

Whose Idea Is It?

Analysts at Wilsons

The subject:

Up and coming fintech company, EML Payments ((EML)).

The company announced earlier today the Central Bank of Ireland has refrained from keeping its local subsidiary under broad based operational limitations, albeit with the caveat that some limitations will remain in place for 12 months or less.

Investors have jumped on the news and pushed up the share price by no less than 21% with the last price at the time of writing this story being $3.33.

Wilsons notes, even after today's positive response, the EML share price is still well below where it was trading before the Irish Central Bank intervened in May and requested more disclose from the company about its subsidiary European business, Prepaid Financial Services (PFS).

Back in May, the share price was well above $5 and it had been as high as $5.75 earlier in the year. Wilsons doesn't necessarily think investors should expect to see the EML share price running back to where it was, as multiples for young fintechs such as EML have de-rated since, but the analysts are still confident the share price will be higher by March next year.

Why March? It is the analysts' forecast EML will report solid, high quality but moderated growth over the nine months to March 2022. As such, the share price is expected to recover more substantially by the time the FY22 numbers are due in August.

Post today's announcement, Wilsons has reiterated its Overweight rating with a price target of $4.62.

More info:

Other brokers covering EML Payments have not yet responded to the company's market update, but their twelve month price targets are well above the current share price. As shown on Stock Analysis on the FNArena website, Macquarie's price target is $3.90, but UBS has a target of $4.40 and Ord Minnett sits at $4.02.

It goes without saying, all ratings are positive (Buy or equivalent).

The low-marker among brokers, as far as we know, is Cannaccord Genuity, whose price target only goes as high as $3.50 and thus rates the stock as a Hold.

Prior to last year's global pandemic, EML Payments had crowned itself to one of the star performers on the ASX with the share price rallying from circa $1.40 to $5.64 throughout calendar 2019.

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

TREASURE CHEST

Treasure Chest: BWX Ltd

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Today's idea is BWX Ltd by CLSA.

By Rudi Filapek-Vandyck

Whose Idea Is It?

Analysts at CLSA

The subject:

Multi-national manufacturer, developer and marketer of natural skin and hair care products, BWX Ltd ((BWX)).

CLSA has upgraded to Buy with the shares considered too cheaply priced, as also implied by CLSA's fresh price target of $5.80 (down from $6.00).

It is the analysts' view that the share price has been held back by the recent performance not meeting expectations due to lockdowns and a slower-than-expected recovery of in-person visits to retailers in the US and in Australia, plus some unfavourable FX moves didn't help either.

On CLSA's assessment, foot traffic is now accelerating and the broker thinks positive momentum will not only continue, but also exceed market expectations.

More info:

BWX listed on the ASX in late 2015 as a premium wellness and skincare brand. It wasn't long before the company captured investors' attention as sales of Sukin skin care products quickly gained market share throughout Australia, but the story came unstuck in 2018 and the share price subsequently fell from near $8 to below $2 in 2019.

Through acquisitions, BWX has by now effectively turned itself into a US market story where partnerships with North American retailers offer the promise of a much brighter future. The share price has more than doubled over the past 2.5 years.

On current forecasts (see Stock Analysis on the FNArena website) profits are expected to dip due to the aforementioned slower-than-expected recovery from lockdowns, but expected to be followed-up by a strong growth recovery in FY23.

Analysts at Macquarie, who updated on Thursday morning, equally hold a positive view, as also demonstrated by their $6 price target and Outperform rating. Citi, with a price target of $5.70 and a Neutral rating, had earlier warned that higher freight costs and other covid-related set-backs would eat into the company's margin.

Two other brokers who haven't updated for a while, Moelis and Canaccord Genuity, equally hold price targets well above today's share price. Moelis sits at $5.20 and Canaccord at $5.62.

Where both differ is in their focus. Moelis is with Citi and thus concerned about higher costs eroding the benefits from an acceleration in growth. Its rating is thus Hold, also in line with Citi.

Canaccord Genuity is with CLSA, confident about a very strong looking growth profile for the years ahead, with a valuation that is thus too cheap. No surprise, Canaccord's rating is Buy.

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

RUDI'S VIEWS

Rudi's View: The Secret Ingredient

In this week's Weekly Insights:

-The Secret Ingredient
-Conviction Calls
-Research To Download
-All-Weather Model Portfolio

By Rudi Filapek-Vandyck, Editor FNArena

The Secret Ingredient

Imagine two similar companies, competing in the same sector. One is hellbent on doing the right thing, the other cares a lot less about the long-term picture and instead is obsessed with its share price in the short term.

To many an investor, the difference between these two investment options is rarely obvious and mostly simply a matter of personal preference. One year one is in fashion and performs better, the next year the competitor catches up and proves the doubters wrong.

This is where the art of investing shares shows one crucial similarity with the appreciation of visual art: stand too close and you might see a lot of details, but you'll never enjoy the full beauty of the artist's creation.

Let's assume our two companies are equally profitable, which could be something like 25c out of every dollar in sales. The first company decides to invest for longer term benefit, while the second is happy to pay most of it out to happy shareholders.

Usually what happens in the share market is the second company is instantly rewarded while the first one sees its share price being punished for not spending its cash profits on pampering the shareholders. At least, that's what first optics show us, with share prices heading south every time management at a listed company announces increased investment.

It's a tough gig, being at the helm of a publicly listed company, but investors should not assume the share market prevents boards and managers from making long-term decisions; it's just that tough questions will be asked, in particular for unlikely or unproven strategies.

If the first of our companies decides to spend 5c out of the 25c in cash profits each year on future benefits, this is only a headwind in the short term. Once investors get comfortable with the extra spending and the returns that are achieved, and can be expected, today's initial scepticism will turn into tomorrow's reward.

Sure, profits for company number one might start to accelerate faster, though this is not always immediately obvious, certainly not when both companies operate in a booming environment. But everyone can figure out that applying the same valuation multiple for both companies doesn't seem 'fair' or even logical.

For starters: company one could easily report the same profit as company two, it's just that it chooses not to for an identifiable purpose: achieving higher rewards for longer for today's shareholders. Investors in the share market can be emotional, single-eyed and short-term obsessed, but they are not completely without a brain.

Give them enough evidence that those investments bring tangible rewards, and they will sit up and pay attention.

Under favourable circumstances, it is possible there is no genuine difference in profitability between our two competitors, but as investors we do understand that company number one could stop its investment if it wanted, and this would instantly increase its profits and thus the short-term valuation of the business. Thus it makes little sense to value company number one less than its competitor.

One way to close the gap between these two is by applying a slightly higher multiple to the 20c in profits at company one vis-a-vis the 25c reported by number two. After all, company one is not simply throwing those 5c out of the window and the board could stop spending that cash any time.

What we are witnessing here is the birth of a valuation premium.

Any investor unaware of the specifics would look at the face value valuation for both companies and conclude: one is on par with the other but reports less profits and pays a smaller dividend. This makes no sense! The common mistake being made is to declare company one is "expensive".

Logic tells us, it might take a while, but the relative gap in operational performances between our two competitors will widen over time, further enlarging the gap in valuations. Of even more importance is that when the tough times arrive for the industry, and they will, investors will learn one extra invaluable lesson: company one is much better protected than competitor number two.

As with a property that has received no maintenance, when proper headwinds arrive investors might discover there are a lot more leaks in the roof that cause a lot more damage, while the building on the other side is standing firm and tall. There is value in the knowledge the next storm won't simply blow off the roof or decimate the front of the house, though we don't know exactly how much that value is.

The share market does have a collective memory. It builds as booms follow downturns; peaks follow troughs; cycles wind-up and wind-down.

In credit markets, it is but basic practice to reward the most solid and reliable borrower with a loan at lesser cost. In the share market investors have equally come to appreciate the worth of reliability and steadiness, albeit with a less defined, less identifiable benefit, but it is there in the share price valuations for companies that have gained investors' trust and confidence.

It is usually granted to sector leaders with pricing power who have the ability to defend their territory. It may not always be visible or obvious, but continuous investments made can act as a genuine moat around the business, which further adds to investors' confidence and trust.

Understanding the above is appreciating that successful investing is so much more than simply jumping on bombed-out, 'cheap' looking stocks. It also explains why many of the outperformers over the past decade(s) never once landed on the radar of bargain-obsessed, value-seeking investors, but their outperformance stands undisputed.

The above also explains why some companies deserve to be labelled 'High Quality' and others never will, as well as the differences in valuation and share price performances beyond the 'right here, right now'.

Compare Sonic Healthcare ((SHL)) and Healius ((HLS)) and you'd be forgiven to think 'valuation' no longer matters in this market (it still does, rest assured, it's just not as simple as solely applying a multiple on next year's estimated profit). The same can be said about Aristocrat Leisure ((ALL)) versus Ainsworth Game Technology ((AGI)), REA Group ((REA)) versus Domain Australia Holdings ((DHG)), Woolworths ((WOW)) versus Coles Group ((COL)), Hub24 ((HUB)) versus Praemium ((PPS)), Computershare ((CPU)) versus Link Administration ((LNK)), and so forth.

But as with the sector premium granted to CommBank ((CBA)), investors should equally never assume things can never change, or market leaders can never lose their status. In the case of Ramsay Health Care ((RHC)), for example, a generally challenging environment for the private hospitals sector internationally has placed a firm ceiling above the share price since 2016. And who can forget the time when hubris took hold of the board and management at Woolworths with its share price tanking between 2014-2016?

In 2021 it is the status of CommBank versus other banks in Australia that has come under investor scrutiny. Similar to all cited examples, CommBank shares started building a relative valuation premium since the second half of the 1990s, only a handful years after its IPO in 1991. The shares have very rarely not traded on a sector premium since.

The explanation as to why is multi-fold (as is often the case with other examples too). One measurable metric is CommBank's return on equity (RoE) has consistently beaten all others in the sector over the past thirty years. As Australia's dominant retail bank, CommBank has steadfastily enjoyed the largest group of loyal shareholders, which has helped with protecting and maintaining its premium status.

A consistent stream of investments made, while others were um-ing and ah-ing, means CommBank is miles ahead of ANZ Bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)), and even further ahead of the regionals, when it comes to technology. This might also explain why CommBank has built a track record of the most consistent operational performance for the sector in Australia.

As with other examples, CommBank shares are seldom hailed as an investment opportunity, and banking sector analysts always have a preference for other banks, with CommBank usually placed on number 3 or last in the Big Four picking order. But as with other examples, CommBank shares have significantly outperformed all peers on mid- and longer-term horizons.

On calculations made by analysts at Wilsons recently, total performance of CommBank shares since its IPO thirty years ago is almost twice as high as that of ANZ Bank, the second best performer over that period. Investors might want to take a deep breath and read that last sentence again.

Never the cheapest, steadfastly the superior performer. If only Warren Buffett had been investing in Australian shares, investors and market commentators might be less obsessed with 'cheap' valuations, and with a better understanding of what makes a sustainable, superior, longer-term investment.

Among banks in Australia, CommBank is the only one whose shares have risen above the peak from May-2015 as well as pre-GFC. Berkshire Hathaway would be owning a large chunk of CBA shares today, and of CSL ((CSL)) and a number of the other examples mentioned.

But more than anyone else, Warren Buffett also understands that hubris can just as easily creep into a share price, which is why loyal shareholders could be in for a prolonged re-adjustment, which is another way of stating: don't expect too much for the months ahead.

CommBank is likely to retain its status as Australia's premier bank, but that valuation gap between it and other banks might have blown out too far in recent years. Or as some sector analysts put it post the recent disappointing quarterly market update: it's a bank, not a technology growth stock. And also: it's the superior among peers, but still a bank.

If we take a leaf from history, CommBank shares on average enjoyed a valuation premium of circa 20% versus other banks. Post Royal Commission, that premium had quickly ballooned to 50%-70%, depending on what metric is used. It is this large premium upon the usual premium that has analysts almost in perfect synchronicity expecting relative underperformance for the sector leader in the year ahead.

And it's not as if the sector in general is experiencing boom times.

Of course, those doubting whether CommBank deserves to trade on a higher valuation than the rest of the sector will most likely be proven wrong, as its technological leadership places CBA in a much better position to fend off aggressive fintechs and other changes impacting on the industry over the decade ahead.

In the short term, however, that premium upon the premium remains a problem now that operationally, CommBank has proven just as vulnerable as the lesser gods on the ASX.

As with all other examples, the secret ingredient is what you don't see when you simply look at the share price, the balance sheet or the financial numbers. Only this time, it is working as a negative.

****

Next week will be my final Weekly Insights for 2021.

Recent editions of Weekly Insights

Ansell, Mach7, Nitro Software, ResMed And Santos:

https://www.fnarena.com/index.php/2021/11/18/rudis-view-ansell-mach7-nitro-software-resmed-and-santos/

Three Risks Into Year-End:

https://www.fnarena.com/index.php/2021/11/11/rudis-view-three-risks-into-year-end/

Bonds Versus Earnings:

https://www.fnarena.com/index.php/2021/11/04/rudis-view-bonds-versus-earnings/

Australia's Share Market Sweet Spot:

https://www.fnarena.com/index.php/2021/10/28/rudis-view-australias-share-market-sweet-spot/

Conviction Calls

The duo of **software sector** enthusiasts at **Shaw and Partners** has stuck with their three sector favourites, in order of preference: Mach7 Technologies ((M7T)), Whispir ((WSP)), and Gentrack Group ((GTK)).

****

Guardians of **Model Portfolios at stockbroker Morgans** didn't think too long before signing up for the opportunity to own extra shares in Aristocrat Leisure ((ALL)) and Macquarie Group ((MQG)) recently (2x capital raisings), but they also made the difficult decision to sell all shares in Magellan Financial Group ((MFG)) for the Growth Model Portfolio.

The latter decision was, on their own admission, "a very difficult call" that has resulted in the Portfolio realising a "chunky loss".

****

Market strategists at **Canaccord Genuity** released their most preferred sector allocations -**Best Investment Ideas**- which saw Newcrest Mining ((NCM)) being added as a large cap and BlueScope Steel ((BSL)) as a mid-cap idea. Following the merger between the two, Saracen Minerals has been replaced with Northern Star ((NST)).

The full list of Best Investment Ideas, as per below, contains a few odd choices (in my humble view) and I can only think of "too cheap" as a justification for their selection. (Apart from the fact that Amcor doesn't belong under building materials).

Best Investment Ideas by Canaccord Genuity

CYCLICALS

Resources
-BHP Group ((BHP))
-Newcrest Mining
-OZ Minerals ((OZL))
-Iluka Resources ((ILU))
-IGO ((IGO))
-Northern Star
-Gold Road Resources ((GOR))
-Orocobre ((ORE))
-Perseus Mining ((PRU))

Oil&Gas
-Woodside Petroleum ((WPL))
-Origin Energy ((ORG))
-Santos ((STO))
-Carnarvon Petroleum ((CVN))

Banks
-National Australia Bank ((NAB))
-Westpac ((WBC))

Mining Services
-MacMahon Holdings ((MAH))
-Perenti Global ((PRN))

Building Materials
-Amcor ((AMC))
-Reliance Worldwide ((RWC))
-BlueScope Steel
-Calix ((CXL))

Financials
-Macquarie Group
-Insurance Australia Group ((IAG))

Consumer Discretionary
-Dusk Group ((DSK))
-Marley Spoon ((MMM))

SENSITIVES

Industrials
-Brambles ((BXB))
-Aurizon Holdings ((AZJ))
-Cleanaway Waste Management ((CWY))
-Downer EDI ((DOW))
-Electric Optic Systems Holdings ((EOS))
-Fleetwood ((FWD))

Info Tech
-REA Group ((REA))
-Elmo Software ((ELO))
-Whispir

Utilities
-Spark Infrastructure ((SKI))

Infrastructure
-Transurban ((TCL))
-Atlas Arteria ((ALX))

Communication Services
-HT&E ((HT1))

DEFENSIVES

Healthcare
-CSL ((CSL))

Wagering & Gaming
-Aristocrat Leisure
-Tabcorp Holdings ((TAH))

Consumer Staples
-Treasury Wine Estates ((TWE))
-Ricegrowers (SGLLV))

LISTED PROPERTY
-Stockland ((SGP))
-Scentre Group ((SCG))
-Lendlease ((LLC))
-Abacus Property Group ((ABP))

Research To Download

Independent Investment Research (IIR) reports on:

-Clime Capital ((CAM)):

https://www.fnarena.com/downloadfile.php?p=w&n=B27297EB-9DC9-B9F6-E07B75AEA3322184

-Initiation on Loomis Sayles Global Equity Fund ((LSGE)):

https://www.fnarena.com/downloadfile.php?p=w&n=B27DBC6A-0C73-D1C7-6CA1C3453C1FC60F

-Antipodes Global Investment Company ((APL)):

https://www.fnarena.com/downloadfile.php?p=w&n=B28448C8-B597-344F-3F45B008A1853B80

All-Weather Model Portfolio

Since late 2014, the FNArena/Vested Equities All-Weather Model Portfolio has been based upon my research into All-Weather stocks on the ASX.

Monthly Portfolio reviews published in 2021:

-October: https://www.fnarena.com/downloadfile.php?p=w&n=4BA408AC-AF35-78F5-F42D94A2CF808BF1

September: https://www.fnarena.com/downloadfile.php?p=w&n=B6798F75-0375-ACE0-CAB39BEDF04567BE

August: https://www.fnarena.com/downloadfile.php?p=w&n=B674AF06-E339-5816-5FD0DA4AE7D29F80

June/July: https://www.fnarena.com/downloadfile.php?p=w&n=B66CC435-9758-005C-77B2719A92612A9B

May: https://www.fnarena.com/downloadfile.php?p=w&n=B66804C2-BB83-93BF-AEFB5A28EC0E4A5A

April: https://www.fnarena.com/downloadfile.php?p=w&n=B664E73A-FBB4-1456-8EF79590D64EBF29

March: https://www.fnarena.com/downloadfile.php?p=w&n=B66218E0-DB14-B8D4-360E91AE22EA01AC

February: https://www.fnarena.com/downloadfile.php?p=w&n=B65DC629-929F-1743-8FF1EEFE600DF5A8

(This story was written on Monday 22nd November, 2021. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

(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).

****

TERMS AND CONDITIONS OF USE, AND DISCLAIMERS

These Terms and Conditions of Use, and Disclaimers constitutes your agreement with FNArena Ltd with respect to your use of its FNArena website, its weekday news periodical, Australian Broker Call, as well as any other publications (including articles) FNArena may publish on its website, or anywhere else, from time to time.

Please read the contents of this page carefully as it contains important legal information and disclaimers. By entering and perusing the website, reading the Australian Broker Call, or, if you are subscriber, by entering the password protected part of the website, you acknowledge that you have read, understood and accept this agreement.

By accepting this agreement you acknowledge, understand and accept the following:

1. Reference to “FN Arena” and “FNArena” means reference to FNArena Ltd, its journalists, directors, other employees, affiliates, agents, associates and subsidiaries.

2. FNArena Ltd is the owner of the FN Arena website and brand name.

3. Reference to “we” or “us” is reference to FNArena.

4. Reference to “this website” or the “FNArena website” means reference to www.fnarena.com, and includes reference to FNArena’s weekday news periodical, Australian Broker Call, as well as any other publications (including articles) FNArena may publish on this website, or anywhere else, from time to time.

5. Reference to “news periodicals” means reference to FNArena’s weekday periodical, Australian Broker Call, as well as any other periodicals FNArena may publish from time to time on this website, or anywhere else, from time to time.

6. Reference to “publications” in this agreement means any material, including articles, published or put in print on the FNArena website, or anywhere else, whatsoever, and includes FNArena’s weekday periodical, Australian Broker Call, and any other periodicals FNArena may publish from time to time.

7. Reference to a “visitor” means, you, a visitor to this website, and includes a subscriber to Australian Broker Call as well as any other publications or periodicals FNArena may, from time to time, publish through its website.

8. FNArena is a media company which employs financial journalists to report financial news. FNArena’s journalists perform the required research and collect the information that is, ultimately, each day, published on this website and in FNArena’s news periodicals. As is obvious, the process by which the information is collected and delivered to you is a purely journalistic one and, therefore, the comments, opinions and recommendations FNArena reports on this website are not the opinions of FNArena or any of its journalist or other employees. FNArena is ONLY and specifically a

matter-of-fact reporter of industry signals suggesting price direction probability of some shares. FNArena simply delivers the information – it does not create it.

9. Although FNArena obtains the information published herein from sources deemed to be reliable, and given and received in good faith, it cannot and does not guarantee its accuracy. FNArena does not take any responsibility either for the financial soundness or for the correctness of statement made or opinion expressed in the data or content reported by FNArena, and cannot and does not guarantee the reliability and accuracy of the opinions of the brokers whose opinions, recommendations and forecasts it reports.

10. FNArena publishes this website, all publications and its periodicals strictly for convenient personal, non-commercial, educational and informational purposes of its subscribers only. Our goal is to provide the subscribers with a convenient starting point of potentially useful, but not comprehensive, content that can educate or otherwise enhance a visitor's knowledge base and frame of reference.

11. FNArena is NOT a stock broker or financial or trading advisor, nor is it an advisory service of any kind, and no advice or recommendations on investments or trading are made nor implied on this website. Nothing contained in this website is intended to be, nor shall it be construed as, advice or recommendation. Any investment or other decisions made by you must be based solely on your own evaluation of the targeted subject for investment, and your financial circumstances and investment objectives, and FNArena will not be held liable for any such investments and decisions.

12. It is distinctly understood and accepted that the shares referred to in the FNArena website, FNArena's publications and/or periodicals have not been recommended by FNArena. The content and or any comments found of this website, including the content and/or comments published in any publication and/or periodicals published by FNArena, do not constitute a recommendation or endorsement by FNArena with respect to any company, security, share or investment or any financial or investment product.

13. This website makes no representations, and, to the extent allowed by the law, specifically disclaims all warranties, express, implied or statutory, regarding the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any material contained in the website.

14. Before making an investment decision, you must do your own research and rely on your own examination of the share, and the risk involved, and not on what you read on the FNArena website, or in any publication or periodical. The content of this website is provided strictly for convenient personal, non-commercial educational and informational purposes only and FNArena shall not be held liable for any investment decisions, sales or purchase decisions, which you may have made based on what you have read on this website or in the periodicals published by FNArena from time to time, or in any other publications FNArena may publish on its website, or anywhere else, from time to time. Anyone who makes investment decisions based on what they read on this website does so at their own risk, and agrees that they cannot hold FNArena responsible and/or liable for any loss whatsoever.

15. It is your responsibility to evaluate the completeness, accuracy and usefulness of any content made available on this website. If you are unsure, or in doubt about the meaning of any information, you should consult your financial advisor.

16. FNArena does not guarantee any returns on investments made in any share mentioned on this website by the visitors. As any investor well knows, any investment opportunity, strategy or concept involves a degree of risk and investors should not invest any funds unless they can afford to take the risk of losing their investment. FNArena strongly suggests that you consult your own financial advisors regarding the soundness of any intended investments, strategies or concepts, and discuss with such advisor your individual investment needs and goals. You may also wish to consult the broker who expressed the opinion we have reported on in the news periodicals we publish.

17. FNArena shall not be held liable to any visitor of the FN Arena website, or any reader of its periodicals and/or publications, or anyone else who may have relied on this website, directly or indirectly, for any inaccuracies in the printed material found on the FN Arena website, in the periodicals and/or other publications, any typing errors, omissions, interruptions, timeliness, completeness, deletions, defects, failure of performance, computer virus, communication line failures, alterations of, or use of any content herein, regardless of cause, for any loss or damage resulting therefrom.

18. Under no circumstances, including, but not limited to negligence, shall FNArena be liable for any direct, indirect, incidental, special or consequential damages that result from the use of, or the inability to use, the FNArena website, and any or the FNArena’s publications and/or periodicals.

19. As a condition of use of the FNArena Website, FNArena’s publications and periodicals, you agree to indemnify FNArena and all those affiliated with it from and against any and all liabilities, expenses (including legal costs) and damages arising out of claims resulting from your use of the FNArena website, FNArena’s publications and periodicals. If you are uncertain about this agreement or the contents of the FNArena’s website, or are dissatisfied in any shape or from, with the content of the FNArena website, or any of the publications or periodicals, or you do not agree with these terms and conditions, your sole and exclusive remedy is to discontinue using the FNArena website, FNArena’s publications and periodicals.

20. FNArena may, from time to time, publish advice, opinions and statements of various third parties, other than the ten stock brokers, and various other information and content providers. FNArena does not represent or endorse the accuracy or reliability of any advice, opinion, statement or other information provided by these third parties. Reliance upon any such opinion, advice, statement, or other information is at your own risk.

21. The FNArena website may contain links and pointers to websites maintained by third parties. FNArena does not operate or control in any respect any information, products or services on such third-party websites. Third party links are included solely for the convenience of visitors, and do not constitute any endorsement by FNArena of any products or services provided by the third party link owners or operators. FNArena has no control over any websites that we might link to and does not

take responsibility for their quality, content or suitability.

22. FNArena is not responsible for claims made by advertisers on the FN Arena website or in any of its periodicals. Such advertisements are included solely for the convenience of visitors, and do not constitute any endorsement by FNArena of any products or services advertised. FNArena does not check the accuracy of the statements made by the advertisers. You assume sole responsibility for the access and use of third party links and pointers from the FN Arena website, as well as any purchases you may make from those third parties (including advertisers).

23. All the content, information and material made available on this website are provided to you "as is" and without warranty of any kind from FNArena whether express or implied, including, but not limited to, implied warranties of merchantability and fitness for a particular purpose, title, non-infringement, security or accuracy, nor does FNArena endorse or take any responsibility for the accuracy or reliability of any opinion, advise or statement made through the FN Arena website, its periodicals, or for making good all or part of any loss and/or damage that may have been caused by the visitor's reliance on any information, advise, product or service obtained from a linked website.

24. FNArena is not liable for any copyright infringements incurred by any outside content or information contributors, or by third parties who have links to this website, or advertise on this website.

25. FNArena reserves the right to make any and all changes to the FN Arena website, including the publications and periodicals, at its sole discretion without notice to you. FNArena reserves the right to deny access to this website or its information to anyone at any time.

26. This agreement shall be deemed to include all other notices, policies, disclaimers, and other terms contained in the FNArena website, provided, however, that in the event of a conflict between such other terms and the terms of this agreement, the terms of this agreement shall prevail.

27. FNArena shall have the right, at its discretion, to change, modify, add or remove terms of this agreement at any time. Changes shall be effective immediately. Notification of any such changes shall be made herein, therefore, you are strongly advised to read these terms each time you wish to access the FN Arena website or any periodical.

28. No permission is granted to copy, distribute, modify, post or frame any text, graphics, video, audio, software code, or viewer interface design or logos. The entire FNArena website, including the publications and periodicals, is subject to copyright with all rights
reserved. The information contained in the website, including the publications and periodicals, shall not be published, rewritten for broadcast or publication or redistributed in any medium, or for any other reason whatsoever, without prior written permission from FNArena.

29. All original content is the copyrighted property of FNArena.