Week
32

Stories To Read From FNArena

Friday, 9 August 2019

FNArena
Financial News, Data & Analysis

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Little Relief In Sight For Banks

Australia's banking sector is under pressure amid soft loan growth, a squeeze on margins and a reinvestment burden. Brokers are not yet factoring in much of a recovery.

-Too early to be confident in a post-election rebound for the banks -Borrowers likely to use lower interest rates to reduce existing debt -Action to support bank share prices may be viewed favourably

By Eva Brocklehurst

It's no surprise that Australian banks have underperformed the broader market since the reduction in official interest rates in June. The issue for brokers now is whether a bottom for the banking sector is moving into view.

Movements in term deposit spreads versus the Reserve Bank's cash rate were mostly negative in July, when the second cut to official rates occurred. Ord Minnett is concerned about this, noting the widening in short-term term deposit spreads has been particularly pronounced on a three-month view.

The broker suggests assets spreads are under pressure amid potential for more cuts to the cash rate, noting the combination of subdued loan growth, downward pressure on margins and a reinvestment burden mean the banks are in a downgrade cycle.

Morgan Stanley also assesses the re-pricing of standard variable mortgages has not been sufficient to offset the lower earnings on free float and the squeeze on deposit spreads from the June/July cash rate reductions.

Housing loan growth appears to have stabilised at record lows but brokers suspect it is too early to be confident in a post-election rebound. System household deposit growth is subdued, at around 5% in June. System housing loan growth fell to 3.7% in June, with major banks' component growing at just 2.0%.

While the federal election outcome has reduced the tail risks and the reductions in official rates have improved housing market sentiment, Morgan Stanley still expects other factors will prevent a material rebound in loan growth.

Households are more leveraged and new responsible lending proposals from ASIC mean further increased scrutiny of bank expenses. Hence there are constraints on loan-to-valuation ratios, amid softer house prices and more conservative valuations.

Credit Suisse agrees, noting there is still no sign of a recovery in financial aggregates data. Total credit provided to the private sector by financial intermediaries increased by just 0.1% during June, housing credit increased 0.2% and business credit fell -0.1%. While being positive on business lending, expecting aggregate credit growth of 4.3% in FY19 and FY20, the broker believes a modest slowdown in housing will weigh.

Moreover, Morgan Stanley expects more reductions to the cash rate of -25 basis points increments will be forthcoming and margin pressure will accelerate if the new "customer first" approach limits home loan re-pricing. Macquarie is cautious, too, about historical correlations in this regard, envisaging borrowers in the current environment will use lower interest rates to reduce their existing debt, rather than take on more.

With the ongoing intent by authorities to enforce responsible lending standards, previous offsets such as a proliferation of interest-only products are likely to diminish. Interest-only flow pulled back sharply in the September quarter of 2017, Macquarie points out, following the introduction of APRA's 30% cap. This has now stabilised.

While the broker accepts that application volumes improved materially after the federal election, increased activity is suspected to be directed to re-financing at lower rates, which is detrimental to bank earnings.

Falling interest rates undermine bank profitability, as margins are squeezed relative to deposit pricing elasticity. In the short term, Macquarie envisages downside risk to bank margins and believes that consensus interest income expectations are too high for the banks.

Citi suggests the investment community may need to set aside a likely messy set of upcoming results and focus on the outlook for FY20. While the election result brought renewed optimism, the direct impact of a stabilising property market, lower funding costs and the conclusion of the Royal Commission impact will be absent from the FY19 results.

Bank Stocks

Morgan Stanley downgrades National Australia Bank ((NAB)) to Equal-weight as the share price has risen by around 20% since the federal election in May. It has outperformed the other banks by an average of 6%.

The broker also cites revenue headwinds for the retail banking arm and the potential for re-investment under a new CEO, as well as little flexibility on capital. Macquarie highlights that National Australia Bank's housing credit growth has turned positive, as management's action has appeared to be successful in stemming a loss of market share.

Heading into reporting season, Macquarie envisages the highest downside risk is in Commonwealth Bank ((CBA)) and Bendigo & Adelaide Bank ((BEN)), given stretched valuations and an overweight exposure to segments with elevated revenue pressure.

In contrast, Morgan Stanley upgrades Westpac Banking Corp ((WBC)) to Equal-weight from Underweight, given the relative valuation support and more scope to mitigate the impact of lower rates. Ord Minnett points out Westpac has been the first of the majors to make a material change the way it advertises mortgage rates.

The bank has moved to a single $150,000-plus discount-to-standard-variable-rate tier from a multi-tier pricing structure previously. Rather than a genuine increase in discounting, Ord Minnett considers this an improvement in transparency, with advertised rates now reflecting more realistic discounts.

Second-tier banks already operate with this approach and the broker suspects other major banks may follow. This will drive modest margin pressure over the longer term, although Ord Minnett cautions against over-playing the impact on margins.

Ultimately, the broker considers the move by Westpac is good for customers and long overdue, as it addresses some of the concerns of the ACCC about clarity in mortgage market rate pricing.

Soft trends are likely to dominate in the near term with respect to fee income, loan growth and competition for the front book. Citi suspects management action, in the face of these challenges, may be required to support Commonwealth Bank and Bendigo & Adelaide Bank share prices. Specifically, cost management programs and capital initiatives could be viewed favourably.

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Rio Tinto's Iron Ore Benefit Hits A Peak

Rio Tinto has spread the benefit of surging iron ore prices in the first half but most brokers believe sustaining such a high rate of earnings will be difficult heading into 2020.

-Record interim cash return of US$3.5bn -Operating difficulties prevail at the Brockman hub -A drop in iron ore prices could be a catalyst for pressure on the shares

By Eva Brocklehurst

Iron ore was the dominant feature of the first half results for diversified miner Rio Tinto ((RIO)), as the price skyrocketed in the period. Still, expectations were high and the results missed some broker forecasts. A higher iron ore price provided a US$2.7bn benefit for operating earnings (EBITDA), delivering a 65% return on capital employed for the segment. Yet lower volumes induced a 9% increase in unit costs.

The strength in the iron ore price more than offset a -8% decline in Pilbara iron ore shipments in the half-year, which was caused by bad weather, a fire at Cape Lambert and operating issues in the Greater Brockman hub.

A US$3.5bn cash return was a record for the company at an interim result. Morgans expects Rio Tinto has considerable potential to continue paying significant returns, even in the event the iron ore price eases. The company delivered a first half dividend of US$1.51 along with a special dividend of US$0.61. UBS believes this should be viewed favourably, as total dividends reflected 90% of free cash flow generated over the half.

First half underlying earnings were slightly below the broker's expectations because of higher costs in iron ore and provisions for onerous contracts. Dividends were weaker than Macquarie expected, in line with the miss to overall earnings versus the broker's forecasts.

Shaw and Partners, not one of the seven stockbrokers monitored daily on the FNArena database, believes the mid year special dividend represents a subtle shift in capital allocation policy, as specials were previously meted out at the full year results. The broker has a Buy rating and $110 target.

Ord Minnett agrees that the pay-out was just a pulling forward of returns that were expected at the 2019 results. The broker observes the share price has weakened following a change in market sentiment, stemming from re-start of Vale's iron ore production as well as modestly higher iron ore and steel inventory in China.

Nevertheless, the iron ore price appears resilient at just below US$120/t and the broker suggests this is likely to continue in the near term. Should the share price continue to soften, Ord Minnett would look to review its recommendation.

Iron Ore Concerns

Higher costs, particularly in iron ore, mean UBS marks down 2019 estimates for iron ore earnings, to US$12bn. Rio Tinto has acknowledged operating challenges in the first half of 2019 and has taken actions to optimise its performance across the iron ore system.

Operating difficulties have affected mine sequencing at the Greater Brockman hub which will mean increased waste movement over 2019/20. Rio Tinto had to cut volumes to preserve the specifications of its flagship Pilbara Blend.

Production guidance has been maintained for 2019, although Macquarie notes guidance was reduced twice in the first half and could be under further pressure given major rail maintenance scheduled for October.

Credit Suisse agrees there is work to be done to get on top of the uncertainties in the Pilbara.The broker expects 300mt in 2019 but, taking into account the Brockman issues and elevated rail maintenance, risks appear to the downside. The broker downgraded the stock to Underperform in July, believing iron ore prices would peak in the current quarter.

Supply from both Brazil and Australia is increasing and, while there is a risk the call has been made too early, Credit Suisse assesses there is more downside than upside as 2020 approaches. The broker fails to envisage how, on a 12-month view, even a high-quality miner like Rio Tinto can offset declining prices for its major product.

UBS believes the current iron ore price is likely to drive higher earnings in the second half but agrees this is unsustainable, as supply is lifting and demand in China is expected to be softer. The rate of draw on Chinese port

inventory has slowed and Credit Suisse assesses, once inventory is move up again, the resultant fall in iron ore prices will be a catalyst for pressure on Rio Tinto.

Citi now assumes Pilbara shipments of 340mt in 2020 and its 325mt assumption for 2019 is unchanged, although acknowledges Rio Tinto needs to operate at 340mtpa in the second half.

Besides Iron Ore

Slower restructuring in China and the resumption of shipments from Rusal meant the aluminium earnings fell short of expectations. Morgans notes, adding to the soft performance, Rio Tinto's aluminium business was loss-making, amid sustained cost pressures driven by high energy costs in Australia. Rio Tinto expects demand to recover in the automotive sector in China, which will lift requirements for aluminium.

Copper sustained a -11% decline in price in the first half. Production at Kennecott was constrained and there was natural grade decline at Escondida. Global mine supply is expected to fall by -1% in 2019 and Rio Tinto envisages a balanced market in copper over the next five years.

Copper projects that are in the wings include Winu in Western Australia and Resolution in Arizona. Impairment charges were largely associated with the Oyu Tolgoi underground project, where Rio Tinto has flagged to 16-30-months delay to first production. Credit Suisse does not expect any new update from Oyu Tolgoi until 2020.

The company has approved construction of the Zulti South mineral sands project in South Africa and first production is scheduled for late 2021. Rio Tinto has also entered into an agreement with China National Uranium Corp for the sale of its 68.6% interest in the Rossing uranium mine in Namibia.

FNArena's database has two Buy ratings, four Hold and one Sell (Credit Suisse). The consensus target is $101.75, suggesting 8.8% upside to the last share price. Targets range from $91.52 (Morgans) to $114 (Macquarie). The dividend yield on 2019 and 2020 forecasts is 7.3% and 6.2% respectively.

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Soft Coal Prices To Weigh On Coronado

While Coronado Resources has flagged significant productivity improvements and returned cash to shareholders in FY19, brokers suspect softer near-term coal prices and poor sentiment will weigh on the stock.

-Plan to lift saleable coal production to 15mtpa at Curragh -A further surprising payout beyond policy limits considered unlikely -Early release of 11% of register from voluntary escrow

By Eva Brocklehurst

In just over 18 months Coronado Resources ((CRN)) has acquired and upgraded the Curragh metallurgical coal mine in Queensland, finishing FY19 with a significant return to shareholders.

The company has outperformed more modest expectations regarding the upgraded Curragh mine plan, envisaging little risk in achieving its new mine plan at Curragh and lifting saleable coal production to 15mtpa from 2023. Coronado Resources has also returned around US$700m to shareholders.

Nevertheless, the coal price is the main driver for marginal investors and, in this regard, Morgans is concerned about the drop in Queensland hard coking coal to US$160/t. The broker eases back 2019-20 forecasts because of softer coal prices, although the expansion at Curragh offsets the impact on valuation. Morgans is positive about the long-term but believes there is risk in the coal market from Chinese restrictions and pricing in the short term.

Credit Suisse agrees that despite the positive aspects of the new mine plan, the coal price and macro sentiment are running ahead of company specific factors. Strong cash generation and distributions, and the potential to be included in the S&P/ASX index are all up against a background of softer metallurgical coal prices.

Distributions totalled US$0.41, including a US$0.112 dividend and a US$0.298 capital return. Gearing has now been re-set at a level that Morgans expects will continue and, therefore, the scope for further surprising pay-out beyond the 60-100% policy appears limited. Bell Potter assesses the distribution paid in excess of free cash flow in the first half is, in part, a pre-payment of the company's commitment to pay out 100% of free cash flow.

Coronado Resources will draw upon its syndicated finance facility to pay the distribution and expects to have gearing of 0.3-0.5x operating earnings (EBITDA) by the end of 2019. The terms of the facility have also been increased by 12 months to February 2023. Additional debt capacity remains in place to enable a company to act on potential acquisition opportunities.

Costs Reduced

First half operating earnings were US$405m and net profit was US$214m. The company has realised significant improvements in productivity at Curragh and mining costs were reduced by -24% in the first half. Moreover, cost reductions are not reliant upon further efficiency gains, Bell Potter notes, rather reduced costs are principally the result of volume leverage on the Stanwell royalty payments.

The broker assesses the long-life and steady-state assets in the company's portfolio as well as the long-term outlook for metallurgical coal underpin a Buy rating with a a target of $4.55.

Morgans considers it too early to know if notional import controls in China will affect pricing and product mix in other jurisdictions. The broker calculates 2019 operating earnings guidance of US$737-807m implies a price assumption for hard coking coal ranging from US$176-193/t and maintains an Add rating and $3.94 target.

Controlling Interest

There is also the potential for a sell-down of -11% by the controlling shareholder that may weigh on the share price. Morgans asserts that the surprising early release (by six months) of 11% of the register from voluntary escrow, with effect from August 19, creates a situation where fundamental buying may be absent in anticipation of a discounted block trade.

The company anticipates the release will facilitate an increase in its free float to 31% of issued capital. This would enable Coronado Resources to satisfy the minimum liquidity requirement for future inclusion in the S&P/ASX index. The Energy & Minerals Group (EMG) currently holds 80% of the listed entity and so carefully managing a selling down of -11% appears to be in its interests.

Credit Suisse highlights that selling down is an option, not a commitment as yet, and a signal that the major shareholder is keen to alleviate the liquidity headwinds that have put a lid on the share price. The week macro picture is likely to remain in the spotlight, although the broker considers the returns are compelling, maintaining an Outperform rating and $4.60 target.

There are three Buy ratings on FNArena's database. The consensus target is $4.18, signalling 34.0% upside to the last share price. The dividend yield, on present FX values, for 2019 is 24.5% and for 2020 it is 13.7%.

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CommBank's Premium Keeps Stockbrokers Wary

A limited negative reaction to a weak FY19 result for Commonwealth Bank bodes well for the FY20 outlook, brokers suggest, although the stock is considered over-priced.

-CommBank's premium to peers considered unjustified -Effects of lower cash rate likely to be offset by further mortgage re-pricing -Capital returns expected in FY20 and more RBA rate cuts likely

By Eva Brocklehurst

Softer revenue and a jump in costs produced a weak FY19 result for Commonwealth Bank ((CBA)) yet the share price reaction was fairly muted and, brokers suspect, probably surprised many investors. Citi attributes the limited reaction to the prospect that FY20 will be better, as lending momentum has returned and compliance costs, while continuing, are unlikely to keep growing.

Morgans also considers the result bodes well for the outlook for major bank earnings, in terms of home lending growth and residential mortgage asset quality. Commonwealth Bank expects an improvement in the housing market, noting there is stimulus on the way from tax cuts and infrastructure expenditure which is yet to flow through.

Cash earnings from continuing operations of $8.49bn were slightly below broker estimates. There was a pick up in mortgage lending in the second half, which grew above system for the first time in a number of months. Business lending growth was 4%. Macquarie points out, on the positive side, new business in the home loan portfolio from brokers was 48% in the second half compared with 41% in the prior corresponding half.

Citi expects, while net interest margins have been flat for the last six months, the effect of a lower cash rate should be offset with the benefit of further mortgage re-pricing. Still, the broker acknowledges Commonwealth Bank has modest prospects given more challenging economic conditions ahead.

While investors may take some comfort in management's guidance regarding the impact of recent official rate cuts, Morgan Stanley envisages downside risk to margins and constraints on home loan and deposit re-pricing. Macquarie is also concerned about industry trends of re-pricing mortgages, assessing this is not a sustainable practice.

Costs were the main disappointment and underlying cost inflation of 2.4% was higher than expected. The bank has reiterated an intention to target a longer-term absolute reduction in costs and a sub-40% cost-to-income ratio.

Yet Morgan Stanley is sceptical that the bank can lower the absolute cost base, or achieve the sub-40% ratio over the next three years. Indeed, Macquarie calculates it will take around four years for Commonwealth Bank to achieve cost-to-income targets.

The bank has retained its premium to peers, which many brokers believe is unjustified. Citi calculates Commonwealth Bank trades in excess of 15x FY20 estimates, which is too high for a low single-digit earnings growth profile and a low double-digit return on equity. The broker assesses there are better opportunities elsewhere in the sector and there is a risk that the sizeable premium to peers closes over the next 12 months

Morgan Stanley agrees the valuation is stretched, suspecting underlying earnings will decline and return on equity remain below 13% in FY20. Fee and margin pressures, stemming from lower interest rates, will result in declining revenue trends in both FY20 and FY21. In the face of this, Macquarie also judges the current valuation premium to peers of 26% to be excessive.

Capital Returns

Citi expects capital returns will be highly valued in the current environment and a $5bn buyback could be announced as divestments are completed in FY20. The broker does not believe the pending capital changes in New Zealand will be an impediment. Capital remains a point of strength, as the bank concluded FY19 with a CET1 ratio of 10.7%.

Morgan Stanley believes an off-market buyback is a most efficient form of capital management, expecting $2.0bn over the next six months after the completion of the Australian life insurance sale. A further $1.0bn is modelled for FY21. Still, the buybacks are not expected to be enough to offset dilution to earnings per share given the earnings hole stemming from asset sales.

Asset quality is considered benign, although Commonwealth Bank noted pockets of stress within business banking that pushed up troublesome and impaired assets. Specifically this occurred in retail, hospitality and construction sectors. Macquarie points out mortgages in negative equity have risen to 4.5%, with the bank reporting that 72% were in Western Australia and Queensland and over 50% have lenders mortgage insurance.

FY19 net interest income was less than Morgans expected, largely because the institutional lending book contracted significantly in the second half. Still, the broker considers this positive from the perspective of a return on tangible equity, as the contraction stemmed from portfolio optimisation initiatives and a focus on risk-adjusted returns.

Cash Rate Outlook

What if there are further cuts to official rates? Morgans notes the futures market is pricing in further reductions and, if the banks pass on future reductions in full to borrowers, this would be negative for margins.

However, the broker suspects the banks will only pass on enough to keep margins stable, remaining of the view that the Reserve Bank would not want margins and returns for the banks to be adversely affected in a material way, as this would hamper the supply of credit to the economy.

Hence, the central bank may end up using unconventional tools, Morgans supposes, such as a funding program akin to the Bank of England's term funding scheme. Moreover, the broker believes the valuation should be taken into account as well as the earnings impact of further reductions to the cash rate. Major bank dividend yields could become more attractive as a general decline in the cost of equity is factored into share prices.

FNArena's database has three Hold ratings and four Sell ratings for Commonwealth Bank. The consensus target is $72.72, suggesting -6.8% downside to the last share price. The dividend yield on FY20 and FY21 forecasts is 5.5% (for both, indicating no growth in ordinary dividends is expected medium term).

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Suncorp To Focus On Margin Versus Growth

Brokers suspect several targets set by Suncorp in recent years will not be met and FY20 will be a transition year.

-Subdued economic conditions putting new business under pressure -Focus appears to be on margin over growth -Capital return and share consolidation take the spotlight in the near term

By Eva Brocklehurst

General insurer and regional bank Suncorp ((SUN)) faces a tough outlook in FY20, suffering the impact of lower bond yields and elevated costs. Brokers suspect several targets set by the company will not be met.

Suncorp will seek to remediate the soft volume trends by reinvesting in its business but this will have some consequences for profit, Ord Minnett asserts. On this topic, the acting CEO was careful not to commit to any of the prior long-term guidance targets other than indicating these were aspirations.

The broker describes FY20 as an investment year with the company reinvigorating its business. This is likely to put pressure on general insurance margins and increase the cost base in the bank segment.

Credit Suisse suspects, having previously lowered expectations around hazard claims and reinsurance, the acting CEO is now lowering expectations around costs. This positions Suncorp for a recovery in FY21 and FY22. Economic conditions are putting the business under pressure, Macquarie observes, leading to fewer new business opportunities, stemming from lower housing growth, reduced turnover and a slowing in new car sales.

While there are difficulties with the bank division and Citi forecasts flat earnings, some pick up in system growth is expected following the two reductions to official cash rates. Pressure on net interest margins is likely to continue although, as a regional bank, Suncorp has a lower proportion of at-call deposits earning less than the cash rate and a recent keenly-priced wholesale funding deal should help.

Overall, general insurance conditions appear broadly favourable to Citi, with claims inflation in line with, or above, rate increases and commercial line margins finally at a level where the company is looking to consolidate.

Also, the broker contends, if bond yields stay low, or are further reduced, this makes Suncorp's dividend yield look more attractive and, with a strong balance sheet, there is potential for further capital initiatives as the business continues to rationalise its footprint.

No top-line guidance was provided and, therefore, Morgan Stanley asserts the focus is on margin over growth, while the potential for elevated reserve releases somewhat lessens the headwinds.

Targets

The company missed most of the targets set at the start of FY19 such as 3-5% growth, a 10% cash return on equity, a 12% underlying insurance margin and bank cost-to-income ratio of less than 50%. UBS believes return on equity and margin targets are clearly out of reach for FY20, although there is scope to achieve these in FY21 amid falling costs and increases in commercial rates.

Importantly, Macquarie notes the business improvement program targets have been retained, if not increased in dollar terms for FY20. The company has upgraded its net benefit target to $380m in FY20, although Citi points out this includes $12m in savings from the removal of stranded costs from the divested life business.

Capital Return

Citi welcomes the renewed focus on core businesses, envisaging the strong balance sheet offers flexibility over and above the pending capital reduction. In time, Suncorp should overcome difficulties with growth although the broker suggests this will be contingent on who is eventually appointed as CEO.

Suncorp announced a $506m capital return will be accompanied by share consolidation on a 0.971 ratio. Macquarie expects this will be the focus for investors in the near term and the stock could trade well, while the appointment of a new CEO later in 2020 should provide the next major catalyst and pin down the company's future strategy.

Citi believes there is a good chance acting CEO Steve Johnston will be made a permanent CEO and the market would probably welcome this. The simplification of reporting lines to reduce the overlap in executive responsibility appears to the broker to be a good move.

Australian general insurance was weak for the home, motor and commercial segments in FY19, partially offset by a stronger outcome in New Zealand. While Suncorp retains leverage to commercial rate increases, UBS remains concerned about volume losses in personal lines.

A small improvement was procured in underlying insurance margins in the second half, with Credit Suisse calculating 10 basis points of underlying margin expansion and, after a large jump in small natural hazard claims in FY18, experience appears to have normalised in line with historical levels.

There were two large events which pushed Suncorp over its allowance in FY19 and, partially in recognition of this, FY20 natural hazard allowances will be increased by $100m to $820m. The prospect of exceeding hazards allowance should now be less than 5%, Citi calculates, which provides a slim chance, albeit one only timidly suggested, of a favourable variance in reported margins.

FNArena's database has three Buy ratings, two Hold and two Sell. The consensus target is $13.52, suggesting 1.4% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 5.2% and 5.4% respectively.

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Material Matters: Battery Metals, Rare Earths, Base Metals, LNG

EV growth no panacea for battery metals; nickel rises in price as alumina falls; step-up in global LNG production projects; rare earths draw attention.

-Strong outlook for battery metals over long term, but short term weakness -Nickel shortage expected to ease; alumina appears oversupplied -LNG capacity to explode, but supermajor links vital for new projects

By Nicki Bourlioufas

Electric vehicles promise bright future for battery metals, but no guarantees

Battery metals including lithium, cobalt and graphite had a spectacular run in 2017 powered by expectations of a boom in electric vehicles (EVs), but prices have since tumbled on fears of oversupply.

Canaccord Genuity predicts that sales of passenger EVs will rise to 11m in 2025 and 28m in 2030, up from 2.1m in 2018. This means EVs will increase to 14% of new vehicles sold in 2025, from 2.6% in 2018.

Such growth would underpin a requirement for 927kt of lithium and 208kt of cobalt in 2025, up from 230kt and 111kt, respectively, in 2018, according to the broker. The need for greater battery density will also drive a transition to lithium hydroxide rather than lithium carbonate.

On the negative side, Canaccord Genuity notes that battery metals producers are not immune to the delays and technical problems common to all miners, and that traditional sources of equity finance are cautious given a series of blowouts in capital expenditure.

As well, the Democratic Republic of Congo's share of cobalt production is likely to rise to 70% from 60%, while China controls nearly 90% of refining capacity of some battery metals and rare earths. The situation could trigger concerns about concentration in the supply chain.

Nickel on a roll, alumina on downward track

Nickel has retraced recent gains following its speculator rally this year, while aluminium and copper too have fallen on poor macro sentiment as fears of a sharp global slowdown grow.

Nickel supply grew by 9% in the first six months of 2019 compared to the same period in 2018, but that was still not enough to meet demand, according to analysts at Macquarie.

Nickel is trading at about US$14,520 a tonne, having risen from just over US$10,000 a tonne a year ago.

The fastest growth was in nickel pig iron (NPI), which grew 30%, while non-NPI declined due to a major fall in production at Brazil's Vale. "The market should move into balance by the end of the year," predicts Macquarie.

Almost all NPI is consumed in making stainless steel, and the rapid growth in supply is elbowing out class 1 nickel metal in its production, Macquarie says. NPI represents almost 10% of recoverable nickel ore, and the vast majority of it is produced in Indonesia and exported to China, raising doubts about whether this intense trade can be sustained.

Alumina is moving in the other direction, with Morgan Stanley saying the price has fallen sharply despite a short-lived disruption to supply at a Chinese refinery. "Falling prices for bauxite, caustic soda and energy have pushed down production costs and China is adding significant capacity this year."

The alumina free on board (fob) price in Australia has fallen from US$650 a tonne in September 2018 to US$300 a tonne in late July. The less volatile price of China domestic alumina (ex-VAT) has declined from about US$450 a tonne to US$325 a tonne over the same period.

The gold price has rallied over US$1,400/oz in response to last week's US Fed decision to lower interest rates. Silver has continued to gain on speculative buying by those who missed gold's initial rally, suggests Morgan Stanley.

For oil, the outlook is grim, according to Macquarie's oil team who sees greater US supply and subdued demand as the key bear risks to oil's price outlook.

LNG gets set for major expansion, but links with supermajors are key

A new wave of investment is coming for the liquified natural gas (LNG) industry, highlights Morgan Stanley. This will be driven by the “Supermajors” - Royal Dutch Shell, Total, BP, Eni, Exxon Mobil and Chevron.

Companies that partner with the supermajors will benefit, but the challenge for investors is that there is a long list of projects vying for expansion. “Not all will proceed and some projects will be left stranded,” Morgan Stanley points out.

Today, more than 40 countries import LNG, compared to nearly 10 around 15 years ago. With China's recent increase in consumption, the industry is positioning for higher demand.

However, spot LNG prices moved lower recently “due to short-term over-supply, a disconnect between the price that buyers are willing to pay to support new projects (required to meet longer-term demand) and the price suppliers need to achieve to make sufficient returns and to secure the financing to develop them.”

Morgan Stanley has upgraded its rating of Oil Search ((OSH)) to Overweight and maintained its Equal Weight on Woodside Petroleum ((WPL)). “We view Oil Search's partnerships with ExxonMobil and Total, and their low-cost nature and proximity to Asia as keys” to its PNG projects moving forward, the stockbroker explains.

Rare earths worth eyeing as demand grows

Ord Minnett has initiated coverage of the rare earth sector and issued its first ratings of producer Lynas Corporation ((LYC)) and developer and explorer Hastings Technology Metals ((HAS)).

The rare earth elements are 17 metals that occur together in the Periodic Table. The group comprises yttrium and scandium, plus the 15 elements classified as lanthanides, such as neodymium, praseodymium and cerium.

The major use of rare earths is as chemical catalysts, such as in vehicle exhaust systems for pollution control. They are also added to alloys to make them more durable, and used in making magnets for motors and generators and in polishing gemstones and optical quality glass.

Demand has been boosted recently by their use as phosphors to make screens glow and in batteries for computers, phones and EVs.

Ord Minnett says the underlying forces in the market appear to be stabilising, and “prices should be supported over the long term by broader demand for electrification, plus environmental reforms in China.”

Lynas mines rare earths at Mount Weld in Western Australia and separates them at Kuantan in Malaysia. With 15% of world supply, Lynas is the only significant non-Chinese producer. Ord Minnett rates Lynas a Buy with a price target of $5.00, compared to its recent price of $2.52 on 5 August.

Hastings is developing the Yangibana deposit in WA’s Gascoyne region and exploring at Brockman near Halls Creek. Ord Minnett rates the company a Speculative Buy with a price target of 30 cents a share. The stock peaked at 20c in February but has since fallen to about 14 cents.

Ord Minnett calls Hastings its “top pick among the developers” due to its high value orebody, low technical risk path to production, offtake agreements with German industrial giants Thyssenkrupp and Schlaeffer AG, and the personal commitment of Executive Chairman Charles Lew, who owns 11.5% of the company and has self-funded most of its development.

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ESG Focus: Executive Remuneration In The Spotlight (Part 2)

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

This part continues from Part One, published on 1 August 2019.

Australian focus: Hello remuneration strikes

-Remuneration strikes on the rise -Regulators ordered to step up -Trend to incorporate ESG metrics

By Sarah Mills

Corporate freedom in Australia is among the greatest in the world but that could change.

The traditional passivity of Australian shareholders is shifting.

In 2018, the number of ASX100 companies to receive a strike against their remuneration tripled on 2017, and there were many close shaves.

In 2018, large strikes were received against National Australia Bank, Mineral Resources ((MIN)), Westpac ((WBC)), Telstra ((TLS)), and AMP ((AMP)).

A second strike vote this year would force a vote on board spills.

According to AON Hewitt Australia, the companies that received strikes tended to be those that took a wait-and-see approach rather than pre-emptive.

According to a report from JP Morgan: “Across the ASX200, support for remuneration reports is in decline.

“Over the most recent AGM season, a record 17 companies received strikes with at least 75% of shareholders voting against the remuneration reports compared with seven companies receiving strikes over the previous corresponding period.

“The trend has continued through the second half of 2019 with CSR receiving a first strike against the remuneration report at the 2019 AGM. “

Royal Commission heralds change

The Haynes Royal Commission into the finance industry last year has identified executive remuneration as a key area of reform.

It has provided a blueprint for remuneration that will most likely extend beyond the walls of the financial sector.

The Final Report’s recommendations did not specify a ratio of fixed to variable pay, nor proposed caps but focused instead on increasing the transparency of the remuneration process and the role of remuneration in driving culture and governance.

In line with international trends, it recommended limiting the use of financial metrics in the design of long-term incentives - across the whole organisation not just executives – to help avoid repeats of some of the major banking scandals of the past decade.

Hayne’s recommended Australian Prudential Regulation Authority (APRA) set the limits on the financial metrics in the long-term variable component of bank remuneration schemes for senior executives, and APRA is in the process of transforming remuneration structures in the finance industry.

Three problems with pay

Following up on the recommendations, APRA published a review identifying three problems with pay:

“Employees at lower levels of organisations received downward adjustments to pay that were not always matched by corresponding adjustments at an executive level to recognise line accountability. “Performance measures for pay

incentives were too focused on shareholder metrics such as Total Shareholder Return (TSR) – and that this had the potential to drive behaviour that does not support long-term organisation success and sustainability. “Shortcomings in oversight by remuneration committees requiring stronger governance of executive pay.” The long and short of it

APRA’s April 2018 ‘Information Paper on Remuneration Practices’ at large financial institutions found that bonus pool amounts are still largely based on short-term performance measures, with little evidence of explicit consideration of longer-term risk measures.

Nor had those sampled developed mechanisms or processes for the adjustment of the bonus pool to respond to significant risk events.

In an interview with the ABC World Today in July, about APRA’s discussion paper for a new prudential standard, APRA’s deputy chair, John Lonsdale, reiterated the regulator’s commitment to enhancing focus on long-term incentives.

“In the financial sector, APRA has observed an over-emphasis on short-term financial performance and a lack of accountability when failures occur, especially among senior management.

“This has contributed to a series of damaging incidents that have undermined trust in both individual institutions and the financial industry more broadly.

“Crucially from APRA’s perspective, these incidents have damaged not only institutions’ reputations, but also their financial positions.”

Lonsdale also warned that executives may have to wait seven years to claim all their bonuses, and companies would be given the power to claw back incentives for up to four years.

These sentiments echoed a previous speech by APRA Chairman Wayne Byres titled ‘Helping to regain trust’.

“The current structure of long-term incentives in Australia is particularly problematic in this regard (TSR focus), and is out of step with how best practices in remuneration are evolving internationally… This will also have to change.”

Byre expects the use of TSR fall will eventually fall to just 25% of long-term incentives in Australia.

“Boards have struggled to gain acceptance that new approaches are needed. So it seems inevitable that regulatory intervention and a greater degree of prescriptions will be required to shift practices,” says Byre.

Regulators ordered to step up

Morgan Stanley notes that Australia has the most concentrated corporate oligarchies in the world and expects the Australian Competition and Consumer Commission (ACCC) will play a major role in policing executive pay.

The Royal Commission recommended that APRA and ASIC take supervisory roles in setting and monitoring remuneration standards).

“Taken together, it seems that regulators believe there is too much weighting on financial metrics in performance assessment for pay incentives (hard targets) and not enough weighting on broader non-financial measures that also drive company performance and sustainability, such as organisational culture and customer satisfaction (soft targets),” reports the AICD.

APRA’s discussion paper for a draft prudential standard suggested a weighting of 50% financial metrics and 50% soft metrics – as starting point for consultation.

APRA has proposed the following key reforms:

“To elevate the importance of managing non-financial risks, financial performance measures must not comprise more than 50 per cent of performance criteria for variable remuneration outcomes; “Minimum deferral periods for variable remuneration of up to seven years will be introduced for senior executives in larger, more complex entities. Boards will also have scope to recover remuneration for up to four years after it has vested; and “Boards must approve and actively oversee remuneration policies for all employees, and regularly confirm they are being applied in practice to ensure individual and collective accountability.” Rather than regulate employee pay structures, the regulator has gone straight to the top.

“APRA will not be determining how much employees get paid. Rather, we want to empower boards to more effectively incentivise behaviour that supports the long-term interests of their entities. By reducing the risk of misconduct, we hope to see better outcomes for customers and higher returns for shareholders in the long-term,” APRA’s Lonsdale told the ABC.

BEAR extends it reach

Meanwhile, APRA introduced an extension of the Banking Executive Accountability Regime (BEAR) in July 2018.

Administered by APRA: Extension of the Banking Executive Accountability regime BEAR introduced in July 2018.

BEAR sets out accountability for deposit taking institution and, among other things, remuneration, key personnel and notification obligations for ADIS.

A paper on the issue was published in October 2018, and small banks will be brought under BEAR as of July 2019.

Beyond the finance industry

ASIC, as part of its new strategy, has included executive remuneration as part of its Corporate Governance Taskforce.

“Remuneration is a clear driver of conduct,” said ASIC Commissioner John Price in a speech on improving conduct and restoring trust.

“We will be looking at whether executive-remuneration structures, grants and vesting of variable remuneration are driving the right behaviour and accountability of executives in Australia’s listed companies.

“ASIC will be looking at whether executive remuneration structures, grants and vesting of variable remuneration are driving the behaviours and accountabilities of executives in Australia’s listed companies,” said Price.

“An initial issue we will be considering is focusing on the decisions by the board remuneration committee to award and grant variable remuneration.”

Linking executive pay to ESG KPIs

APRA’s proposed reforms are likely to reach beyond the financial industry when implemented.

In particular, the regulator seeks to elevate the importance of managing non-financial risks, including specific ESG-related risks, and recommends that financial metrics be confined to just 50% of performance criteria for variable remuneration outcomes at the outset.

This is likely to affect the cost and availability of funding for Australian corporations particularly the resources sector initially, as well as on their culture and governance.

While environmental risks are likely to be the prime focus in the first instance, this is likely to broaden to social risks within the next few years.

Discussions are abreast to add sustainability measure to metrics such as return on investment, earnings per share, revenue and non-financial measures such as customer satisfaction, employee satisfaction and safety.

As a result, the way in which banks measure these risks will increase in sophistication.

It is conceivable that the business equivalent of a FICO score could apply to ESG financing criteria for companies.

Global ESG remuneration trends

Morgan Stanley’s report says asset managers are attempting to determine the right approach for integrating ESG into portfolios, and says considering ESG alongside financial criteria is emerging as the most common global application, particularly as the risk for non-compliance rises.

According to the academic journal Economic Letters ‘Shareholder activism and equity price reaction’, several companies are already embedding corporate social responsibility more deeply within their firms by tying executive pay to ESG and corporate and social responsibility targets.

It cites Royal Dutch Shell’s plans to tie executive remuneration to three-to-five-year targets for net carbon footprints from 2020.

These links will be most evident initially in energy and resources companies given the world’s carbon focus and their operational dependence on water, energy and operational health and safety issues, and is likely to extend to sectors such as finance and pharmaceuticals in the near term.

United Nations has its say on ESG and pay

The UN-backed Principle for Responsible Investment has recently produced a report that identified the major ESG factors behind companies' long-term financial performance and proposed ways of linking them to executive pay.

In an article featured on the IPE website, Rob Lake, director of responsible investment at PRI, says:

"Integrating relevant ESG factors into executive remuneration is in a way, the next frontier for thinking about how companies can take ESG factors seriously and how investors can play a part in that.

"For the overwhelming majority of companies there are indeed ESG factors that are crucial to long-term financial performance, and if they are that significant, it makes sense to find a way to focus senior management's attention on delivering those objectives by linking executive pay to those relevant factors in an appropriate way."

Meanwhile, the ABC has reported that pay for chief executive officers hit record highs in the year to June 30, 2018.

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday July 29 to Friday August 2, 2019 Total Upgrades: 10 Total Downgrades: 26 Net Ratings Breakdown: Buy 37.72%; Hold 44.24%; Sell 18.04%

As the dichotomy between corporate earnings under pressure and share market indices near an all-time high persists, it should be no wonder stockbroking analysts continue issuing decisively more downgrades than upgrades for individual ASX-listed stocks. It should be noted that, while the RBA is widely criticised for lowering the cash rate further in 2019, a record number of Australian companies is issuing profit warnings; a trend that continued up until last Friday.

For the week ending Friday, 2 August 2019, FNArena registered ten upgrades versus 26 downgrades.

Equally noteworthy is the observation that seven out of the ten upgrades only moved to Neutral from Sell, leaving only three fresh Buy ratings. Karoon Gas, ResMed and Xero are the week's lucky three. Further emphasising the bifurcated nature of the 2019 bull market rally is the added observation that both ResMed and Xero are high PE multiple, quality growth stocks. Need I say more?

An important third observation completes the week's trifecta: the table for stocks receiving downgrades throughout the week is populated with companies releasing financial results and/or profit warnings ahead of the release. Adelaide Brighton (profit warning) received three downgrades against one upgrade, AGL Energy received two downgrades (both to Sell), GUD Holdings (FY19 release) received three downgrades, and nib Holdings was downgraded twice.

Fifteen out of the 26 downgrades moved to Sell, which includes household names such as Woolworths, Wesfarmers, Medibank Private and Insurance Australia Group (IAG).

Target prices continue to move higher for a select number of stocks with ResMed grabbing the week's lead, followed by Bingo Industries, Virtus Health, Xero and nib Holdings. On the flipside, a small number of large reductions dominate the table with both GUD Holdings and Adelaide Brighton harshly punished for their disappointment, as is Northern Star.

Increases to earnings estimates remain rather mild in comparison, though battle-hardened, bruised and dented Pact Group saw a gigantic increase during the week. Out of the rest of the table, only Steadfast Group and Bingo Industries are worth mentioning.

As expected, there's a lot more happening inside the table for negative revisions to earnings estimates. Adelaide Brighton tops the ranking, followed by Xero, Northern Star, Nufarm, Pilbara Minerals, and OceanaGold. They all suffered double-digit percentage declines. Further down the table we also find Rio Tinto (half-yearly update), Origin Energy and GUD Holdings.

The August reporting season is only just getting started. Meanwhile, international markets are being dominated by macro and geopolitical matters. August 2019 might well turn into a surprising, multi-leveled experience for local investors.

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/2/4

Following the company's second downgrade to 2019 net profit estimates, Ord Minnett now believes guidance is achievable. Management has signalled a -32-37% decline in net profits over the year.

The broker upgrades to Hold from Lighten, although reduces the target to $3.50 from $3.90. Despite the sharp reaction in the share price following the announcement, Ord Minnett does not believe the stock is cheap.

See also ABC downgrade.

CIMIC GROUP LIMITED ((CIM)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/2/1

First half net profit was below expectations. Mining division strength stood out, delivering 26% growth in pre-tax profit. Operating cash flow was well below expectations. The company has indicated it is moving to alliance-style, rather than fixed-price, contracts which have a more even cash flow profile.

Macquarie upgrades to Neutral from Underperform, given the extent of the fall in the share price and support from the share buyback. The broker reduces the target to $40.00 from $43.80.

A return to positive construction growth is required to support a more favourable fundamental view, the broker asserts.

KAROON GAS AUSTRALIA LIMITED ((KAR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/1/0

The company will acquire the Bauna oilfield for US$665m, becoming the fourth largest liquids producer on the ASX. Macquarie suggests a US$100-120m capital raising may be required to fund the acquisition shortfall and strengthen the balance sheet.

The broker assesses the company's three-year wait to obtain the field appears to have paid off. Seller Petrobras is undergoing an extensive divestment program to reduce debt.

Macquarie believes the field is more suited to a company such as Karoon Gas, which has the ability to focus on lifting production volumes. Rating is upgraded to Outperform from Neutral. Target rises to $3.00 from $1.15.

MYER HOLDINGS LIMITED ((MYR)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 1/2/1

Credit Suisse retains bearish forecasts for discretionary retailers but upgrades Myer to Neutral from Underperform. Target is 44c.

REDBUBBLE LIMITED ((RBL)) Upgrade to Hold from Reduce by Morgans .B/H/S: 0/1/0

Morgans was surprised by the strength in the fourth quarter, particularly in margins, noting the company is looking at a secondary listing of shares in the US.

Forecasts are upgraded to reflect the lower marketing and overhead costs seen in the fourth quarter. Morgans upgrades to Hold from Reduce and raises the target to $1.51 from $0.67.

Risks are expected to diminish greatly if the company can prove cash flow self-sufficiency in FY20.

RESMED INC ((RMD)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/2/1

UBS upgrades to Buy from Neutral. Following the results, which were slightly ahead of expectations, the broker updates assumptions which underpin upgrades of 5-8% over the forecast period.

Mask growth stood out in the Americas, up 16%, and US re-supply growth is also showing no signs of slowing. Target is raised to US$140 from US$122.

SPARK INFRASTRUCTURE GROUP ((SKI)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/4/2

Credit Suisse is upgrading to Neutral from Underperform as the stock is trading in line with valuation. Relative underperformance is rendering Spark Infrastructure undervalued based on historical correlation of valuation multiples. Target is raised to $2.30 from $2.10.

Still, the broker cautions that forecast cash flows put significant doubt on the company's ability to grow dividends and an extension of a discounted dividend reinvestment plan may be required beyond what is needed to fund the Bomen equity.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/3/2

Following a material decline in bond yields UBS is reducing its cost of equity assumptions, which drives an upgrade to valuation. The stock's long-dated concession, and longer-term cash flow, means it has strong leverage to lower

bond yields.

UBS upgrades to Neutral from Sell. The broker expects weakening bond yields to be the primary driver of share price performance. Target is raised to $8.50 from $7.00.

WESTPAC BANKING CORPORATION ((WBC)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/4/1

Morgan Stanley assesses major bank PE multiples have re-rated since the federal election but have underperformed the broader Australian market since the first cut to official rates in June.

The combination of subdued loan growth prospects, downward pressure on margins from lower interest rates and a reinvestment burden is likely to mean the banks remain in a downgrade cycle, in the broker's view.

Westpac has become the broker's preferred major bank and the rating is upgraded to Equal-weight from Underweight because of relative valuation support and more scope to mitigate the impact of lower rates. Target is raised to $26.60 from $26.00. Industry view: In Line.

XERO LIMITED ((XRO)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/1/2

Macquarie has decided to upgrade Xero to Outperform from Neutral while bumping up its price target by 21% to $76.50. The analysts believe Xero is well positioned to establish itself as a global platform of choice for SMEs, underpinned by its core subscription SaaS product.

The underlying thesis is that strong unit economics will drive operating leverage for the company. The analysts argue Xero is still only at the precipice of its long term growth story. They see the US market as equally ripe for cloud disruption.

Downgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Downgrade to Neutral from Outperform by Macquarie and Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/2/4

Macquarie had already set its forecasts below Adelaide Brighton's prior guidance range on concerns over Queensland demand, but new guidance is lower still, given weak demand in SA and Victoria as well, leading the broker to cut forecasts a further -22%.

The broker had expected a lower dividend, but now no interim will be offered.

Macquarie downgrades to Neutral from Outperform, citing concerns over earnings visibility. It's not just weak demand that is the issue, the broker believing the business model may need to be reconsidered. Target falls to $3.75 from $4.80.

The company has downgraded net profit guidance for the second time for 2019. Management has attributed this partly to market deterioration and partly to company-specific factors. Credit Suisse notes the company's business model has been caught poorly positioned, affected by circumstances more than peers.

Adelaide Brighton is not sufficiently vertically integrated in Queensland and Victoria to pick up infrastructure work, which is one of the factors. The company will not declare a first half dividend and special dividends are dependent on land sales.

Credit Suisse downgrades to Underperform from Neutral and reduces the target to $3.00 from $3.70.

Adelaide Brighton has downgraded net profit guidance, again, to $120-130m, a -25% reduction to Morgan Stanley's estimates. No interim dividend will be paid.

The main drivers of the weakness are soft conditions in residential and civil construction markets and continued competitive pressures in Queensland and South Australia.

Morgan Stanley is concerned about the dramatic decline in earnings since the last downgrade in May and the lack of a dividend removes one of the key pillars of support for the stock.

Rating is downgraded to Underweight from Equal-weight and the target lowered to $3 from $4. Industry view: Cautious.

See also ABC upgrade.

AGL ENERGY LIMITED ((AGL)) Downgrade to Lighten from Hold by Ord Minnett and Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/4

Ahead of the company's results on August 8, Ord Minnett downgrades to Lighten from Hold. The broker expects FY20 guidance will lead to significant downgrades to market estimates.

The broker believes management will be cautious about the outlook, being under continued pressure from politicians to lower retail prices.

Ord Minnett also believes AGL Energy will need to better articulate growth plans since it terminated discussions to acquire Vocus Group ((VOC)). Target is reduced to $19.75 from $21.00.

Back in May, AGL flagged several headwinds that would impact on the company in FY20. Yet Macquarie points out consensus estimates have barely changed. Cash generation is strong and the balance sheet under-geared but the broker believes AGL has now entered a multi-year earnings reduction cycle, forecasting a -30% drop by 2023.

Further downside risk is added as 60-70% of earnings are coal related, and under threat from state-based policies, technology and any change in government. Macquarie cuts its target to $19.50 from $21.00 and downgrades to Underperform.

BINGO INDUSTRIES LIMITED ((BIN)) Downgrade to Hold from Add by Morgans .B/H/S: 1/2/0

Morgans revises its modelling to allow for a weaker economic outlook that is implied by government bond yields. A lower cost of capital reflects a lower interest-rate environment but the implications of low bond yields will affect future earnings growth.

Morgans assumes earnings from the existing business decline in FY19 but the DADI acquisition provides growth. The company will report its results on August 22.

Rating is downgraded to Hold from Add, given recent strength in the share price has compressed the total return potential. Target is raised to $2.64 from $2.41.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/3/4

UBS is finding it too difficult to justify the share price. While Commonwealth Bank has a strong franchise, with a technological lead and robust financial returns the earnings profile is declining. Hence, the broker downgrades to Sell from Neutral.

UBS believes the bank has a dilemma regarding whether to return excess capital or face a potential shortfall, should the Reserve Bank of New Zealand proceed with its capital review proposals and/or the Australian Prudential Regulatory Authority closes its "capital re-positioning" regulatory arbitrage.

The broker believes it would be more prudent to retain capital for New Zealand until the rules are clarified by the end of the year. However, UBS assesses investors appear to favour a full return of around $5bn up front and then rebuild capital for NZ over time. Target is steady at $72. The bank will report its results on August 7.

COLES GROUP LIMITED ((COL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/4/2

Credit Suisse notes, while retail share prices appreciated strongly in the fourth quarter, retail trade remains subdued.

The broker believes the market has set earnings expectations low for most retailers and any misses will result in significant reductions to the share prices.

The broker downgrades to Underperform from Neutral. Target is $12.04.

FREELANCER LIMITED ((FLN)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/0/1

FX was a key driver of top-line growth in the first half and UBS estimates the underlying marketplace revenue was essentially flat. While the broker likes the stock, the share price is seen incorporating a hefty recovery as well as some undeveloped opportunities.

Further monetisation and uplift in growth is required. The broker downgrades to Sell from Neutral. Target is raised to $0.88 from $0.70.

GENWORTH MORTGAGE INSURANCE AUSTRALIA LIMITED ((GMA)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/2/0

The company reported in line, with a seasonally stronger second half to come. The market responded favourably to the remaining buyback being paid as an unfranked special dividend instead. Macquarie notes shareholders have already approved the buyback of another 100m shares which could happen in the next six months, subject to regulatory approval.

A reserve release is also possible, with reserves levels remaining high. This, and a cut to forecast investment yields, lead the broker to cut earnings forecasts and its target to $3.25 from $3.50. On the strong share price response, Macquarie pulls back to Neutral from Outperform.

G.U.D. HOLDINGS LIMITED ((GUD)) Downgrade to Sell from Buy by UBS and Downgrade to Neutral from Outperform by Macquarie and Downgrade to Neutral from Buy by Citi .B/H/S: 1/3/1

FY19 results were in line with expectations. UBS was disappointed with the Narva catalogue launch, with industry feedback suggesting weaker sales.

The company faces substantial FX headwinds over FY20, and the broker points out prices have not increased for the largest brand Ryco. Hence, it could be difficult to grow earnings (EBIT) in FY20.

UBS downgrades to Sell from Buy and lowers the target to $9.50 from $12.30.

FY19 results were softer than expected. Valuation is undemanding, in Macquarie's view, yet the automotive division was impacted by several problems that accelerated in the second half and may persist in the near term.

The broker downgrades to Neutral from Outperform, having been disappointed organic growth was not sustained above 5% or boosted by bolt-on acquisitions. Target is reduced to $10.50 from $14.50.

Citi remains cautious, in light of the FY19 results, lowering estimates for FY20-21 by -16-19%. The broker downgrades to Neutral from Buy because of the decline in momentum in the second half.

The company has noted soft demand from re-sellers and also increased competition in filters. Prices remain flat at Ryco. Target is reduced to $11.02 from $14.91.

INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/5/2

Credit Suisse expects Insurance Australia Group will hit the lower end of its insurance margin target in FY19. Guidance was initially considered conservative and likely to be beaten but following downgrades to consensus estimates over the year, the broker's is not so sure this is the case.

Rating is downgraded to Underperform from Neutral as the risk to the share price is considered skewed to the downside. Target is steady at $7.80.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/4/1

Cost guidance for FY20 is modestly higher than UBS expected and Tropicana production is lower. This has resulted in a -10% downgrade to the broker's FY20 estimates for net profit.

The broker remains concerned that the move higher in the nickel price may not be fundamentally backed. The stock appears to be trading around fair value and UBS downgrades to Neutral from Buy. Target is steady at $5.40.

MARLEY SPOON AG ((MMM)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/1/0

Investors should expect volatility in Marley Spoon's operating metrics as the company scales up, Macquarie suggests, but a June Q reversal of the prior positive cash flow trend and a decline in active customers has led to market uncertainty when cash flow breakeven is the key focus.

Meal kits still offer high growth potential and the partnership with Woolworths ((WOW)) is supportive but the broker pulls back to Neutral from Outperform, expecting uncertainty to weigh on valuation in the near term. Target falls to 68c from $1.10.

MEDIBANK PRIVATE LIMITED ((MPL)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/2/4

Ord Minnett assesses growth in the health insurance sector is constrained. Downgrading of medical insurance cover continues, premium rate increases are low and there is pressure on industry margins.

The broker downgrades to Lighten from Hold, largely on valuation concerns. Target is raised to $3.33 from $3.05 as the model is rolled forward to June 2020. The company will report FY19 results on August 22.

NATIONAL AUSTRALIA BANK LIMITED ((NAB)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 2/4/1

Morgan Stanley assesses major bank PE multiples have re-rated since the federal election but have underperformed the broader Australian market since the first cut to official rates in June.

The combination of subdued loan growth prospects, downward pressure on margins from lower interest rates and a reinvestment burden is likely to mean the banks remain in a downgrade cycle, in the broker's view.

National Australia Bank's rating is downgraded to Equal-weight from Overweight, as it has outperformed the other major banks since the federal election. The target is lowered to $26.40 from $27.30. Industry view: In-line.

NIB HOLDINGS LIMITED ((NHF)) Downgrade to Sell from Hold by Ord Minnett and Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/3/4

Ord Minnett believes the company faces regulatory pressures on premium rates that will constrain growth and margins.

Hence, the broker suggests the stock should not be trading on elevated price to earnings (PE) multiples, which are currently around 23x FY20 estimates.

Rating is downgraded to Sell from Hold, although the target is raised to $6.58 from $5.71 because of changes to forecasts as the model is rolled forward to June 2020.

Morgan Stanley believes structural issues continue to overhang the health sector, notwithstanding the federal election outcome as, in a community-based model with falling participation and an ageing pool of participants, claims per policy will experience upward pressure.

In the face of a soft consumer backdrop and continuing downgrades, the broker believes the market is likely to be too bullish on revenue and policyholder growth. Despite this, health insurers continue to over earn, with returns above 22% considered unusually high in a regulated industry with government approved pricing.

Rating is downgraded to Underweight from Equal-weight. Target is raised to $6.00 from $5.30. Industry view: In-line.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/4

Northern Stars June Q production missed Macquarie's forecast by 7% and costs were 8% higher, reflecting weakness at Pogo and Kalgoorlie offsetting strength at Jundee. Pogo has nevertheless shown signs of gradual operational improvement.

The company will provide FY20 guidance tomorrow ahead of its strategy day on Saturday. In the meantime, Macquarie downgrades to Underperform from Neutral. Target falls to $11.00 from $11.60.

ORIGIN ENERGY LIMITED ((ORG)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 4/3/0

Ord Minnett believes strong cash flowing from APLNG in FY19 could be overshadowed by earnings downgrades. The broker reduces net profit estimates by -15%, ahead of the results on August 22.

The broker also expects energy market operating earnings (EBITDA) guidance for FY20 will be -10-20% lower. Rating is downgraded to Hold from Buy and the target is steady at $8.35.

PREMIER INVESTMENTS LIMITED ((PMV)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/3/0

Smiggles' UK transition is in its early stages, but cyclical and structural headwinds are persisting, Macquarie notes, and increasing competition is now making its mark. Apparel has been doing the "heavy lifting" but will now begin to cycle tougher comparables.

Cost improvement has nonetheless surprised and should provide somewhat of a buffer, but with the risks now more evenly balanced the broker downgrades to Neutral from Outperform. Target falls to $17.20 from $19.20.

TRANSURBAN GROUP ((TCL)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/4/2

Following a decline in bond yields, UBS is reducing its cost of equity assumptions, which drives an upgrade in valuation. Despite this, the broker finds insufficient upside to warrant a Buy rating and downgrades to Neutral.

With such low bond rates and a low cost of equity the broker muses about whether Transurban may become more aggressive in its growth plans. Target is raised to $15.10 from $13.75.

WESFARMERS LIMITED ((WES)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/2/3

Credit Suisse notes, while retail share prices appreciated strongly in the fourth quarter, retail trade remains subdued.

The broker believes the market has set earnings expectations low for most retailers and any misses will result in significant reductions to the share prices.

The broker downgrades to Underperform from Neutral. Target is $33.41.

WOOLWORTHS LIMITED ((WOW)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/2/4

Credit Suisse notes, while retail share prices appreciated strongly in the fourth quarter, retail trade remains subdued.

The broker believes the market has set earnings expectations low for most retailers and any misses will result in significant reductions to the share prices.

The broker downgrades to Underperform from Neutral. Target is $29.51.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ADELAIDE BRIGHTON LIMITED Neutral Sell Ord Minnett 2 CIMIC GROUP LIMITED Neutral Neutral Macquarie 3 KAROON GAS AUSTRALIA LIMITED Buy Neutral Macquarie 4 MYER HOLDINGS LIMITED Neutral Sell Credit Suisse 5 REDBUBBLE LIMITED Neutral Sell Morgans 6 RESMED INC Buy Neutral UBS 7 SPARK INFRASTRUCTURE GROUP Neutral Sell Credit Suisse 8 SYDNEY AIRPORT HOLDINGS LIMITED Neutral Sell UBS 9 WESTPAC BANKING CORPORATION Neutral Sell Morgan Stanley 10 XERO LIMITED Buy Neutral Macquarie Downgrade 11 ADELAIDE BRIGHTON LIMITED Neutral Buy Macquarie 12 ADELAIDE BRIGHTON LIMITED Sell Neutral Credit Suisse 13 ADELAIDE BRIGHTON LIMITED Sell Neutral Morgan Stanley 14 AGL ENERGY LIMITED Sell Neutral Macquarie 15 AGL ENERGY LIMITED Sell Neutral Ord Minnett 16 BINGO INDUSTRIES LIMITED Neutral Buy Morgans 17 COLES GROUP LIMITED Sell Neutral Credit Suisse 18 COMMONWEALTH BANK OF AUSTRALIA Sell Neutral UBS 19 FREELANCER LIMITED Sell Neutral UBS 20 G.U.D. HOLDINGS LIMITED Neutral Buy Macquarie 21 G.U.D. HOLDINGS LIMITED Neutral Buy Citi 22 G.U.D. HOLDINGS LIMITED Sell Buy UBS 23 GENWORTH MORTGAGE INSURANCE AUSTRALIA LIMITED Neutral Buy Macquarie 24 INDEPENDENCE GROUP NL Neutral Buy UBS 25 INSURANCE AUSTRALIA GROUP LIMITED Sell Neutral Credit Suisse 26 MARLEY SPOON AG Neutral Buy Macquarie 27 MEDIBANK PRIVATE LIMITED Sell Neutral Ord Minnett 28 NATIONAL AUSTRALIA BANK LIMITED Neutral Buy Morgan Stanley 29 NIB HOLDINGS LIMITED Sell Neutral Morgan Stanley 30 NIB HOLDINGS LIMITED Sell Neutral Ord Minnett 31 NORTHERN STAR RESOURCES LTD Sell Neutral Macquarie 32 ORIGIN ENERGY LIMITED Neutral Buy Ord Minnett 33 PREMIER INVESTMENTS LIMITED Neutral Buy Macquarie 34 TRANSURBAN GROUP Neutral Buy UBS 35 WESFARMERS LIMITED Sell Neutral Credit Suisse 36 WOOLWORTHS LIMITED Sell Neutral Credit Suisse Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MYR MYER HOLDINGS LIMITED -10.0% -50.0% 40.0% 5 2 VRT VIRTUS HEALTH LIMITED 67.0% 33.0% 34.0% 3 3 BSL BLUESCOPE STEEL LIMITED 42.0% 25.0% 17.0% 6 4 SKI SPARK INFRASTRUCTURE GROUP -33.0% -50.0% 17.0% 6 5 XRO XERO LIMITED -8.0% -25.0% 17.0% 6 6 RMD RESMED INC 43.0% 29.0% 14.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 GUD G.U.D. HOLDINGS LIMITED -10.0% 70.0% -80.0% 5 2 ABC ADELAIDE BRIGHTON LIMITED -67.0% -25.0% -42.0% 6 3 BIN BINGO INDUSTRIES LIMITED 33.0% 67.0% -34.0% 3 4 NHF NIB HOLDINGS LIMITED -57.0% -29.0% -28.0% 7 5 URW UNIBAIL-RODAMCO-WESTFIELD -50.0% -25.0% -25.0% 4 6 IAG INSURANCE AUSTRALIA GROUP LIMITED -29.0% -7.0% -22.0% 7 7 AGL AGL ENERGY LIMITED -64.0% -43.0% -21.0% 7 8 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 20.0% 40.0% -20.0% 5 9 OGC OCEANAGOLD CORPORATION 30.0% 50.0% -20.0% 5 10 IFL IOOF HOLDINGS LIMITED -40.0% -20.0% -20.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 RMD RESMED INC 18.603 17.007 9.38% 7 2 BIN BINGO INDUSTRIES LIMITED 2.563 2.370 8.14% 3 3 VRT VIRTUS HEALTH LIMITED 5.203 4.870 6.84% 3 4 XRO XERO LIMITED 58.250 55.250 5.43% 6 5 NHF NIB HOLDINGS LIMITED 6.267 6.043 3.71% 7 6 BSL BLUESCOPE STEEL LIMITED 13.642 13.225 3.15% 6 7 MPL MEDIBANK PRIVATE LIMITED 2.980 2.890 3.11% 7 8 MYR MYER HOLDINGS LIMITED 0.496 0.486 2.06% 5 9 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 2.382 2.338 1.88% 5 10 IFL IOOF HOLDINGS LIMITED 5.380 5.310 1.32% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 GUD G.U.D. HOLDINGS LIMITED 10.664 13.282 -19.71% 5 2 ABC ADELAIDE BRIGHTON LIMITED 3.283 3.883 -15.45% 6 3 NST NORTHERN STAR RESOURCES LTD 8.850 9.542 -7.25% 6 4 OGC OCEANAGOLD CORPORATION 4.660 4.770 -2.31% 5 5 PMV PREMIER INVESTMENTS LIMITED 18.018 18.418 -2.17% 5 6 AGL AGL ENERGY LIMITED 18.877 19.270 -2.04% 7 7 NAB NATIONAL AUSTRALIA BANK LIMITED 26.986 27.114 -0.47% 7 8 SHL SONIC HEALTHCARE LIMITED 27.236 27.307 -0.26% 7 9 CBA COMMONWEALTH BANK OF AUSTRALIA 73.107 73.250 -0.20% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PGH PACT GROUP HOLDINGS LTD 23.260 -8.215 383.14% 4 2 SDF STEADFAST GROUP LIMITED 14.200 13.200 7.58% 3 3 BIN BINGO INDUSTRIES LIMITED 8.133 7.800 4.27% 3 4 QBE QBE INSURANCE GROUP LIMITED 88.766 86.412 2.72% 7 5 NHF NIB HOLDINGS LIMITED 34.071 33.257 2.45% 7 6 MPL MEDIBANK PRIVATE LIMITED 16.714 16.400 1.91% 7 7 NCM NEWCREST MINING LIMITED

106.051 104.191 1.79% 6 8 MYR MYER HOLDINGS LIMITED 3.810 3.750 1.60% 5 9 CCL COCA-COLA AMATIL LIMITED 51.674 50.960 1.40% 7 10 SUN SUNCORP GROUP LIMITED 76.086 75.229 1.14% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ABC ADELAIDE BRIGHTON LIMITED 17.155 24.733 -30.64% 6 2 XRO XERO LIMITED 10.554 12.463 -15.32% 6 3 NST NORTHERN STAR RESOURCES LTD 31.795 37.053 -14.19% 6 4 NUF NUFARM LIMITED 23.720 27.473 -13.66% 6 5 PLS PILBARA MINERALS LIMITED -1.023 -0.913 -12.05% 3 6 OGC OCEANAGOLD CORPORATION 15.818 17.717 -10.72% 5 7 RIO RIO TINTO LIMITED 998.815 1045.902 -4.50% 7 8 ORG ORIGIN ENERGY LIMITED 58.740 61.359 -4.27% 7 9 GUD G.U.D. HOLDINGS LIMITED 67.720 70.600 -4.08% 5 10 ALQ ALS LIMITED 39.928 41.567 -3.94% 6 Technical limitations

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

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Uranium Week: Empty Market

Traders are the only ones playing the uranium market at present as the August summer break begins.

-Court appeal against Yeelirrie rejected -Utilities remain on sidelines -Uranium prices going nowhere

By Greg Peel

News from the Australian uranium market last week is that the Western Australian Court of Appeal has dismissed an attempt to overturn state approval for the Yeelirrie project on environmental grounds. The WA Minster for the Environment approved the project, owned by Canada's Cameco, in January 2017.

An initial attempt to block the decision was overturned by the WA Supreme Court in February 2018. The project has since gained approval from the federal government.

"Cameco Australia is committed to minimizing environmental impacts from its projects and we have duly followed the regulatory process, ensuring that the assessment was thorough and transparent," said Cameco Australia's general manager last week. "We will continue to work with the local community."

It's all academic of course. A decision by Cameco to advance Yeelirrie "will depend on market conditions". Market conditions are currently keeping one of Cameco's major operations in Canada, McArthur River, in mothballs until prices improve.

In the meantime, it remains cheaper for Cameco to make good on its delivery contracts by buying material in the spot market. This would leave the producer as one of few buyers in the market, outside of traders, given utilities and financial investors remain absent.

For utilities it's a matter of out from under one market overhang, being section 232, and into another one, being submissions to the US government's Working Group, which is investigating the state of play in the whole US nuclear cycle.

For financial investors it would be a matter of a stalled market.

A pick-up in activity is also now unlikely in the short term as August is typically a quiet holiday period during the northern summer.

Going Nowhere

For the month of July, industry consultant TradeTech reports 29 transactions totalling 3.6mlbs U3O8 equivalent. Traders remain the primary participants on both the buy and sell sides.

The week ending last Friday saw a mere two transactions for a total of 250,000lbs.

TradeTech's spot price indicator ended July at US$25.25/lb, up from $24.50/lb at the end of June. The indicator also closed last week at US$25.25/lb, down -US25c from the week before.

The spot price has now oscillated between US$25.25 and US$25.50 for three weeks running, which rather sums up current market conditions.

TradeTech's term price indicators remain unchanged from end-June, at US$28.50/lb (mid) and US$31.00/lb long.

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The Short Report

Guide:

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

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

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

Summary:

Week ending August 1, 2019

Last week saw a blow-off rally for the ASX200, kissing the all-time intraday high and falling back again ahead of this week's precipitous slide.

The run to the high itself might explain why there's a lot more red than green on the table below, although there were a couple of individual stories.

One stock that had been left behind in the run is poultry company Inghams Group ((ING)), which last week became the most shorted stock on the market with an increase to 19.3% from 16.8% the week before. No new news, just a relentless drought, which is also why we see Nufarm ((NUF)) in second position on 17.8%.

Satellite company Speedcast International ((SDA)) has chopped around since its big fall on another profit warning in early July, with brokers suggesting the company may need to raise capital or may become an opportunistic takeover target. Assuming ASIC data are accurate, Speedcast shorts fell to 8.8% from 10.3% last week on the run-up to the high.

There has similarly been no new news from any of child care centre operator G8 Education ((GEM)), debt collector Collection House ((CLH)) or kitchen/bathroom specialist GWA Group ((GWA)), yet last week saw shorts in those companies jump from under 5% to 6.9%, 7.7% and 7.9% respectively, possibly implying shorters are setting for earnings result disappointment.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+ ING 19.3 NUF 17.8 BAL 16.4 GXY 15.8 ORE 15.5 JBH 14.3 NXT 13.9 SYR 13.2 BWX 12.0 PLS 11.9 DMP 11.8 HUB 11.1

In: HUB Out: BIN, SDA

9.0-9.9

SGM, RWC, BGA, BIN, IFL, MTS, HVN

In: BIN Out: HUB 8.0-8.9%

PPT, SDA, AMP, KGN, BOQ, SUL, IVC, CSR

In: SDA Out: BOQ

7.0-7.9%

GWA, CLH, CGC, MYR, DCN, BKL, WSA, CGF

In: GWA, CLH Out: BOQ

6.0-6.9%

NEC, GEM, ELD, GMA, A2M

In: GEM, ELD, GMA

5.0-5.9%

SFR, CTD, COE, LNG, NCZ, CLQ, MSB, SXY, NWL, SAR, OML

In: SFR, NWL, SAR Out: GMA, ELD

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.9 0.9 RIO 4.4 4.6 ANZ 0.7 0.7 S32 1.4 1.1 BHP 2.9 2.8 SCP 0.6 0.6 BXB 0.2 0.2 SUN 0.3 0.3 CBA 1.1 1.1 TCL 0.8 0.9 COL 1.0 1.3 TLS 0.3 0.4 CSL 0.3 0.4 WBC 1.0 1.2 IAG 0.4 0.6 WES 1.2 1.5 MQG 0.7 0.7 WOW 1.6 1.7 NAB 0.6 0.7 WPL 0.9 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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High Expectations For Pinnacle Investment

Significantly higher earnings are expected from Pinnacle Investment over the longer term, although the business is likely to wear some short-term volatility.

-Soft inflows in the second half in retail and institutional channels -New affiliates to diversify asset class exposure -Brokers find long-term value embedded in the stock

By Eva Brocklehurst

Brokers are confident in Pinnacle Investment Management's ((PNI)) mandates heading into FY20, believing there is long-term growth potential as the company targets at least two new affiliates per year. Given the FY19 performance, Wilsons believes the business will provoke the attention of potential new affiliates, turning the company into a "one-stop shop" for retail investors.

Morgans agrees there is structural growth in the business with the maturing profile of existing affiliates. While market direction will influence the short-term outlook, the broker expects significantly higher earnings over a longer period.

The company has three segments that drive profitability. This includes minority equity stakes in boutique investment managers, earnings from the Pinnacle parent that derive revenue from distribution and administration services and gains from principal investments in associate funds.

Funds under management (FUM) as of June 30 reached $54.3bn. FY19 net profit was up 32% and a final distribution of 9.3c was declared. Ord Minnett reduces its forecast for FY20 flows, to $2.4bn, but expects the uplift in funds under management over FY19 will provide a compelling tailwind.

The broker assesses volatility will continue in the short term as the market chops around and investors monitor the performance of affiliates, which has been patchy. Nevertheless, there is fundamental long-term value, in Ord Minnett's view.

Inflows in the second half were soft in the retail and institutional channels, Wilsons points out. While accepting the company's explanation, the broker does trim forecasts to increase the margin of safety. Inflows have formed a major part of the company's growth path since July 2017, the broker notes, and the strong performance of key affiliates such as the Antipodes Global Fund should underpin growth in average monthly inflow rates.

Value Bias

Retail inflow rates did fall -45% half on half in the second half of FY19, which Wilsons suspects relates to current market conditions for value-biased Antipodes Global. Despite the Antipodes Global funds remaining ahead of benchmark since inception, market strength lately has been driven by growth stocks, which has meant that outperformance versus the benchmark has gradually eroded.

The broker believes this erosion has been responsible for the slowing of retail flows into Pinnacle Investment. Wilsons supports its view with data from the company, which indicates the Antipodes Global share of retail inflows fell to 31% in FY19 from 71% in FY18. Hence this momentum in the "growth over value trade" poses the single largest risk to assumptions.

Management has pointed out that institutional funds under management are spread over 78 separate account clients and there is no single affiliate that is fully exposed to concentrated client FUM. Morgans interprets this to mean diversity is countering the risk of a loss of mandate.

The broker suspects the investment performance of key affiliates such as Antipodes Global and Firetrail Absolute Return will generate hurdles for Pinnacle but, further ahead, the maturing profile of more recently-acquired affiliates will provide support. Over the medium term, Macquarie expects operating leverage to increase, finding the potential return on investment in product and distribution attractive.

Outside of the growth versus value trade reverting to mean, Wilsons believes a successful marketing of Hyperion Global should support inflows. Hyperion Global was the top performing global equity fund in 2018 according to surveys from Morningstar and Mercer. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, is attracted to the strength of the distribution platform and retains a Buy rating and $5.85 target.

Expenses were up 52% in FY19, Morgans points out, driven primarily by additional personnel. The company is investing heavily to support the long-term growth of its affiliates, although costs growth is expected to moderate in FY20.

FNArena's database shows three Buy ratings from three covering brokers. The consensus target is $6.01, suggesting 36.0% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 3.9% and 4.8% respectively.

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Treasure Chest: BidEnergy Automates The Bill

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Canaccord Genuity assesses a clear opportunity for BidEnergy to build a profitable operation.

-Enables easy monitoring of real-time energy use for enterprises -Channels such as energy broking and facilities management identified -Break-even expected across FY21-22

By Eva Brocklehurst

Energy software developer BidEnergy ((BID)) is pursuing contracts in a number of channels and geographies to gain beneficial scale, rolling out its "land and expand" strategy. While this makes it hard to predict revenue in the near term, Canaccord Genuity believes there is a clear opportunity to build a profitable operation.

The broker has initiated coverage with a Buy rating and $1.50 target, noting annualised revenues are low but growing quickly. BidEnergy reported annual subscription revenue of $4.6m as of June 30, 2019 from 92 clients across Australasia, the UK and US. Meters under management from active contracts almost doubled over the financial year, to more than 85,000.

The software-as-a-service platform enables the easy monitoring of real-time energy use for enterprises. The platform outsources workflow relating to energy expenditure from bill collection through to payment and uses automation technology that becomes more efficient as it builds scale.Yet businesses have the choice of using the software to automate specific bottlenecks initially, rather than outsource the entire process straight away.

The company has won contracts with large Australian organisations that have high energy expenditure and/or multi-site operations. These include BP, Toll Holdings, Cotton On, SingTel and Flight Centre. Additional market channels have been identified, such as energy broking and facilities management, which offer lower initial revenues on a per-meter basis but provide significant scale immediately.

For example, in December 2018 an agreement to serve the Australian customer base of facilities manager Cushman & Wakefield meant the company secured more than 10,000 meters under management in one contract.

Expansion Opportunities

BidEnergy intends to expand where opportunities present. Early success in Australia is being exported to the US and UK via existing relationships in Australia such as with BP in the latter.? Canaccord Genuity finds the UK particularly interesting, as the company is establishing partnerships in a large and complex energy market amid legacy processes that appear ripe for automation.

Many of the businesses in the UK have legacy processes which involve considerable manual/data entry requirements. Energy brokers, common in the UK, often provide administrative services such as bill validations and reminders, and can use the software to advise on energy consumption levels.

The broker considers the US a longer-term opportunity for BidEnergy. At present, not all US states have deregulated electricity markets, bills are issued less frequently and most are paid by cheque. BidEnergy acquired RealWinWin in November 2016 to build a foothold in the US market. This company helps small businesses secure rebates from utilities where applicable under state-based energy efficiency programs.

Another feature means the company can sell its software to other parties that may provide adjacent or overlapping services to energy users. Energy retailers may use the software to provide detailed dashboards to large clients or to validate accuracy of data before a bill is sent to a customer.

BidEnergy is also engaged in paid pilot programs with energy retailers to explore the potential of a self-service solution for enterprise customers in Australia. This may offer considerable upside which Canaccord Genuity does not include in forecasts. The broker assesses an addressable market of nearly 5m energy meters and expects break-even across FY21-22.

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Treasure Chest: Upbeat View On Macquarie

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Will Macquarie Group again manage to beat guidance in FY20? Several brokers remain upbeat about the prospect.

-Slump in equity markets may trigger fears of a return to FY12 -Rally in Macquarie Group shares unsurprising, given significant infrastructure holdings -Likely to encounter tough comparables as FY20 gets underway

By Eva Brocklehurst

Are subdued conditions here to stay? Bell Potter suspects the current slump in equity markets may embolden those with a negative view of Macquarie Group ((MQG)) that recall the difficult days of FY12.

Macquarie Group has started off FY20 in a solid fashion and reaffirmed guidance at the AGM, on the back of stronger-than-expected commodities, although this boost is expected to dissipate as the year gets underway. Still, Citi notes annuity-style businesses had a challenging first quarter.

The only business that grew was commodities and global markets (CGM), which benefited from strong conditions that the company does not expect to continue over FY20. A record 17% growth in earnings in FY19, skewed to the second half and underpinned by commodities and asset realisations, has meant Macquarie Group will cycle higher comparables as the year progresses.

Citi suggests this is the key risk over FY20, as there were record profits from oil/natural gas volatility and natural gas marketing which will be a challenge to cycle. The broker still envisages earnings risk is skewed to the upside but sticks with a Neutral rating.

Ord Minnett believes Macquarie Group is well-positioned in global investment banking, underpinned by niche areas including commodities, infrastructure and green energy. However, the contribution from volatile income streams is well above historical levels and at risk of normalising, while the earnings mix is also increasingly towards market-facing businesses.

The company has indicated net profit will be slightly lower than FY19, but Bell Potter considers current guidance is ultra-conservative. Macquarie Group has consistently beaten its early guidance over the last seven years. The broker, not one of the seven monitored daily on the FNArena database, retains a $140 target, suggesting the stock displays a good Buy opportunity.

Morgan Stanley acknowledges the company needs to deliver a strong first half, as the second half will encounter tough comparables, but assesses the downside risk is reduced, confident first half earnings can grow by around 9%.

The recent rally in the share price reflects risk-on market sentiment and declining long-bond yields, Ord Minnett observes. The stock has been weak since the FY19 result and the rally has been provoked by increasingly dovish central banks. The broker finds this unsurprising, given Macquarie Group has a significant holding of infrastructure assets.

Annuity-Style Model

The diversified financial group has distanced itself from FY12, moving to a more annuity-style model. Bell Potter notes such business models were relatively resilient seven years ago, while Macquarie Group's overall performance back then was affected by sovereign debt contagion from Europe as well as losses in Macquarie Securities and real estate banking - which are no longer stand-alone divisions.

Macquarie Group has recently restructured and Corporate and Asset Finance (CAF) is no longer a stand-alone division. Instead it will be separated into three parts and these incorporated into other divisions including Macquarie Asset Management, Macquarie Capital and CGM. Morgan Stanley notes CAF was once an important driver of profitability and merging it with other divisions is indicative of a lack of growth.

Macquarie Group has diverse management and entrepreneurial capabilities and is leveraged to the fast-growing wealth management segment, Bell Potter points out. There is a small footprint in mortgage lending, which is being addressed, while opportunities are envisaged for green investment bank earnings, amid an ability to capitalise on an upturn in global wealth services.

There are three Buy ratings and three Hold on FNArena's database with a consensus target of $131.28, signalling 10.2% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.9% and 5.0% respectively.

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August Preview: Lower Rates & Lower Growth

Dear time-poor reader: preview to the August reporting season, and a video appearance, plus (in Part Two) Conviction Calls, and an update on the CSL Challenge.

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

-August Preview: Lower Rates & Lower Growth -Conviction Calls -CSL Challenge: Brief Update -Rudi Talks -Rudi On Tour

August Preview: Lower Rates & Lower Growth

By Rudi Filapek-Vandyck, Editor FNArena

Coming into the August reporting season Australian equities had enjoyed seven months of uninterrupted gains, despite more than 250 profit warnings from ASX-listed companies and with underlying corporate profits (ex-iron ore miners) negative and in decline.

But central bankers are cutting interest rates and reassuring investors they remain ready to act whenever necessary. Combine all of the elements and it was always going to be an open question as to how investors would respond to benign profit results and (most likely) cautious guidance from Australian companies.

In the absence of real and tangible improvement on the ground, but with the prospect of rate cuts triggering a turnaround for Australian housing, and related spin-offs in the domestic economy, investors had been inclined to find "value" in beaten down sectors such as building materials and consumer spending.

But how much leeway would be granted to these companies in case August were to deliver no concrete signals of an actual turnaround?

We will never know the answer as the overriding theme in the first seven days of August has been a resumption of tit-for-tat hostilities between the Trump administration and China, putting the world on notice this battle between the two global economic giants is not about to be resolved amicably or soon.

All of a sudden investors can see the scary prospect of a recession on the horizon, and they are voting with their feet.

All at once heading for the exit door; it ain't a pretty looking picture. And on Tuesday, when I am writing these sentences, the local share market certainly is showing its ugly side.

We might all have had a sense, an inkling, that deep feeling that, maybe, August wasn't going to be just about corporate profits.

Well, our sixth sense has been proven correct. But whereas previously, when things looked a lot rosier from the hilltop with no clouds surrounding, investors might have chosen to grant companies the benefit of potential improvement on the horizon, the concern now has to be that the general turn in sentiment means no prisoners will be taken, and investors might elect to sell first, and revisit later.

If ever one wanted to study the importance of confidence and sentiment for financial markets, August 2019 might be the ideal starting point.

Australia Is Enjoying Growing Profits, But Is It?

Let's start off with the basic ingredients. The Australian share market is one of few worldwide that has enjoyed improving profit growth projections in the first half of calendar 2019, which should be a positive and supportive of its relative outperformance during the period.

But dig deeper and it is all about iron ore. Ex-iron ore, the trend is negative as is projected growth for the rest of corporate Australia, including the all-important banks. Hence, it looks positive from a distance, but it actually isn't.

The more bullishly inclined investor might counter that low expectations means companies are facing a lower hurdle to "beat" during reporting season. The more realistic approach, I believe, is to take into account that expectations are low for very good reason and it is no coincidence this reporting season has been preceded by what most likely has been the largest number of profit warnings recorded post-GFC in Australia.

Baillieu Chief Investment Officer Malcolm Wood has a slightly different set of numbers, but his message sounds remarkably similar. Baillieu counted 63 profit warnings from major ASX-listed companies since early April, representing circa 15% of the ASX100 and 14% of the ASX300.

Discretionary and housing-related sectors have dominated the downgrades in corporate outlooks, but all-in-all the softness has been broad-based on Wood's observation. Profit warnings have been issued by Village Roadshow and Speedcast International, as well as by Ainsworth Gaming, AGL Energy, Flight Centre, Costa Group, Viva Energy, McMillan Shakespeare, Syrah Resources, Citadel Group, Link Administration, Gold Resources, and many more.

In recent trading sessions investor sentiment had been shaken by further warnings from Adelaide Brighton, Graincorp and Bega Foods.

Observation: up until August successful investing in the Australian share market was closely correlated with avoiding profit warnings. This month, however, investors are facing the additional conundrum that market forecasts for the year(s) ahead might prove too optimistic, as illustrated by the following quote from a recent report by stockbroker Morgans:

"We see a strong chance of FY19 results beating low expectations, but market estimates for FY20 look too heroic, leaving scope for some disappointment versus very stretched valuations."

Share Prices Might Have Rallied Too Hard

Are share market valuations too rich?

Consider the following quote from Ord Minnett this week (actually the quote is from JP Morgan, but Ord Minnett never mentions that):

"We have fielded a number of questions regarding whether multiples really are that stretched in light of very low long-term bond yields. In our view, the answer is still yes."

On JP Morgan's analysis, stripping away mining stocks that have been enjoying buoyant iron ore prices, the remainder of the ASX200 was at the end of July trading on 18.7x next year's projected earnings, which equals over three standard deviations above the market's five-year average.

This made JP Morgan strategists rather uncomfortable with the share market entering August, also because the direction of business sentiment is heading south while price momentum keeps on beating every other factor-based share price performance, and in a noticeably dominant fashion.

Against the background of the All Ordinaries' best year-to-date performance since 1991, JP Morgan has stuck with its ASX200 target of 6300; below the 6400 from steadfastly bearish Morgan Stanley.

Such targets suggest the share market might need to have a decent correction first before Australian equities start representing attractive valuations again.

Early Signals Not That Promising

Reporting season in August only ramps up slowly and gradually and it'll be more than a week still until we witness the true tsunami in corporate updates that await investors in Australia this month. Early indications suggest investors better expect plenty of volatility even without further tweets from Trump or central bank announcements.

The first ten profit releases registered by FNArena, starting with Cimic Group in late July, saw only 30% (3 results) of corporate updates "beating" expectations while 40% (4 reports) disappointed. This includes the rather generous inclusion of Rio Tinto with the "beats" on the basis of a larger than expected special dividend, otherwise the early stats would look even less promising.

Apart from Cimic, CYBG, GUD Holdings and Janus Henderson all disappointed and share prices were subsequently sold down. But Credit Corp showed its usual solid self and still saw its shares heading lower after the FY19 release.

In line with my prediction that August would most likely turn into a multi-layered experience for investors, I observe Unibail-Rodamco-Westfield's ((URW)) financial performance was better than expectations but investors remain wary because of medium to longer term challenges for retail landlords.

A special dividend and the potential for a share buy back triggered a rally on the day of reporting for shares in Genworth Mortgage Insurance Australia ((GMA)). ResMed ((RMD)) -high quality performer on a High PE multiple- managed yet another solid performance and its shares jumped 5% on the day.

With a cocktail as diverse as the above, who would dare to make any bold predictions this early in the results season?

Corporate Outlooks In Focus

Current market forecasts are for FY19 EPS growth in the order of 1-2% (including iron ore miners) and for 8-9% in FY20. There is general scepticism about the latter prospect, so corporate guidance and analysts re-adjusting post financial report releases should be closely watched.

Thus far, it remains remarkable but analysts have been extremely busy paring back forecasts for FY19, while leaving FY20 numbers largely untouched.

Adelaide Brighton and Bega Foods had been singled out for potential disappointment by a number of analysts and both companies recently issued a profit warning, vindicating the pre-result analysis. Another company that is regularly mentioned for likely disappointment is Suncorp ((SUN)), alongside Bendigo & Adelaide Bank ((BEN)), Coca-Cola Amatil ((CCL)), Cochlear ((COH)), Coles ((COL)), and G8 Education ((GEM)).

Companies that have multiple analysts expecting a positive surprise include a2 Milk ((A2M)), Charter Hall ((CHC)), Cleanaway Waste Management ((CWY)), and Treasury Wine Estates ((TWE)) though the latter also has a few analysts warning about a potential miss through FY20 guidance. Webjet ((WEB)) is equally a divisive name, as are Flight Centre ((FLT)), Medibank Private ((MPL)) and Aurizon ((AZJ)).

Also noteworthy is popular high flyers including Appen ((APX)), Altium ((ALU)) and Pro Medicus ((PME)) continue to be mentioned for potential outperformance.

Otherwise, the general view is that Australian companies in many sectors are doing it tough, and this should be apparent from financial results and management commentary. RBA rate cuts have come too late to make a serious impact this season, and the same principle applies for the returning Morrison government and/or the weaker Aussie dollar.

Investors can stay on top of corporate results via the dedicated section on the FNArena website (including a calendar for upcoming releases):

https://www.fnarena.com/index.php/reporting_season/

See also: "Corporate Earnings Still Matter In 2019"

https://www.fnarena.com/index.php/2019/07/25/corporate-earnings-still-matter-in-2019/

Rudi Talks

Video interview with Peter Switzer and Julia Lee on Monday:

https://www.youtube.com/watch?v=03jqw77Owgg&t=1102s

Rudi On Tour In 2019

-AIA and ASA, Perth, WA, October 1

In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday and Tuesday 5th & 6th August 2019. 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. Part two follows on Friday).

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

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Rudi's View: CSL, Ramelius And Sonic Healthcare

Dear time-poor reader: Part Two offers Conviction Calls, and an update on the CSL Challenge.

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

-August Preview: Lower Rates & Lower Growth -CSL Challenge: A (Not So) Brief Update -Conviction Calls -Rudi Talks -Rudi On Tour

CSL Challenge: A (Not So) Brief Update

By Rudi Filapek-Vandyck, Editor FNArena

Something has gone amiss with my messaging to investors, maybe?

At the recent National Conference organised by the Australian Investors Association (AIA), I showed a price chart during my presentation of a sustainable and structural growth story and asked: anyone a guess which stock this is? The answer came straight from the room: CSL! (In multiple voices).

Yet, it couldn't be CSL as the top of the chart didn't reach beyond $100 and everybody who has been paying attention should know by now CSL ((CSL)) shares surged a second time through $100 in late December 2016 and subsequently never looked back. The share price recently reached a new all-time high of $232.03, more on that further below.

Just as a side-remark: today, I tried to look up recent share price levels for CSL and both Yahoo Finance and the ASX website are ostentatiously displaying incorrect data. What is happening here? FNArena provides access to correct share price data, of course, but for more detail we can all still visit Google Finance.

Upon arrival in Australia, back in late August 2000, I never imagined myself becoming the go-to expert for CSL background and insights nineteen years on. My research into investing in the local share market has led to the concept and identification of All-Weather Performers, and CSL is only one of them.

From memory, my presentations in recent years have specifically highlighted DuluxGroup, Carsales, Bapcor, TechnologyOne and NextDC, alongside others, and occasionally the price chart shown was picturing CSL. The biggest compliment I have received is from investors thanking me for directing their attention, and courage to buy, towards stocks they otherwise would never have considered.

The right answer at the conference was REA Group; yet another one of my all-time favourites, and for good reason. REA Group shares recently surged above $100, equally an all-time high. This means that those who bought at or pre-IPO at $1 a share, and stayed on board since, have enjoyed a 100-bagger, including funds manager Hyperion.

CSL shares, corrected for shares split, IPO-ed at $0.77. Plus there was another shares split pre-GFC. CSL shares have thus performed even better than REA Group's 100-bagger since listing. Needless to say, it is difficult to find a single shareholder today who is unhappy with how management, the company and the share price have performed over the past 2.5 decades (CSL started life in 1991, and listed in 1994).

On my observation -at the conference and elsewhere- investors do not necessarily grasp the importance of what I just pointed out. The fact that CSL shares, 25 years after listing, have surged to a new all-time high means that everybody who bought the shares, at any given point in time, has made a profit.

Everybody. No matter when the shares were bought.

Think about this for a while and one instantly starts to realise how truly amazing the CSL experience has been for shareholders who stayed the course. REA Group's performance has been equally impressive, but it has only been listed since December 2008. Still very impressive though.

A few stats to highlight the strength and importance of these performances:

-Resources stocks in Australia are still some -33% below their peak in May 2008 -Bank shares are still some -28% below their peak in May 2015

Consider, for example, that BHP Group shares peaked at $50 in late 2007 and again at $49 the following year. CommBank shares reached $96 in 2015.

Hint: local indices recently finally managed to surpass the all-time record (ex-divs) set in late 2007 and while resources and banks were instrumental in getting there over the past seven months, we would still not be nowhere near current level if it wasn't for the steady and continuous, uninterrupted contributions from All-Weather, sustainable, structural growth companies such as CSL, REA Group, and numerous others I have been highlighting through my research in years past.

Yet, when one looks back from the chair I am sitting on, it is difficult to not also remember the abuse, the disbelief, the rejections that have occurred throughout the period. It was only a few months ago I had to stand my ground amidst a wave of criticism and personal attacks. Surely I had lost my sanity? Didn't I know that no single stock trading on a PE multiple above 15x had ever proved to be a genuine, profitable long term investment? CSL is going to crash, and take me and my reputation down with it!

As you all would have guessed, those same voices have gone missing by now. Understanding CSL is effectively understanding how little investors know and understand about the share market. Which is why I launched the CSL Challenge earlier this year (see further below).

To my surprise, a recent analysis by the Australian Financial Review (The stocks doing the heavy lifting, 3-4 August 2019) once again put CSL at the top of the performance table for having contributed the most index points in 2019. My own analysis conducted earlier had the iron ore miners on top, but those share prices deflated quickly while CSL's surged onwards and upwards. Just goes to show how much of these performance tables are determined by timing and time-period.

Time to apologise. Earlier this year I asked long term shareholders to send in their personal experiences to share with other investors but I haven't yet found the time to fully execute that plan. It will happen though. I am aiming for September, after the August reporting season.

CSL is scheduled to release FY19 financials on August 14 and analysts are expecting yet another strong performance, also carried by quite the savage flu season in 2019. No doubt, this was one of the reasons as to why the share price recently surged to a new all-time high.

To fully understand why CSL shares are where they are, and how much of a stand-out the company's performance has been, consider that a recent analysis by UBS puts the average EPS growth for Australian companies since 2007 at 0.1% per annum. This is not a typo. The Australian share market has effectively lived through an earnings recession over the past twelve years. Judging by forecasts for the upcoming August reporting season, this is not about to change.

One disconcerting observation, however, is that the share price has retreated quite quickly throughout the market turmoil that pulled the local share market in a fierce downdraft this week. It used to be the case that CSL shares held up reasonably well when others were staring into the abyss. Maybe too many momentum and trend followers are on board these days? Maybe this is the price we all have to pay for CSL being such a stand-out?

Maybe, just maybe, in an era of passive investing, this is the toll to pay when CSL is now one of the Top Four in Australia?

Some analysts have been suggesting CSL might disappoint this season as the strong performance over FY19 might be followed up by a more moderate guidance for FY20. I have no extra insights into whether this might happen or not, but history tells me, as with the experiences of REA Group shares I highlighted at the recent conference, that if for some reason CSL's share price comes under pressure upon the release of FY19 financials, this would only be a genuine concern under extremely rare circumstances.

This is what JP Morgan published on Thursday morning: "With a tight market for immunoglobulins, continued solid growth in specialty sales and an expected recovery in albumin and coagulant revenues we are confident CSL will deliver a decent sales result. This should ensure a profit number at or above the top end of the FY19 guidance range as gross margins lift. However, we expect FY20 guidance to come in below our forecasts as management maintains its conservative approach."

It is far more likely that share price weakness in CSL is simply an opportunity to buy (more) shares. See also ResMed shares in late January and where they are trading at today.

In case you read this and you still haven't joined the CSL Challenge, do know you can join at any time, from any place of your own choosing.

Here's more info about it: https://www.fnarena.com/index.php/2019/01/14/rudis-view-join-the-csl-challenge/

Also, paid subscribers have access to my eBooks and other writings about CSL and All-Weather Performers, see the dedicated section on the FNArena website. The slides of my presentations are available through the Special Reports section. The slides I used at the recent AIA National Conference are now included.

P.S. And don't you worry, this success story is nowhere near its end.

Conviction Calls

Market strategists at Morgan Stanley have been taken by surprise by how strongly the domestic equity market has performed over the past seven months. They had warned their customers about generally weaker profits for Australian corporates, which has proved to be a prescient warning, but the share market decided to ignore the earnings and concentrate on falling bond yields and more central bank stimulus instead.

Morgan Stanley had a target for the ASX200 of no more than 6000, which does look a little bit silly in the current context. That target has now been lifted to 6400. In case of a very bullish outcome, the strategists are willing to accept 7000 for the major index which still only leaves a little bit of room for further expansion.

Their current warning is that, in the absence of a solid pick-up in corporate profits (not expected this month), share prices might have to fall to match the rather sober outlook for corporate Australia.

From this starting point, Morgan Stanley strategists have been making a number of changes in terms of Model Portfolio positioning. Cash levels have increased to 5% on the back of selling shares in BlueScope Steel ((BSL)) and Iluka Resources ((ILU)). The idea here is to reduce the portfolio weighting towards resources.

The Model Portfolio has now gone significantly overweight National Australia Bank ((NAB)) in order to neutralise the previous underweight positioning in banks. Inside healthcare the relative overweight has switched to Sonic Healthcare ((SHL)) from Cochlear ((COH)) while among defensives the portfolio is now more underweight Telstra ((TLS)).

In the energy sector Oil Search ((OSH)) has been added to sustain a sector overweight position.

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Retail specialists at UBS are of the view that forthcoming tax cuts from the Morrison government will only have a small impact on consumer spending with retail sales in FY20 expected to -maybe, potentially- increase by an additional 1% (annualised) on the back of these cuts being delivered.

They are equally of the view this prospect has already been priced in for most retailers listed on the ASX. And then, of course, we have the August reporting season yet to be fully unleashed upon us.

UBS's key consumer sector picks ahead of corporate results are Flight Centre ((FLT)), Treasury Wine Estates ((TWE)), Viva Energy ((VEA)), a2 Milk ((A2M)) and Bapcor ((BAP)). The analysts also like the prospect of Myer ((MYR)) shares.

Recommended Sell views are alive and kicking for Coles ((COL)), Coca-Cola Amatil ((CCL)), JB Hi-Fi ((JBH)), Inghams Group ((ING)) and GUD Holdings ((GUD)).

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The combination of geopolitical risks increasing and the Aussie dollar being clobbered has proved to be highly beneficial for Australian gold producers. Most share prices have surged, a lot, but stockbroker Morgans still sees selected value in the sector.

Morgans recently elevated gold to its most favoured commodity and junior and emerging gold producers are seen as the best hunting ground for investors still looking to add exposure through the local share market. Morgans in particular likes Ramelius Resources ((RMS)).

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Market strategists at stockbroker Morgans, still worried about High PE stocks not having any room to disappoint in August, have decided to take profits in Kina Securities ((KSL)) -which led to the removal of this stock from their list of High Conviction Stocks. In its place the strategists have added Volpara Health Technologies ((VHT)).

Other stocks that have retained their inclusion are Sonic Healthcare, OZ Minerals ((OZL)), ResMed ((RMD)), Westpac ((WBC)) and Oil Search ((OSH)) inside the ASX100 and Australian Finance Group ((AFG)) and Senex Energy ((SXY)) outside the Top100.

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This month's update on Morningstar's Best Stock Ideas has led to the removal of Westpac ((WBC)) with Ardent Leisure ((ALG)) and Computershare ((CPU)) joining the small selection instead.

Morningstar has a predominantly valuation driven methodology to decide on inclusions and exclusions and I personally have been a long term critic of their methodology to determine protective moats for companies. While once upon a time setting rules for corporate moats was cutting edge analysis, today I think Morningstar's methodology is no longer quite in sync with modern economies and shifting market dynamics.

Anyway, Ardent Leisure has been added on the potential for a successful turnaround, while for Computershare share price weakness seems to have been the key ingredient. Westpac's removal follows a strong sector re-rating.

The other seven stocks on the list are Bapcor, Domino's Pizza ((DMP)), Link Administration ((LNK)), Nufarm ((NUF)), Pact Group Holdings ((PGH)), Telstra ((TLS)), and Woodside Petroleum ((WPL)).

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CLSA has put Ed Henning in charge of researching Australian banks and the direct result has been a removal of the firm's Underweight recommendation for the sector. Instead, CLSA has now adopted the view that, on a relative basis, Australian banks don't look too expensive at all, certainly not when taking into account that interest rates can, and probably will, move lower from here still.

The Underweight recommendation has thus been replaced with a Neutral stance with analyst Henning adopting the view that all of the negatives are by now well known and understood, and in the share prices. One offsetting positive is that today's dividend yields across the sector will prove sustainable.

CLSA's sector ranking in order of preference is ANZ Bank ((ANZ)), National Australia Bank ((NAB)), Westpac and then CommBank ((CBA)).

Elsewhere at the CLSA office, analysts Richard Barwick and Mark Wade have continued repeating and reiterating their Conviction Buy rating for Treasury Wine Estates with an unchanged price target of $23. As reported earlier, both CLSA analysts see the upcoming FY19 results release and the subsequent investor day in September as two catalysts that seem poised to get the share price a lot closer to their target (Trump & Xi permitting).

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Meanwhile, no changes have occurred to the list of Conviction Buys at Wilsons. The most recent addition thus remains Countplus ((CUP)) which had been added in early July.

Other inclusions are Bravura Solutions ((BVS)), EML Payments ((EML)), ReadyTech ((RDY)), Whispir ((WSP)), Collins Foods ((CKF)), Ridley Corp ((RIC)), ImpediMed ((IPD)), National Veterinary Care ((NVL)), EQT Holdings ((EQT)), Pinnacle Investment ((PNI)), Noni B ((NBL)), Ausdrill ((ASL)), Mastermyne ((MYE)), and Whitehaven Coal ((WHC)).

Just like most other human portfolio managers and stock pickers in Australia, Wilsons' Conviction Insights Portfolio has found it rather challenging to keep pace with share market indices in Australia (unless we go back to last year, or to inception in early 2017).

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Market strategists at JP Morgan have stuck with their target for the ASX200 of 6300, meaning they are now positioned below Morgan Stanley, usually the low marker in Australia.

JP Morgan has singled out a number of key stocks that are rated Underweight and considered to have downside potential of -20% or more from share prices in late July/early August.

Some of the key Underweights are Magellan Financial ((MFG)), Orica ((ORI)), Wesfarmers ((WES)), Coles ((COL)), REA Group ((REA)), Cochlear (COH)), and Goodman Group ((GMG)).

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Lastly, but certainly not least, bank analysts at Bell Potter have used this week's sell down in Aussie shares as yet another opportunity to reiterate their positive view on Macquarie Group ((MQG)) shares.

In Bell Potter's view, any weakness in the stock will be temporary at worst and it provides investors with the opportunity to simply buy more. The price target currently sits at $140, accompanied by a Buy rating.

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

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time a new Rudi's View story has been published on the website.

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

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