WEEK 37

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Friday, 11 September 2020

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AUSTRALIA

Are Concerns About A-REITS Overdone?

Significant disruptions to rental returns for retail and office A-REITs have led to the scrutiny of balance sheets post the August reporting season but, is the market overdoing its concerns?

-Balance sheets positioned for future devaluations in retail and office
-Short term retail segment cash flow likely to be under pressure
-Alternative Long WALE A-REITs best performers during pandemic

By Eva Brocklehurst

As a volatile reporting season draws to a close, one main observation centres on the significant disruptions to the income of Australian real estate investment trusts (A-REITs). The majority have provided no guidance for FY21.

Yet there were some better-than-expected results from property fund managers and residential developers, UBS points out, as investors sought yield and entry-level home buyers took advantage of low interest rates and government subsidies.

Guidance has been limited this time, despite A-REITs typically providing quantitative earnings and distribution guidance. Most are choosing to keep distributions flat or slightly lower. JPMorgan assesses, aside from a couple of exceptions, balance sheets are positioned for future devaluations in retail and office, caused by a softening of the markets in these areas.

Macquarie asserts the market is mis-pricing the sector and there is value. The sector has underperformed the broader market by around -760 basis points in 2020 to date. The broker notes the only A-REITs with positive distribution growth are **Arena REIT** ((ARF)), **Charter Hall Group** ((CHC)) and **Charter Hall Long WALE** ((CLW)).

Earnings per share for the sector were down -9.5% in FY20 compared with consensus because of weaker retail rent collection and provisioning for rental relief, and are likely to be down a further -4.9% based on forecasts.

This compares to industrials which were down -24% but expected to grow 6.4% in FY21.

Macquarie points out the use of FFO (free funds from operations) as the primary reporting measure for A-REITs ignores incentives to tenants, commissions to leasing agents and maintenance expenditure required for real estate. Hence, the broker prefers to focus on free cash flow generation, deriving this estimate by deducting maintenance expenditure and incentives from reported operating cash flow.

This indicates **Mirvac** ((MGR)) and **GPT Group** ((GPT)) may even need to write back provisions and, in the case of the latter, it would aid distributions, given this is based on free cash flow. Macquarie notes **Dexus Property** ((DXS)) is continuing to sell assets and highlights **Stockland** ((SGP)) is also shifting out of non-core assets.

Of note, JP Morgan has recently downgraded Stockland to Underweight because it was the best performing A-REIT in August. Its residential sales were strong and retail business better than peers. Hence, the good news is now priced in.

Retail

Retail net operating income was down -42% half on half in the second half for major retail landlords, following around $580m of rent waivers or provisions. While structural headwinds may be priced into retail, UBS agrees short-term cash flow will be under pressure and a second wave of coronavirus adds to the uncertainty.

Nevertheless, while the listed market is pricing in declines in asset values of -35% for shopping malls, and retailers will reduce store footprints, key locations still remain critical to business. Retail rents are likely to structurally re-base -20% lower, UBS calculates, and this will affect valuations.

Macquarie generally assumes rent relief will finish by the end of September and company-specific factors will then weigh. For example, **Vicinity Centres** ((VCX)) has a portfolio that is heavily exposed to Victoria.

Concerns over the balance sheet are likely to impact on **Scentre Group** ((SCG)) and **Unibail-Rodamco-Westfield** ((URW)). Both companies are considered candidates for equity raisings as they require reduction in financial leverage based on the broker's analysis.

Scentre Group indicated in August it does not intend to raise equity or divest assets, although Macquarie calculates that about $1.8bn of equity is required or, alternatively, around $2.8bn of asset sales. Meanwhile, **Cromwell Property** ((CMW)) is intending to sell assets while UR Westfield is considering its options.

Office

In office, growth slowed to 2.4% in FY20 and valuations continue to lag the physical market, with rents in Sydney and Melbourne coming under pressure in the last two months. Yet JP Morgan is more constructive on the basis that rental changes are cyclical, tenant covenants are stronger and capital demand is firm.

Specifically, Macquarie expects rent declines in office will drive earnings down for Dexus and Mirvac while growth expectations are retained for Charter Hall Group and **Goodman Group** ((GMG)).

Media speculation suggests Blackstone is considering a move on a large Australian A-REIT, potentially Dexus, and JPMorgan assesses office valuations are unduly bearish. The broker has upgraded Dexus to Overweight and highlights that Mirvac is trading well below fundamental valuation, as is indeed GPT.

The broker believes investors are being paid a substantial risk premium to hold the shares and the risks to the commercial office segment are overstated. Moreover, JP Morgan envisages a scenario where investors deploy capital earlier in Australia compared with other jurisdictions.

Less risk in Australia also implies less outward shift in capitalisation rates (ratio between income and market value of an asset), particularly for prime assets in Sydney and Melbourne. Equity markets currently imply these rates will stabilise at 6-6.5% and CBD office asset values will fall -20-25%.

In the event of M&A, JPMorgan would typically expect premiums to the current prices of around 25-30% for large vehicles with heavy office exposure. This would be well above the historical premium of 12.5%.

Long Duration Alternatives

Goldman Sachs has analysed the benefits of long WALE (weighted average lease expiry) A-REITs, which have materially outperformed since 2018. A key trend in the last reporting season was these alternative A-REITs experiencing minimal impact from the pandemic. Moreover, in a low interest-rate environment, the relative attractiveness of those with long WALE exposure has increased.

This has led to asset value appreciation and increased demand from the direct property market. These A-REITs have defensive characteristics including long lease terms to essential services with minimum expiries over the near term. There are also strong rental escalations and government support to operators.

Rent relief, as opposed to retail, has been minimal. Hence, because of relatively lower debt costs and gearing, Goldman Sachs estimates **Charter Hall Social Infrastructure** ((CQE)), Arena REIT and **Waypoint REIT** ((WPR)) have ample capacity to add debt. The broker retains a Buy rating for CH Social Infrastructure and Waypoint, given secure income streams and the liquidity to pursue attractive investment opportunities.

In the case of Arena REIT and CH Social Infrastructure, the concerns around the child care sector and operator ability to pay rents have led to them underperforming long-lease peers and the broker believes these concerns are overdone. Childcare is a critical piece of infrastructure in returning people to work.

Meanwhile, Waypoint, with a focus on service station assets that are deemed essential, is not expected to experience disruptions to rental collections. The acquisition pipeline and transaction capabilities also provide avenues for growth.

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AUSTRALIA

August In Review: Technology Powers On

The ASX200 rose 2.2% in August with technology and consumer discretionary leading the way during the reporting season, while further trading updates are expected during the upcoming AGM season.

-The ASX200 climbed 2.2% during August, gaining 2.8% including dividends
-Information technology rose, while utilities fell
-The Small Ordinaries gained 7.3% for the month

By Mark Woodruff

The Australian stock market ended August with the ASX200 rising 2.2% to close the month at 6,061 points, for a total gain of 2.8% including dividends. This was the fifth consecutive month of gains.

To gain a helicopter world view of stock markets during August, the Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) index rose 6.5%. The MSCI ACWI is comprised of around 3,000 stocks from 23 developed countries and 26 emerging markets.

The August surge has carried the MSCI World Index into positive territory in the year-to-date, with the index now up 3.5%. The two countries driving the gains are China up 17.3% and the US up 10.0%.

Most global developing market sectors rose, with consumer discretionary and technology outperforming, while utilities, REITs and energy underperformed.

The S&P500 in the United States rose 7.25% and the technology heavy Nasdaq was up nearly 10% over the month.

<u>Relative underperformance by Australia</u>

Banks (-0.6%) and materials (+0.3% rise) are the largest sectors in the ASX300, with a weighting of 17.5% and 20% respectively. In an analysis by stockbroker Macquarie, if US sector weights were applied, the ASX300 would have risen 5.2% in August.

Of course, a lot of that US outperformance is attributable to technology stocks which account for around 28% of the S&P500 index. The weighting of around 4% technology on the local bourse is too small to provide a material lift to the overall market. Additionally, the US outperformance doesn't factor in country-specific swing factors such as the August profit reporting season for stocks on the ASX.

JP Morgan notes, while global earnings per share expectations picked up across August, forecasts for Australia barely moved through the month. This gap, in the broker's view, is a key factor in the ASX200's underperformance over the past month. Other contributors to underperformance are considered to be a resurgent Australian dollar, index composition and comparatively deep dividend cuts.

Industrials outperformed resources across the various ASX indices by size, with Small Industrials the best performing. Small caps were preferred over mid and large cap stocks, with the Small Ordinaries returning 7.2% versus 2.5% for the ASX100 Index.

The best performing sectors in Australia were information technology, consumer discretionary and real estate, while utilities, communication services and consumer staples were laggards.

Some key downgrades at a stock level through August were Qantas Airways ((QAN)), Sydney Airport ((SYD)), Seek ((SEK)), Telstra ((TLS)), Commonwealth Bank ((CBA)), Challenger ((CGF)), GPT Group ((GPT)) and Unibail-Rodamco-Westfield ((URW)).

Top % Gainers and Losers

The best performing ASX100 stocks during the month were Reliance Worldwide ((RWC)), WiseTech Global ((WTC)) and Afterpay ((APT)). The worst performers were Treasury Wine Estates ((TWE)), ResMed ((RMD)) and Saracen Mineral Holdings ((SAR)).

Other notable rises were within the travel sector and included Flight Centre ((FLT)), Qantas Airways and Sydney Airport. In the top ten for percentage declines were two gold stocks in Northern Star Resources ((NST)) and Newcrest Mining ((NCM)). Also appearing were two defensive industrials in Telstra and AGL Energy ((AGL)).

Among the Small Ordinaries, the best performers were Pointsbet Holdings ((PBT)), Corporate Travel Management ((CTD)) and Zip Co ((Z1P)). The worst performers were Whitehaven Coal ((WHC)), Australian Ethical Investment ((AEF)) and Mayne Pharma ((MYX)).

August reporting season

Surprises:
The biggest large cap positive surprises for UBS were Cleanaway Waste Management ((CWY)), JB Hi-Fi ((JBH)), Reliance Worldwide, Suncorp ((SUN)) and Treasury Wine Estates.

The biggest negative surprises were from Bendigo and Adelaide Bank ((BEN)), Origin Energy ((ORG)), ResMed, Telstra and Vicinity Centres ((VCX)).

Banks:
The reporting season highlighted to JP Morgan the competitive, low-rate world in which banks are operating. This has led to credit quality deterioration, elevated costs and revenue pressures.

The broker's top pick in the sector remains National Australia Bank ((NAB)). The overall sector is considered in need of greater macroeconomic certainty to re-rate. Capital surprise and re-emergence of dividends is helpful but might not be enough on their own.

Commodities and Currency

The Australian dollar continues to strengthen, rising 3% in August, and is now up 10% over the last year. It gained support from a weaker US dollar, improving Chinese growth and impressive strength in commodity prices.

Iron ore, nickel and zinc all posted double-digit gains, while copper and Brent crude both rose around 4%. Australia's high weighting to mining and energy is expected to be an advantage if commodity prices continue to recover.

Bonds

Global bond yields rose sharply in August, with US 10 year government bond yields rising 17 basis points to 0.70%. The Australian 10 year government bond yields also rose 17 basis points to 0.98%. This was largely driven by rising inflation.

The future for bond yields is all about the US Federal Reserve and in particular the new FOMC framework, according to JP Morgan. The Fed had previously strongly signalled it was moving toward average inflation targeting, though the announcement in August came a little sooner than the broker expected.

Whether this strategy shift will actually raise inflation outcomes and inflation expectations will depend on the success of the Fed's actions.

Technology

As noted above, it was another month of technology outperformance, led by the WAAAX* stocks (market cap weighted), which were up 23%, while the S&P/ASX All Technology index rose 13.1%.

Technology was the best performing sector, with the rise driven by WiseTech Global soaring 36% and Afterpay rising 33%.

Other best performers within the technology index were Redbubble ((RBL)), Hansen Technologies ((HSN)) and Bigtincan ((BTH)), while PainChek ((PCK)), ELMO Software ((ELO)) and Resapp Health ((RAP)) were the worst performers.

Listed as Outperforms by Credit Suisse in order of preference are Infomedia ((IFM)), Xero ((XRO)) and Life360 ((360)). The broker is Neutral on Audinate Group ((AD8)), Iress ((IRE)) and WiseTech, while Appen ((APX)) has been marked down to Underperform due to a recent downgrade.

*Wisetech, Afterpay, Altium ((ALU)), Appen ((APX)) and Xero.

Small Ordinaries

The small ordinaries ended the month of August with a gain of 7.3%, which outperformed both mid cap and large cap indices that returned 6.3% and 2.5%, respectively.

Small industrials were up 9.6%, outperforming the ASX100 Industrials by 6.7%, while small resources were down -1.5%, underperforming the ASX 100 Resources by -2.7%.

As alluded to previously, the best performing stock was Pointsbet Holdings which rallied following the announcement of its FY20 result and a partnership agreement with NBCUniversal. Corporate Travel rallied on the expectation of the return of international travel. The third largest percentage rise was Zip Co after reporting a result ahead of expectations and some positive indications for trading of its newly acquired US business QuadPay.

The worst performers were Whitehaven Coal on soft guidance and rising debt levels. Australian Ethical Investment ((AEF)) fell after IOOF Holdings ((IFL)) sold down a large proportion of its stake in the company and Mayne Pharma ((MYX)) declined on concerns over ongoing price erosion of generic drugs.

Looking Forward

Guidance continues to be replaced with rolling trading updates with the AGM season the next checkpoint.

Macquarie notes domestic industrials and banks are forecast to deliver another year of falling earnings per share in FY21, albeit still much improved on FY20. The broker continues to favour resources over industrials, given the expectation that higher commodity prices can support an earnings upgrade cycle.

AUSTRALIA

IPH Ltd's Growth Plans Undaunted

Despite the potential for softness to continue into FY21, IPH Ltd has a resilient patent filing business with a broad geographic reach which should allow it to bounce back.

-Cash generating business with a sustainable dividend
-Flow of patent filings, new work meant redundancies were avoided
-Synergies with Xenith IP should be a positive contributor to growth

By Eva Brocklehurst

Patent filing business IPH Ltd ((IPH)) is intent on delivering synergies from its acquisition of Xenith IP along with scouting for secondary IP market acquisitions offshore. That said, there was no specific guidance provided at the FY20 results and weakness related to the pandemic and US dollar softness is expected to continue into FY21.

Canaccord Genuity notes the shares spiked ahead of the results and then failed to maintain momentum, despite strong cash conversion evident in the second half.

Revenue was less than the broker expected, mostly attributable to the performance of Xenith IP. The company pointed to a slowing of workflow because of disruptions among some clients and the general economic uncertainties, as well as temporary closures of some patent offices.

However as Canaccord Genuity again points out, **there does not appear to be a threat of the GFC-style decline in filings amid indicators such as patent lapses**. US filings remains within normal ranges.

The broker considers IPH a quality business which is attractively priced and retains a Buy rating with a $9.50 target. The final dividend of $0.15 was 10% ahead of FY19. Macquarie, with an Outperform rating and $8.50 target, lauds the relative resilience of the company's business model, and the potential for acquired earnings signals it is an attractive, defensive stock.

In Australia organic revenue growth fell -5% and the market share of the combined IPH group fell to 36.5% from 38.3%. Still, as Goldman Sachs notes, IPH was cycling very strong comparables. The contributing factors, such as the pandemic and the merger of Xenith IP are temporary, Morgans agrees and market filings should bounce back, as 2019 filings in primary markets increased over the 3% in 2019.

Morgans also likes the defensive characteristics of IPH, although expects the first half in FY21 will be "depressed" and a more normal environment will only return in FY22. Patient investors should be rewarded, nonetheless, and the broker does not rule out acquisitions in existing or new secondary market regions. Morgans has an Add rating with an $8.64 target.

The company received no assistance in Australia or New Zealand as a result of the government stimulus but around $1.1m was received across Singapore, China and Hong Kong. Filing activity across the main Asian jurisdictions eased in the second half of FY20 compared to the strong prior comparable period. Yet Asia remains strong with underlying revenue up 9.9% amid benefits from currency and organic growth of 6%.

The flow on effect of prior filings and the level of new work enabled the company to avoid making any redundancies or stand down staff and Bell Potter notes the pre-existing business achieved a more resilient result compared with recent acquisitions.

The company has been prudent, Macquarie observes, in managing its business during the pandemic as it controls discretionary expenditure and decisions regarding remuneration increases have been delayed.

Griffith Hack

Griffith Hack was the main drag on the Australasian business in FY20, contributing to the overall revenue decline of -5% with a -6% decline. Griffith Hack, which includes Watermark, was most affected by the pandemic, the company points out, as well as integration activity.

Still, AJ Park and Griffith Hack are now top ten referral clients of the IPH China business. The company has referred to this as the network effect and Morgans believes this will be the main driver of earnings going forward.

Bell Potter reduces Australasian FY21 forecasts because of the recent softness, particularly in Griffith Hack, but makes no material change to subsequent years. The broker believes the company's quality client base, diverse geography and flexible business should underpin earnings and retains a Buy rating and $8.65 target.

Goldman Sachs also cuts estimates over FY21 and FY22, taking into account the likely FX headwinds that are estimated could take off -$7m from operating earnings (EBITDA) in FY21 based on current assumptions. Still, the annualisation of the merger with Xenith IP and synergies should be a positive contributor to growth.

The broker is yet to incorporate Baldwins into its numbers and anticipates more bolt-on acquisitions will continue to be the core strategy of the business. Goldman Sachs likes the stock because it has a **high market share in the relatively stable Australasian and Singapore markets while being exposed to high growth in Southeast Asia and China**.

Moreover, the business generates cash and has a sustainable dividend pay-out. The broker calculates a prospective 23.5% return on capital employed in FY21. Goldman Sachs has a Buy rating and $8.90 target and does not believe the current share price fully reflects the attributes of the business.

AUSTRALIA

Bumper Harvest On The Table For Graincorp

ABARES has upgraded its forecasts for the Australian east coast winter crop, which points to a more robust outlook for grain handler and processor Graincorp.

-Upside earnings potential beyond a 24mt winter harvest
-Graincorp likely to be loss-making in second half of FY20
-Strong rise in exportable surplus likely

By Eva Brocklehurst

After some savage weather conditions over the past year, grain handler Graincorp ((GNC)) is facing a much more pleasant outlook and brokers are counting the beans.

Official agricultural forecaster, ABARES, has upgraded its east coast winter crop outlook to 24.4mt. This is an upward revision of 13% on the initial estimate in June and represents the largest crop since the 2016/17 season.

A significant turnaround in the amount of rainfall received in south-eastern Australia at the start of 2020 has contributed to favourable seasonal conditions. The size of the crop will not be known until harvesting in November-December, and Morgans points out rainfall at harvest could negatively impact quality.

There is also potential for the first "decent" summer crop in five years, the broker notes, as the first forecast for the 2020/21 summer crop is 3.5mt, up 290%. Summer harvests occur between February and June.

Moreover, a larger canola crop, where production is forecast to rise 47%, is a positive for Graincorp's processing business. Greater volume should improve the crush margins, Morgans notes. That said, while Graincorp will incur a lower price for the canola seed and reduced freight costs, its end-sale prices for meal and oils are currently unknown and will be determined by the international market.

Goldman Sachs reduces forecasts for marketing operating earnings (EBITDA) in FY21 by -7%, amid trade disruptions, and allowing for lower crush margin assumptions.

Morgans also points out that **in FY21 the processing business will have a difficult comparable to cycle as operating conditions were ideal in FY20**.

The company has not provided earnings guidance for FY20 and the broker highlights that agribusiness earnings and tonnage are seasonally skewed to the first half. Morgans forecasts Graincorp will be loss-making in the second half and will be retaining a modest net debt position. Graincorp will report its FY20 results on November 12.

Upside?

Macquarie considers there is further upside to ABARE's winter crop estimate, with its analysis pointing to the potential for 25.6-27.3mt by June next year. UBS highlights a stronger earnings leverage that exists for a crop that is over 24mt as Graincorp's derivative payment is maximised at this level.

Graincorp received a payment of $58m in FY20, reflecting another below-average winter crop. The company will have to pay its insurer $76m gross in FY21 under the crop production contract based on this current estimate.

In a scenario where the FY21 crop is similar to the FY17 "bumper crop" of around 28mt, UBS estimates an operating earnings potential for the agribusiness segment of $190m. In turn, this implies a valuation at $6.40 per share compared with the UBS target of $4.50.

A strong crop in FY21 is also expected to support earnings growth into FY22, assuming this is, at the least, a normal cropping year. UBS notes a supportive balance sheet, with options through a minority interest in United Malt ((UMG)).

Goldman Sachs suspects the bulk of upgraded harvest expectations will be offset by the Graincorp's crop derivative contract although the strong harvest should improve the company's position following the drought.

Exports

Macquarie assesses there will be 7.8mt of exports, assuming Graincorp captures 75% of the export market. This exportable surplus compares with virtually no exports in FY19 and FY20. This is significant, as Graincorp earns higher margins on exports. However, the company will also need to replenish the domestic market, following three years of drought.

Moreover, Morgans points out the company's grain marketing operations are now smaller since the de-merger of the malt business and, following more prudent risk management policies, i.e. the derivative instrument, **there is not the material upside that once occurred with bumper crops**.

The derivative protects shareholders during poor seasons and reduces some of the upside in good seasons. Morgans calculates, looking at 23 years of data, if the derivative were in place it would have been more dilutive to earnings than has been the case.

While yet to comment on ABARE's latest forecast, Credit Suisse upgraded its winter crop estimates earlier this month to 25mt and suspects the market may be underestimating the size of the winter crop, along with Graincorp's leverage to incremental export volumes.

Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, acknowledges it missed the stock's recent rally but retains a Neutral rating with a $4.66 target. The database has three Buy ratings and one Hold (Morgans). The consensus target is $4.59, signalling 4.4% upside to the last share price.

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AUSTRALIA

Window Opens On Consumer Trends

EMBARGOED UNTIL THURSDAY SEPTEMBER 10

Consumers shopped in larger quantities, less frequently and increasingly online during the height of the nationwide lockdowns. The question now is: which trends will persist and which stocks will benefit as restrictions ease?

-While the pandemic remains a threat, robust retail sales are likely
-Numbers mask significant divergences across the retail sector
-Preferences lie with those factoring in a less supercharged earnings outlook

By Eva Brocklehurst

A window has opened on the consumer/retail sector, with the latest reporting season revealing changes to habits -short and long term - as a result of the pandemic and the lockdowns put in place to control the spread.

Goldman Sachs highlights a significant focus on managing short-term volatility and costs during reporting season. Consumers shopped in larger quantities, less frequently and increasingly online.

Retail trade over July and August posted like-for-like sales increases of 29% for discretionary items and 13% for grocery. Despite prior concerns to the contrary, total retail sales increased 12.8% in July 2020, up 6.3% compared with the 12-month average.

Nevertheless, given the quantum of lost sales in April -- the peak of the lockdown -- Morgans asserts revenue growth rates in the second half cannot be considered "ridiculous". Growth rates averaged 6% across the broker's coverage with notable outliers at the top end being **JB Hi-Fi** ((JBH)), **Motorcycle Holdings** ((MTO)) and **Beacon Lighting** ((BLX)).

Electronics, household goods and furniture sales were elevated and positive growth was recorded in clothing. UBS expects the benefits from at-home consumption and the reallocation of expenditure will continue but will be offset somewhat by a decline in government stimulus after September.

Deloitte Access Economics observes the headline numbers are masking significant divergence across the retail sector. Restrictions have meant expenditure at cafes, restaurants and catering services is more than -20% below pre-pandemic levels in July. In contrast, recreational goods, alcohol, electronics, hardware, building and garden supplies have all posted gains of 30% plus.

However, not all were intent on a retail splurge and the savings rate has also risen sharply, as households hunker down for uncertain times. Researcher David Rumbens expects some parts of retail will take longer than others to recover. Those that will take much longer will be department stores, catered food and apparel.

Still, the amount of cash being spread through the economy is unprecedented and, as Mr Rumbens notes, while employee earnings may have dropped over the June quarter household disposable income actually rose 2.2%.

Citi believes **growth in cash flow to households is likely to slow materially in the December quarter and the issue retailers face is the degree of moderation that will occur as the stimulus unwinds**.

As restrictions are eased more expenditure is likely to be directed outside of retail. The main swing factor, in Citi's view, is how far households draw down savings. On the other hand, Goldman Sachs is now factoring in the maintenance of the home consumption trend for longer than previously expected.

While the pandemic remains a threat to communities, Morgans expects robust sales trends will persist. Anything to do with the home is likely to continue to perform over the balance of the first half. As Christmas comes into view the broker expects some strength in fashion, accessories and outdoor/leisure categories will emerge, providing restrictions don't re-intensify.

<u>Preferences</u>

Citi retains a preference for grocery, retaining Buy ratings for **Coles** ((COL)) and **Metcash** ((MTS)), over discretionary retail, given the earnings outlook and relative valuations. While discretionary retailer share prices are factoring in further earnings upgrades, and there is upside potential for first half consensus estimates, beyond this point risks are building.

Inevitably, retail sales growth will slow and the broker prefers those discretionary retailers that are factoring in less optimistic FY22 normalised earnings such as **Super Retail** ((SUL)) and **Harvey Norman** ((HVN)). The broker considers the valuations of **Wesfarmers** ((WES)), JB Hi-Fi and **Lovisa** ((LOV)) are stretched.

UBS notes those stocks that should be revisited post the reporting season and appear to have overreacted to the results include **Costa Group** ((CGC)), **Adairs** ((ADH)) and **Domino's Pizza** ((DMP)). The latter has been investing in the business during the period and Goldman Sachs, with a Neutral rating, expects growth will accelerate strongly in FY21, calculating operating earnings growth of 19.5%.

Those that under-reacted to the results, in UBS' assessment, were **a2 Milk** ((A2M)), Harvey Norman, **Woolworths** ((WOW)), Coles and **Treasury Wine Estates** ((TWE)). Goldman Sachs highlights the generally negative impact on sales from the pandemic for the latter, noting that, while the company's new CEO has an optimistic view of restructuring, there was no specific guidance.

UBS isolates three opportunities worth watching, including a2 Milk, Harvey Norman and Woolworths ,while Goldman Sachs considers Harvey Norman is in a sweet spot, because of government stimulus. While not expecting Harvey Norman's current level of elevated sales will be maintained, the broker believes the softer outlook is already accommodated in the "conservative" valuation.

Macquarie is of the same view, believing that despite material movements in the share price over 2020, valuation remains highly supportive. The broker also likes a reduced exposure to ancillary investments that is expected to encourage new investors.

Supermarkets

In supermarkets, Goldman Sachs suspects lower award wage growth and ongoing goods inflation should all help to manage margins but the potential for recessionary conditions could increase the risk of price competition.

Coles is expected to experience comparable sales growth of around 2% in supermarkets and liquor is a key area to watch, in the broker's view. Management is in the process of restructuring its liquor business and changes in the offer, pricing and store layouts are expected.

Meanwhile, online sales growth for Woolworths has been strong and the growing penetration of online and reduce store efficiency is the main theme for the longer-term sustainability of the company's stores. Further clarity on the approach the company will take to the demerger of Endeavour Group could be a catalyst, Goldman Sachs asserts.

Macquarie agrees restrictions are likely to support elevated supermarket and liquor volumes but also highlights the strength in in the independents. Macquarie's key stock ideas include Coles, Woolworths and Harvey Norman.

Online

Online sales continued to go from strength to strength, accelerating rapidly in July because of the reinstatement of lockdowns in Victoria and surpassing previous highs recorded in April when there was a national lockdown. All categories recorded sales growth, led by games, toys and fashion and Morgans believes higher penetration rates for online are here to stay.

Coles and Woolworths exceeded the capacity of their online networks during the height of the lockdowns, Macquarie points out, which led to "underwhelming" second half growth for Coles. The broker notes **Accent** ((AX1)) indicated 50% of online customers in the fourth quarter had never shopped via digital means before, at least with its stores.

Adairs' online sales were up 61.4%, **Baby Bunting**'s ((BBN)) online delivery sales grew 44% in the second half and **City Chic**'s ((CCX)) online channel grew to represent 65% of sales. For the first time since the coronavirus outbreak, Wilsons has included Adairs and City Chic as key picks in the retail sector.

Morgans maintains a constructive outlook for the sector but already finds **evidence the market is starting to weigh up the strength some of the retailers will have to cycle in the fourth quarter of FY21 and the first half of FY22**

The broker considers Baby Bunting possibly the best placed retailer under its coverage in terms of growth and market position, but after a strong rally would prefer to buy on weakness. Morgans is prepared to be patient with Lovisa as a second phase recovery stock assessing that when it turns around it will be quick.

COMMODITIES

Material Matters: Gold, Iron Ore & Base Metals

A glance through the latest expert views and predictions about commodities. Gold; iron ore; coking coal; and base metals.

-Gold price likely to be stronger for longer
-Is further upside in the iron ore price likely?
-Risk to the downside in chasing copper price
-Implied demand growth for aluminium a mystery

By Eva Brocklehurst

Gold

A strengthening Australian dollar has chewed the margins for Australian **gold** producers, JPMorgan notes, and estimates are downgraded by -5-10% for the short term as a result. Still, stocks are beginning to price in more modest FY21 guidance and valuations are not considered stretched.

Morgans, meanwhile, suspects the gold price will be stronger for longer, i.e. at least the next 1-2 years, as central banks increase money printing to support their respective economies throughout the pandemic

The US Federal Reserve has also put upside pressure on the US dollar gold price in shifting its policy on inflation targets, although the response may be more subdued in Australian dollar terms.

The Australian dollar gold price rose to a high of $2800/oz and is currently around $2650/oz. This compares with $1800/oz at the beginning of 2019. No two gold miners are the same, as scale of production, jurisdiction and number of operations feature in market valuations.

In this way, Morgans suggests the larger miners have safer options regarding the gold price as production is spread across several operations. In contrast, small producers may offer more leverage but are relatively high risk.

Within the broker's coverage, **Ramelius Resources** ((RMS)) and **Regis Resources** ((RRL)) are preferred producers for a combination of scale, management, cost discipline and delivery. For those comfortable with development, **West African Resources** ((WAF)) and **Westgold Resources** ((WGX)) also rank well.

JPMorgan upgrades **Newcrest Mining** ((NCM)) to Overweight and Regis Resources and **Saracen Mineral Holdings** ((SAR)) to Neutral. JPMorgan retains a long-term gold price forecast of US$1600/oz with an AUD rate of US$0.74.

Iron Ore

Credit Suisse asserts the **iron ore** price should hold up, despite Chinese authorities attempting to pressure the price down. Margins in **steel** have disappeared and the broker suspects mills are complaining that all the benefits of stimulus have gone to overseas iron ore producers.

Credit Suisse envisages little risk in subduing the demand for steel at this point in time as inventory is relatively elevated. The autumn construction season in China is likely to mean inventory is consumed as well as new production, although a further climb in the iron ore price appears more difficult.

Macquarie notes demand outside of China is also recovering. Benchmark iron ore prices have averaged US$116/t for the September quarter. Meanwhile, major Australian miners continue to ship at strong rates with July volumes matching April and August producing a run rate of around 818mtpa.

The current strength underpins upside risk to the broker's earnings forecasts with 11% upside cited for **BHP Group** ((BHP)), 23% for **Rio Tinto** ((RIO)), 38% for **Fortescue Metals** ((FMG)), 9% for **Mineral Resources** ((MIN)), 25% for **Mount Gibson Iron** ((MGX)) and 14% for **Champion Iron** ((CIA)).

JPMorgan upgrades Fortescue Metals to Overweight, becoming more confident iron ore prices will remain buoyant. The broker concedes that its previous -20% forecast discount in the company's iron ore price realisation was too bearish.

The estimate now reflects an improving product mix and the valuation for the stock rises to $20/share, with the next three years' average projected dividend yield set at 9%. Meanwhile, valuations for BHP and Rio Tinto are compelling, in the broker's view, on current metrics. One-year forward free cash flow yields are calculated at 8.2% in FY21 for BHP and 11% for Rio.

Coking Coal

Credit Suisse's top pick in commodities is **metallurgical (coking) coal**, expecting the price to lift in the fourth quarter. Indian steel mills are increasing production and depleting inventory and should return to the coal market by the fourth quarter. In Japan some blast furnaces are expected to re-start by October and spot trade from these markets should allow the metallurgical coal price to rise.

Base Metals

Credit Suisse asserts risk is to the downside in chasing the current **copper** price, as the fundamental reason for the increase has passed. A price of around US$3.10/lb now reflects depleted London Metal Exchange (LME) stocks after record copper imports by China.

China's imports are expected to fall sharply and surplus copper from elsewhere, where demand remains soft, should now be available to refill warehouses. While there is the potential for the arbitrage to re-open later in the year and copper demand in China is likely to be positive, this is not yet a fait accompli and there is great uncertainty, the broker assesses.

That said, copper fabricators are experiencing strong activity and if that follows through then a new wave of demand has probably begun and demand growth in China may be significantly greater than the 2.5% Credit Suisse forecasts for 2020. As a result, imports may be needed later in the year, but for now the trade appears to be over.

Copper and **nickel** are well above Macquarie's forecasts which underpin a preference for **OZ Minerals** ((OZL)) (copper) and **Western Areas** ((WSA)), **Nickel Mines** ((NIC)) & **Mincor Resources** ((MCR)) (nickel).

Western Areas offers the greatest leverage to nickel prices on average, the broker notes, as a 20% rise in nickel prices has enhanced momentum in the spot price scenario which suggests more than 100% higher earnings in FY21/22.

Sandfire Resources ((SFR)) has the greatest leverage to copper. Both OZ Minerals and Sandfire continue to offer upside risk to earnings in a spot price scenario and the broker notes both have robust balance sheets.

Macquarie prefers Western Areas and Nickel Mines as producers and Mincor as a development play. **Panoramic Resources** ((PAN)) will need to return to the market for additional capital as the broker highlights it is loss-making on current forecasts and spot prices until FY25.

Meanwhile, the earnings risk for **IGO** ((IGO)) has moved into positive territory on spot prices, driven by the re-basing of nickel forecasts and the gold exposure from the company's Tropicana mine.

Credit Suisse assesses, in the case of **aluminium**, where the quantities in both LME and other warehousing are greater than for copper, heavy imports by China have modestly reduced levels but not to a level where a price spike is likely to occur. China's import arbitrage was so great that total aluminium imports overtook exports in July, which Credit Suisse notes is an extremely rare occurrence.

Hence, the LME price climbed to US$1750/t and the arbitrage narrowed. The broker finds it hard to explain where all the metal is going in China, as it is not appearing in visible inventory. The explanation may be consumption but on Credit Suisse's estimates the implied demand growth rates appear extraordinary.

ESG FOCUS

ESG Focus: Of Waste And Resources

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/

FNArena examines the latest financial reports from the waste-management industry, which stands to benefit from several ESG megatrends; and an update on Rio Tinto's Juukan Gorge and its implications for the resources industry, which stands at the opposite end of the ESG stick

-Waste-management stands at the megatrends crossroads
-Major waste companies showing different ESG approaches in August
-Juukan Gorge sounds a warning bell for resources sector

By Sarah Mills

Waste management is a key ESG theme and two of the ASX's largest waste companies reported in August: Bingo Industries ((BIN)) and Cleanaway Waste Management ((CWY)).

Share prices for both rose sharply, despite both companies reporting broadly in line with market forecasts, albeit with Bingo Industries performing relatively best against expectations.

Both companies provide some interesting observations from an ESG perspective.

Cleanaway shares have outperformed Bingo Industry in the past year, possibly a reflection on its lower debt levels (given weak appetite for debt post-covid) and its lower price-earnings multiple, to trade above pre-coronavirus levels.

Bingo industry jumped roughly 25% leading up to and upon publication of its results, but its share price remains closer to its post-covid trough.

While Cleanaway was trading above fair value, Bingo Industries was trading below fair value, possibly explaining some of the discrepancy.

ESG milestones, joint ventures and expenditures

From an ESG perspective, it is possible that Cleanaway has also benefited over the year from its public tilt towards plastic recycling given the government is expected to heavily subsidise the industry to solve the national plastic pollution challenge after China abruptly withdrew its plastic recycling service.

The full government funding proposal has been postponed until the October budget.

Bingo Industries, on the other hand, may have been struggling under expectations of further capital expenditure as it pivots to a recycling model, and the perception that, without joint ventures such as those secured by Cleanaway, it might not find end markets for its recycled products.

While performing much better on the ESG metrics reporting than Cleanaway over the past year, the company seemed to suffer from a lack of more defined strategic positioning in terms of new strategic announcements. Bingo also seemed to be struggling to gain full market appreciation for its strategic vision.

Much of that changed with the FY20 results. Bingo Industries came out guns-a-blazing on the strategic ESG front, leaving Cleanaway looking like a tactical small-fry.

If investors didn't get the picture before the presentation, the company left little room for confusion post the presentation.

Waste management industry stands at megatrends crossroads

Very few industries stand to benefit from the world's major ESG trends as does waste management.

Sustainability, the sustainable fourth industrial revolution, the circular economy, the plastic war, climate change and alternative energy sources, you name it, the waste management industry stands in a pivotal position to all of them.

The industry promises to be a huge beneficiary, once it transforms/reforms its business model.

Yet, up until Bingo's *FY20 Investor Presentation*, the country's leading companies have failed to demonstrate publicly they really understand the opportunity at hand. Possibly because of a reluctance (not to mention the cost) to restructure old business models to meet future demands.

Bingo turns in impressive sustainability report

Bingo Industries clearly signalled an understanding that the world is transforming to a circular economy; and that circularity/sustainability and ESG are key planks of its strategy going forward.

The company devoted the first several pages of its *FY20 Investor Presentation* to primarily strategic sustainability and ESG issues. Where the report was light on tactics, it was strong on strategy.

The company's FY20 achievements and key takeaways were headlined by:

- Significant progress towards zero harm; and
- Leader in sustainability and social responsibility

Upfront, Bingo Industries reported on resource recovery, education, recycling, employee engagement, renewable energy, female representation, sustainability reporting excellence, climate change, responsible sourcing, indigenous participation, charity and modern slavery.

From a strategic and operational perspective, the company reported on progress with recycling and earmarked vertical integration – a key 4IR and sustainability/circularity theme as a "secondary focus" and a key strategic enabler.

Its five-year strategy was underpinned by the "priorities" of zero harm, customer experience, sustainability, growth and innovation, and develop and retain talent.

Bingo seemed at pains to stress its ESG credentials and went to some details to benefit progress on vertical integration. Some cynics might say Bingo was keen to shore up institutional investment; but there could be no doubt about the clarity of its strategic vision.

In a relatively short report, the company goes to some length to point out trends in this space. It points to to

COAG's 2020 ban on waste exports, expecting this will force the development on the domestic recycling market; federal government recycled content targets for new developments; higher minimum standards for compliance (which should increase barriers to entry; the push to scale up and accelerate the development of the circular economy in Australia (the company expects it will benefit from the need for Bingo's recycled content).

The company singled out regulation and vertical integration, key sustainability themes, as key growth drivers; as well as the development of the Recycling Ecology Park at Eastern Creek.

The flipside to this is the company's lack of progress to date on securing end markets and ventures with key industry players.

In comparison, Cleanaway's FY20 Investor Presentation was underwhelming, leaving the observer to think this company missed an opportunity to impress investors.

While, Bingo Industries' report was strong on strategy and low on tactics, Cleanaway's report read like a tactical hit list of projects delivered (not necessarily a bad thing).

Cleanaway also reported its maiden ESG scorecard stamped with "Delivered", which, buried as it was deep in the report in small type (that this writer could not read on her laptop), made it appear as if the company were reluctantly ticking a box, rather than recognising ESG as a strategic opportunity.

Cleanaway's report appeared to show no real comprehension of the enormous opportunity, not to mention structural change, ahead of the industry. Nor the chance to inspire investors. This may have been politic.

Cleanaway's presentation did include one strong paragraph:

"*Our objective to drive a circular economy in Australia continues and in the coming years, we will pursue several key projects that are strategically important for our business.*"

Cleanaway identifies two of these as its proposed energy-from-waste facility and the plastic pelletising plant in Albury – a joint venture with Pact Group ((PGH)) and Asahi Beverages.

The latter is more significant than it sounds, in that it demonstrates solid steps towards securing an end market for the company's products.

Investors don't mind investing in the future, but they like to know where the money is coming from. Investors are aware that plastic recycling is likely to yield strong subsidy support from governments in the near and long term.

Restructuring the business model

While the waste management industry is one of the most interesting ESG spaces, its traditional business model is not geared to many of the challenges ahead, such as plastics recycling, and is essentially one of collect and dump.

The industry doesn't yet have the manufacturing skills or infrastructure to dominate this space, making it vulnerable to new entrants and new technologies.

This is why joint ventures with major industry players, and the internalising of manufacturing skills is critical to securing future revenue.

While large cap companies such as Bingo Industries and Cleanaway appear to have an advantage over smaller existing operators, much will depend on the strategic execution of the pivot.

Strategy during periods of structural change is critical and Bingo Industries in its report went to great lengths to clearly demonstrate to the market it understands the challenges and opportunities ahead. Bingo also sent a clear signal to ESG investors it understands what it is required to attract and maintain capital support.

But so is revenue, and Cleanaway appears to have the edge on that front, although a relatively small one.

Investors will be expecting joint venture activity and recycling contracts to accelerate as proof that the funds will be forthcoming – from both Bingo Industries and Cleanaway.

They would also be keeping an eye to any mergers or acquisitions which would beef up the companies' manufacturing infrastructure and skillsets.

Rio Tinto's Juukan Gorge incident a warning to resources companies

Meanwhile, Rio Tinto ((Rio)) published its board review of the Juukan Cave destruction. The board blamed systemic failures in communication and information management since 2014, reduced pay for its executive team (roughly between $1 and $2m per executive and a GBP1m reduction in CEO JS-Jacques' 2016 long-term incentive plan; and further pay penalties down the hierarchy for those found to be bearing some responsibility.

Rio Tinto's board pledged to enhance standards and oversight through a new Social Performance function, and embark on a cultural change program, the rebuilding of its relationship with traditional land-owners, greater resourcing for the Heritage division which will be reviewed in its sustainability audit, and greater interactions between Rio Tinto Iron Ore senior leadership and traditional owners.

The board and executives are set to appear before the parliamentary inquiry into the incident in September and the joint standing committee inquiry is due on September 30.

The chastisement of Rio Tinto appears to be a warning shot across the bow, and it appears the incident is being used as an example to other resources companies in Australia.

Genuine penalties for the company, as in large financial recompense to traditional landowners, have to date been non-existent, so the cynical observer might say the destruction of the site paid dividends, literally.

Institutional investors have not and are unlikely to penalise the company for the event.

The resources sector has less opportunity to benefit as directly from ESG megatrends as does the waste management industry, and more to lose.

Resources will be needed to drive the fourth industrial revolution. But on the other hand, circularity will require more recycling and re-use/repurposing of existing resources, and most of the sustainability challenges will add to costs in the near term.

At an individual stock level, improvements in efficiency in areas such as water and energy useage will benefit investors, but the efficiency process is expected to be continual, requiring continual capital expenditure. At an inter-sector level, sustainability competition should see some companies emerge stronger than their peers.

And then there is the "S" in ESG – social, which offers few financial benefits to resource-sector investors, although it does offer some reassurance that if an organisation performs well here, they are also likely to perform well on other metrics and show a similar respect to shareholders.

For now, Rio Tinto's destruction of the archaeological significant Juukan Gorge has gone relatively unpunished. Again, it was a warning shot across the bow, not just for Rio Tinto but all resource companies.

The real commitment of ESG investors on this issue is likely to be tested in the next major incursion on this front.

It would be difficult for institutional investors to let another incident pass without penalty. Then, ESG's "S" metal will truly be tested, its ramifications stretching from the Pilbara to the Pilliga.

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

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

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

FEATURE STORIES

August 2020 Result Season: The Wrap

The August result season could be called "best ever" in terms of beats to misses, but in 2020, such a conclusion would be misinformed

-Guess and giggle forecasts
-Government support and cost cutting
-Uncertainty ongoing

By Greg Peel

With the August result season now complete in 2020, the FNArena Corporate Result Monitor, which has been building throughout the month, is now complete and published in its final form here (see attachment).

Guide

The table contains ratings and consensus target price changes along with brief summaries of the collective responses from FNArena database brokers for each individual corporate result, and an assessment of "beats" and "misses". Australian corporate results tend to focus on the profit line, with all its inherent potential for accounting vagaries, tax changes, asset write-downs and other "one-off" impacts. FNArena has focused mostly on underlying earnings results (more in line with Wall Street practice) as a more valuable indicator of whether or not a company has outperformed or underperformed broker expectations. There is also a level of "quality" assessment here rather than simple blind "quantity".

The Monitor summarises results from 318 major listed companies. By FNArena's assessment, 114 companies beat expectations and 61 missed expectations, for a percentage ratio of 36/19 or 1.9 beats to misses. The aggregate of all resultant target price changes came in at a net 5.0% gain. In response to results, brokers made 54 ratings upgrades and 52 ratings downgrades, or an even enough ratio of upgrades to downgrades.

The attached PDF contains all this data and summaries of broker responses to every company reporting.

The first FNArena Corporate Result Monitor was published post the August season of 2013. See table:

FNArena Result Season Tracker

	#Stocks	%In-Line	%Beats	%Misses	Ratio	Up-grades	Down-grades	Ratio	%Target Change	Index Start	Index Finish	%Move
Aug-20	318	45	36	19	1.9	54	52	1.0	5.0	5928	6061	2.2
Feb-20	314	42	31	27	1.1	72	48	1.5	3.9	7017	6441	-8.2
Aug-19	316	50	24	25	1.0	65	72	-1.1	2.5	6813	6604	-3.1
Feb-19	308	34	33	33	1.0	31	93	-3.0	-0.1	5864	6169	5.2
Aug-19	311	48	28	24	1.2	47	84	-1.8	3.4	6280	6319	0.6
Feb-18	319	38	37	25	1.5	87	54	1.6	4.3	6037	6016	-0.3
Aug-17	319	46	27	27	1.0	48	62	-1.3	1.8	5720	5714	-0.1
Feb-17	320	38	35	27	1.3	55	66	-1.2	1.4	5620	5712	1.6
Aug-16	321	44	32	24	1.4	56	90	-1.6	3.7	5562	5433	-2.3
Feb-16	317	42	37	21	1.7	70	70	1.0	1.4	5005	4880	-2.5
Aug-15	315	50	30	20	1.5	116	40	2.9	1.2	5699	5207	-8.6
Feb-15	318	38	36	26	1.4	38	118	-3.1	5.6	5588	5928	6.1
Aug-14	269	44	30	26	1.1	55	90	-1.6	2.1	5632	5625	-0.1
Feb-14	269	48	30	22	1.4	64	74	-1.2	5.4	5190	5404	4.1
Aug-13	248	56	25	19	1.3	61	86	-1.4	2.2	5052	5135	1.6
Average		44.2	31.4	24.3	1.3	61.3	73.3	-0.6	2.9			

Notes:

#Stocks	Stocks covered by FNArena database brokers.
Beats/Misses	FNArena's own assessment based on net database broker responses.
Ratio	Expressed as positive when beats exceed misses, negative if misses exceed beats.
Up/downgrades	To ratings provided by FNArena database brokers.
Ratio	Expressed as positive if upgrades exceed, negative if downgrades exceed.
Target	The net simple average of FNArena database broker target price changes post result.
Index	Index start to finish taken from Jan 31/Jul 31 to Feb 28 (or 29)/ Aug 31.
%Move	Of the index over that period.

Into the Darkness

Late last year, the ASX200 finally surpassed its pre-GFC high. The achievement took twelve years. It had taken Wall Street five. The ASX200 continued to rally into blue sky as we moved into 2020, peaking on February 17.

At that stage we were three weeks into the February reporting season, and to that point the season was shaping up as very positive. We all know what happened next.

Almost all companies reporting in the last week of February declined to provide forward guidance as they had no clue what might ultimately transpire. Some cut, deferred or abandoned their dividends in order to preserve capital.

By the time the country went into lockdown, the rush was on among those companies which had reported before February 17 to withdraw the guidance they had provided, and in some cases put the dividends they had declared on hold.

The next step was a rush of companies raising fresh capital to cover debt and build a provision against a likely collapse in earnings.

Stock analysts were left with a dilemma. They were being paid to provide earnings forecasts. If managements had no idea, why would analysts know any better? But to earn their pay, they had to provide *something*.

All would ultimately be revealed in the August result season, following books close on June 30.

Record Beats

For what was shaping up to be the “worst” reporting season in anyone’s lifetime, it actually turned out to be the “best” (since the FNArena monitor began in August 2013) in terms of the ratio of results beating analyst forecasts to those missing. That ratio of 1.9 smashed the average of 1.3, and surpassed the previous high of 1.7 in February 2016.

But to call it the “best” would be disingenuous.

For starters, ASX200 earnings fell -20% in the half to June. That is your “worst” result right there, but the Monitor’s job is to compare actual numbers to forecast numbers.

More importantly, we come back to the aforementioned analyst dilemma.

Analysts themselves for the most part admitted, in updating their forecasts for companies post February, that really they were just guessing, even if they didn't put it quite so candidly. Those guesses, as it turned out, were typically conservative, for no one would blame the analyst for fearing the worst and then being proven overly fearful, but the analyst who proved too optimistic under the circumstances would look a fool.

On that basis, upside (to very low forecasts) was always a likelihood even before the season began.

We then note that the stock market bounced hard off its lows in April, having been declared "oversold", and then continued to rally as lockdown restrictions were eased and the economy gradually "re-opened" as we moved towards June. For managements, the clouds began to part, providing an opportunity to provide fresh guidance, and after June books close, to pre-release actual headline results.

Every season sees such pre-season activity and indeed this August season saw an average number of "in line" results. Earnings forecast and ratings upgrades/downgrades were made by analysts before the season proper, hence we may have yet had more beats to misses than the final "best ever" ratio suggests.

But why so many beats?

I'll offer four reasons: (1) the aforementioned preference by analysts to go in low and be beaten rather than go in high and be missed; (2) JobKeeper; and (3) an impressive rush by managements to cut costs; and (4) where applicable, extraordinary gains in online activity.

Many companies were JobKeeper recipients and while this rather distorts profit lines, given it's a one-off government handout, it did save the bacon for a lot of companies, particularly those with high debt levels.

In many cases, a "beat" of analyst forecasts was largely attributable to cost-cutting efforts which were above and beyond what analysts thought possible. Of course there are two "types" of cost-cutting – the cuts that streamline a business and lead to greater earnings efficiency, and the cuts implemented in desperation to prevent a company's demise.

Both were in evidence, but if we add in aforementioned capital raisings we can conclude that to some extent "beats" were a matter of simply remaining commercially viable.

As for online activity, it was no surprise to anyone online sales would dominate in the lockdowns, but what was a surprise was just how much of a surge there was. Companies that existed only online were obvious beneficiaries, companies complementing in-store retail with established online retail also fared very well, and even some companies which up to now had been slow online movers managed to rectify the situation with haste.

All of the above can in varying amounts explain why the worst earnings performance since the GFC led to the "best" earnings season on a comparative forecast-to-actual result basis.

But I'll also throw in the fifth factor.

The bulk of companies beating forecasts -- and note the Monitor covers 318 stocks covered by FNArena database brokers, not just 200 -- were small cap companies. Many of those small companies are only reviewed by analysts after each result season, meaning once every six months.

<u>The Outlook</u>

It was assumed from the outset the half to June would be a shocker, in terms of absolute earnings results and overall economic performance. The August result season, and the more recent June quarter GDP release, confirmed both. But it was also assumed the half to December would be one of recovery, even, perhaps, record GDP growth off a very low base.

To that end, analysts were looking forward to companies providing forward guidance with their August results, making life a bit easier.

But along came Victoria. First came the spike, then came the re-lockdown, then came the lockdown extension. The first two steps led many a company to yet again refrain from providing guidance, and others to provide guidance but with a big Victoria uncertainty caveat. The extension may yet bring more reviews and possible withdrawals.

So here we go again.

Another notable aspect of this reporting season in particular is the growing number of analyst views and subsequent recommendations based on a "look through" to subsequent years in which one assumes a vaccine has been found and life will slowly return to something like normal.

Analysts set price targets for twelve months hence, but many a rating this season has been based on assumptions for FY22, FY23, and even FY24, and thus an emphasis on longer term value.

Of course “normal”, if we ever get there, will be a “new normal”. Online services have been growing for a decade but we have since seen a rapid acceleration to levels analysts believe will not ease back in the future, but grow. Indeed anything to do with the internet has a bright future, while legacy industries will need to adapt lest they fade away.

Not everything can go online. Miners will always need to dig rocks out of the ground for example, but then already we see Tonka trucks that drive themselves and processing systems run more efficiently using cloud-based software.

And that’s just one example.

The future’s so bright, I have to wear shades. If only we knew when the future will be.

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

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 04-09-20

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday August 31 to Friday September 4, 2020
Total Upgrades: 13
Total Downgrades: 8
Net Ratings Breakdown: Buy 48.25%; Hold 40.74%; Sell 11.01%

Rounding out the August reporting season for ASX-listed stocks, the week ending Friday 4th September yielded thirteen upgrades and eight downgrades to company ratings by stockbroking analysts. Of the thirteen upgrades, nine went to a direct Buy, while half of the eighth downgrades were moved to a direct Sell.

NextDC received two upgrades to Buy from separate brokers who forecast the increased demand for public cloud and data services will continue post-pandemic. Meanwhile, Pointsbet Holdings received two downgrades after announcing an agreement with NBCUniversal. After a spectacular rise in share price, one broker downgraded on valuation concerns, while the other projects it will be at least FY25 until the company realises any operating earnings in the US.

NextDC had the largest positive percentage adjustment by brokers to its target price. Next followed Zip Co after brokers factored in the company's FY20 result, a capital raising for the recently acquired QuadPay in the US and the entrance of PayPal into the BNPL sector.

The target price for OceanaGold received the largest percentage downgrade due to a reassessment of the Haile mine plan and downgraded production guidance. Coming in second was Nufarm after the company provided lower-than-expected FY20 guidance and its European business was downgraded by brokers.

Consistent with target price reductions, both OceanaGold and Nufarm received significant earnings downgrades. Also featuring in the top three negative percentage earnings downgrades was Air New Zealand due to the grim outlook for international travel, despite the company beating FY20 result expectations.

On a more positive note, the largest lift in percentage terms for earnings was Cooper Energy, after some easing of concerns over the Sole gas project near Orbost in Victoria. Afterpay was second on the table with momentum expected to continue and execution expected to be key. The cashed-up Reece came in third as brokers expected the company to deploy some of its capital into further acquisitions.

Total Neutral/Hold recommendations take up 48.25% of the total, versus 40.74% on Neutral/Hold, while Sell ratings account for the remaining 11.01%.

Upgrade

AGL ENERGY LIMITED ((AGL)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 1/4/2

AGL Energy has acquired Click for around $155m. Macquarie observes Click offers limited strategic value as customers are spread across the eastern seaboard where AGL Energy already has a good position.

Churn in this group is naturally higher and the credit risk is elevated, the broker adds. Nevertheless, this is a low-risk acquisition that provides operating earnings upside of around $30m, funded with cash.

Macquarie observes cyclical pressure on the share price has peaked and upgrades to Neutral from Underperform. The target is lifted to $14.98 from $14.65.

AURELIA METALS LIMITED ((AMI)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 2/0/0

Ord Minnett believes the stock remains misunderstood in terms of the quality of the portfolio. While operational risks continue, the broker advises buying any dips as Aurelia Metals trades at a discount relative to fundamentals & peers.

The broker believes the Federation project is a game changer and early exploration results warrant a re-rating. Rating is upgraded to Buy from Accumulate and the target lifted to $0.75 from $0.60.

AUTOSPORTS GROUP LIMITED ((ASG)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

Strong support from original equipment manufacturers and JobKeeper led Autosports Group to a better result than Macquarie first spotted on release. Lead indicators of order writing are exceeding deliveries heading into FY21, making the broker more positive.

No guidance provided due to uncertainty, but Macquarie suggests a swift bounce out of Victoria's lockdowns should provide a catalyst for re-rating. Upgrade to Outperform, target rises to $1.65 from $1.10.

AUSTRALIAN VINTAGE PTY LTD ((AVG)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Australian Vintage delivered a solid FY20 result slightly ahead of Morgans forecasts.

The broker highlights the UK/Europe business was the standout, while Australia also performed strongly. Conditions remain challenging in North America and Asia.

FY21 outlook comments were positive and management is targeting a 48% improvement in return on capital employed (ROCE), with lower wine costs to provide a significant tailwind, explains the analyst.

The rating is upgraded to Add from Hold and the target price is increased to $0.62 from $0.50.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/3/4

The investor briefing highlighted the potential the company envisages for Red Lake. Macquarie finds the prospect of an open pit at the site compelling but awaits more clarity on the costs and the path to approval before including it in forecasts.

The broker assumes a higher conversion of resources to reserves, which extends assumed mine life of the assets. This leads to an upgrade to Neutral from Underperform. Target is raised to $5.60 from $5.20.

INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 5/2/0

Macquarie believes concerns about the potential for a new CEO to re-base earnings are overdone and business interruption losses are over estimated.

The broker calculates probable business interruption losses at -$125m but estimates, at current levels, the market is pricing in a -$1.9bn loss post reinsurance for Insurance Australia Group, which is considered highly unlikely.

The broker believes the valuation has finally become attractive and upgrades to Outperform from Neutral. Target is $5.50.

IOOF HOLDINGS LIMITED ((IFL)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/2/0

Ord Minnett notes risks around IOOF Holdings' proposed acquisition of National Australia Bank's ((NAB)) MLC business. The broker highlights the company has bought businesses like MLC that have negative net flows and it is unclear if the negative flow can be stopped.

On the bright side, the company will be the largest superannuation player in the market which, the broker feels, should ensure longevity.

Ord Minnett upgrades its recommendation to Buy from Hold with the target price lowered to $4.15 from $5.00.

NUFARM LIMITED ((NUF)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 4/2/1

Nufarm, which reports its FY20 result on September 23, anticipates underlying FY20 operating earnings of $230-240m. A non-cash impairment of -$215m will be taken in relation to the European assets.

Europe is the main culprit in the weaker-than-expected outcome although there was some potential relief on the way with lower raw material costs over the last quarter.

Given the extent of the recent share price decline, Macquarie upgrades to Neutral from Underperform. Target is reduced to $4.26 from $4.85.

NEXTDC LIMITED ((NXT)) Upgrade to Accumulate from Hold by Ord Minnett and Upgrade to Add from Hold by Morgans.B/H/S: 5/2/0

FY20 results highlight the appeal of the stock, in Ord Minnett's view. Revenue was in line with forecasts. The net loss of -$45m included a large one-off adjustment for tax losses and timing differences.

The broker envisages NextDC is well-placed to benefit from the increased demand for public cloud and data centre services post the pandemic. Rating is upgraded to Accumulate from Hold and the target lifted to $13 from $10.

NextDC’s FY20 result was in-line with guidance and the result and outlook demonstrates to Morgans how uncorrelated digital infrastructure is to economic cycles and what a high quality the company’s business model and earnings streams are.

The broker projects earnings to exceed $200m in the next four years and potentially $300m in the next five, if options granted to cloud solution provider (CSP) customers are granted.

Morgans poses are we currently seeing a short-term spike in cloud demand due to remote working or has the world permanently changed? The broker is betting on demand remaining robust.

The rating is upgraded to Add from Hold and the target price is increased to $13.89 from $11.11.

SONIC HEALTHCARE LIMITED ((SHL)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/5/0

On calculating the contribution of coronavirus testing to the company's financial performance, UBS makes material upgrades over the short term.

Well aware that rates may fall and reimbursement rates may decline, the broker believes Sonic Healthcare will still be a beneficiary of above-normal free cash flow for 1-2 years.

This could be used to fund growth opportunities not previously accessible. UBS upgrades to Neutral from Sell and raises the target to $32.10 from $29.80.

TRANSURBAN GROUP ((TCL)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/2/2

As the stock has underperformed the market by -10-15% since late May and there is an end in sight to the lockdowns in Melbourne, UBS upgrades Transurban to Buy from Neutral. Target is raised to $15.50 from $14.70.

UBS assesses Transurban is highly leveraged to a recovery in the Melbourne network as it accounts for one third of group operating earnings. Moreover, the market is seeking growth in a structurally weaker environment.

The broker expects a dividend in FY21 of $0.46, to reflect underlying growth of 10%. Growth estimates in FY22-25 of 13% rely on the completion of WestConnex stage 3 in Sydney, WestGate Tunnel in Melbourne and a number of projects in Washington.

WEST AFRICAN RESOURCES LIMITED ((WAF)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/0

West African Resources reported a profit of $3.7m in the first half with a net debt position of -$204.1m. This is in-line with Macquarie's estimate.

The company also noted its first earnings from Sanbrado and the broker expects production to progressively grow over the next year.

Even so, Macquarie decides to take a more conservative view and predicts production of 275koz between the third quarter 2020 to second quarter 2021 versus West African Resources' 300koz plus outlook.

Macquarie upgrades its rating to Outperform from Neutral with a target price of $1.10.

Downgrade

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Downgrade to Hold from Add by Morgans .B/H/S: 4/1/1

Link Administration Holdings reported a FY20 result broadly in-line with consensus for revenue and operating profit (NPATA), according to Morgans.

The broker expects FY21 to be a tough year before growth recovers on cost-out, the Pepper European Servicing (PES) acquisition and property Exchange Australia, PEXA.

The analyst downgrades EPS estimates for FY21 and FY22 by -11% to -18% on reduced revenue and margin forecasts in both years.

The rating is downgraded to Hold from Add pending signs of improving earnings momentum, which Morgans believes will be more a FY22 story, and the target price is decreased to $4.21 from $4.80.

NATIONAL TYRE & WHEEL LIMITED ((NTD)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The rating for National Tyre and Wheel is downgraded to Hold from Add, following a strong share price rally and increased debt position.

Morgans notes the earnings from the Tyres4U (T4U) acquisition are key to the future performance. The broker awaits the findings of the T4U strategic review in September.

The FY20 earnings result was 8% above Morgans forecast, with a strong surge in demand/trading in the fourth quarter.

The post balance date acquisition of T4U has seen the group gear up its balance sheet to a net debt position of circa $24m.

The target price is increased to $0.633 from $0.501.

OCEANAGOLD CORPORATION ((OGC)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/1/0

2020 production guidance has been downgraded to 295-345,000 ounces. This stems from disruptions at Haile. Meanwhile, progress at Didipio remains stalled and the operation has now been shut for over a year.

UBS removes assumptions for a re-start and does not factor in earnings or valuation from this asset. This has resulted in a material downgrade to estimates.

The broker downgrades to Neutral from Buy, contemplating no near-term catalysts to close the gap to peers. Target is reduced to $3.40 from $4.40.

OZ MINERALS LIMITED ((OZL)) Downgrade to Lighten from Accumulate by Ord Minnett .B/H/S: 3/2/1

Ord Minnett suggests investors take profits after a surge of 50% in the share price over the past three months.

The broker now considers the stock expensive and downgrades to Lighten from Accumulate. Target is reduced to $14.50 from $10.50.

The next catalyst is expected from the Prominent Hill expansion scoping study in the fourth quarter.

POINTSBET HOLDINGS LTD ((PBH)) Downgrade to Hold from Buy by Ord Minnett and Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/1/1

FY20 results were better than Ord Minnett forecast. Results were overshadowed by the partnership deal with NBC, which should allow the PointsBet brand awareness to "skyrocket" in key markets.

Despite the merits of the deal and the strong chance of success in building USmarket share, the jump in the share price means the stock is now trading around fair value. Hence Ord Minnett downgrades to Hold from Buy. Target is raised to $13.60 from $6.15.

The company has announced an agreement with NBCUniversal, to be funded by scrip and options which Credit Suisse asserts actually turns PointsBet into an option.

The market commitment, at US$393m over five years, is so large that the company is unlikely to deliver operating earnings in the US until at least FY25, predicts the broker.

Given the power of NBCUniversal, if PointsBet can demonstrate revenue that covers the new costs investors are likely to focus on revenue for valuation purposes, in the broker's view.

Credit Suisse downgrades to Underperform from Neutral. Target is $6.50.

STOCKLAND ((SGP)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/4/0

Ord Minnett observes Stockland was the best performing A-REIT in August as the share price rose 24.1% compared with the index rising 7.9%. The broker assesses the good results and spike in residential sales in June are now priced into the stock.

Ord Minnett also believes there are further devaluations to come from the retail and retirement portfolios. The improving residential outlook is encouraging but diluted by the cycling of project profits worth $100m from FY20.

Thus, rating is downgraded to Lighten from Hold and the target lowered to $3.60 from $3.70.

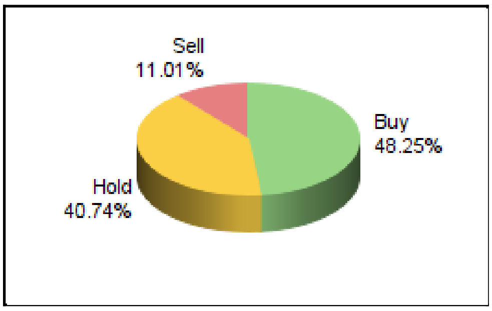
ZIP CO LIMITED ((Z1P)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/0/3

Citi envisages potential for the share price to outperform in the near term. Still, the stock is up 35% over the last month and the entry of PayPal into the BNPL segment increases concerns regarding growth expectations for the medium term.

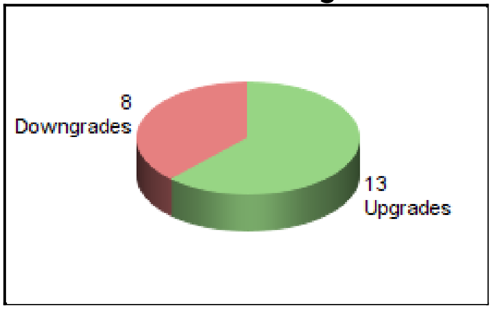
Citi downgrades to Sell/High Risk from Neutral/High Risk and retains a $6.70 target. Zip intends to step up in investment and has recently signed up new enterprise merchants and Quadpay's trends continue to improve.

While the core Australian business is differentiated, Citi remains concerned that Zip is a late entry in the US, given Afterpay ((APT)), Klarna and Affirm's sizeable lead.

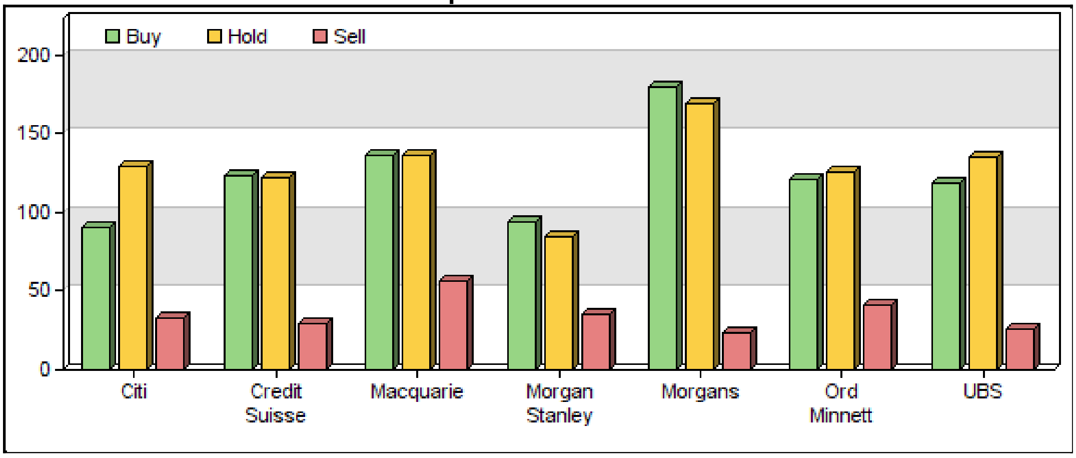
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	AGL ENERGY LIMITED	Neutral	Sell	Macquarie
2	AURELIA METALS LIMITED	Buy	Buy	Ord Minnett
3	AUSTRALIAN VINTAGE PTY LTD	Buy	Neutral	Morgans
4	AUTOSPORTS GROUP LIMITED	Buy	Neutral	Macquarie
5	EVOLUTION MINING LIMITED	Neutral	Sell	Macquarie
6	INSURANCE AUSTRALIA GROUP LIMITED	Buy	Neutral	Macquarie
7	IOOF HOLDINGS LIMITED	Buy	Neutral	Ord Minnett
8	NEXTDC LIMITED	Buy	Neutral	Ord Minnett

9	NEXTDC LIMITED	Buy	Neutral	Morgans
10	NUFARM LIMITED	Neutral	Sell	Macquarie
11	SONIC HEALTHCARE LIMITED	Neutral	Sell	UBS
12	TRANSURBAN GROUP	Buy	Neutral	UBS
13	WEST AFRICAN RESOURCES LIMITED	Buy	Neutral	Macquarie
Downgrade				
14	LINK ADMINISTRATION HOLDINGS LIMITED	Neutral	Buy	Morgans
15	NATIONAL TYRE & WHEEL LIMITED	Neutral	Buy	Morgans
16	OCEANAGOLD CORPORATION	Neutral	Buy	UBS
17	OZ MINERALS LIMITED	Sell	N/A	Ord Minnett
18	POINTSBET HOLDINGS LTD	Sell	Neutral	Credit Suisse
19	POINTSBET HOLDINGS LTD	Neutral	Buy	Ord Minnett
20	STOCKLAND	Sell	Neutral	Ord Minnett
21	ZIP CO LIMITED	Sell	Neutral	Citi

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	IFL	IOOF HOLDINGS LIMITED	50.0%	17.0%	33.0%	4
2	NXT	NEXTDC LIMITED	64.0%	43.0%	21.0%	7
3	KMD	KATHMANDU HOLDINGS LIMITED	67.0%	50.0%	17.0%	3
4	AGL	AGL ENERGY LIMITED	-21.0%	-36.0%	15.0%	7
5	ABC	ADBRI LIMITED	-14.0%	-29.0%	15.0%	7
6	SHL	SONIC HEALTHCARE LIMITED	29.0%	14.0%	15.0%	7
7	EVN	EVOLUTION MINING LIMITED	-57.0%	-71.0%	14.0%	7
8	TCL	TRANSURBAN GROUP	7.0%	-7.0%	14.0%	7
9	IAG	INSURANCE AUSTRALIA GROUP LIMITED	71.0%	57.0%	14.0%	7
10	NUF	NUFARM LIMITED	43.0%	29.0%	14.0%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	APX	APPEN LIMITED	40.0%	70.0%	-30.0%	5
2	OGC	OCEANAGOLD CORPORATION	63.0%	88.0%	-25.0%	4
3	Z1P	ZIP CO LIMITED	-30.0%	-13.0%	-17.0%	5
4	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	42.0%	58.0%	-16.0%	6
5	FLT	FLIGHT CENTRE LIMITED	36.0%	50.0%	-14.0%	7
6	OZL	OZ MINERALS LIMITED	36.0%	50.0%	-14.0%	7
7	SGP	STOCKLAND	8.0%	17.0%	-9.0%	6
8	WSA	WESTERN AREAS NL	67.0%	71.0%	-4.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	NXT	NEXTDC LIMITED	12.670	11.337	11.76%	7
2	Z1P	ZIP CO LIMITED	6.746	6.200	8.81%	5
3	APX	APPEN LIMITED	36.380	34.580	5.21%	5
4	KMD	KATHMANDU HOLDINGS LIMITED	1.145	1.090	5.05%	3
5	EVN	EVOLUTION MINING LIMITED	4.997	4.883	2.33%	7
6	ABC	ADBRI LIMITED	2.503	2.450	2.16%	7
7	AGL	AGL ENERGY LIMITED	15.036	14.839	1.33%	7
8	OZL	OZ MINERALS LIMITED	13.641	13.498	1.06%	7
9	TCL	TRANSURBAN GROUP	14.311	14.197	0.80%	7
10	SHL	SONIC HEALTHCARE LIMITED	34.034	33.849	0.55%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	OGC	OCEANAGOLD CORPORATION	3.813	4.275	-10.81%	4
2	NUF	NUFARM LIMITED	4.761	5.234	-9.04%	7

3	IFL	IOOF HOLDINGS LIMITED	4.663	4.858	-4.01%	4
4	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	4.535	4.685	-3.20%	6
5	FLT	FLIGHT CENTRE LIMITED	13.344	13.474	-0.96%	7
6	SGP	STOCKLAND	3.913	3.930	-0.43%	6

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	COE	COOPER ENERGY LIMITED	0.093	-0.178	152.25%	4
2	APT	AFTERPAY LIMITED	6.167	-14.167	143.53%	6
3	REH	REECE LIMITED	36.100	19.000	90.00%	3
4	NXT	NEXTDC LIMITED	-0.930	-3.983	76.65%	7
5	PLS	PILBARA MINERALS LIMITED	-0.930	-3.040	69.41%	4
6	FLT	FLIGHT CENTRE LIMITED	-95.386	-181.671	47.50%	7
7	GXY	GALAXY RESOURCES LIMITED	-6.927	-10.498	34.02%	6
8	CCX	CITY CHIC COLLECTIVE LTD	9.267	7.267	27.52%	3
9	WOW	WOOLWORTHS LIMITED	144.357	131.717	9.60%	6
10	OZL	OZ MINERALS LIMITED	47.416	44.744	5.97%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	OGC	OCEANAGOLD CORPORATION	-9.263	0.318	-3012.89%	4
2	AIZ	AIR NEW ZEALAND LIMITED	-17.708	-7.148	-147.73%	3
3	NUF	NUFARM LIMITED	-8.286	-3.653	-126.83%	7
4	WHC	WHITEHAVEN COAL LIMITED	-5.900	-3.843	-53.53%	7
5	REG	REGIS HEALTHCARE LIMITED	4.275	7.600	-43.75%	4
6	WSA	WESTERN AREAS NL	6.840	10.006	-31.64%	6
7	LNK	LINK ADMINISTRATION HOLDINGS LIMITED	21.867	26.573	-17.71%	6
8	CMW	CROMWELL PROPERTY GROUP	6.767	8.200	-17.48%	3
9	GOZ	GROWTHPOINT PROPERTIES AUSTRALIA	19.733	23.733	-16.85%	3
10	IFL	IOOF HOLDINGS LIMITED	31.833	37.083	-14.16%	4

Technical limitations

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WEEKLY REPORTS

Uranium Week: 2019 Nuclear Generation Near Record Highs

The uranium price slide continues, despite nuclear power programs advancing in America and China.

-Nuclear generation reached a near-record high in 2019
-Weekly spot prices fall just under one percent
-Nuclear power plants advanced in America and China

By Mark Woodruff.

Nuclear generation reached a near-record high in 2019, enough to meet more than 10% of the world's electricity demand, according to the World Nuclear Association's Performance Report 2020 released on August 25.

Growth was particularly strong in Asia, where nuclear generation rose by 17% last year . China has more than tripled nuclear generation in six years and is now responsible for more than one-half of nuclear generation in Asia.

The report notes that six reactors started up in 2019, four large pressurised water reactors (PWRs) commenced operation, one in South Korea, one in Russia, and two in China. In addition industry consultant TradeTech reports, two small reactors started up on the world's first purpose-built floating nuclear plants, harbored at Pevek on the northeast Russian coast. Nuclear generation fell fractionally in North America and in West & Central Europe, but rose in Africa, Asia, South America, and East Europe and Russia

Nuclear power plants advanced in America and China

In a turnaround from last weeks commentary on economically driven shutdowns of nuclear power plants, TradeTech highlights this week saw two US utilities focus on their zero-carbon emissions goals by advancing their nuclear power programs, while China made notable advances in its nuclear power plant construction program.

Dominion Energy filed an application with the US Nuclear Regulatory Commission to renew the operating licenses for the two units at its North Anna Nuclear Station for an additional 20 year term.

In addition, Duke Energy's Integrated Resource Plans filed this week by Duke Energy Carolinas and Duke Energy Progress demonstrate the valuable role nuclear and natural gas can play as part of a balanced portfolio, the two companies said. The plans outline options to achieve varying levels of carbon reduction, including, for the first time, potential pathways to achieve an emissions reduction of up to -70%. TradeTech notes the two companies' portfolios include eleven reactors at six nuclear power facilities in North and South Carolina.

The Chinese government this week granted approval for two new nuclear power projects, the first such activity in more than a year notes TradeTech, as the Asian nation seeks an economic boost and remains focused on goals to curb pollution derived from fossil fuel use.

The State Council, China's cabinet chaired by Premier Li Keqiang, also stressed at a September 2 meeting that it would maintain a flexible monetary policy stance to support the weakened economy due to the pandemic. The cabinet approved the two projects in the coastal provinces of Zhejaing and Hainan, at an expected cost of around US$10.2b.

Uranium Pricing

TradeTech's Weekly Spot Price Indicator fell to US$30.50/lb U3O8 last week. This was a decrease of -US$0.25 or -0.8% from last week's value.

The weekly spot price has trended downward in recent months, losing an average of -0.6% per week since early May. The average weekly uranium spot price for 2020 is US$29.64/lb, US$3.81/lb above the 2019 average.

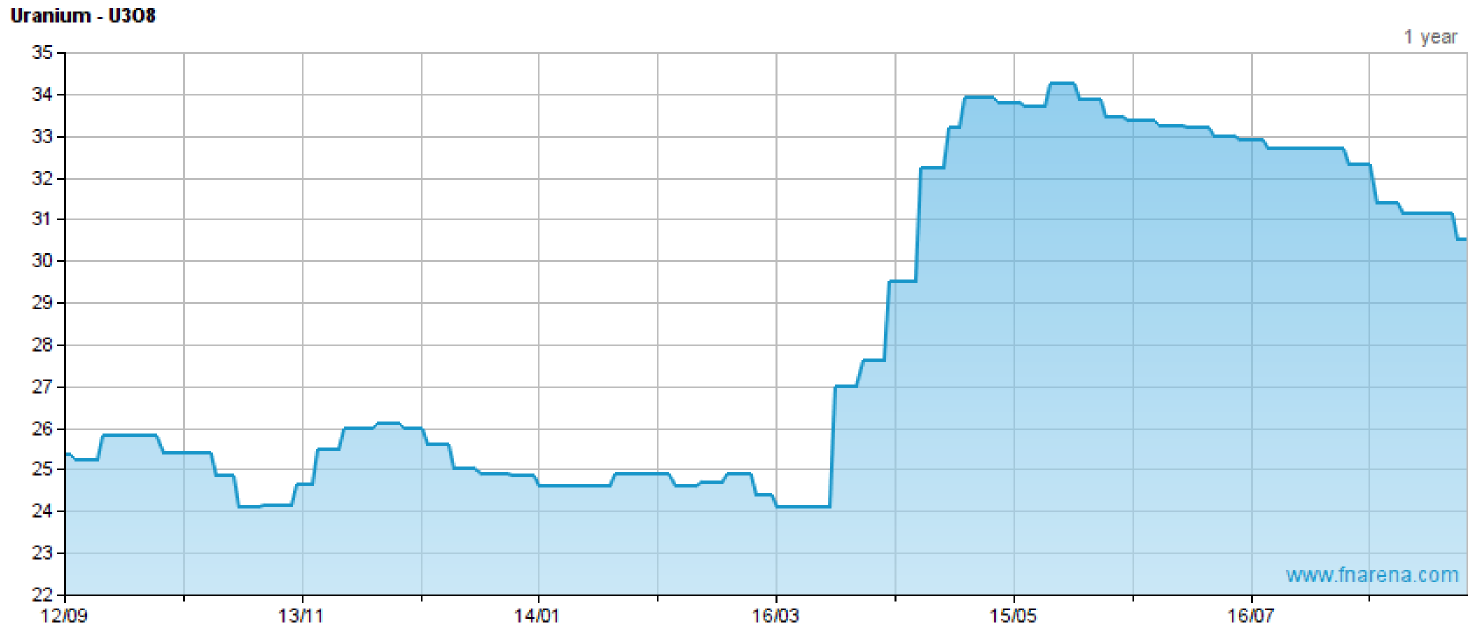
Twelve transactions were completed this week, which involved approximately 3.5mlbs U3O8 equivalent.

TradeTech's monthly spot price for August 31 was US$31.05/lb, down -$1.65 from July 31, but up US$0.30 from the August 28 Weekly Spot Price Indicator.

The month saw 5.6mlbs change hands in 29 transactions.

TradeTech's Mid-Term Price Indicator for August 31 is US$34.50/lb, down -US$2.00 from last month.
TradeTech's Long-Term Price Indicator for August 31 dropped -US$2.00 to US$37.00/lb.

Although sellers remain firm on their need for higher prices in order to adequately cover their future production costs, the lack of forward buying by utilities in 2020 is exerting pressure on sellers anxious to secure new long-term sales commitments. As a result, a few sellers have exhibited a willingness to accept lower prices for the earlier portion of a long-term commitment, particularly if the delivery volumes over the life of the contract are significant.



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

WEEKLY REPORTS

The Short Report - 10 Sep 2020

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

Summary:

Week ending September 3, 2020

Last week included the last couple of days of August and the beginning of September. The last day of August saw a big end-of-month sell-off. When the clock struck September, that sell-off was completely reversed.

So nothing to glean from that. But then the Nasdaq corrected and the ASX200 has this week felt obliged to follow suit.

Two things stand out in the table below. One is the number of stocks shorted by 5% or more has again diminished, by a net three. The other is that Webjet ((WEB)) now stands alone in the 10%-plus shorted bracket, and by a mile. Webjet was 15.4% shorted as at last week, and next most shorted is Myer ((MYR)), which dropped to 9.5%.

Myer fell from 11.3%. More on that below.

Other stocks to see short position changes of one percentage point or more last week were Orocobre ((ORE)), to 7.7% from 9.2%, IOOF Holdings ((IFL)), to 8.9% all the way from 5.6%, and FlexiGroup ((FXL)), to 7.8% from 5.8%.

More on those below.

Also wee saw Electro Optic Systems ((EOS)) appear at 6.3% shorted from below 5%. The stock is is not covered by FNArena database brokers, but seems popular with the tip sheets, other than one.

Simply Wall St published a report a couple of weeks ago questioning whether the company's reported metrics (Electro is yet to break even) might be sending negative signals. This may, or may not, explain short interest.

Weekly short positions as a percentage of market cap:

10%+
WEB 15.4

Out: MYR

9.0-9.9

MYR, IVC

Out: ORE

8.0-8.9%

IFL, ING

In: IFL, ING

7.0-7.9%

CUV, FXL, ORE, NEA, BOQ

In: FXL, ORE Out: ING, CTD

6.0-6.9%

FNP, CTD, PNV, MTS, GXY, EOS, BIN, FLT, SGM, A2M

In: CTD, EOS, FLT. A2M Out: Z1P, JBH

5.0-5.9%

SUL, AVH, LOV, Z1P, JIN, ALG, SEK, BUB, BEN, PGH, JBH

In: Z1P, JBH, JIN, BEN

Out: IFL, FXL, FLT, A2M, MSB, CLH, AMA, NEC, CLQ

Movers & Shakers

In a desperate attempt to remain relevant in a world that long ago moved on, department chain **Myer** has signed a deal with Amazon to act as a pick-up point for Amazon's online sales. The deal was worth a 16% rally on the announcement.

Myer hopes this will bring more foot traffic to its largely empty stores, hence one might assume Amazon shoppers will be directed past as much of the Myer displays as possible before finally finding a little window down the back somewhere.

Myer shorts fell to 9.5% from 11.3% last week on short covering, but today the shares are down -12% (as I write) after reporting an -800% year on year fall in profit, to a loss of -$172m, mostly due to writing down the book value of its brands.

Fund manager **IOOF Holdings** last week launched a very big capital raising in order to acquire MLC Wealth from National Australia Bank. That in itself explains the big jump in shorts to 8.9% from 5.6% (takeover arbitrage) but given the fact MLC has not seen positive funds flows for years, there have been some questions asked.

Lithium miner **Orocobre** also announced a capital raising with its result last week.

FlexiGroup has been on the nose with investors ever since announcing late last month it was expanding its consumer finance business to include a BNPL service, or as analysts saw it, to jump on the increasingly crowded BNPL bandwagon. As of this week, that bandwagon now includes PayPal.

A move in shorts up to 7.8% from 5.8% implies shorters smell blood.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	4.2	4.1	NCM	0.1	0.3
ANZ	0.8	1.0	RIO	1.7	1.7
BHP	4.3	4.3	SCG	1.3	1.1
BXB	0.2	0.2	SUN	0.6	0.4
CBA	0.6	0.5	TCL	0.5	0.5
CSL	0.3	0.4	TLS	0.3	0.4
GMG	0.5	0.6	WBC	0.7	0.7
IAG	0.8	0.9	WES	0.5	0.6
MQG	0.3	0.3	WOW	0.3	0.2
NAB	1.1	1.0	WPL	1.3	1.1

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

WEEKLY REPORTS

The Wrap: PayPal And BNPL, Casinos, And Pathology

BNPL meets PayPal; Crown Resorts may gain market share; Market consolidation opportunities in Australian Pathology.

-UBS tries to assess the PayPal-effect for Australia's BNPL first movers
-Why Crown Resorts is the casino favourite
-Further consolidation might upset local pathology labs sector

By Mark Woodruff and Angelique Thakur

BNPL: PayPal says #MeToo

While the Buy-Now Pay-Later (BNPL) sector has provided innovative payment and credit solutions with attractive economics, there was always the risk of either regulation or competition. The latter has arrived in the form of PayPal's freshly introduced 'Pay in 4' offering.

UBS runs the numbers on first-movers Afterpay ((APT)) and ZIP Co ((Z1P)), should they 'meet halfway' by lowering margins by around -90 basis points over five years to match the new competition. This is estimated to lower FY25 profit (NPAT) by -55% and -20%, respectively. In the uglier scenario of 'intense competition' (margins lowered by -140 basis points), profits are estimated to be reduced for Afterpay and Zip by -70% and -40%, respectively. It should be noted these are highly speculative scenarios.

With 26 million active merchants globally, PayPal's merchant reach is 500 times that of Afterpay and 900 times that of Zip. This is a tad unfair on the incumbents, given their average sales per merchant is currently significantly higher than PayPal's. This is because of a greater focus on larger merchants, notes the broker.

Nonetheless, it highlights the challenge Afterpay and Zip face to win the long tail of smaller merchants as well as larger merchants not yet on their platform. This is especially so given PayPal's offering is significantly cheaper. The company charges merchants around 2.4% on average, versus Afterpay's 3.9% (the average merchant fee is not disclosed for Zip's recently-acquired QuadPay). Additionally, PayPal's offering requires no additional integration by the merchant.

Clearly a giant such as PayPal will have a significant marketing advantage. According to UBS research the company spent around A$2bn on marketing in FY19. This compares with Afterpay's and Zip's FY20 outlay of A$71m and A$10m, respectively.

Crown still wears the crown

While Australian and New Zealand casinos have been materially impacted by the pandemic, Macquarie experts feel they provide exposure to a quicker recovery from a covid-19 resolution.

To justify this view, Macquarie shines the spotlight on resilience seen during recent trading for those casinos that have re-opened.

While Macquarie analysts expect to see material earnings forecast revisions in the near-term, they suggest investors should focus on operating income and free cash flow rather than only earnings to account for the impact from capitalised interest and increased D&A from new developments.

Crown Resorts ((CWN)) is Morgan Stanley's preferred casino stock. The analysts feel the market is being too negative and overly focused on the near-term headwinds. Morgan Stanley instead remains focused on Crown's ability to gain market share in Sydney with its new casino opening in December 2020.

Acknowledging the casino will be opening in a difficult environment, Macquarie nevertheless expects share price upside, a view further bolstered when one notes the stock is trading at a -30% discount to the casino's five-year average.

What adds to the investment case for the casino is its leverage to a recovery in VIP/International travel in the medium term, adds Morgan Stanley. It also hepls that Crown is backed by a relatively strong balance sheet.

Macquarie rates Crown as Outperform and Morgan Stanley follows suit, upgrading its rating for the casino to Overweight.

Star Entertainment Group's ((SGR)) FY20 result coupled with trading and border travel restrictions has prompted Morgan Stanley analysts to push out their recovery forecast.

Macquarie is more positive and believes the recent favourable outcomes on The Star Sydney's main floor tax and securing Gold Coast exclusivity at no cost should have led to a re-rating.

While The Star Sydney will face new domestic tables competition in early-2021, Macquarie sees this segment as under-penetrated currently, possibly expanding by 30% in FY25 with The Star Sydney expected to hold a 65% share.

A thorn in the group's side is the Crown Casino opening in Sydney, highlights Morgan Stanley. Headwinds from this are made worse by a relatively weaker balance sheet and challenging return metrics for the Brisbane project.

Morgan Stanley had downgraded its rating to Underweight but Macquarie holds onto its Outperform rating.

Morgan Stanley experts are a tad more positive on New Zealand's SkyCity Entertainment Group ((SKC)), expecting stronger trading earlier than expected. The guidance around Auckland reopening and insurance reimbursements prompts them to increase their earnings forecasts for FY21-22.

Macquarie feels earnings for the entertainment group will recover faster than peers led by the skew towards domestic rather than VIP customers with some benefits coming from the online casino.

Moreover, with growth developments drawing to a close, Macquarie believes the group will return to positive free cashflow in FY22 for the first time in five-years.

Macquarie rates SkyCity as Outperform. Morgan Stanley remains Underweight since it believes the net debt is yet to peak with returns on Adelaide looking challenged in the near-term.

Overall, Morgan Stanley prefers Crown Resorts, Star Entertainment Group and SkyCity Entertainment Group, in that order.

Foresight on 4Cyte

The news of a potential ownership change at Crescent Capital's Australian Clinical Labs (ACL) prompted UBS to analyse the situation, taking into account the current structure of the Australian commercial pathology sector, market concentration and potential scenarios going ahead.

UBS analysis points to a market that looks heavily concentrated across each State/Territory and therefore at the national level. Therefore, an acquisition by Healius ((HLS)) or Sonic Healthcare ((SHL)) for that matter will breach the Australian Competition and Consumer Commission's (ACCC) concentration risk. This makes the broker suggest a transaction of this nature may be difficult to complete.

However, UBS highlights the emergence of a fourth player may change the game. While the ACCC may take issue with the Australian Clinical Labs tying-up with either Healius or Sonic, UBS believes the regulator may not object to a tie-up with the fourth-largest player in the sector - 4Cyte.

4Cyte currently has about 5% national share (in terms of roved collection centres) and UBS thinks a merger of the third and fourth largest competitors may make sense in terms of increasing the scale of the combined entity.

The broker highlights ACL's hospital-based pathology services and 4Cyte's community pathology services may complement each other.

Government support and the rise in spending

The Commonwealth government had provided two automatic economic support payments of $750 to eligible Australian recipients, in April and July. ANZ's economic insights team uses its collated card data to assess the impact this may have had on spending.

The analysis revealed average spending (monthly) by 15-29-year-old payment recipients grew faster than any other age group. There was also a rise in spending by payment recipients in the 30-44 and 45-59 age groups. All the three categories (that received payments) spent more on shopping and services.

Seen from the viewpoint of recipients versus non-recipients, the study finds the average spending for a 15-29-year-old payment recipient was up 51% in July (year on year) versus a mere 9% rise for a non-recipient.

Irrespective of whether the cardholders received the $750 payments, the average monthly spending by cardholders aged 60-plus did not return to pre-pandemic levels, note ANZ analysts.

Younger workers were more likely to be stood down or receive the JobKeeper assistance scheme and some of them got a pay rise due to the scheme. This, states ANZ, may explain the higher rise in spending by the younger cohort.

Moreover, the ones who dropped their average monthly spending the most during April and May and recovered the least in June and July were the higher-income earners. The analysts attribute this to a lack of avenues to spend, especially true for discretionary spending.

Lower-income earners, on the other hand, already had a smaller share of discretionary spending to begin with with the income having less scope to fall.

In a nutshell, monthly spending by the lower-income groups and the younger cardholders turned out to be more sensitive to government support payments which leads ANZ analysts to conclude direct household support for these groups will stimulate consumption more than for the other groups.

TREASURE CHEST

Treasure Chest: Growth Spurt For Life360

Life360 is in a strong position to capitalise on its opportunities, revealing a strong growth outlook even in the midst of the pandemic.

-Growth trajectory has moderated
-But user paying circle memberships are robust
-And the smartphone app now has scale

By Eva Brocklehurst

Smart phone location app provider Life360 ((360)) continues to gain ground as the number of paying circles, and revenue generated, have improved even in the wake of the coronavirus outbreak. The company has provided 2020 guidance for revenue of US$79-82m and, as Bell Potter asserts, it is in a strong position to capitalise on opportunities, with over US$50m in cash and no credit risk.

The promising initial results from the new membership offering represent an important commercial milestone and Moelis agrees operating leverage is starting to play out, reiterating a Buy rating with a $4.75 target. The first four months post the launch of the new membership offering have meant more than 40,000 paying circles have been added or “upsold” and the remainder grandfathered into Gold and Silver tiers.

New US paying circle signings at an average fee of US$115 are up 33% on the previous Driver Protect plan and up 62% compared with the average across the legacy US paying base of US$71. The upgrades signal to Bell Potter that over 20% of total subscribers by the end of this year will be on the higher-value plans.

Moelis considers this growing membership support will be a key driver of growth over the next few years. Management expects new membership subscribers to make up 20-25% of the US base by the end of 2020.

The company has been cautious about the uncertainties in operating conditions and **a resumption of new marketing expenditure outside of paid user acquisitions will depend on improvements in the operating environment**.

First half revenue of US$37.8m, up 54%, reflected a 42% uplift indirect revenue to US$27.3m. Along with an operating loss of -$7.1m this was substantially better than expected, and Moelis believes it demonstrates Life360's ability to operate at a positive earnings level if user acquisition expenditure is pared back.

Growth Moderates

Global users were up 9% in the first half, albeit -10% below the March quarter. Credit Suisse is not surprised the growth trajectory has moderated since the coronavirus outbreak, given core features of the product are location and driving information and these are less relevant in an environment of reduced mobility. Still, early signs of a possible step change from the launch of the membership offer are encouraging and the broker retains an Outperform rating and $4.80 target.

Bell Potter agrees the business is resilient, and believes **Life360 will be able to expand its features further when it owns the platform and access to users**. The broker assesses the hard yards have been done and there is scale, so now it's a matter of how quickly the business can grow.

The company plans to be the "go to" platform whereby users can access an app that brings families together, offering a range of safety features. The largest geographies outside of the US include India, Brazil and the UK, and Australia is growing fast.

Bell Potter assesses a sales/enterprise value multiple of 5-10x within a year is realistic and Life360 is currently trading on 3.2x FY21. As a result of the higher-than-expected revenue, the broker upgrades estimates for 2020 by 15.8%, 2021 by 12.5% and 20 2 by 14.9%. As a result, and after increasing estimates for retention rates, the broker upgrades the target to $7.00 from $5.20, retaining a Buy rating.

See also, Life360 On The Profitability Path on August 3, 2020.

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

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

TREASURE CHEST

Treasure Chest: Is a2 Milk In Danger?

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Elevated inventory accrued during the height of the pandemic has led to de-stocking of infant milk formula product in China. Is a2 Milk in danger of more permanent disruptions?

-a2 Milk adversely affected by resurgence in China's domestic brands
-MVM acquisition tying a2 Milk more closely to Chinese partners
-Significant insider selling recently in the stock

By Eva Brocklehurst

Is a2 Milk ((A2M)) in danger of more permanent disruptions to the daigou channel, where exporters outside of China purchase commodities for customers inside China?

While enjoying extremely high rates of revenue growth in recent years, current observations suggest a2 Milk's growth is slowing and, as Ord Minnett points out, this is consistent with concerns regarding elevated inventory levels and pantry de-stocking.

Management has repeated expectations that revenue growth will be supported by investment in marketing and production capabilities and reiterated margins of 30-31% for operating earnings. Capital expenditure intentions of around NZ$50m are targeted at investment in systems and Australian fresh milk processing.

Stockpiling which occurred during the height of the pandemic is still unwinding, although Citi is surprised it has continued for such a long period. This is based on a previous survey that showed only four weeks of excess supply among Chinese consumers had been purchased.

The broker is concerned that a2 Milk is being adversely affected by a resurgence of China's domestic brands and increased competition. The company has indicated the entire daigou channel has been disrupted in the midst of stage 4 lockdowns in Victoria.

Warehousing and logistics may be considered essential services but operating efficiency is being affected by the lockdowns. This adds to **weakness experienced in the small end of the daigou channel from lower levels of inbound Chinese tourism and lower international student numbers.**

This situation is unlikely to recover any time soon. Citi calculates the corporate daigou channel accounted for 29% of a2 Milk's infant milk formula (IMF) sales in FY20 and Australian retail, predominantly pick & pack daigou, accounted for 23%. Weakness in both these channels could impact on the company's ability to acquire new customers, to the extent this is not offset by other marketing or promotional activities elsewhere.

Yet while there have been discussions recently about the political tensions between Australia and China and the risks to a2 Milk, Macquarie suspects IMF is largely immune, given the essential nature of the product and sensitive consumer base. **A lack of IMF self-sufficiency in China is, to some extent, preventing large producers and brands being caught up in political tensions.**

While acknowledging the pandemic has disrupted the supply/demand balance and tilted consumption towards China's labelled product CLSA considers this temporary. The broker, not one of the seven monitored daily on the FNArena database, retains a Buy rating and $22.60 target.

Mataura Valley Milk

Moreover, under the proposed acquisition of 75.1% of New Zealand's Mataura Valley Milk, the remaining 24.9%, will be owned by China Animal Husbandry, a subsidiary of China National Agricultural Development, which is also the parent of a2 Milk's strategic partner in China.

The main curiosity for Macquarie, therefore, in terms of China's domestic policy on infant formula, is at what point in the value chain the product is classified as domestic.

Noting a2 Milk's reliance on its primary manufacturer Synlait Milk ((SM1)), Citi considers the acquisition will boost bargaining power but also increase capital intensity. The broker would have preferred the company built its manufacturing capability in China with a local partner, as this would provide easier access to the market.

The broker believes there is still substantial upside in China for a2 Milk although a Sell rating is retained, as the outlook is increasingly risky while the regulatory landscape evolves and geopolitical risks mount.

a2 Milk has made a non-binding indicative offer to acquire the Mataura stake for NZ$270m, which Macquarie points out will not even "scrape the sides" of the current cash balance.

The broker assesses the investment is consistent with the strategy of more close participation in manufacturing and believes this only strengthens the relationship with China. A2 Milk has not ruled out launching new infant formula products, including a potential second label for China.

Over the longer term, UBS believes Mataura provides manufacturing diversity and protection against any potential regulatory shift in China that requires integrated manufacturing and a deeper relationship with a Chinese state entity.

The broker also points out, for Mataura to be capable of producing finished IMF, it will need to add a blending and canning line. For Chinese labelling, it would need to obtain factory registration and brand registration in China, a process that could take five years.

Insider Selling

There has been significant insider selling recently in a2 Milk, as these investors have enjoyed high-value equity holdings and options on issue. The size and value of these sales as well as breadth of selling across management has created some concern among brokers, including Ord Minnett.

While the due diligence on Mataura may have been a catalyst for the sales, concerns in this regard linger and Ord Minnett retains a Lighten rating. FNArena's database has three Buy ratings, one Hold and two Sell. The consensus target is $18.08, signalling 9.1% upside to the last share price.

RUDI'S VIEWS

Rudi's View: August 2020 Lifts Price Targets

Dear time-conscious investor: *Conviction Calls, stock ideas and investment themes post-August*

In this week's Weekly Insights:

-August 2020 Lifts Price Targets
-Stock Ideas & Conviction Calls
-Extras & Bonuses

August 2020 Lifts Price Targets

By Rudi Filapek-Vandyck, Editor FNArena

For securities analysts, each reporting season offers a welcome update on how companies are faring operationally, and this includes contracts, investments and sales, as well as margins, inventories and cash flows.

Within this framework, market forecasts had never looked as wide and as diverse as post-February, so the August reporting season has been more than just welcome, with widely diverging forecasts in many cases rejoining around a much more feasible middle ground.

For many an investor/shareholder, this background re-adjusting of modeling and forecasts is often largely ignored, even though paying attention can provide clues about future sentiment towards and the direction of a share price.

Not every investor is convinced these analysts are worth every cent they are being paid, but fact remains: upward and downward adjustments to forecasts act like a magnet on share prices, sometimes even on what looks like rather small changes.

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One of the easiest accessible indicators for what is happening behind the scenes of daily volatile market moves are **consensus price targets for individual stocks**.

In essence, these targets symbolise the general idea of where analysts think the share price should be, roughly, incorporating current information and with all else remaining equal.

As I have pointed out numerous times over the years, share prices often tend to converge with these targets, unless there are other factors in play that weigh on investors' sentiment.

[*Special Note: the FNArena service includes The Icarus Signal, which signals when share prices are above or very close to consensus targets, though investors should always include context and their own insights and observations when taking guidance from such a broad-based, generalising, automated tool.*]

Hence, every reporting season one of the key indicators I look at is what happens to price targets once companies have publicly disseminated and discussed their financial performance, and analysts have digested the numbers, and put fresh insights through their now updated modeling.

In simple terms: when targets move higher, it's probably because forecasts have gone up, and this usually means the share price will rise.

If the above coincides with a positive "surprise" (otherwise known as an earnings beat) and the share price is nowhere near the new targets, then you can almost be assured the share price is now being carried further by ongoing positive momentum.

Such momentum carries into general sentiment, and before you know it, we're talking multiple weeks, if not months of additional gains.

The opposite holds true as well. Irrespective of whether a financial result met forecasts or not, if the outcome post-release is falling expectations and a reduction in valuations and targets, chances are very much in favour of persisting downward pressure on the share price.

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As happens in every reporting season, August offered plenty of examples for each of these scenarios.

AGL Energy ((AGL)) surprised most with a downbeat guidance and the consensus target for the stock tumbled to $14.84 from $16.45 prior to the FY20 release.

In response, the AGL share price quickly reset around $15 from $17-$18 before the market update.

The AGL board promised to pay out 100% of cash earnings to shareholders in the next two years, but this hasn't prevented analysts from putting the knife in their forecasts, assuming near 100% payouts in FY21 and FY22, but ultimately forecasting a lower dividend in two years' time.

The reset in profit forecasts is clearly visible on the bottom part of the share price graph that can be found via Stock Analysis on the website, idem for the reduction in consensus target.

The same basic principle applies to similarly underwhelming market updates released by companies such as Bendigo and Adelaide Bank ((BEN)), Blackmores ((BKL)), Challenger ((CGF)), Cimic Group ((CIM)), GWA Group ((GWA)), InvoCare ((IVC)), Japara Healthcare ((JHC)), Mayne Pharma ((MYX)), Origin Energy ((ORG)), Seek ((SEK)), Telstra ((TLS)), and Seven West Media ((SWM)).

In all of these examples, price targets have fallen post the release of financials, and in all cases the share price has not even made a half-hearted attempt since to close that glaring gap between share price and target.

Data-analysis from past reporting seasons in Australia has shown share prices post earnings disappointment are poised for persistent underperformance that can last three months, at times even longer.

I haven't done any broad analysis regarding falling forecasts and price targets and their effect on share prices, but anecdotal observations suggest these are the kind of stocks that are, for the time being, likely to remain deprived from any sustainable upward momentum.

Until things turn around, which can take a while.

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It goes without saying, each reporting season has plenty of examples of companies outperforming expectations, forcing analysts to lift forecasts, which usually pushes up price targets, providing ongoing momentum to already rising share prices.

August saw plenty of such events with, on FNArena's calculations, the average gain for price targets during the month climbing to 6.49%. All price targets in aggregate rose by 5% (net) over the month.

Considering that profit forecasts went down to -20% for FY20, and they fell a little further (net) throughout the season, those target data easily explain as to why August 2020 turned into a positive experience for Australian investors.

The key insight, however, is that these numbers are predominantly generated outside of the ASX50. Consider the following:

-For the ASX50 (44 companies)

-Total Beats: 11 (25%)
-Total Misses 12 (27.3%)
-Average increase in individual price target: 1.67%
-Total increase in aggregate price targets: 3.14%

Now consider the total stats for **318 companies recorded for the season** (which also includes the ASX50):

-Total Beats: 114 (35.8%)
-Total Misses 61 (19.2%)
-Average increase in individual price target: 6.49%
-Total increase in aggregate price targets: 5%

If there is still anyone out there who questions as to why there is such a wide gap between winners and losers in the share market, and why the Australian share market finds it nigh impossible to keep up with the US in this bull market, or why so many investors instinctively are drawn to smaller cap companies when looking for the next opportunity, I think the above numbers tell all.

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Some of the eye-catching, stand-out performances last month, with price targets literally jumping into a higher dimension, came from Adairs ((ADH)), Afterpay ((APT)), Ansell ((ANN)), ARB Corp ((ARB)), AUB Group ((AUB)), Australian Vintage ((AVG)), Austal ((ASB)), Autosports Group ((ASG)), Aventus Group ((AVN)),.. I am still only at the first letter of the alphabet while going through the final conclusions of the FNArena Results Monitor for August…

If you are an FNArena subscriber, my message to you is: we built this easily accessible tool. It's available 24/7 on the website. Use it. (There is an archive too going back to August 2013).

The more intriguing cases are those where forecasts & targets and the share price have moved in opposite directions. Similar to the examples mentioned above: it all comes down to specific strategies and horizons, and to personal knowledge and convictions.

Appen's ((APX)) FY20 result was not well-received and it certainly did not help that the release was preceded by a rally in the share price to $44 from $36 (so much for the market knows best, *n'est-ce pas?*)

Fact remains, while the share price got clobbered post event, the average target actually went up; to $37.75 from $34.58.

Admittedly, opinions among analysts covering the company have become more polarised and nothing is ever without risk, but I am siding with the optimists: there still is so much growth ahead of this company, and that is what will ultimately drive the share price.

Appen remains part of the FNArena-Vested Equities All-Weather Model Portfolio and we have used this weakness to buy additional shares, as we did with ResMed ((RMD)).

In similar vein, Nanosonics ((NAN)), MNF Group ((MNF)) and APA Group ((APA)) all sold off post results release – see last week's Weekly Insights.

Not every share price that falls represents an equally attractive investment opportunity, but when analysts are adding to their valuation it's good to remember that if these valuations stand their ground, the share price will follow, eventually.

<u>Stock Ideas & Conviction Calls</u>

Some statistics from the research department at **Macquarie**:

-Earnings per share (EPS) fell by -20%, an outcome on par with the GFC, says the broker (Others have estimates falling by between -17.5%-22%)

-Earnings beats were primarily driven by small caps and new economy companies

-Macquarie's buy ideas from the August season, included in the strategy portfolio, are Charter Hall ((CHC)), Amcor ((AMC)), Worley ((WOR)), Fortescue Metals ((FMG)), BHP Group ((BHP)), Crown Resorts ((CWN)), Sydney Airport ((SYD)), Ramsay Health Care ((RHC)), Telstra, and Oil Search ((OSH))

-Maquarie's EPS growth forecasts are for 4.8% in FY21 -driven by iron ore- and 11% in FY22

-Macquarie has singled out two covid-19 beneficiaries that seem destined for underperformance: ResMed and Ansell

-Investors looking to rotate into covid-19 losers should consider Crown Resorts, Star Entertainment ((SGR)), Sydney Airport, Qantas ((QAN)), Cochlear ((COH)), and IDP Education ((IEL))

-Value opportunities to consider include Qantas, BlueScope Steel ((BSL)), Challenger, Telstra, Oil Search, Stockland ((SGP)), Link Administration ((LNK)), nib Holdings ((NHF)), Transurban ((TCL)), BHP Group, Lendlease ((LLC)), Ramsay Health Care

-Stocks to avoid, Macquarie suggests, include Hub24 ((HUB)), Netwealth Group ((NWL)), Ansell, and Newcrest Mining ((NCM))

-Potential value traps, according to Macquarie: Bendigo and Adelaide Bank, Alumina Ltd ((AWC)), InvoCare, Whitehaven Coal ((WHC)), and CommBank ((CBA)) – I bet you haven't seen the latter being called a value trap, possibly ever!

Some additions from **stockbroker Morgans**:

-50% of companies that reported FY20 earnings are forecast to return to FY19 numbers in FY21 (pretty good, considering)

-In general terms, market earnings in Australia are forecast to recover to FY19 levels by 2022

-In this context Morgans finds the local market's 17x FY22 profit forecast "passable" on the proviso investors remain happy to look through the two years' earnings dip and wear associated risks to the economic recovery

-Dividend payers considered well-placed to weather the risks, include Aurizon Holdings ((AZJ)), APA Group, Centuria Industrial REIT ((CIP)), Iress ((IRE)), IPH Ltd ((IPH)), and Waypoint REIT

UBS made the point that heavily shorted stocks were among major market outperformers in August.

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Sze Chuah, senior investment strategist at **Ord Minnett,** has equally made a number of changes post reporting season.

Ord Minnett has identified five themes for investors to incorporate in their strategies and portfolios; four positive and one negative.

<u>Theme 1: Reopening and recovery</u>

Preferred exposures include National Australia Bank ((NAB)), Origin Energy, Star Entertainment, and Sealink Travel Group ((SLK))

<u>Theme 2: Flight to quality</u>

Here Ord Minnett's assessment of "quality" is clearly different from mine (in some cases). Preferred exposures are Amcor, APA Group, Coca-Cola Amatil ((CCL)), Coles ((COL)), GPT Group ((GPT)), Rio Tinto ((RIO)), and Sonic Healthcare ((SHL))

<u>Theme 3: Dividend defenders (low chance of having to cut)</u>

Preferred exposures: AusNet Services ((AST)), Charter Hal Long WALE REIT ((CLW)), Perpetual ((PPT)), Service Stream ((SSM)), and Waypoint REIT ((WPR))

<u>Theme 4: Policy tailwinds (companies that rely less on economic conditions)</u>

Suggested exposures: Clover Corp ((CLV)), Cleanaway Waste Management ((CLW)), Hub24, and Lynas Corp ((LYC))

<u>Theme 5: Risky Business (best to avoid)</u>

Here Sze has removed Flight Centre ((FLT)) and TechnologyOne ((TNE)), both following share price weakness.

Remain on the avoid list: Computershare ((CPU)), Northern Star ((NST)), Goodman Group ((GMG)), Tabcorp Holdings ((TAH)), and Treasury Wine Estates ((TWE)).

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Small Cap specialists at UBS have updated their list of most preferred stocks, now including Eagers Automotive ((APE)), Appen, Bapcor ((BAP)), Breville Group ((BRG)), Collins Foods ((CKF)), EclipX Group ((ECX)), Graincorp ((GNC)), Harvey Norman ((HVN)), IDP Education, NRW Holdings ((NWH)), NextDC ((NXT)), and United Malt Group ((UMG)).

UBS's key sell recommendation remains TechnologyOne, with the analysts suggesting while this remains a high quality business, risks are building short term from covid-19 interruptions and a potentially slower migration to SaaS by clients.

The team has also lined up a list of "laggards" that could well turn into winners over the next six months: Webjet ((WEB)), G8 Education ((GEM)), Servcorp ((SRV)), Flexigroup ((FXL)), Audinate Group ((AD8)), Corporate Travel Management ((CTD)), Bingo Industries ((BIN)), and AMA Group ((AMA)).

Their peers at **JP Morgan** have elevated Superloop ((SLC)) to be their Top Pick, while Flight Centre is Bottom Pick.

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Strategists at **Morgans** see the biggest potential for upside surprise from here onwards with companies higher leveraged to economic activity and currently held back by low expectations. Think sectors like Travel, Gaming, Energy, and Commercial Services.

Key stock ideas post August are divided over four baskets:

<u>-Blue Chips:</u>

Westpac ((WBC)), BHP Group, Rio Tinto, Macquarie Group ((MQG)), Amcor, Aurizon Holdings, Coles

<u>-Quality Growth:</u>

-ResMed, Aristocrat Leisure ((ALL)), NextDC, Breville Group, Hub24

<u>-Recovery plays:</u>

-Sydney Airport, Corporate Travel Management, ALS Ltd ((ALQ)), Aventus Group ((AVN)), Santos ((STO)), Beach Energy ((BPT)), Eagers Automotive, Incitec Pivot ((IPL))

<u>-Defensive yield:</u>

-APA Group, APN Convenience Retail REIT ((AQR)), and Waypoint REIT

Morgans also retains a positive view towards **retailers**, with the strong sales momentum experienced by many leading into August expected to remain firm at least until the start of 2021.

Morgans argues retailers face two large risks: societies opening up quicker, or government support being withdrawn.

Preferential ideas leading into AGM season include Adairs, Accent Group ((AX1)), Baby Bunting ((BBN)), Domino's Pizza ((DMP)), and Super Retail ((SUL)).

Following August, and a strong rally for many retailers, Morgans' sector preference lays with Adairs, Eagers Automotive, Breville Group and Super Retail.

The broker prefers a cheaper entry point for Baby Bunting, and is willing to be patient with Lovisa Holdings ((LOV)).

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Market strategists at **Wilsons** stick with their Quality and Growth bias, but have nevertheless decided it's best to add more cyclicality to their Australian Focus List portfolio, as positive vaccine news can potentially change market dynamics instantly and dramatically.

Wilsons added Reliance Worldwide ((RWC)), while also adding to exposure to BHP Group, Seven Group Holdings, Santos, and News Corp ((NWS)).

Equally remarkable, Wilsons has decided to remain Overweight the local healthcare sector and has reduced the weighting of CSL ((CSL)) but increased exposure to ResMed.

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Strategists at **Citi** highlight the point the division between higher valued and lower valued stocks is, essentially, a division between those who have growth, and are expected to continue to grow, and those who don't have it.

Sectors expected to continue growing earnings over FY19-FY22 are healthcare, food & beverages, retailing and technology.

With exception of food & beverages, these are the sectors that outperformed throughout August, further underpinning Citi's analysis.

Value investors should be aware that if current market expectations continue to be met, the same growth companies should continue to outperform the market laggards, where growth remains absent, suggests Citi.

As such, the analysts observe sectors that offer growth outperform, irrespective of downgrades to forecasts.

Which then leads to the following statement: "*Until COVID-19 distortions to economies begin to fade, companies with earnings growth should continue to outperform and widen the valuation divide.*"

Citi's forecasts are more subdued for FY21, with a much bigger growth recovery projected for FY22 (16.9%). The difference for FY21 seems to be in Resources, which suggests a different view on iron ore, or simply one catch-up short that still needs to happen.

This doesn't negate the fact that, as forecasts stand post August, the big focal point for today's value & laggard stocks, and the Australian share market in general, is FY22, not the year ahead.

Citi strategists in the US also believe today's elevated valuations for the top leaders on the US stock market are similar to the bubble-alike valuations back in 2000, when measured by backward looking data and corrected for the much lower taxes being paid today.

While fully well realising how contentious this type of analysis/conclusions are, the strategists do acknowledge the fact such valuations were more broad-based back then.

Peter Warnes, head of equities research at **Morningstar**, believes Trump will win the November 3 election in the US.

<u>**Extras & Bonuses**</u>

Pitt Street Research is offering a special discount of $100 (33%) for FNArena subscribers who'd like to purchase their 50-page research report into the Buy Now, Pay Later sector.

Use the following link: https://stocksdownunder.com/buy-now-pay-later-report-fnarena

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Independent Investment Research (IIR) is offering to share a few publications:

-August pharma & biotech newsletter:

https://www.fnarena.com/downloadfile.php?p=w&n=0D80CCAB-EB90-180A-19B2090C07DAE822

-initiation of coverage on BNK Banking Corp ((BBC))

https://www.fnarena.com/downloadfile.php?p=w&n=0DA28E79-D35D-2A94-D9AAF12D4E49D1C2

-Listed Managed Investment Indicative NTA Report

https://www.fnarena.com/downloadfile.php?p=w&n=0DAED2AE-0AC1-86CC-A4EE44C40BAFDA41

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Research as a Service (RaaS) is offering two recent updates:

-Total Brain ((TTB))

https://www.fnarena.com/downloadfile.php?p=w&n=0DC30F8A-0CD8-4C34-46E171107B05CDE5

-Shekel Brainweigh ((SBW))

https://www.fnarena.com/downloadfile.php?p=w&n=0DD9F17E-A6C1-C43E-02A1E44BE700FBF1

(This story was written on Monday 7th September, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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