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FNArena
Financial News, Data & Analysis

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

Your editor:
Rudi Filapek-Vandyck

Your dedicated team of journos:
Greg Peel, Danielle Austin, Mark Woodruff & Sarah Mills

AUSTRALIA

Coronado Global Resources: Upside Despite Near-Term Weakness

While 12-month target prices for Coronado Global Resources are set lower following second quarter results, buoyant met coal fundamentals and prices keep brokers Buy-rated.

-Coronado Global Resources reveals weaker-than-expected 2Q production
-Management lowers FY22 production guidance and expects higher costs
-Curragh mine suffers from weather impacts
-Revenue rises by 5% on stronger realised met coal prices
-Brokers buoyant on the outlook

By Mark Woodruff

Brokers generally lower 12-month target prices for Coronado Global Resources ((CRN)) after second quarter results reveal weaker-than-expected production and higher costs, though realised prices increased.

Saleable production and sales were -30% and -15% below consensus expectations, which Bell Potter attributes to weather impacts at the Curragh mine in Australia, and geological conditions in the US resulting in lower coal yields at Buchanan in Virginia.

The company produces and exports metallurgical (met) and thermal coal from the US states of Virginia and West Virginia, and from its Bowen basin mining complex in Queensland.

The company supplies to steelmaking customers located in the Americas, Europe and Asia and met coal accounted for 79% sales in the second quarter.

Coal sales were 3.9mt (2.3mt Australian Operations and 1.6mt US operations) for the quarter, which was -11% below Macquarie's forecast and -9% down quarter-on-quarter.

The broker points out **US operational strength was offset by weakness in coal production at the Curragh mine in Australia.** Group run-of-mine (ROM) coal (containing impurities) and saleable coal production of 5.5mt and 3.3mt were -19% and -29% lower than expected, and down -20% quarter-on-quarter.

ROM coal production at Curragh of 2.3mt was -45% below Macquarie's expectation and -34% lower than the prior quarter, due to adverse weather and planned maintenance activity.

While Macquarie had previously flagged a risk of higher costs across the group, weather impacts and inflationary pressure exceeded expectations. Mining cost guidance was lifted to US$79-81/t from US$69-71/t.

Management now expects saleable production guidance at the lower end of the guidance range of 18-19mt, after the weak start at Curragh. However, Outperform-rated Credit Suisse points out that a 40% half-on-half improvement would be required at Curragh for this guidance to be achieved, and forecasts 17.5mt. The broker's target falls to $2.60 from $3.00.

Despite soft sales, **revenue increased by 5% quarter-on-quarter as group realised met coal prices rose 21% to US$321.2/t**, while unit costs were US$91/t.

Thermal and metallurgical coal prices have rallied since mid-2021, after a weak pricing period since the onset of covid-19. Thermal coal prices averaged US$77/t in FY21 and have increased 200% to a US$235/t average in FY22.

Macquarie expects strong cash flows will continue to strengthen Coronado's balance sheet and support the company's commitment to additional shareholder returns. The net cash position at the end of the quarter was US$171m, down by -US$86m, as free cash flow of US$265m was offset by -US$351m in dividends.

While the target price slips by -10% to $2.50, the broker's Outperform rating remains with buoyant met coal prices expected to drive upside.

Outlook

Following the recent met coal price collapse amidst a softening macro backdrop, Credit Suisse lowers its met coal price forecasts by -40% and -2% for the second half of 2022 and 2023, respectively.

These pricing downgrades are offset by an increase in Coronado's second half price realisation to 80% from 60%, given lagged pricing. In addition, the European Union embargo on Russian met coal comes into effect on August 10.

Buy-rated Goldman Sachs also suggests these bans should support a more balanced global seaborne met coal market in the second half. The broker, not one of the seven brokers updated daily in the FNArena database, reduces its target to $2.15 from $2.50.

While Bell Potter, also not one of the seven, anticipates the global economic backdrop may result in short term weakness in met coal markets, longer term supply-demand fundamentals remain very strong.

The broker forecasts strong free cash flow generation based on its met coal price outlook and retains its Buy rating, while lowering its target to $1.95 from $2.15.

Credit Suisse also points out Coronado's share price has retreated significantly from its May peak, which suggests some earnings downside is factored in, and the broker anticipates met coal prices may be bottoming out in three to six months.

The share price was around $2.40 in May and is currently trading around -42% lower at $1.40 at the time of writing. The average target price set by three Buy-rated (or equivalent) brokers in the FNArena database suggests 80% upside to the latest share price, though Morgans is yet to update its research for Coronado's second quarter results.

While production has started 2022 weaker than anticipated, Macquarie expects a ramp-up over the remainder of the year, as production is weighted to the second half.

AUSTRALIA

Nanosonics' Q4 Surprises, But Brokers See Risk

Nanosonics' June quarter update proved a positive surprise but most brokers cannot get past the many risks, also finding the shares look expensive.

-Nanosonics' Q4 sales beat market expectations, brokers upgrade price targets
-New direct sales channel implemented
-Full earnings results and R&D update to be reported on 23 August
-Risks ahead without GE as commercial partner

By Nicki Bourlioufas

Transition to new business model looks successful

Analysts have welcomed a positive trading update from medical device company Nanosonics ((NAN)), with revenue for FY22 expected to be $120.3m -- 17% higher than the previous financial year -- beating expectations and raising confidence the company has transitioned smoothly to a new sales model.

However, while many have lifted their price target for Nanosonic, views are mixed on the outlook for the company and the risks ahead.

Nanosonics provides infection prevention solutions and materials, with significant numbers of clients among hospitals in the US and Europe. The company said this week its transition to a revised sales model in North America has been substantially completed with a significant proportion of sales now going through a direct sales channel.

Under a revised business model, all of GE Healthcare's existing Trophon disinfection device customers will transition to Nanosonics for the ongoing provision of consumables.

Nanosonics had previously advised GE Healthcare would transition from a distributor of the Trophon device to a re-seller and that the company would expand its own US workforce to become the sole distributor of both the re-agent consumable and hardware.

The changes, announced earlier this year, had raised concerns of a slowdown in Nanosonics' sales, but this week's update has allayed those fears, while also removing some uncertainty about a revenue gap emerging in FY23 and beyond.

Direct customer access seen as a positive

One of the most upbeat on the company's outlook is Canaccord Genuity.

With a previously announced one-off hit to revenue from the GE transition process, the broker highlights "revenue has still managed to improve 17% year on year, which is a commendable performance."

With direct access to its customer base, the broker sees potentially significant operating leverage on the horizon. In addition, given Nanosonic's heavy investment in the EU market through the pandemic, Canaccord is bracing for a meaningful improvement in revenues from the EU region.

In response to the pleasing market update, Canaccord has lifted its price target to $4.89 from $4.78 and retained its Buy recommendation.

Wilsons, too, is confident about Nanosonics' prospects. While management at the company expects a second half revenue impact of -$13m to -$16m from changes to the business model, Wilsons finds confidence in the observation that Nanosonics has executed well, reducing the threat of a revenue "hole" in the months ahead.

Wilsons has maintained its price target at $7.00, including prospective R&D assets.

Nanosonics is scheduled to report full year results on 23 August, together with an update on R&D, which, analysts say, will be important for the market to understand the clinical and regulatory progress of the Coris endoscope decontamination device program, and other product launches.

What about the valuation?

Nanosonics may have surprised positively with its June quarter performance, this does not stop some brokers from calling the shares overvalued.

One such broker is Citi, whose target price increase does not reach further than $3.85, up from $3.65 prior. No surprise thus, with the shares trading above $4.00, Citi analysts have maintained their Sell rating for the stock.

One obvious impediment for Citi is it does not expect the company's earnings per share (EPS) to rise above FY19 levels until FY25, and nor is Nanosonics expected to report a material profit until at least FY25.

The biggest risks, according to Citi, are that the Trophon device takes longer or fails to gain traction in emerging and Asia Pacific markets and that new products fail.

Bell Potter too is doubtful about the stock's potential to sustainably rise further from its current price level.

Bell Potter considers Nanosonics fully valued, with the current share price already assuming significant value from the R&D pipeline. Bell Potter's has maintained its Hold rating, with its price target increasing to $4.05 from $3.95 on the positive sales result.

While guidance didn't cover earnings, Bell Potter now expects Nanosonics to post an operating result close to breakeven for the full year.

Goldman Sachs shares the view that Nanosonics shares look overvalued. This broker's price target currently sits at $3.20.

Beyond the positive sales result, Goldman Sachs continues to point at significant risks on the horizon. In particular the loss of GE, the leading global ultrasound manufacturer, as a commercial partner may challenge the penetration of the company's products and sales.

Irrespectively, Goldman Sachs cannot get past the elevated earnings multiples, which seem an anomaly given the degree of risks surrounding the company's outlook. Goldman Sachs has reiterated its Sell rating.

Joining the chorus of brokers believing Nanosonics shares are overvalued is Ord Minnett. A lack of growth in markets outside the US leaves this broker cautious. Following the sharp recovery in the share price over the past month, Ord Minnett has maintained its Lighten recommendation, with its target price increasing slightly to $3.70 from $3.50 due to upgrades in earnings forecasts.

According to FNArena's database, the consensus target price for Nanosonics is $4.14, suggesting -8.3% downside to the last share price. All of Goldman Sachs, Wilsons and Canaccord Genuity are not included in FNArena's consensus calculations.

AUSTRALIA

Health Is Wealth

When originally published, this story contained a reference to Japara Healthcare. That reference has now been removed. Japara was delisted late last year.

In times of great uncertainty the Australian healthcare sector can offer investors plenty of choice, with varying degrees of risk and opportunities.

-Australia's healthcare sector has seen record government investment
-Global pandemic has accelerated changes for healthcare services
-ASX-listed healthcare sector is dominated by international operators
-Next generation of success stories are announcing themselves

By Nikhil Gangaram

With the nasty words of recession, volatility and inflation dominating global headlines, it would be all too easy for investors to miss the fact that a healthcare revolution is bubbling along right beneath our eyes.

In addition to being the nation's largest employer, the Australian healthcare sector has served as a reliable crux for money managers for an extended period of time.

Companies in the sector benefit from a unique combination of attributes well suited to the current environment.

Healthcare companies in general are not overly impacted by slowing economic activity or higher interest rates.

Additionally, post the general de-rating of higher-multiple Quality companies since the start of 2022, healthcare stocks are now trading at lower valuations, while boasting strong balance sheets accompanied with long-term pipelines of well-funded research and development.

The healthcare sector is also on the precipice of a seismic shift.

The covid-19 global pandemic has served as a catalyst for clinical, financial, and operational transformation of the sector.

Despite its devastating impacts, the pandemic has seen exponential advances in medical science followed by an explosion of digital technologies.

These changes have resulted in better data access and analytics in addition to more informed and empowered consumers.

The pandemic has also accelerated numerous existing and emerging healthcare trends, including new delivery models and clinical innovations.

The most recent example of seismic change for the sector was reflected in the prior Australian Government's budget.

<u>Record Investment</u>

Earlier this year, the then Coalition Government highlighted its commitment to Australia's health care system by pledging a record $537bn to the sector over the next four years.

Around $45.5bn will be dedicated to providing access to more affordable medicines through the Pharmaceutical Benefits Scheme (PBS). In addition, Medicare, hospital and aged care facilities are earmarked for a large chunk of funding.

As per usual, Medicare reimbursements take the lion share of funding, reflecting the increased demand for doctors during the pandemic.

In particular, the emergence and demand for telehealth services presents an intriguing opportunity for investors.

According to a report from consultant Deloitte, more than 100m telehealth services have been delivered since March 2020.

The demand prompted former Federal Treasurer Josh Frydenberg to declare telehealth as one of the most significant reforms to Medicare since its inception.

For those looking to invest in the telehealth sector, the Australian stock market offers a plethora of prospects, albeit they all comprise of micro-cap companies.

Global Health ((GLH)) is one company that offers various telehealth and online services that facilitate patients in obtaining health information directly from their health provider.

Other beneficiaries include the likes of inline health directory 1st Group ((1ST)), Doctor Care Anywhere ((DOC)) and Cloud-based patient management company Oneview Healthcare ((ONE)).

There is also MedAdvisor ((MDR)) whose software system connects patients to tools and education materials from their preferred pharmacy.

Aged care is also poised to be a large beneficiary of the government's record spending in the healthcare sector.

In response to the Royal Commission, the previous government had just started implementing its five-year aged care reform program estimated at around $18.8bn.

The reforms slated are based on five pillars of residential aged care services, residential quality and safety, home care, workforce and governance.

Stocks in the aged care sector have been trampled on in the last few years, as lack of reform and government underfunding eventually resulted in a Royal Commission that unearthed a barrage in negative news, including revelations about poor service and client-unfriendly contracts.

A general recovery in share prices for pure aged-care plays Regis Healthcare ((REG)) and Estia Health ((EHE)) -from prior lows- signals at least part of the investment community thinks the worst may now be in the past for the local aged care sector.

The ASX offers various peripheral options too with companies like Intellicare Holdings ((ICR)) and HSC Technology Group ((HSC)) assisting seniors with living at home independently.

Healthcare Revolution

In addition to funding traditional parts of the healthcare sector, the previous government also unveiled an exciting new program called 'Biotechnology in Australia'.

This initiative is designed to support the development of the country's promising biotechnology sector and encourage the commercialisation of products invented and developed locally.

Over the next 10 years, Biotechnology in Australia aims to create $8bn in gross value added and generate $12bn in manufacturing exports.

Apart from wearable technology and the automation of tedious administrative tasks, technological innovation in the Australian healthcare sector is just starting to scratch the surface.

According to Deloitte, Australian medical science is on the precipice of scientific discoveries that will dramatically advance the way we diagnose and treat different diseases.

The consultant notes breakthroughs in digital medicines, nanomedicine, genomics, and others are occurring at an unprecedented and exponential pace.

Australia's listed healthcare sector is dominated by CSL ((CSL)), ResMed ((RMD)), Cochlear ((COH)), Ramsay Health Care ((RHC)) and Sonic Healthcare ((SHL)); all successful multi-national operators whose operational outlook is only partially tied-in with what is happening on Australian soil.

Underneath the local Top Five a number of next-generation success stories is already in the making with Pro Medicus ((PME)) commanding global leadership in portable imaging, while Nanosonics ((NAN)) is successfully changing hospital practices for disinfecting surgical tools.

Others that have started to attract the attention of investors include Aroa Biosurgery ((ARX)), Cogstate ((CGS)), immutep ((IMM)), MediBio ((MEB)), Medical Developments International ((MVP)), Polynovo ((PNV)), SomnoMed ((SOM)), and Telix Pharmaceuticals ((TLX)).

Buyer Beware

Despite the glitz and glamour on the outside, and the promise of potentially outsized returns, internally the healthcare sector is instinctively conservative by nature.

No surprise thus, healthcare has been a perennial lagger when it comes to adopting innovation.

But no regulatory or other constraints will stop the many changes and innovations from transforming healthcare services in the decade ahead.

For investors, these many (and significant) changes offer both danger and opportunity - just like the rest of the share market.

AUSTRALIA

Rio Tinto: No Soup For You

While Rio Tinto's earnings were roughly in line with forecasts, a surprising low dividend payout was the focus of attention.

-Rio Tinto H1 earnings largely in line
-Capex guidance reduced
-Surprise at only a 50% dividend payout
-More M&A?

By Greg Peel

Rio Tinto's ((RIO)) first half earnings result was equally a bit below, a bit above or a in-line with forecasts from the brokers in the FNArena database.

The result was nevertheless down on the prior first half, reflecting sector-wide headwinds of cost inflation, supply chain constraints, covid absenteeism, weather and so forth, which has been the decisive theme of this month's June quarter updates from the various miners on the ASX.

But Rio's cash position came in stronger than most expected, because capital expenditure was lower in the half than forecast. Management has cut full year capex guidance, but the lower figure in the first half still means a step-up in spending in the second.

FY23-24 capex guidance is unchanged.

So with even more cash available than brokers had assumed, and no debt on the balance sheet, it was obvious shareholders would be in for a cracking dividend payout, perhaps including a special.

Not so. Broker forecasts for the payout ratio ranged from 60% to 75% heading into the result. In the first half of 2021, Rio paid out 75%. This half it is paying only 50%.

Why play Scrooge?

Given current volatility in commodity prices, management explained they wanted to be conservative and see how conditions play out by year-end. We note that commodity prices surged on the Russian invasion, crashed back on Chinese lockdowns, peaked again on Chinese re-openings and then crashed again as recession fears gripped the globe.

Fair enough then. But even with iron ore prices around at half of last year's peak, Rio and peers are still cash-generating machines.

Brokers suspect management may look to a more handsome payout for shareholders after the second half. Maybe that's when a special dividend will be delivered. Rio typically exhibits an earnings skew to second half.

But while 2022 capex guidance is lower, there is still plenty to spend in the second half and in 2023-24, so that's one reason to hang on to cash.

Another is management's counter-cyclical investment strategy, ie, making acquisitions at lows on commodity prices rather than highs. The balance sheet may be maintained at elevated cash levels in order to exploit further opportunities.

JPMorgan suggests that following the recent Rincon lithium deposit purchase (Argentina), and given community opposition to the Jadar lithium project in Serbia, Rio is likely to pursue further lithium acquisitions.

Recently Rio offered to buy the remaining 49% of Canadian-listed Turquoise Hill it doesn't own, putting the company in a better position to negotiate with the Mongolian government with regard the massive Oyu Tolgoi copper-gold project. The deal remains outstanding.

JPMorgan wouldn't be surprised if Rio also looked for other copper projects while prices are low.

There's little disagreement on the M&A front from other brokers.

Undaunted

Ord Minnett white-labels JPMorgan's research and the broker has retained its Hold rating, while easing its target to $199 from $102.

Credit Suisse and UBS are yet to update, but among the other database brokers there has been no change to either ratings or target prices in the wake of the surprise dividend announcement.

All of Morgans, Morgan Stanley, Macquarie and Citi have retained Buy or equivalent ratings. Credit Suisse was on Buy and UBS on Hold.

None of the above have changed their targets (yet), with Ord Minnett's decrease taking the average database target down to $110.79 from $111.36.

At the time of writing, Rio is trading at $59.42, which makes Ord Minnett's Hold rating on a $99 target seem odd, but the broker feels macro uncertainty, reflected in Rio's conservative dividend, will keep investors on the sidelines in the short term.

That said, investors have pushed the stock up 0.5% today (so far).

AUSTRALIA

Oz Property Should Ride Out The Storm: S&P

Analysts have been examining the prospects for the Australian property market in the face of toughening macro conditions, and the forecast is for clearing skies with pockets of drizzle and the prospect of buybacks.

-S&P sees no major calamities for Australia's property sector
-RBA cash rate forecast to peak near 2.8% in 2024
-Australian banks considered well positioned
-Jarden and Morgans pick property winners and losers
-Morgan Stanley says time is ripe for AREIT buybacks

By Sarah Mills

S&P Global Ratings conducted an Australian Property Spotlight webinar this week and says given Australia's low unemployment is not expected to shift markedly over the next two years, the sector should hold up well.

Key Macro Forecasts

The webinar primarily examined the macro environment, before drilling down to property sub-sectors.

S&P Global expects the Australian cash rate should rise from 1.35% now, to 2.5% in 2023 before peaking at 2.8% in 2024 and then easing to roughly 2.5% in 2025.

Australia's real GDP growth is expected to bottom just above 3% in 2022 before recovering to roughly 5.5% in 2023 after which GDP is expected to ease to roughly 5% in 2024 and 4.8% in 2025.

Housing prices are expected to fall in an orderly manner (meaning S&P is not on board with the many forecasts for a -10% to -20% average price fall next year).

S&P says the main cause for concern in the near term is that consumer sentiment indicators have fallen sharply in 2022, but notes business confidence has held up much better, albeit gyrating every few months.

Residential Property Forecasts

In a nutshell, S&P expects Australian residential property price growth to fall to roughly -15% in 2022 before embarking on a reasonably swift recovery, rising 15% in FY23 to hit roughly 7% by mid-2024.

If S&P is correct, the price nadir is almost behind the sector. Also, with most forecasters in Australia predicting -10% to -20% falls in housing prices over the coming two years, S&P's projections are significantly more positive.

S&P says supporting factors for residential property include:

- a recovery in immigration, S&P citing a backlog of 1m visa applications;
- historically low unemployment rate (expected to continue for two years);
- the fact that while prices are coming off the boil, the cost of construction is rising, constraining new supply; and
- millennials, which comprise 21.5% of the population are on the hunt for houses, looking for nests as they move into the 29-34-year age bracket.

On the flipside, S&P notes that a big contributor to a recent decline in business sentiment has been the rising cost of construction, which has been squeezing margins, and believes this will likely keep a lid on euphoria.

A Tale Of Two Cities For Retail Landlords

When it comes to big retail landlords, S&P agrees with most analysts the outlook for discretionary sector (retail strip shopping) is more pessimistic than for the non-discretionary sector (suburban malls).

The latter are already returning to normal trade notes S&P, but the slowdown in the CBD office market post-covid as the work-from-home theme persists is hurting CBD retailers in particular.

Commercial and Industrial Property another story of division

Rising debt costs from rate rises and expansion of the credit spread is a growing feature of the AREIT sector.

S&P expects the commercial and industrial AREITs should be able to manage the rising costs of debt given their high proportion of fixed-rate debt and smooth maturity profile.

The agency says only an estimated 14% of debt is expected to mature over the next two years, making refinancing manageable.

S&P expects landlords that enjoy fixed CPI-linked rents should prove defensive while commercial landlords with mixed office retail are expected to pay sizeable tenant incentives to attract occupancy in the CBD.

Industrial REITS, once often beneficiaries of covid, are unlikely to escape the rising rate environment unscathed, says the agency. But S&P notes the majority have considerable headroom within debt covenants.

Weaker REITs could endure a -30% slump in property prices, says the agency, while the strongest could ride out a -72% fall.

Meanwhile, inflation should eventually translate into higher rents.

Build-To-Rent Sector

There has been a lot of talk for decades about the “build to rent” sector, but to date Australia has lagged the US and Europe.

S&P suspects this may be an area of movement over the next few years.

Given tenants are expected to pay a premium for the security of a long-term lease, it should attract investor interest.

Already there is movement in the Australian market and S&P confirms the time is ripe.

Banks Expected To Be Just Fine

Meanwhile, Australian banks with their strong earnings and capital bases are likely to weather the short-term decline with ease. S&P retains its Stable to Positive outlook on the sector.

While some heavily leveraged borrowers may struggle, these represent roughly 1% of total borrowings, notes S&P, and credit losses are likely to return to pre-pandemic levels.

Writing new loans may be a different matter as rising interest rates unnerve consumers, and the shortage of housing due to rising construction costs limits growth.

S&P expects credit growth will slow from 8% in FY22 to 5% over two years.

The low unemployment rate is likely to stay low for two years, meaning repayments should stay on track.

Just to be sure to be sure, S&P notes Australians have a long history of favouring mortgage repayments over discretionary spending, and have been busy squirrelling money away during covid, just in case.

The wildcard would be a sharper than expected downturn but most analysts doubt this, with only a few lone voices ringing the worst (although China is, apparently, expecting a global asset crash within the next two to three years).

There are plenty of clouds circling the horizon but S&P remains sanguine (hopefully not a reiteration of their sanguine approach during the GFC). The agency notes that even should new loan-growth deteriorate, the banks should benefit from rising interest rates, which should improve margins.

Most are also planning to write new ESG-related loans.

S&P says non-banks are more likely to move into higher debt-to-income lending as banks retreat. Meanwhile, S&P says lenders mortgage insurers – the high-risk financiers – are tracking well after being place on watch in 2020.

LMI claims rose in the early days of covid before rallying and S&P expects return on equity should return to the 9% historical average.

S&P also expects residential mortgage backed securities should survive its stress test scenario, which assumes 30% of mortgages are under stress.

Jarden and Morgans Lay Their Bets

Jarden and Morgans both conducted recent reviews of AREITs.

Jarden notes consensus earnings for AREITs have eased with FY23 consensus EPS/FFO forecasts falling to a 7.9% weighted average. The broker also points out the growth prospects for AREITs do diverge sharply.

Overall, Jarden expects AREITs will continue to enjoy superior growth and could deliver earnings surprises.

The analyst forecasts the cap rate will expand to 30-40bps in FY23 but concedes this may prove optimistic.

Jarden says balance sheets are looking good but suspects growth will come through asset recycling rather than equity or debt. The analyst expects acquisitions will slow, believing it will be hard to "stack up acquisitions at scale" and given development margins are under pressure.

But it does spy opportunities for sector consolidation at present valuations.

When it comes to rental growth, childcare, Long WALE (weighted average lease expiries), retail and manufactured housing estates appear to offer the best safe harbours, says Jarden, thanks to their inflation-linked leases.

Jarden says the slowing in tenant performance is likely to drag, particularly in retail. The broker also takes a cautious approach to office REITs. Growth in storage is forecast to slow.

Approaching the reporting season in August, the analyst favours Scentre Group ((SCG)), Vicinity Centres ((VCX)), Shopping Centres Australasia Property Group ((SCP)), Homeco Daily Needs REIT ((HDN)) Charter Hall Retail REIT ((CQR)), National Storage REIT ((NSR)), Abacus Property Group ((ABP)), Goodman Group ((GMG)), Ingenia Communities Group ((INA)), Lifestyle Communities ((LIC)), Centuria Industrial REIT ((CIP)) and Charter Hall Long Wale REIT ((CLW)).

Morgans Has Its Say

Morgans says the market is factoring in the likelihood that cap rates will expand, but counters the REITs ability to grow rental income through inflation-linked leases or to value-add via development and leasing should partially offset this.

The broker also appreciates the sector's historical performance as an inflation hedge. Morgans expects fee income may be hit by lower asset values and transactional activity, which may hit fund managers.

This analyst likes niche sectors with good underlying cash flows underpinned by strong tenant covenants, sustainable distributions and growth options.

"This includes REITs exposed to pubs; social infrastructure; convenience retail and industrial/logistics," says Morgans.

"*We expect the favourable tailwinds for industrial/logistics assets will remain n place with significant demand for the asset class given the growing shift to e-commerce and focus on supply-chain resilience*."

<u>Morgan Stanley Says The Time Is Ripe For Buybacks</u>

Morgan Stanley speculates that buybacks may represent the best capital allocation option for REITs given they are trading at an average -21% discount to net tangible assets.

While conceding that astute developments are likely to yield windfalls for investors, the analyst doubts commercial developments will be able to retain their historical margins of 25% to 30%.

Instead, the broker suggests buybacks would provide value-add certainty and a margin of 17%. Morgan Stanley estimates that for every $100 a REIT spends on a buyback, it would gain $117 in return.

The analyst considers this very attractive given the rate's proximity to the 25% to 30% historical margin, and given the fact that a buyback carries fewer leasing, construction and timing risks, particularly in a higher interest rate and input-inflation context.

In support of this view, Morgan Stanley points to the fact that Sydney and Melbourne office cap rates are at historical lows, and that rates are rising as the cap rate differential compresses.

The analyst has observed the market cap rate has broadly tightened by roughly 75bps between the dates of construction commencement and project completion.

This, says the broker, suggests roughly half of the historical 25-30% margin may have been attributable to market forces, which are, of course, looking a touch less optimistic.

However, Morgan Stanley reassures investors that projects already under way should deliver the traditional 25% margin given most costs have been locked in and profits assured through agreements with capital partners.

The most likely buyback contenders are Mirvac Group ((MGR)), GPT Group ((GPT)), Dexus ((DXS)) and perhaps Scentre Group, says the broker.

COMMODITIES

EV-Makers Connect With Miners

Richard (Rick) Mills
Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

This story was first published 23/07/22.

EV-makers connect with mining companies to ensure adequate supply of battery raw materials

Recently, attention has turned to the shortfall of raw materials that is limiting the production of electric vehicles. Simon Moores, the influential CEO of Benchmark Minerals Intelligence, has said that carmakers may have to get involved in mining if they want to make electric vehicles at scale.

Moores added that, while lithium's major producers have large investments planned, those alone will not be sufficient and new mines are needed.

His thoughts are echoed by one of the most influential voices in mining, Robert Friedland. At the Investing in Africa Mining Indaba conference, the Ivanhoe Mines founder pointed out the problem with renewable technologies is they are incredibly energy- and metals-intensive.

"We're going to have a freakout as we try to change the world economy unless we develop a lot more mines," said Friedland in a Mining.com report.

According to his data, a 1,000-pound electric vehicle requires 500,000 pounds of raw materials. "So, to transition just the world's passenger cars to electric, we have to mine more materials in the next 30 years that we mined throughout human history," he said.

Tesla's CEO, Elon Musk, reportedly met Indonesia's President in Texas to discuss potential investments and technology. The archipelago nation is a major nickel producer and aims to develop a domestic EV battery materials supply chain. Musk has also made a public appeal for more investment in lithium mining, hinting that the Texas-based automaker would consider mining or refining it after prices rose to "insane levels".

Tesla was the first to ink offtake agreements with mining companies, but many other large automakers have since done the same — certainly enough to call it a trend. Here we offer a run-down of who is buying what from whom, and then, a summary of US and Canadian government support for the building of an electric vehicle supply chain, "from mine to battery to showroom", in North America.

Note that, while a lot of attention has been paid lately to lithium supply and skyrocketing lithium prices, the electrification of the global transportation system doesn't take place without copper, needed for all the wiring and in the EV motor; and graphite, an essential ingredient of the lithium ion battery anode, for which there is currently no substitute.

Tesla

The world's number one electric-car maker has easily been the most active company of the top 5 (Tesla, SAIC Motor, Volkswagen, BYD and Hyundai) firms to ink raw-material agreements with miners.

Lithium

The deal-making started in 2015, when Tesla made a curious purchase agreement with tiny Pure Energy Minerals in Nevada. The five-year supply deal takes effect if and when Pure Energy puts its early-stage Clayton Valley South lithium brine project into production. Last summer Pure Energy got approval to build a pilot plant, to be operated by Schlumberger, the oilfield services giant.

In 2018, Australian lithium miner Kidman Resources said it entered a binding agreement with Tesla to supply the company with lithium hydroxide, one of two lithium end products, the other is lithium carbonate, used in an EV battery's cathode.

The lithium would flow for an initial three-year term, sourced from a yet-to-be-built refinery in Western Australia, that Kidman is developing with a major lithium miner from Chile, Sociedad Quimica y Minera de Chile, better known as SQM.

Last year Tesla signed another lithium off-take, with China's Ganfeng Lithium and its unit GFL International, allowing the companies to provide Tesla with battery-grade lithium starting in 2022.

Since 2009, Tesla has had an agreement with Japan's Panasonic to supply battery cells for its electric vehicles. The collaboration deepened in 2016, when the Japanese company said it would spend $1.6 billion in the Nevada Gigafactory project Tesla had initiated two years earlier.

Tesla also makes its own batteries, and along with Panasonic, counts China's Contemporary Amperex Technology (Tesla is CATL's largest customer) and Korea's LG Energy Solutions, among its suppliers. On top of this, BYD, the Chinese automaker backed by Warren Buffett, is reportedly trying to sell its batteries to Tesla.

LG Energy, the battery unit of South Korea's LG Chem, has been actively involved in sourcing lithium. In January of this year Australia's Lionstown Resources ((LTR)) announced it had signed a deal with LG Energy to sell 100,000 dry metric tonnes of lithium spodumene (the hard-rock form) from its Kathleen Valley project in Western Australia. The company says the off-take will account for nearly 30% of the project's annual output, after the first year of production, expected in 2024.

LG Energy is working with another Australian lithium miner, Vulcan Energy Resources ((VUL)) to source the battery ingredient from its geothermal brine project in Germany. The two companies signed a deal in 2021, wherein Vulcan will extract lithium from geothermal brine at its US$1.4 billion project in Germany's Upper Rhine Rift, and sell 5,000 tonnes of battery-grade lithium hydroxide to LG Energy in 2024, the first year of operation, rising to 10,000 tonnes thereafter.

Vulcan also signed supply deals with Volkswagen (see below) and French-Italian carmaker Stellantis, with the latter recently investing $52 million for an 8% stake in Vulcan, Reuters reported in June.

Graphite

In December 2021, Tesla agreed with Australian company Syrah Resources ((SYR)) to purchase battery-ready graphite from Syrah's Vidalia plant in Louisiana. According to Bloomberg, Vidalia's initial 10,000 ton a year production rate would supply about 3% of US battery demand by 2025. By mid-decade the plant, which sources graphite from Syrah's Balama mine in Mozambique, would ramp up to 40,000 tons per annum.

Nickel

Five months earlier, Tesla scored a major supply deal with BHP Group ((BHP)) to supply nickel for its EV batteries. Elon Musk has repeatedly expressed the need for a steady nickel supply, since the metal packs more energy into batteries and allows producers to reduce the amount of cobalt, which is more expensive and comes primarily from one country, the Democratic Republic of Congo (DRC).

The world's largest miner is providing Tesla with nickel from its Nickel West operation in Western Australia. Opened last year, the $140 million facility is located next to BHP's existing nickel refinery.

In October of 2021, Tesla made another nickel agreement with Vale's Goro mine in New Caledonia. The small French territory in the South Pacific is thought to contain up to a quarter of the world's nickel, trapped in laterite deposits that are harder and more expensive to process than nickel sulphide ores found in North America.

The mine has been the source of conflict between Vale and locals due to the use of highly polluting HPAL technology, with the Brazilian company searching for a buyer. Last fall a consortium called Prony Resources, comprised of the mine's employees, three provinces, and Singapore commodity trading group Trafigura, said Tesla has agreed to buy almost the entire new planned nickel output from the mine.

The group plans to produce 44,000 tonnes of nickel by 2024.

Cobalt

An ingredient in nickel-manganese cobalt (NMC) batteries, cobalt is hard to get outside of the DRC, which produces about three-quarters of the metal, and up to 20% of the output is from makeshift mines where fatalities and human rights abuses are commonplace.

In 2020 Tesla announced a deal with Glencore, the world's largest cobalt miner, to supply 6,000 tons a year of the battery cathode material. Glencore has also struck cobalt deals with Korean battery makers Samsung SDI and SK Innovation, with Samsung agreeing to buy 21,000 tons, and SK contracting to purchase about 30,000 tons. China's GEM Co will buy 61,200 tons from Glencore, and BMW Ag will purchase cobalt directly from Glencore's Murrin Murrin mine in Australia, Bloomberg reported.

Ford

Ford Motor Co recently announced a series of deals to accelerate its shift to electric vehicles. The American auto-making icon plans to make 600,000 EVs annually by 2023 and more than 2 million by 2027. According to media reports, the Dearborn, Michigan-based company has secured all of the 60 gigawatt hours of cell capacity needed to support the 600,000 run rate.

Among its key suppliers, CATL will provide lithium iron phosphate (LFP) battery packs for Ford's Mustang Mach-E crossovers for North America starting next year, and the F-150 Lightning pickups in early 2024.

LFP batteries are considered less powerful than NCM batteries, the type used by most Western automakers, but are far cheaper, due to iron being more abundant. However, technology championed by CATL has improved their performance.

Ford is also working with LG Energy and SK Innovation, which last year struck a deal to build a massive battery plant in Georgia. The US$2.6 billion development will supply batteries for Ford and Volkswagen.

As for raw-material off-take agreements, Ford has contracted with Rio Tinto ((RIO)) to provide lithium from its Rincon project, Argentina, and Lake Resources ((LKE)), also in Argentina; with Compass Minerals for lithium hydroxide and lithium carbonate from Utah; and with Syrah Resources and SK On for natural graphite from Louisiana. Most recently, Ford contracted with ioneer Ltd to supply lithium carbonate from its Rhyolite Ridge project in Nevada beyond 2025, and with BHP to supply nickel from Australia.

Under terms of the deal announced this week, ioneer will supply 7,000 tonnes annually to BlueOvalSK, Ford's battery joint venture with SK Innovation in Kentucky. Shipments are expected to start mid-decade.

Ford's MOU with BHP, also announced this week, involves a multi-year nickel supply agreement, from its Nickel West asset in Western Australia — the same facility supplying Tesla, as mentioned above.

Last year Ford signed a non-binding memorandum of cooperation with nickel miner Vale Indonesia and China's Huayou Cobalt, to build a plant capable of producing 12,000 tonnes per year of mixed hydroxide precipitate, a material extracted from nickel ores.

GM

Like its rival Ford, General Motors has been scouring the globe for battery raw materials it hopes will ensure its transition to electrics. The carmaker plans to sell more than 1 million EVs annually by 2025, introduce 30 new models by that year, and end sales of all gasoline-powered vehicles by 2035.

In July 2021, General Motors took steps to secure lithium, by partnering with Controlled Thermal Resources (CTR), an Australian company advancing a geothermal brine project near Salton Sea, California, called Hell's Kitchen. The automaker will have first rights to lithium produced in the first phase of the project, expected to start in 2024. The company plans to use the mine's output in its Ultium battery cells, which currently power the Chevy Silverado EV, the electric GMC Hummer and the Cadillac Lyriq.

In April 2022, GM inked a multi-year agreement with Glencore to provide cobalt from Glencore's Murrin Murrin mine in Australia.

This was followed by an announcement in May from South Korea's POSCO Chemical, which plans to invest US$278 million of a US$663 million battery cathode materials plant being built in Canada with General Motors. The US$400 million facility is in Becancour, Quebec, where Germany's BASF also announced plans to make and recycle cathode active materials (CAM), starting in 2025. GM's Ingersoll, Ontario car plant, meanwhile, is expected to start EV production later this year.

Mercedes

The German automaker has budgeted US$43.8 billion this decade for electrifying its line-up, including logistics centers, new production lines, and a billion-dollar battery plant in Alabama. The facility in Tuscaloosa reportedly is able to switch production between gas-powered, plug-in hybrid and fully electric drivetrains. It opened in March.

Mercedes has also partnered with Chinese battery company Envision AESC, which plans to set up a US cell facility by mid-decade. Envision already supplies batteries to Nissan's Leaf hatchbacks in Smyrna, Tennessee.

BMW

BMW Group got into the lithium supply game in 2019, signing a five-year, EUR540 million off-take with China's Ganfeng Lithium. According to Green Car Congress, the contract secures 100% of BMW's lithium hydroxide needs for its fifth-generation battery cells. The company aims to have 25 electrified models in place by 2023, with more than half being full electric.

As for cobalt, BMW will source it directly from mines in Australia and Morocco. The group also said in 2019 it is increasing its order for battery cells from China's CATL to EUR7.3 billion (2020-31), and signed a contract worth EUR2.9 billion with Samsung SDI for its fifth-generation electric drivetrains.

Volkswagen

As mentioned SK Innovation will supply Ford and Volkswagen from its US$2.6 billion battery plant being built in Georgia. The German company's newly formed battery business, PowerCo, is tasked with supplying VW's raw materials. According to Bloomberg, *VW plans to partner with Umicore SA to source cathode materials, is exploring working with Robert Bosch GmbH for machinery and agreed to offtake battery-grade lithium hydroxide from miner Vulcan Energy Resources.*

The private company, which plans to IPO next year, earlier this month broke ground on its first European factory, expects to invest more than USD$20 billion in five of its own cell factories by 2030, and is building a sixth factory in Sweden through a partnership with Northvolt AB. PowerCo's flagship plant in Salzgitter, Germany, is due to start pilot production in 2024, Bloomberg said.

VW secured cobalt supplies back in 2017, through a triangular deal involving China's CATL and Glencore, with the latter agreeing to supply 20,000 tonnes of cobalt to CATL over four years.

Earlier this year, Volkswagen said it will form joint ventures with Huayou Cobalt and Tsingshan Group to secure nickel and cobalt supplies for electric vehicles in China — part of a US$33 billion push by the world's second largest carmaker to build a network of battery cell factories and secure direct access to raw materials.

Hyundai

In May Hyundai Motor Group announced that Georgia will be the site of the Korean company's first dedicated EV battery plant and EV manufacturing facility in the United States. The facility in Bryan County, GA has a capital cost of US$5.5 billion and is expected to break ground in 2023. By commercial production in 2025, the plant will have an annual capacity of 300,000 EV units, the company said in a statement.

Reuters notes that Hyundai's battery supplier, SK On, has built two adjacent plants in Georgia, one that supplies Volkswagen, and the other that will provide batteries to Ford starting early next year. SK On will also supply the battery for Hyundai's Ioniq 7 EV.

Toyota

The Japanese automaker that pioneered hybridization through its Prius, is getting into all-electrics in a big way. In December, CEO Akio Toyoda presented his company's EV plans, setting out a goal of 3.5 million battery-electric vehicles annually by 2030, through 30 Toyota and Lexus models. All told, Toyota's electrification strategy is costed at an eye-watering US$70 billion.

Toyota developed a plan to source EV raw materials in 2020. An MOU between Australia-based lithium miner Orocobre [now Allkem ((AKE))] and Prime Planet Energy Solutions (PPES) — a joint venture between Toyota and Panasonic — entails up to 30,000 tonnes of lithium carbonate equivalent (LCE). The lithium is sourced from Allkem's producing Olaroz brine asset in Argentina, and converted to lithium hydroxide at the Naraha plant in Eastern Japan.

In 2021, PPES secured a contract with BHP to supply nickel sulfate from the latter's newly opened Kwinana plant south of Perth. According to the Sydney Morning Herald, Toyota was the second car company after Tesla to become a Nickel West customer.

Conclusion

Just about every automaker is transitioning to electric vehicles, with hundreds of billions of dollars earmarked over the next decade for new models, production lines and battery plants. The electrification of the global transportation system also involves the rollout of thousands of electric-vehicle charging stations, a task which governments at all levels are beginning to take seriously. All of this will require copious amounts of raw materials, including copper for EV motors, wiring and charging stations, permanent magnets that use rare earths like neodymium and dysprosium, and battery metals such as lithium, graphite, cobalt, sulphide nickel and manganese.

For years neglected by governments, critical minerals like graphite are finally getting the attention they deserve. In June, the Canadian government unveiled its low-carbon industrial strategy that will see Ottawa partnering with each province to "identify, prioritize and pursue opportunities". Specific to critical minerals, this means battery manufacturing in Quebec and electric vehicle production in Ontario.

Natural Resources Minister Jonathan Wilkinson pointed to CAD$3.8 billion already earmarked for critical minerals in the April budget. On top of that, "we have a billion and a half dollars in the Clean Fuels Fund, we have eight billion dollars in the Net Zero Accelerator, we're setting up the Clean Growth Fund, we have the Canada Infrastructure Bank," Bloomberg quoted him saying. He added:

"The average mine takes 15 years to bring into production. In the context of the energy transition, we don't have 15 years if we're actually going to provide enough of the minerals to be able to support just the battery development. So it behoves us to bring everybody into the room to figure out how to do it."

At AOTH, we couldn't agree more. Canada's new industrial strategy dovetails with what is happening south of the border.

The US, which has long sought to improve its battery supply chain, recently invoked its Cold War powers by including lithium, nickel, cobalt, graphite and manganese on the list of items covered by the 1950 Defense Production Act, previously used by President Harry Truman to make steel for the Korean War.

To bolster domestic production of these minerals, US miners can now access US$750 million under the act's Title III fund, to be used for current operations, productivity and safety upgrades, and feasibility studies. The DPA could also cover the recycling of these materials.

Later this year, the Department of Energy will begin doling out over US$7 billion in grants for battery production, nearly half of which are earmarked for domestic supplies of materials and battery recycling. The DOE has also committed US$45 million in funding for battery development called the Electric Vehicles for American Low-Carbon Living program. It's all part of the Biden administration's goal of making half of all new vehicles sold in the United States electric by 2030.

It’s encouraging to see public money directed towards electrification is beginning to flow, despite efforts by Democratic Senator Joe Manchin to block the climate provisions in Biden’s scaled-back Build Back Better plan. Earlier this month, Manchin told the Democratic leadership he won’t support the climate provisions in the reconciliation bill, potentially sinking the US$1.75 trillion package, given that Manchin holds the swing vote in the 50-50 Senate. The bill would allocate billions in incentives to slash carbon emissions, helping to meet the White House’s goal of a 50% reduction in US greenhouse gas emissions from 2005 levels by 2030, and net-zero emissions by mid-century.

CNBC reported Manchin saying in a radio interview he won’t support any climate provisions until he has a better understanding of inflation figures for July. Amazing how one individual can hold so much power for a program that is so important to the future US economy.

But it’s funny. Most public officials appear to have no concept of how important mining is to developing a North American EV supply chain, one that encompasses everything “from mine to battery to showroom”.

A green infrastructure and transportation spending push will mean a lot more metals will need to be mined, including lithium, nickel, and graphite for EV batteries; copper for electric vehicle wiring, charging stations and renewable energy projects; silver for solar panels; rare earths for permanent magnets that go into EV motors and wind turbines; and silver/tin for the hundreds of millions of solder points necessary in making the new electrified economy a reality.

In fact, battery/energy metals demand is moving at such a break-neck speed, that supply will be extremely challenged to keep up. Without a major thrust by producers and junior miners to find and develop new mineral deposits, glaring supply deficits are going to beset the industry for some time.

Richard (Rick) Mills

rick@aheadoftheherd.com

Richard is the owner of Aheadoftheherd.com and invests in the junior resource/bio-tech sectors. His articles have been published on over 400 websites, including:

WallStreetJournal, USAToday, NationalPost, Lewrockwell, MontrealGazette, VancouverSun, CBSnews, HuffingtonPost, Londonthenews, Wealthwire, CalgaryHerald, Forbes, Dallasnews, SGTReport, Vantagewire, Indiatimes, ninemsn, ibtimes and the Association of Mining Analysts.

If you're interested in learning more about the junior resource and bio-med sectors, and quality individual company’s within these sectors, please come and visit us at ***www.aheadoftheherd.com***

RUDI'S VIEWS

Rudi's View: 'I'm so Bearish, I'm Bullish'

In this week's Weekly insights:

-'I'm so Bearish, I'm Bullish'
-Corporate Earnings: Between Dr Jekyll & Mr Hyde
-Conviction Calls
-FNArena Talks

By Rudi Filapek-Vandyck, Editor FNArena

'I'm so Bearish, I'm Bullish'

Economists at **Oxford Economics** summarised this year's financial market's dilemma as follows: The risk of a global recession has clearly grown. It's far from inevitable, still, but orchestrating a soft landing will require luck.

It has taken this long into the calendar year -approximately seven months- but a global recession has now pretty much become the consensus view among financial institutions. Such is the conclusion drawn by **Bank of America** analysts following BofA's latest monthly global fund managers survey.

The July survey, reported BofA, embodies full capitulation with respondents signalling expectations for global growth and corporate profits have sunk to all-time lows, average cash levels have risen to the highest since 9/11, with equity allocation at its lowest since Lehman Bros went bankrupt in late 2008.

The BofA Bull & Bear Indicator remains at "max bearish" triggering the response: I'm so Bearish, I'm Bullish.

Market fundamentals are poor, acknowledges BofA, but overall sentiment is extremely poor, increasing the likelihood that equities and credit will rally over the weeks ahead.

Further fueling the thesis of market sentiment having sunk too deep, too quickly was the observation by analysts at JP Morgan that short positioning for US futures had accumulated to an all-time record high.

No surprise, some market commentators have made a connection with short covering to (at least partially) explain the general improvement in equity indices this month.

Volumes are dreadful, so any change in those cash levels or short positions would have had a larger-than-usual impact.

As I Tweeted last week:

"What Bear Market teaches us is there are a million reasons to sell/buy a stock; only a few are related to a specific company's underlying fundamentals. Something to keep in mind also when the next Bull Market rages on high volume."

There is also positive news to report: while most forecasters are now anticipating the arrival of economic recession, unless a great deal of 'luck' happens to interfere, general consensus believes any recession will be 'mild', more like the early 2000s rather than that dreaded 2008 precedent when the global financial system came within a heartbeat of total dysfunction.

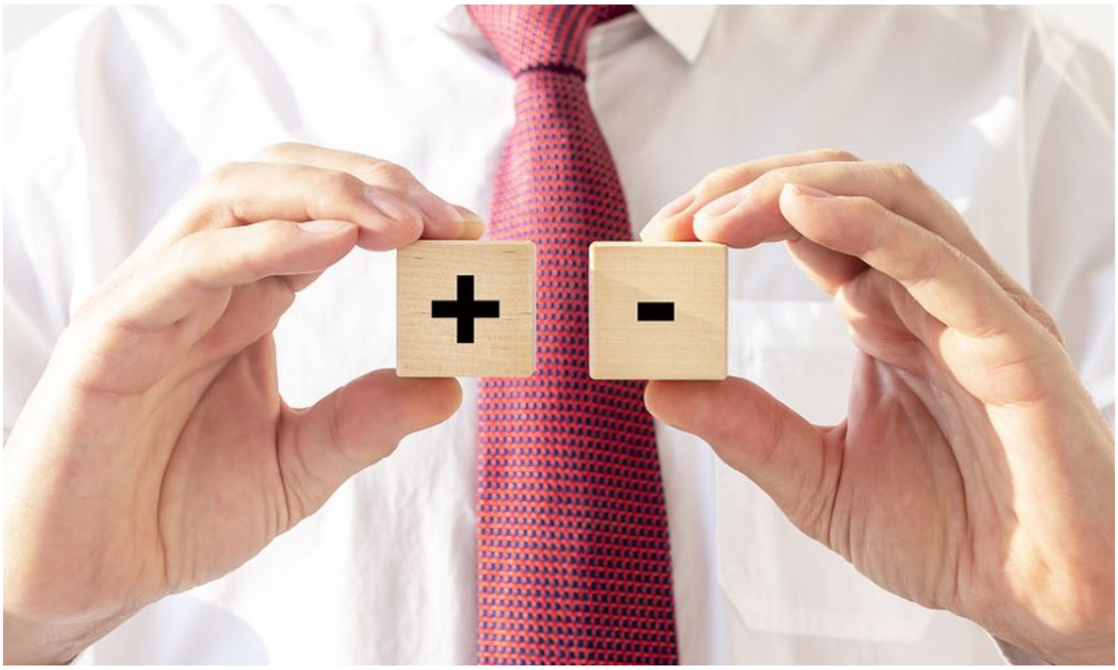
If correct, this will have major positive ramifications for financial assets. First up: corporate earnings might prove more resilient. Secondly: central banks might not have to go full throttle for much longer, assuming inflation, as is also widely forecast, will start deflating over the months ahead.

Another reason as to why Quality and Growth equities (in particular: Quality Growth) have encountered less headwinds these past few weeks is because global bond markets have also started to reflect the general consensus that economic recession might be unavoidable over the year ahead, which is what yield curve inversion implies (shorter-duration bonds offering a higher yield than longer-duration bonds).

Whereas the valuation for your typical higher multiple Quality company a la Goodman Group ((GMG)), WiseTech Global ((WTC)) or Carsales ((CAR)) comes under pressure when bond yields are on the rise (compression of multiples), the opposite occurs when longer-dated bond yields fall in recognition of plausible recession.

While this might temporarily lift many boats from the Growth basket, the fact there might be a recession on the horizon implies most Growth stocks remain at risk of operational disappointment either in the upcoming results season, or in February next year.

A cautious investor, therefore, wouldn't stray too far away from Quality, Solid and Defensive, lest he/she has a particular short-term trading strategy.



Corporate Earnings: Between Dr Jekyll & Mr Hyde

Viewed from afar, the upcoming results season in Australia will be rather unusual in that it might arrive too early in the down-cycle for investors to properly assess the resilience of a company's client base, profits and margins.

This is also the view of some commentators in the USA who believe the Q3 season over there might turn out only the first in a series of accumulating deterioration in company fundamentals.

Whereas an oft mentioned number, both here and in the USA, is -20% for corporate earnings, it's pretty much a given this is too large a reduction to be fully incorporated into updated forecasts throughout July and August. If -20% proves to be accurate, we won't know until much later, maybe as late as this time next year.

Confronted with this set-up, investors globally have not hesitated to de-risk their positioning, and to de-risk heavily. Shares in commodity producers, earlier in the year seen as the *beez kneez* when inflation-protection seemed on everybody's mind, have given up all their gains plus some over the seven weeks past.

Similarly, prices for gold, copper, oil, iron ore and the like have all declined over that period and most prices are now trading below analysts' forecasts, from a sizable premium previously, further adding downward pressure to consensus forecasts for corporate earnings.

As also illustrated by this month's quarterly production reports, many producers have found it difficult to meet guidance and/or expectations due to bad weather, staff absenteeism, rising costs and production shortfalls.

The fact commodity prices are now in many cases below previous forecasts keeps the pressure to the downside, at least until the general mood towards the sector improves.

To illustrate how fast and how fierce the general de-rating has been for the ultra-cyclicals in the share market: the ASX200 Resources index was up nearly 25% in April, and more than 20% up by late May, but the index is now negative when measured from January 1.

The irony is that many in the local sector, be they BHP Group ((BHP)), Woodside Energy ((WDS)) or Whitehaven Coal ((WHC)), stand ready to pay out more dividends to shareholders than the banks or insurers, and with plenty of additional excess cash flows on top to have analysts speculating about share buybacks and special dividends forthcoming.

History shows there is **no hiding in commodities leading up to an economic recession**, and this time around many questions remain about what exactly China is up to. But a large number of investors has stayed true to their conviction that this time is different and selected commodities including coal, gas and lithium will prove resilient even in case of a recession because of specific supply limitations.

Others might reason: who exactly is selling down a stock that has a prospective dividend yield of 42% and 31% respectively for this year and next, as is the case for Coronado Resources ((CRN))? But also: how long exactly can these shares stay at the current beaten-down level?

For what it's worth: some commodity analysts now believe the risk has shifted to the upside now that commodity prices and share prices have sharply corrected. A general view about only a mild recession coming next feeds into such optimism.

One of the local sectors that has disappointed investors since April are the **ASX-listed gold producers**. Not only has the narrative about buying gold as protection against inflation not held up this year (see link to video below), further adding to the general disappointment have been numerous profit warnings and sub-par production updates marred by rising costs and other headwinds.

Sector analysts at **Ord Minnett**, in a sector preview to August, believe this sector might not yet be done with issuing disappointing market updates. On Monday, with copper-gold producer OZ Minerals ((OZL)) yet again disappointing with lower revenues and higher costs, this prediction proved rather prescient indeed.

Note: OZ Minerals had already downgraded guidance in June and the share price had been shellacked in response, probably explaining why the punishment on Monday remained limited to circa -3%.

Ord Minnett believes market sentiment towards Australian gold producers is now "extremely low" but, reports the broker following a number of company visits throughout Australia, green shoots are emerging for the sector.

Ord Minnett suggests once forecasts have been re-based following the upcoming reporting season, there will be an opportunity to get on board as even the Quality names in the sector are trading at large valuation discounts.

Ord Minnett's sector favourites are Northern Star Resources ((NST)), Gold Road Resources ((GOR)), Silver Lake Resources ((SLR)) and Red 5 ((RED)) respectively for large-cap, mid-cap (2x) and small-cap exposure.

Another sector that looks poised for more disappointment in August are **online consumer-oriented business models**, in particular those which benefited from covid and lockdowns previously. Again, analysts will not accept these business models, carried by multi-year mega-trends, are now indefinitely ex-growth, but shorter-term more pain seems but logical.

Retailers and various other consumer-oriented companies have had it tough so far in 2022 as investors prepared for weakness in property prices putting pressure on household spending. Again, the August reporting season might come too early to properly assess the strengths and weaknesses for companies in this segment.

Shoe retailer Accent Group ((AX1)) issued a profit warning on Friday, showing investors' fears are not completely unfounded, and the share price got punished hard on the day despite already having halved since November last year. On Monday, buyers are moving in and the share price remains well-above its trough from June.

A positive signal for patient bargain hunters?

A similar observation can be made for Insurance Australia Group ((IAG)) whose shares are very much in demand on Monday, having sold off on Friday following yet another disappointing market update for which this insurer has accumulated a chequered track record.

There will always be investors who seek refuge in a share price that has fallen deeply enough, rather than owning shares in higher valued business models that are of a lesser risk of disappointing in August. It is but one reason as to why a season that will bring out the best and the worst out of ASX-listed companies, is poised to offer different opportunities to different types of investors.

Taking a general macro-view, **earnings forecasts are now falling across the globe**, but they have as yet not gone into negative territory. The implication here is that corporate profits might prove more resilient than those forecasting -20% decline are giving them credit for.

This is the optimistic view of **global strategists at Citi** who, despite preparing for economic recession, believe earnings forecasts most likely will surprise in a positive manner, which would also translate into less downside for equities in general.

Citi's optimism is consistent with in-house top-down modeling, which suggest 0-5% global EPS growth is possible for both 2022 and 2023.

Others are not as optimistic, with **Macquarie**, for instance, declaring equities in Australia or the USA look "cheap" when measured against historical PE multiples, but not when, as Macquarie strategists assume, corporate earnings might fall by up to -20% by this time next year.

Applying this rough assumption to current US forecasts, and multiplying by a recession-appropriate 16x multiple average, suggests to Macquarie the S&P500 might have to visit the 3300 level before resuming the next uptrend.

Others, like the **strategy team at JP Morgan**, believe that falling forecasts in 2022 are building the next platform from which equities can rally higher again, because lower forecasts are easier to beat and history shows equities trough well before the last earnings forecast cut has been put in place.

JP Morgan, too, believes weakness in corporate earnings should remain limited this year as nominal GDP in the USA, and elsewhere, remains positive.

On my personal observation, analysts in Australia have started reducing their profit projections, but more so for FY23 than for the current running year. This makes a lot of sense, also given most fiscal years end on June 30th in Australia. But what this also implies is that **FY22 financial results are not the real story this August**.

Share prices might still rally or sink following the release of FY22 financials, the further-out trajectory will likely be more closely linked to the changes in consensus forecasts in response to the release.

It might complicate matters just a tad more than usual this year (as a great FY22 result might still not prevent forecasts to be cut, and vice versa).

One final positive observation: the local share market's average dividend yield has climbed back to 5% on the back of lower share prices. I suspect many a local retiree will be very pleased about that.

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Regarding gold: I explained this year's conundrum for gold at last month's Australian Gold Conference. Here's the video (30 minutes):

https://www.youtube.com/watch?v=J7IzgE5eQ0k&t=4s

Conviction Calls

Ord Minnett has used mid-year to nominate **Top Picks** and **Least Preferred** exposures.

For the local energy sector, the broker has nominated Woodside Energy ((WDS)) -Top Pick- and Worley ((WOR)).

For local consumer-oriented companies the nominations are Endeavour Group ((EDV)) -Top Pick- and Wesfarmers ((WES)).

In the healthcare sector, Top Pick is ResMed ((RMD)) while Integral Diagnostics ((IDX)) is considered a No-Go.

Among miners, the favouritism resides with South32 ((S32)) while Sandfire Resources ((SFR)) sits at the opposite end of the broker's sector ranking.

In the local REITs sector, Mirvac Group ((MGR)) is seen as the best buy, while GPT Group ((GPT)) is handed the wooden spoon.

Among diversified financials, Ord Minnett's favourite is AUB Group ((AUB)) while Least Preferred is Challenger ((CGF)).

The preference for AUB Group over Steadfast Group ((SDF)) seems to be related to the latter's recent outperformance and subsequently higher valuation.

(Most of the work done behind the scenes is by JP Morgan, with Ord Minnett white-labeling the research).

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Analysts at **Morgan Stanley** have started to communicate their highest confidence winners and (potential) losers from the upcoming August reporting season.

They find themselves in a bind when looking at Adore Beauty Group ((ABY)), strongly arguing the online beauty platform operator has a long-term promising future ahead, but shorter-term there could be disappointment lurking.

Headwinds are also there because twelve months ago this was one of the covid-beneficiaries, and that makes comparison this time around a tough hurdle to overcome.

Increased competition, margin pressure, tough comparisons with last year... enough to make Morgan Stanley nervous ahead of the upcoming FY22 release, to be expected in late August.

On the other hand, the broker is optimistic about Data#3 ((DTL)) with company management releasing a positive update recently. Morgan Stanley sees continued strong operational momentum.

What's quite astonishing about the Data#3 nomination is the broker officially only commenced coverage of the company less than a week earlier.

The same positive conviction applies to TPG Telecom-spin off Tuas Ltd ((TUA)) which is Morgan Stanley's preferred telco on the ASX.

Morgan Stanley is cautious on Dicker Data ((DDR)), short-term, because of supply chain risks. Longer-term there is no such caution as also proven by the broker's Overweight rating.

The highest concern ahead of August has been reserved for InvoCare ((IVC)) with Morgan Stanley analysts isolating multiple threats and risks for the funeral services operator.

One of the observations made is the company is no longer communicating its market share with investors; this is one metric that has not gone the company's way in recent years. Poor weather is likely to have impacted as well.

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Market strategists at **Macquarie** are still of the view that profit resilience needs to be sought after in the face of next year's economic slow down, with the potential for a global recession.

If we had to pick just one Outperform stock from each sector that has our confidence in likely **earnings resilience** during a period of recession, stated the strategists on Monday, they'd nominate the following:

-Steadfast Group
-Goodman Group
-The Lottery Corp ((TLC))

-TPG Telecom ((TPG))
-NextDC ((NXT))
-CSL ((CSL))
-Coles Group ((COL))
-Transurban Group ((TCL))
-Amcor ((AMC))
-Newcrest Mining ((NCM))
-Origin Energy ((ORG))

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Recent strategy update by **Shaw and Partners**:

"Borrowers should refrain from locking in longer term loan interest rates at prevailing levels as it is likely that the RBA will not raise rates as far as the market is currently pricing.

"Competition amongst lending institutions will continue to put downward pressure on net-interest-margins with positive implications for borrowers, but negative implications for banks.

"House prices are likely to continue to fall as rates rise, credit growth will slow from the current 9.2% level and bank share prices will struggle to move ahead."

And also:

"We maintain a defensive stance in multi-asset portfolios and await the slowdown in global growth and tightening of financial conditions to ease before becoming neutral and then constructive on growth assets."

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Morgan Stanley recently lined up seven reasons to Buy Top Pick **Whitehaven Coal**, irrespective of the coal miner's stellar run this year (still ongoing).

1. June-quarter production performance was strong
2. Legal proceedings regarding Narrabri Stage 3 extension can be conducted without significant production disruptions
3. FY23 free cash flow yield on the basis of current spot prices is simply enormous; 82% on Morgan Stanley's modeling
4. FY23 dividend forecast is, on the same basis, enormous too; 21% says Morgan Stanley
5. High spot prices make the current valuation look extremely cheap; FY23 EV/EBITDA is 0.2x on spot
6. The company's net cash is forecast to rise to $3bn in FY23, allowing optionality for significant capital management
7. Morgan Stanley rates the stock Overweight and lifted its price target to $8.50 from $7.75 (shares are at circa $6.16)

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Stockbroker Morgans' Core Model Portfolio has trimmed its exposure to Macquarie Group ((MQG)), as that stock had grown to an "excessive weight" in the Portfolio. Morgans is also expecting a lesser-year for the Golden Doughnut, while still expecting Macquarie remains a great holding for the longer-term.

Post share price weakness for BHP Group the Portfolio has bought extra shares in the Big Australian.

Morgans' Growth Model Portfolio has also sold some shares in Macquarie, for exact the same reason, while selling out of Megaport ((MP1)). The latter decision was made with pain in the heart, judging from the commentary explaining the move.

Morgans sees equally compelling opportunity among growth companies on the ASX that offer less risk and are of higher Quality. Currently on the Watchlist are:

-Seek ((SEK))
-REA Group ((REA))
-Domino's Pizza ((DMP))

-IDP Education ((IEL))
-Reliance Worldwide ((RWC))
-PWR Holdings ((PWH))

Additional commentary: "Feedback from our institutional clients suggests that many are now willing to dip their toes into the highest quality and oversold growth names among the small-mid caps."

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Strategy update by **Wilsons**:

"It may be the case that the market settles into a groove where the outperformance of the growth or value style is less marked than it has been in recent years.

"This has been the case in previous periods in history, implying that stock selection could trump investment style.

"To the extent that growth can regain its footing, quality growth is likely to be the way to go. We think it makes sense to invest in quality-focused portfolios that can weather a slower business cycle and cope with cost pressures.

"We retain exposure to all 3 investment styles -growth, value and quality – although our current style preference is quality."

FNArena Talks

My latest interview with Peter Switzer:

https://www.youtube.com/watch?v=Zd64jzYG3Us&t=1629s

(This story was written on Monday 25th July, 2022. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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

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

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SMALL CAPS

Dr Boreham's Crucible: Orthocell

DR BOREHAM'S CRUCIBLE: ORTHOCELL

Market cap: $74.9m

Shares on issue: 197,127,913

Chief executive officer: Paul Anderson

Board: Dr Stewart Washer (chair), Mr Anderson, Matthew Callahan, Prof Lars Lidgren, Qi Xiao Zhou, Leslie Wise

Finances (March quarter 2022): receipts $313,000, operating cash outflows $2.35m, cash of $11.25m*, quarters of available funding five.

***This excludes the $23m of proceeds from the dental deal and a $2.14m research and development tax refund received in early June 2022**

Notable shareholders: Ming Hao Zheng (founder and chief scientific officer) 4%, Paul Anderson/Nicole Telford 3.3%, Qixiao Zhou 3.1%, Jia Xun Xu 2.7%

By Tim Boreham

Given the current unsympathetic market conditions, any biotech that tries to raise equity will suffer the equivalent of being stabbed in the eye with a syringe.

Other non-dilutive funding sources are vital, which explains the outbreak of investor joy at Orthocell's ((OCC)) deal in late June to sell the rights to its dental regenerative tool for $23.1m.

And just to be clear, that's in upfront cash.

Orthocell shares vaulted as much as 50% on the deal, which involves licensing its Striate+ device to Fortune 500 company Biohorizon Implant Systems, an arm of top 500 company Henry Schein and the fourth biggest dental provider.

But it's not just about the money.

Orthocell chief Paul Anderson says the deal validates the bona fides of the Perth-based companies wider suite of Celgro collagen based regenerative devices for skins, nerves, tendons and toes.

"We don't see ourselves as a dental company but we know we had some very effective products used in the dental field," Mr Anderson says.

"We never intended to build an infrastructure for our dental business, it was always a partner-driven strategy."

The proceeds of the deal will be used for Orthocell's nerve repair program.

Speaking of which, earlier in June, Orthocell shares also bounced on positive data from the final readout of its nerve regeneration trial (see below).

About Orthocell

Orthocell was founded in 2016 by Mr Anderson and chief scientific officer Prof Ming Hao Zheng, former chief executive of cell therapist Verigen.

The company listed on the ASX in August 2014, having raised $8m at 40 cents a share.

Paul Anderson has been working on regenerative therapies since 2000 with Prof Zheng, of the University of WA's Professor Minghao Zheng.

At the core of Orthocell's is a biological collage membrane 'platform' device, Celgro. Celgro is the basis of Striate + and the nerve product called Remplir.

Initially Celgro was pitched at the surgical repair of bone and soft tissue, but after a recent trial involving quadriplegics the company has widened its horizons to nerve repair.

The collagen originally was derived from pigs but it's not an oink-ment.

In January last year, the US Food and Drug Administration (FDA) approved Celgro as a 510(k) device for dental bone and tissue regeneration procedures.

In March 2022 Orthocell won local Therapeutic Goods Administration (TGA) approval to use Remplir for peripheral nerve damage repair procedures.

To date, 300 patients have been treated with Celgro under the regulator's special access scheme, for nerve, tendon, cartilage and dental maxillo-facial procedures (teeth, jaw, bones and the face).

The company also has US, European and local approval to use Celgro in dental implant procedures. The European assent covers dental (bone) and facial (soft tissue) applications.

Dental deal delivers

Orthocell has granted the Birmingham, Alabama based Biohorizon an exclusive 25 year licensing and distribution deal for its Striate+ resorbable collage membrane, used for dental bone and regeneration procedures.

Mr Anderson notes that 40% of implants require a bone graft because the bone doesn't have enough oomph to support the implant.

The membrane is put on top of the bone graft to encourage the bone to grow more quickly.

Mr Anderson says the deal took nine months to negotiate. Because of Covid, the parties only met face to face three days before the paperwork was signed.

But he says the deal was a culmination of two and a half years of building awareness among the clinicians who count.

The cold hard cash aside, Mr Anderson is chuffed that the deal included Orthocell having the right to manufacture the devices. The company is in the process of scaling up its 1000 square metre Perth facility to increase volume from 10,000 units a year to up to 100,000.

The company will add ten staff to its current roster of 32 employees.

Apart from receiving a manufacturing margin, Orthocell also enjoys the scale benefits from the cost of goods sold being reduced across all of it products.

Oh, the nerve …

The Celgro procedure supersedes the old and primitive suture (needle and thread) method, which risks further damaging – rather than repairing – the delicate nerve tissue.

The “customized conduit” protects the nerves from outside influences such as tissue that can cause scarring and also contains healing growth factors within the nerve site.

Other scaffold-type products act as conduits for the re-joined nerves to grow. But because they are hard rigid tubes, the surgeons cannot go around ‘corners’ and it is difficult to feed the nerves into the pipes.

In early June this year Orthocell reported “encouraging results” from the final data readout of its nerve reconstruction trial, under the watchful eye of Dr Alex O’Bierne from Subiaco’s Western Orthopaedic Centre (in Perth).

The result showed early recovery of muscle function to paralysed upper limbs, with continued improvement over 12 and 24 months.

Patients had suffered traumatic nerve injuries following motor vehicle, sporting or work-related incidents, resulting in partial or total loss of use of their arms and, in more severe cases, their legs and torso as well (quadriplegia).

Last month’s 24-month readout showed 85% of the nerve reconstruction procedures - 23 out of 27 – resulted in functional recovery of target muscles closest to the reconstruction site.

Even more encouraging, eleven of twelve of the quadriplegic cohort (92%) showed improved function.

This was an improvement on the (also positive) 12 month data, which showed similar functional recovery in 76% of reconstructions (25 out of 33).

With local TGA approval in the bag, the company is working on a US trial to win FDA approval. The size and design of the US nerve trial is yet to be decided, but it would likely enrol about 50 patients.

<u>Also in the toolkit</u>

Orthocell already has two cell-based, regenerative products, Ortho-ATI (autologous tenocyte implantation) and Ortho-ACI (autologous chondrocyte implantation).

(Autologous means healthy cells are taken from the patient’s own body, cultivated and reinserted into the affected area).

Ortho-ACI is approved for use in Australia, New Zealand, Singapore and Hong Kong under good manufacturing practice protocols. More than 500 patients have been treated to date.

Ortho-ATI is used for tendon injuries such as rotator cuff injuries and tennis elbow, while Ortho-ACI is deployed for cartilage restoration in dodgy knees and ankles. But as it’s more of a drug than a device, it’s harder to get to market.

While the company continues to sell Ortho-ACI, its focus is on Ortho-ATI. The latter is yet to approved, but is available here under a special access scheme.

Locally, the company has completed recruitment for a study comparing Ortho-ATI with elbow surgery.

“The next big piece for Ortho-ATI is Australian approval, which we expect in the next 18 months,” Mr Anderson says. “At the same time, we are working on a business plan for Ortho-ATI in the US.”

He estimates an addressable market of 700,000 rotator cuffs in the US. “Ortho-ATI might be harder to get to get to market, but the need is huge and the product works.”

<u>Finances and performance</u>

Orthocell clocked up $300,000 of receipts in the March quarter, from its suite of nerve bone and tendon products.

Revenue for the full year to June 30 2022 should come in at $1.5m compared with $1m.

Mr Anderson says the company has focused on “good” revenue from reputed clinicians who can advocate for the company. “We made a deliberate decision to sacrifice a little revenue to making sure we got the right people.”

Mr Anderson believes Orthocell’s cash of circa $30m is enough to fund the US nerve trial. The company last raised funds in late 2019: $14.4m at 50 cents apiece.

Locally, Orthocell has applied to the Australian Prosthesis List Assessment Committee for reimbursement for Remplir, under a code which would pay $1380 per unit.

Hopefully this won't cost patients an arm and a leg, either.

"We should hear about this in November," Mr Anderson says. "We're as optimistic as we can be, we stand an excellent chance."

Mr Anderson notes the existence of several federal and state collaborative grants to enable automation, which would be "tailor made" for Orthocell.

Immediately after the dental deal, Orthocell shares closed up nine cents to 39 cents, a 30% jump. They also jumped 7% on the back of the nerve trial results.

Orthocell shares plumbed a record low of 20 cents in March 2020, having peaked at 80 cents in August 2015.

Dr Boreham's diagnosis:

Putting a human slant on it, Orthocell cites the experience of Damien Hall, a nerve trial participant who seriously injured his hand in a skateboarding mishap.

Mr Hall has now returned to his favourite pursuit of rock climbing and the company has the pics to prove it.

Of course, Orthocell is not exactly an orphan in the regeneration game.

The closes comparison is to ASX-listed Perth counterpart Osteopore ((OSX)), which is using three-dimensional printing technology to produce bioresorbable implants for bone replacement.

Orthocell's preferred exemplar is Polynovo ((PNV)), given the latter also uses lattice-type device for procedures such as wound repair and hernias.

These days Polynovo's worth a hefty $2bn, but at a similar point of development to Orthocell it was valued at Orthocell's current $100m.

While the older Ortho-ACI and Ortho-ACI have clear market positions, Celgro is the company's "genuine platform technology".

Just over a year ago Mr Anderson said Celgro would be the "game changer and the company maker".

That sounds about right, given nerve repair is a "massive indication" worth $US7.5bn a year, with two million nerve repair procedures done annually.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. But he has a full set of teeth and his rotator cuffs are fine, so thanks for asking.

This article first appeared in Biotech Daily. It has been re-published with permission.

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SMALL CAPS

Nitro Software Disappoints, Better Times Ahead?

Brokers set lower price targets for Nitro Software on lower growth expectations after a trading update surprised negatively.

-Nitro Software lowers FY22 annual recurring revenue guidance
-Management aims for a lower loss by reducing costs
-Brokers set lower 12-month price targets
-Positive cash flow expected in 12-18 months
-Goldman Sachs points to a reduced capital raising risk

By Mark Woodruff

Brokers have set lower 12-month price targets for Nitro Software ((NTO)) following a disappointing trading update by the global document productivity software company.

Morgan Stanley downgraded its rating to Equal-weight from Overweight on the assumption of lower growth into FY23 and FY24. The broker points to ongoing underperformance by the company versus consensus expectations and reduces its target price to $1.30 from $2.00.

While Shaw and Partners also lowered its rating to Hold from Buy, given the potential for a recovery to take longer, Shaw still sees value over the longer term.

Over that longer term, the company stands to benefit from the secular growth of e-signature adoption as well as broader digital transformation spending, particularly in a world of hybrid work.

Wilsons reminds investors that appeasing both growth and cost "gods" can be difficult. Last November, at the time of the Connective acquisition, the company's valuation reflected potential to grow revenues strongly with the aim of reaching scale.

The plan now, as outlined in the trading update, is to prioritise cost reduction ahead of growth, which resulted in a -23% fall in share price following the update. The Overweight-rated Wilsons decreases its target price to $1.93 from $2.60.

Management lowered FY22 annual recurring revenue (ARR) guidance to US$57-60m from US$64-68m. This was based upon a combination of sales & marketing headcount reductions, challenges for e-signature cross-sell, and deal slippage due to macroeconomic conditions.

ARR synergies from the Connective acquisition were also reduced to US$1.0m from US$2.5m due to lengthened sales cycles, while revenue guidance was unchanged.

The company intends to reduce costs to achieve FY22 guidance for a reduced earnings (EBITDA) loss of -US$10-US$13m, down from -US$15-US$18m. A US$5m cost-out program for the second half aims to simplify the business and drive the company to cash flow breakeven in the second half of FY23.

Goldman Sachs displays a more understanding attitude and retains its Buy rating. It's felt the update will rebase market expectations on the company's growth outlook (lower), given the pull-back in sales & marketing spending, and highlight the path to breakeven (sooner). It's even felt the new outlook further reduces the requirement for additional funding.

However, the broker acknowledges several quarters of strong ARR performance are necessary to allay concerns over execution challenges.

Overall, Bell Potter assesses the trading update was disappointing and a slowdown in hiring reduces the medium-term growth outlook. More positively, the business model is thought to remain sound and there is a clear path to positive cash flow in 12-18 months' time.

When this pathway is combined with a strong cash position, the overall outlook is still considered reasonable, and the broker retains its Buy rating.

UBS appears the most positive and sets the highest target price ($2.30, down from $2.50) from among brokers covered in this article. It's believed near-term macroeconomic challenges are already reflected in the share price and thus the Buy rating is retained.

The outlook

Management of Nitro Software noted sales enablement for e-sign cross-sell has proven more complex than anticipated, which has impacted both PDF and e-sign sales. This marks the third consecutive quarter of sales execution issues, points out Goldman Sachs, though the company has made changes including sales organisation simplification which should assist improved performance.

The company emphasised the pipeline remains strong and should convert in coming quarters, which echoes recent commentary from other enterprise software companies, according to the analysts.

Goldman Sachs notes the company trades at a wide discount to SaaS peers relative to its growth potential and believes investor sentiment is at a low point following the broader technology sell-off and disappointing second quarter trading update.

Potential positive catalysts such as ARR growth momentum, improvement on sales execution and e-signature cross-sell could re-focus market attention on Nitro's long-term potential, believes the broker.

On the other hand, Morgan Stanley feels the trading update is a material step-down in FY23 ARR growth, a key value driver, and forces a re-examination of the sustainable long-term growth profile.

While UBS feels the decision to lower ARR investment in favour of faster cash flow breakeven is prudent amid a weaker macroeconomic backdrop, further clarification is needed on any potential constraints to a growth recovery as the operating environment improves.

The FNArena database has two broker ratings with one Buy and one Hold (or equivalent) rating, and an average target price of $1.80, which suggests 52.50% upside to the latest share price.

Outside the database, which in this case is made up of UBS and Morgan Stanley, all of Goldman Sachs, Bell Potter and Wilsons have Buy (or equivalent) ratings, while Shaw and Partners is on Hold. The average target price set by these four brokers is $1.95.

TREASURE CHEST

Treasure Chest: The Outlook For Cochlear

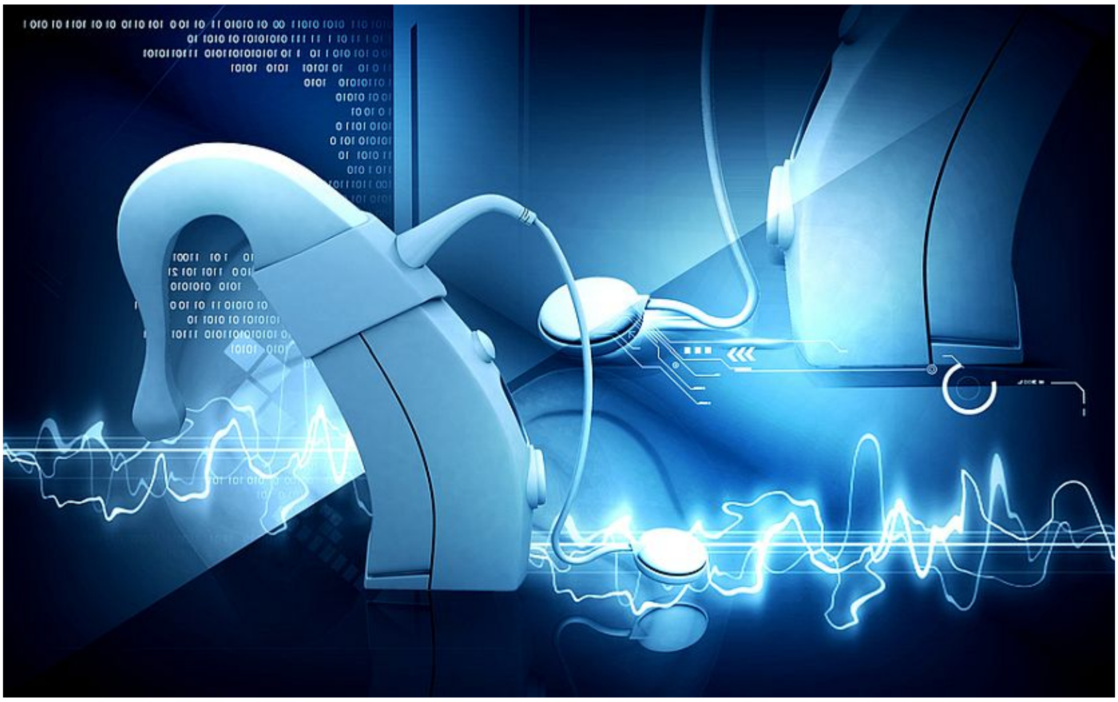
FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Today's idea regards Cochlear.

Whose Idea Is It?

Jarden

The subject:

The outlook for Cochlear ((COH)).



The drum:

This month **Jarden** initiated a global survey of 54 cochlear implant (CI) specialists from a across the globe, including the US, Europe and India. The broker's key findings highlight improving momentum for CI patient volumes, especially in key markets such as the US, and Cochlear's ongoing product dominance.

Cochlear has rebounded from omicron, Jarden notes, and has the ability to leverage its dominant market position across the recent expansion of its total addressable market.

This stems from the company's CI label expansion for single-sided deafness, and a proposal from the US Centre for Medicare & Medicaid Services to expand the eligibility criteria for CIs.

Jarden believes this should stand Cochlear in good stead for number of years. Add to this the imminent launch of the Nuclear 8 processor, which the broker expects in the second half of 2023, and Jarden retains an Outperform rating on the stock.

Jarden has nevertheless cut its target to $224.74 from $250.36 to account for a higher risk-free rate in valuation.

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Macquarie also conducted a survey, in June, of twelve US audiologists specialising in CIs.

While this broker also noted market share gains for Cochlear over the past six to twelve months, it feels a recovery in market share for competitor Advanced Bionics is likely.

Macquarie's survey also signalled new patient numbers are still below pre-pandemic levels.

The broker agreed the new processor from Cochlear may provide support, amid expectations this will occur over the next six to twelve months. Macquarie retained a Neutral rating and cut its target to $197 from $215.

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Looking more generally at the Australian healthcare sector earlier this month, Morgan Stanley noted that while healthcare PE multiples had been contracting, they remain above levels seen in 2013 when the Australian ten-year bond rate was last above 4%.

Note that the ten-year had reached above 4% at the time, but has since fallen back to around 3.3% on global recession fears.

Morgan Stanley favours those stocks for which the growth outlook is now better than in 2013, or earnings certainty is high. The broker cut its target for Cochlear to $194 from $208 but retained an Equal-weight rating on the growth outlook.

Six FNArena database brokers (of which Jarden is not one) cover Cochlear. Currently they share three Buy (or equivalent) ratings and three Hold. The consensus target is $241.42, suggesting 4% upside from the current trading price.

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 22-07-22

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

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday July 18 to Friday July 22, 2022
Total Upgrades: 9
Total Downgrades: 7
Net Ratings Breakdown: Buy 59.53%; Hold 33.57%; Sell 6.90%

For the week ending Friday July 22 there were nine upgrades and seven downgrades to ASX-listed companies covered by brokers in the FNArena database.

A technical glitch was responsible for Zip Co appearing atop the table for the largest percentage increase in average target price set by brokers last week. That position belonged to Whitehaven Coal following unaudited FY22 earnings that were a 16% beat versus the consensus forecast.

Morgans noted far higher than expected pricing offset volume and cost headwinds, and referred to "staggering" cash accumulation, with $1.4bn generated in the June quarter. The broker raised its target price to $6.70 from $5.25.

Citi raised its thermal coal price estimates for FY22 and FY23 by 60% and 100%, respectively, to US$350/t and US$210/t, and FY22 and FY23 earnings forecasts for Whitehaven Coal by 50% and 350%, respectively. As a result, the broker upgraded its rating to Buy from Neutral and increased its target to $7.85 from $4.90.

On the flipside, Charter Hall Group had the largest percentage fall in average target price after both Citi and Macquarie undertook REIT sector reviews last week.

Citi lowered its target to $12.60 from $24.80, and its rating to Neutral from Buy. Rising interest rates are expected to result in higher debt costs across all of Charter Hall Group's funds, and increased acquisition costs could reduce the number of potential acquisitions.

While Outperform-rated Macquarie also lowered its target to $15.33 from $16.33, it was more upbeat than Citi. It's thought the addition of a fund manager like Charter Hall would supplement more defensive REIT holdings, should bond yields show signs of stabilising.

Auckland International Airport received the largest percentage fall in forecast earnings last week, after Morgan Stanley lowered its FY22-24 EPS estimates to reflect June 2022 traffic data, and cost pressures resulting from inflation and disrupted supply chains.

The broker predicted an international passenger recovery to 60% of 2019 levels by the end of 2022, and the resumption of a dividend in the second half of FY23.

Last week Citi downgraded its metals deck to account for weaker demand, and sharply downgraded its earnings forecasts for 29Metals, expecting cash burn to emerge in the second half. At the same time, the company's June-quarter production report outpaced the broker's forecasts and management retained 2022 guidance.

Underperform-rated Credit Suisse also lowered FY22 earnings forecasts for 29Metals on weaker June and September quarter revenues.

As part of its general review of REITs prior to the reporting season, Macquarie lowered earnings forecasts for Outperform-rated HealthCo Healthcare & Wellness REIT. Increased market scrutiny over capital management was noted, given the dividend is unlikely to be covered until FY25.

Earnings forecasts for Alumina Ltd were also revised lower by brokers following June quarter results for the AWAC joint venture with Alcoa. Morgan Stanley revised its estimate for Alumina Ltd's 40% share of AWAC's first half dividend to US$4.1cps compared to the US$5.7cps previously expected.

Incorporating the AWAC result and lower forecasts for the San Ciprian refinery triggered a -16% cut to Macquarie's earnings forecasts. Credit Suisse noted the refinery accounts for around 12% of AWAC production, and according to Alcoa is losing circa -US$75m per quarter at current gas and power prices in Spain. Gas prices have increased five-fold from 2021 levels.

Best to substitute Iluka Resources for Tabcorp at the head of the table below for positive earnings changes, as broker forecasts for Tabcorp continue to be distorted by the demerger of it's Lotteries and Keno business.

Iluka's June quarter production of both zircon and synthetic rutile came in above consensus forecasts, according to Credit Suisse, and a sell-off in inventories for zircon, rutile and synthetic rutile resulted in a 20% beat for sales versus consensus.

Outperform-rated Macquarie noted the company is set to benefit from rising zircon, rutile and rare earth prices in the short and medium term, while Buy-rated Citi pointed to strong US demand due to supply chain constraints on paints, coating and plastics, and raised 2022 earnings forecasts by 38%

Reasons are advanced above for target price changes for Whitehaven Coal and Charter Hall Group. While both also appeared on the list for a material uplift in earnings forecasts by brokers, Charter Hall's position should be disregarded due to technical issues.

Ampol also received higher earnings forecasts from brokers. Macquarie returned from a period of research restriction on the company with an Outperform rating, noting the Z Energy acquisition is more than 20% accretive and should accelerate debt reduction.

Second quarter refining margins confirmed Buy-rated UBS's suspicions that the Lytton refinery will continue to benefit from strong margins, given 97% of its fuel is transport related. Meanwhile, Morgan Stanley noted recent share price weakness and sniffed a buying opportunity.

Total Buy recommendations take up 59.53% of the total, versus 33.57% on Neutral/Hold, while Sell ratings account for the remaining 6.90%.

Upgrade

AGL ENERGY LIMITED ((AGL)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 3/2/0

Ord Minnett has used a general sector update to upgrade AGL Energy's rating to Buy from Hold. The broker's price target has lifted to $10.60 from $9.15.

ANSELL LIMITED ((ANN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/1/1

Macquarie notes Ansell's near term earnings continue to be impacted by the unwinding of covid demand from FY20/21.

But the broker sees this factor as discounted in forecasts and consensus earnings for the company.

Macquarie downgrades earnings by -8% and -9% for FY22 & FY23, respectively, reflecting revised assumptions for operations and FX forecasts.

Ansell is trading at 12.7x 12-month forward consensus forecast earnings, a -29% discount to the ASX200 industrials, with a strong balance sheet, leverage to a lower AUD and defensive healthcare earnings, notes the broker.

The price target raises to $27.85 from $27.65 and the rating is upgraded to Outperform from Neutral.

COOPER ENERGY LIMITED ((COE)) Upgrade to Buy from Accumulate by Ord Minnett and Upgrade to

Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/3/0

Ord Minnett has used a general sector update to upgrade its rating for Cooper Energy to Buy from Accumulate with a fresh price target of 34c, up from 33c previously.

As Cooper Energy's share price continues to underperform, Morgan Stanley's rating is lifted to Equal-weight from Underweight. It's felt the Orbost Gas Processing Plant transaction last month puts the company in control of its own destiny.

Morgan Stanley feels Sole is showing signs of improvement after a disappointing couple of years. In a 4Q update, the company reported higher annual production, sales volume and revenue for FY22.

The analyst estimates the removal of the Orbost Gas Processing Plant tariff will save the company around $50m per year, partly offset by a -$25m increase in opex related to the plant.

The target price rises to $0.25 from $0.23. Industry view: Attractive.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/4/0

Evolution Mining's June quarter numbers proved broadly in-line with Ord Minnett pointing out management at the gold producer had already lowered expectations in late June, so no flowers this time around (we made up the latter).

Now that expectations have been re-based, and so has the share price, Ord Minnett sees an opportunity to jump on board of a lower cost producer with a quality management team at an attractive price.

Hence, the rating has been upgraded to Accumulate from Hold. Target price has lost another -10c to $2.90.

JB HI-FI LIMITED ((JBH)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/2/1

Citi assesses a strong 4Q trading update by JB Hi-Fi with 2H earnings (EBIT) a 29% beat versus the broker's forecast. The rating is upgraded to Buy from Neutral.

Margins expanded in the 2H for JB Hi-Fi Australia and The Good Guys on better gross margins and operating leverage, explains the analyst.

As previously tipped by the broker, households remain well placed to weather increasing cost-of-living headwinds in FY23. While the FY23 earnings forecast is increased by 9.6%, the target falls to $47 from $52 on a de-rating of multiples for the market and peers.

RIO TINTO LIMITED ((RIO)) Upgrade to Add from Hold by Morgans .B/H/S: 5/2/0

Morgans upgrades its rating for Rio Tinto to Add from Hold after recent share price weakness. By late 2022 and heading into 2023, a better outlook for metals is expected as Chinese growth starts to recover.

The broker makes minor changes to assumptions following last week's 2Q result and the target price falls to $113 from $114.

SIMS LIMITED ((SGM)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/3/0

Citi cuts FY22 earnings forecasts for Sims -1% and FY23 forecasts -6% to account for lower Turkish scrap price assumptions.

The broker notes scrap prices have fallen -38% since March and Turkish scrap now looks oversold.

Add to that the recent -35% share-price retreat and Citi spies value, not to mention the strong net cash position and balance sheet.

Rating upgraded to Buy from Neutral. Target price slips to $17 from $20.40 to reflect the broader market de-rating.

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

Whitehaven Coal's June quarter & FY22 coal production proved in-line with guidance, observes Citi.

The broker highlights the link between rising thermal coal prices and the switch by European countries to bring back more coal plants due to the Russian gas restrictions and gas supply outages (Freemont).

Citi expects the global seaborne coal market to remain tight with an EU ban on Russian coal expected in mid-August.

Accordingly, the broker has upgraded thermal coal estimates for FY22/23 by 60/100%, respectively to US$350/$210t and earnings forecasts by 50% and 350%, for FY22/FY23, respectively.

If the coal price forecasts are correct, Citi believes there is more upside scope for the shares on valuations of circa 0.6x DCF, despite the 100% increase in the last 6 months.

Target price rises to $7.85 from $4.90. Rating is upgraded to Buy from Neutral.

Downgrade

ATLAS ARTERIA ((ALX)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/3/0

Morgan Stanley lifts its target price for Atlas Arteria to $8.08 from $6.88 to incorporate the growth outlook and potential corporate activity. IFM Global Infrastructure Fund obtained a 15% shareholding in the company at $8.10/share in early June.

The broker also lowers its rating to Equal-weight from Overweight on valuation. Industry view: Cautious.

APPR 2Q traffic and revenue were lower than expected and the analyst now has less hope for a French traffic recovery for the rest of the year, due to weather, petrol prices and economic uncertainty.

BEACH ENERGY LIMITED ((BPT)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 5/1/1

For Ord Minnett's early response, see yesterday's Report. Today, upon further reflection, the broker has downgraded Beach Energy to Accumulate from Buy - we can blame the share price performance for that.

Ord Minnett believes the company released a "reasonable quarterly activities report" which hereby gets rewarded with minor upgrades to forecasts.

In response, the price target has climbed to $2 from $1.95.

CHARTER HALL GROUP ((CHC)) Downgrade to Neutral from Buy by Citi .B/H/S: 4/2/0

Citi reviews the Australian Real Estate sector and forecasts a -6% to -10% fall in asset values by 2024 in response to rising bond yields but expects a hard landing will be avoided.

Add to that the near-term and medium-term earnings hit from higher rates, Citi favours asset classes with better demand supply dynamics such as industrial, or short-term leases such as Storage.

Income favourably exposed to high inflation such as convenience and certain weighted asset lease expiries are also preferred.

Citi expects rising interest rates will hit Charter Hall hard, resulting in higher debt costs across all funds, as well as increase acquisition costs, potentially reducing the number of forecast acquisitions.

While valuation is starting to appeal, the broker spies no upside catalysts.

Rating downgraded to Neutral from Buy. Target price slumps to $12.60 from $24.50.

CHARTER HALL LONG WALE REIT ((CLW)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/0

Citi reviews the Australian Real Estate sector and forecasts a -6% to -10% fall in asset values by 2024 in response to rising bond yields but expects a hard landing will be avoided.

Add to that the near-term and medium-term earnings hit from higher rates, Citi favours asset classes with better demand supply dynamics such as industrial, or short-term leases such as Storage.

Income favourably exposed to high inflation such as convenience and certain weighted asset lease expiries are also preferred.

Citi expects Charter Hall Long WALE REIT's low hedging and high gearing will result in a hit to near-term and medium-term earnings.

While 46% of the REIT's income is linked to the CPI, Citi expects the REIT's long weighted average lease expiries on the other 54% will work against it in a rising rate environment.

Rating downgraded to Neutral from Buy and Citi issues a downside catalyst watch, expecting FY23 guidance will miss consensus.

Target price falls to $4.70 from $5.71.

SUNCORP GROUP LIMITED ((SUN)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 4/1/1

Ord Minnett is not overly enthusiastic about the move to sell the banking operations to ANZ Bank ((ANZ)); and that's putting it mildly.

The broker highlights the lack of large takeover premium, significant transaction costs, uncertainty on regulatory approval, on top of a number of dis-synergies.

In addition, and separate to the deal, Ord Minnett harbours concerns around reinsurance and perils costs in FY23 delaying a return to 10–12% margins for the insurance business.

Downgrade to Hold from Buy. Target price drops to $13.25 from $14.

TABCORP HOLDINGS LIMITED ((TAH)) Neutral by UBS .B/H/S: 2/4/0

Following a period of restriction on Tabcorp Holdings research, UBS reinstates coverage with a Neutral rating and $1.00 target price, down from $4.70 following the demerger of the Lotteries and Keno business. Despite a lack of growth options, it's felt there's little downside risk.

For the remaining Wagering business, the analyst feels the company will need to improve its product and value perception to stabilise market share.

While structural reform of key licences will be the most significant value driver, the broker cautions that such reform is uncertain and the timing difficult to forecast.

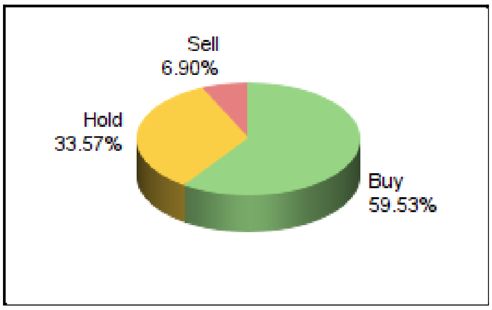
WISETECH GLOBAL LIMITED ((WTC)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 2/1/1

WiseTech Global has upgraded earnings margin guidance to above consensus expectations for the fourth consecutive period. But having seen earnings margins expand from 30% in FY20 to 50% in FY22, Macquarie sees limited upside from further large expansion.

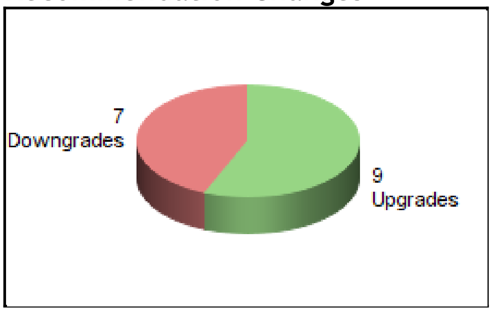
The operational outlook remains positive, Macquarie suggests, but the catalysts to drive further outperformance are either becoming less material or have unclear timing. Going forward, slowing revenue growth coupled with weaker margin expansion may cause further downward pressure on valuation.

Downgrade to Underperform from Neutral. Target falls to $42 from $44 on a higher risk-free rate.

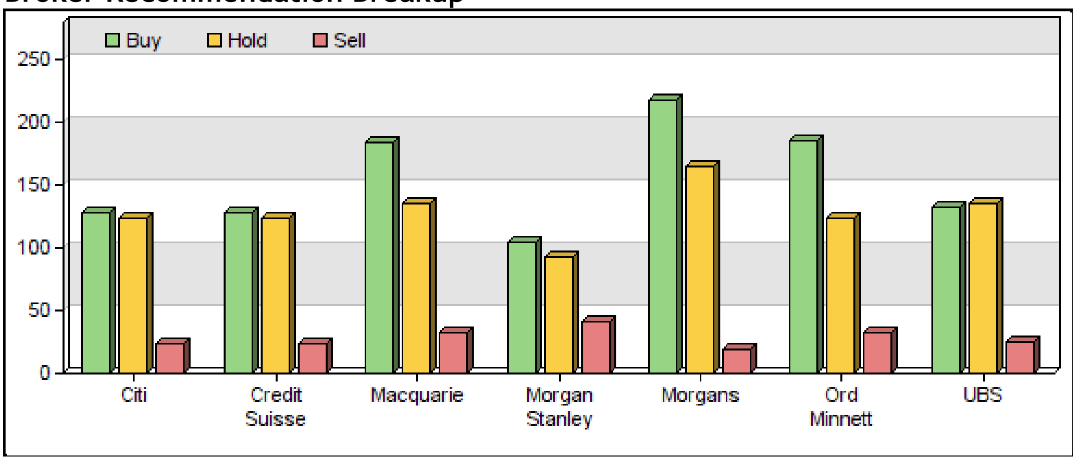
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				

1	AGL ENERGY LIMITED	Buy	Neutral	Ord Minnett
2	ANSELL LIMITED	Buy	Neutral	Macquarie
3	COOPER ENERGY LIMITED	Buy	Buy	Ord Minnett
4	COOPER ENERGY LIMITED	Neutral	Sell	Morgan Stanley
5	EVOLUTION MINING LIMITED	Buy	Neutral	Ord Minnett
6	JB HI-FI LIMITED	Buy	Neutral	Citi
7	RIO TINTO LIMITED	Buy	Neutral	Morgans
8	SIMS LIMITED	Buy	Neutral	Citi
9	WHITEHAVEN COAL LIMITED	Buy	Neutral	Citi
Downgrade				
10	ATLAS ARTERIA	Neutral	Buy	Morgan Stanley
11	BEACH ENERGY LIMITED	Buy	Buy	Ord Minnett
12	CHARTER HALL GROUP	Neutral	Buy	Citi
13	CHARTER HALL LONG WALE REIT	Neutral	Buy	Citi
14	SUNCORP GROUP LIMITED	Neutral	Buy	Ord Minnett
15	TABCORP HOLDINGS LIMITED	Neutral	N/A	UBS
16	WISETECH GLOBAL LIMITED	Sell	Neutral	Macquarie

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	ZIP	ZIP CO LIMITED	0.852	0.450	89.33%	5
2	WHC	WHITEHAVEN COAL LIMITED	7.450	6.365	17.05%	6
3	CPU	COMPUTERSHARE LIMITED	28.561	26.976	5.88%	7
4	ALX	ATLAS ARTERIA	8.283	7.920	4.58%	4
5	BPT	BEACH ENERGY LIMITED	1.979	1.893	4.54%	7
6	AGL	AGL ENERGY LIMITED	9.760	9.470	3.06%	5
7	HDN	HOMECO DAILY NEEDS REIT	1.516	1.485	2.09%	5
8	ALD	AMPOL LIMITED	37.818	37.135	1.84%	5
9	COE	COOPER ENERGY LIMITED	0.282	0.280	0.71%	5
10	ANN	ANSELL LIMITED	29.635	29.602	0.11%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	CHC	CHARTER HALL GROUP	14.665	16.815	-12.79%	6
2	IDX	INTEGRAL DIAGNOSTICS LIMITED	3.844	4.260	-9.77%	5
3	EVN	EVOLUTION MINING LIMITED	2.826	3.047	-7.25%	7
4	CLW	CHARTER HALL LONG WALE REIT	4.766	5.042	-5.47%	5
5	RIO	RIO TINTO LIMITED	111.357	115.500	-3.59%	7
6	HMC	HOME CONSORTIUM LIMITED	6.338	6.560	-3.38%	5
7	SGM	SIMS LIMITED	20.025	20.592	-2.75%	6
8	SUN	SUNCORP GROUP LIMITED	13.165	13.537	-2.75%	6
9	TAH	TABCORP HOLDINGS LIMITED	1.133	1.160	-2.33%	6
10	WTC	WISETECH GLOBAL LIMITED	47.213	48.338	-2.33%	4

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	TAH	TABCORP HOLDINGS LIMITED	6.665	4.798	38.91%	6
2	ILU	ILUKA RESOURCES LIMITED	132.500	99.150	33.64%	5
3	WHC	WHITEHAVEN COAL LIMITED	189.583	150.183	26.23%	6
4	ALD	AMPOL LIMITED	355.950	290.200	22.66%	5
5	CHC	CHARTER HALL GROUP	113.917	95.485	19.30%	6
6	JBH	JB HI-FI LIMITED	478.360	419.633	13.99%	6
7	ZIP	ZIP CO LIMITED	-44.240	-51.000	13.25%	5
8	WDS	WOODSIDE ENERGY GROUP LIMITED	489.269	446.645	9.54%	7
9	SQ2	BLOCK INC	160.330	146.419	9.50%	4
10	WTC	WISETECH GLOBAL LIMITED	54.800	51.133	7.17%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	AIA	AUCKLAND INTERNATIONAL AIRPORT LIMITED	-1.567	-0.398	-293.72%	4
2	29M	29METALS LIMITED	-3.125	7.575	-141.25%	4
3	HCW	HEALTHCO HEALTHCARE & WELLNESS REIT	5.150	6.900	-25.36%	3
4	AWC	ALUMINA LIMITED	11.326	14.157	-20.00%	5
5	RIO	RIO TINTO LIMITED	1522.432	1729.654	-11.98%	7
6	SUN	SUNCORP GROUP LIMITED	53.414	59.243	-9.84%	6
7	STO	SANTOS LIMITED	115.934	127.830	-9.31%	7
8	EVN	EVOLUTION MINING LIMITED	14.776	16.214	-8.87%	7
9	IAG	INSURANCE AUSTRALIA GROUP LIMITED	12.300	13.386	-8.11%	7
10	PDL	PENDAL GROUP LIMITED	48.133	51.820	-7.12%	5

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: Production On The Move

In a quiet week in uranium markets, news of Paladin Energy's production restart provided a highlight.

-No spot transactions
-Producers tendering for supply to US government
-Paladin Energy to restart Langer Heinrich

By Greg Peel

As is typically the case, the uranium market goes quiet when one of the many industry gatherings each year is underway somewhere in the world. Last week the Nuclear Energy Institute's *Nuclear Fuel Supply Forum* drew market participants to Washington DC.

And drew all interest out of the spot market.

The news last week that an exemption had been granted to the Canadian shipper waiting to load Russian enriched uranium product in St Petersburg lifted concerns over an imminent delivery disruption, hence buyers are now less motivated to pay up, industry consultant TradeTech reports.

Nor are sellers much motivated to close the gap. The result was a week with no spot transactions completed. TradeTech's weekly spot price indicator remains unchanged at US$45.75/lb.

Term markets were also quiet, with US producers focused on preparing their responses to the US Department of Energy's request for proposals for the supply of up to 1mlbs U3O8 for the government's strategic reserve. The DoE is hoping to spread purchases around.

TradeTech's term market indicators remain at US$52.00/lb (mid) and US$53.00/lb (long).

<u>All Systems Go</u>

Last week Australian-listed Paladin Energy ((PDN)) formally announced the planned restart of its Langer Heinrich mine in Namibia. It will take another 18 months to get operations to the point of restart, and a further fifteen months to reach full capacity.

Paladin shut down Langer Heinrich six years ago after the uranium price fell below commercial levels. After a couple of years of redevelopment, the decision was confirmed to restart the mine as a result of "strong uranium market fundamentals".

Following a recent capital raising, the company is fully funded for restart. Capital expenditure guidance has nevertheless increased by 46%, reflecting inflation pressure on supply chain costs, and the bring-forward of key utility infrastructure work packages to ensure the stable and reliable provision of water and power over the 17-year life of the mine.

The announcement by Paladin is a reflection of the many challenges the supply-side will face in meeting future demand expectations on schedule and at prices that will entice utilities to commit to purchases today, TradeTech suggests.

Presently, there are only a limited number of producers that have demonstrated their ability to meet production milestones at prices that are acceptable to utilities. This is especially true for US utilities, which, in the absence of cheap Russian uranium, are seeking secure supply partners able to demonstrate their ability to meet production milestones at prices that allow the utilities to remain competitive. Producers are also suffering from inflation.

After shutting down Langer Heinrich and facing an uncertain future, Paladin engaged with a Chinese joint venture partner with which the company now has a supply commitment, although the China National Nuclear Corp (25%) is yet to finalise its funding or participation decision. Paladin also now has a binding offtake agreement with US utility Duke Energy.

The Brokers

Stockbroker Shaw and Partners believes Paladin Energy will continue to engage with global utilities with the intent of securing uranium term price contracts of sufficient duration and value (north of US$60/lb) as Langer Heirich moves closer to first production. The mine is expected to operate at a cost in the mid-US$30s/lb.

Paladin also owns and operates a large global portfolio of uranium exploration and development assets, underpinned by high-grade resources, in the favourable jurisdictions of Australia and Canada.

Shaw notes Paladin is the premium and most liquid name in the (Australian-listed) sector, and it remains the broker's preferred exposure to an improving uranium market. Shaw has a Buy (High Risk) rating and $1.30 price target.

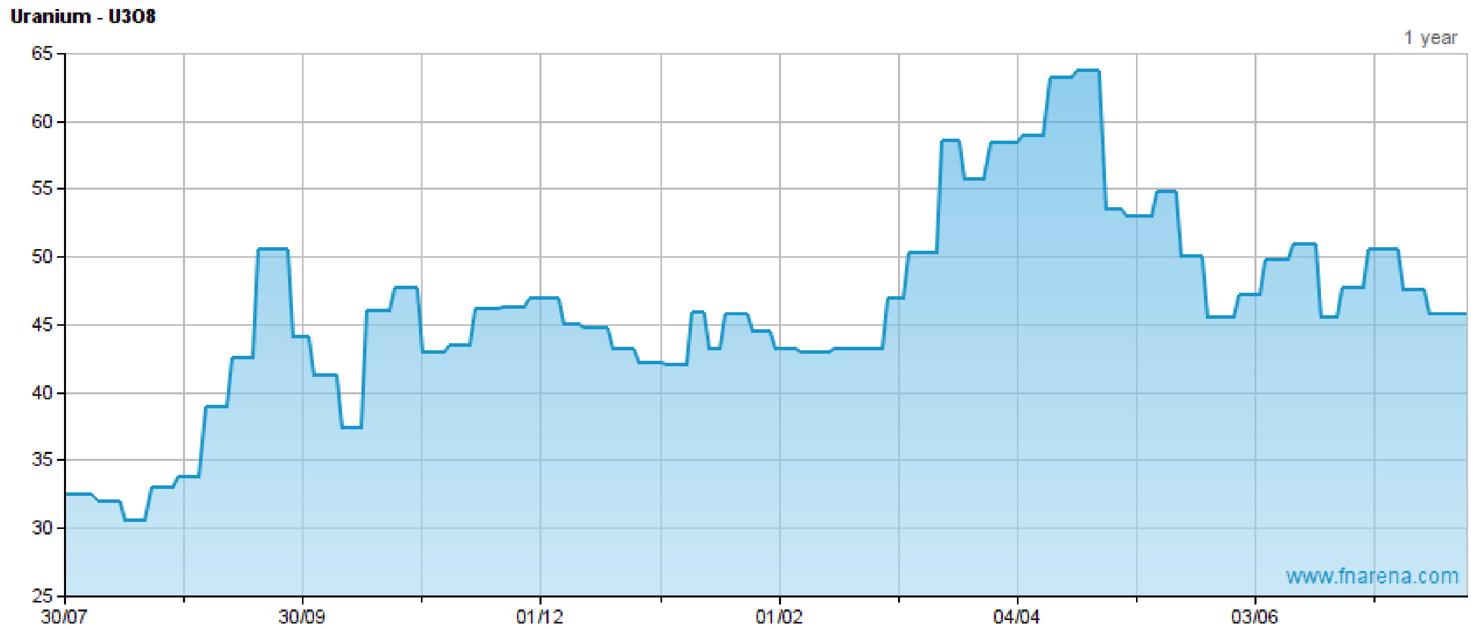
Broker Bell Potter agrees, and adds that further upside may come from expansion of the resource base, extending the Langer Heinrich mine life, and/or materially higher uranium pricing. Bell Potter has a Speculative Buy rating and $1.05 target.

Macquarie notes the Langer Heinrich project is fully licensed, in a known uranium jurisdiction and has a near-term path to market buoyed by a positive uranium outlook. Outperform, 80c target.

At the time of writing, Paladin is trading on the ASX at 64c.

Uranium companies listed on the ASX:

ASX CODE	DATE	LAST PRICE	WEEKLY % MOVE	52WK HIGH	52WK LOW	P/E	CONSENSUS TARGET	UPSIDE/DOWNSIDE
BKY	25/07/2022	0.3500	▼- 2.78%	$0.64	$0.14			
BMN	25/07/2022	0.1800	0.00%	$0.44	$0.12			
BOE	25/07/2022	1.9900	▼- 0.51%	$3.10	$0.14		$2.600	▲30.7%
ERA	25/07/2022	0.2400	▲ 9.52%	$0.58	$0.16			
PDN	25/07/2022	0.6500	0.00%	$1.12	$0.42	-64.9	$0.800	▲23.1%
PEN	25/07/2022	0.1700	▲ 6.25%	$0.35	$0.12			
VMY	25/07/2022	0.2000	▲ 5.56%	$0.33	$0.09			



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

WEEKLY REPORTS

The Short Report - 28 Jul 2022

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

Summary:

By Greg Peel

Week Ending July 21, 2022.

Last week Wall Street decided, without any specific trigger, that enough was enough and began to rally. Supported by some less-bad-than-feared earnings reports, and last night by the Fed only hiking by 75 points, the S&P500 is now 10% off its June low.

While not as dramatic, the ASX200 has seen a similar rally.

Stem cell biotech Mesoblast ((MSB)) enjoyed a similar rally last week, although it has given some of it back this week. Like most biotechs, Mesoblast can be highly volatile at the best of times, and quite a binary proposition - either your drug gets approval or not.

The rally was driven by some positive trial results, but only served to spark up the shorters, who took their positions to 8.0% from 6.6% the week before.

It was the only stock on the table to see a move of one percentage point or more.

Otherwise there was just a lot of swapping about.

One stock that did tick up a bit was Zip Co ((ZIP)), to 8.0% from 7.4%. See below.

Weekly short positions as a percentage of market cap:

10%+

FLT 15.6
BET 11.9
NAN 11.7
SQ2 11.5

No changes

9.0-9.9

LKE, RRL

In: RRL Out: EML

8.0-8.9%

EML, PNV, KGN, ING, MSB, ZIP

In: EML, KGN, ING, MSB, ZIP Out: RRL

7.0-7.9%

CCX, CXO, IEL

In: IEL Out: KGN, ZIP, ING, WEB

6.0-6.9%

PDN, VUL, WEB, SBM, CUV, BGL, ADH, PNI, TPW, OBL, PBH

In: WEB, PNI, PBH Out: MSB, IEL, MP1

5.0-5.9%

NEA, DEG, BOQ, MP1, AMA, 92E, IMU, NHC, FFX, MFG, SYR, JBH, PME

In: MP1, JBH, PME Out: PNI, PBH, APX, ANN

Movers & Shakers

BNPL company Zip Co's shorts rose to 8.0% from 7.4% last week, noting rival Block ((SQ2)) is at 11.5%. Zip rallied 44% over the week.

It has since rallied a total of 97%, which is fitting, as that's how far it fell. It's up another 15% this morning as I write. But on top-down versus bottom-up measurement, Zip is still down -86% from its high.

There is nothing at all fundamental about Zip Co's rally. Block has risen 4.7% in the same period. It is all about momentum trading, and eventually someone will be left without a chair when the music stops.

Just like GameStop. In the meantime, the shorters must be stinging.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.2	0.3	NAB	0.7	0.5
ANZ	0.6	0.5	NCM	0.3	0.4
BHP	0.3	0.2	RIO	0.7	0.5
CBA	1.0	0.9	STO	0.2	0.2
COL	0.7	0.7	TCL	0.3	0.5
CSL	0.4	0.4	TLS	0.2	0.1
FMG	1.6	1.4	WBC	1.2	1.2
GMG	0.7	0.7	WDS	0.9	0.7
JHX	0.4	0.4	WES	0.9	0.7
MQG	0.3	0.4	WOW	0.4	0.5

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

WEEKLY REPORTS

In Brief: China Property, Growth Investing, Asset Managers & Private Health Insurers

In brief: China's mortgage payment boycotts; growth style investing; earnings forecasts slashed for asset managers & private health insurers.

-Boycotts on Chinese mortgage payments
-Is the Growth style of investing re-emerging?
-Morgan Stanley slashes forecasts for asset managers
-Lower claims growth for private health insurers

By Mark Woodruff

Chinese mortgage payment boycotts

Unlike the situation in Australia, most homeowners in China start making mortgage payments before taking possession of their homes, and generally before building has even commenced.

Due to a lack of confidence in distressed developers, homeowners across China have begun mortgage payment boycotts, which according to Oxford Economics is a very serious threat to the financial position of the sector.

Because these boycotts don't reflect an inability to pay, Oxford Economics believes the immediate potential damage to the banking sector looks manageable, as the size of mortgages involved so far is limited. Also, most homebuyers will likely opt to continue to repay their mortgages to avoid damaging their social credit scores.

In the name of social stability, not just financial, Oxford Economics expects authorities will take more forceful actions should the boycott worsen rapidly, as some 70% of householder wealth is tied up in property. So far, banking and housing authorities, together with local governments, have stepped in to contain the fallout.

Recent media reports suggest the probable establishment of a real estate fund. Citi sees this as the first crucial government-led step to save the stressed property sector, though the initiative alone is considered insufficient to fundamentally resolve the property developer default risk.

The broker expects the mortgage payment boycott will have far-reaching unintended impacts, including increased difficulties for developers to refinance and destock.

While the strategists at Oxford Economics are ruling out a crisis at this stage, reduced confidence in developers would likely exacerbate the real estate downturn and add to financial stability and growth concerns over the longer term.

Housing sales, a major source of developer funding, look set to remain weak, according to Oxford Economics. Although monetary easing and debt reprieves have helped to contain financial risks, these measures are not considered a long-term solution to the problem. In short, defaults by high-profile property developers are thought to remain the biggest risk to China's real estate and financial sectors.

Deeper real estate weakness could potentially undermine fiscal health and affect local governments' ability to roll out much needed policy stimulus to boost growth in the second half of 2022, according to Oxford Economics. A lack of land demand by property developers is expected to weigh on land sales by local governments, which accounts for around about 40% of their revenue.

Is the Growth style of investing re-emerging?

Wilsons retains exposure to the Growth, Value and Quality investment styles, with a current preference for Quality.

The Growth style is showing signs of life again in recent weeks, observes the broker. All things remaining equal, this style is expected to be favoured by a lower-growth environment.

Obviously, the growth stocks then need to deliver actual growth, and stock selection may end up trumping investment style, suggests Wilsons. As the market settles into a groove, the outperformance of the Growth or Value style may be less pronounced than it has been in recent years.

If Growth does reassert itself, the analysts expect a less dramatic, "Quality Growth" revival this time around, as opposed to the highly speculative growth phase witnessed in 2021.

Neither the Growth nor Value style seems to do well when rates are moving up at a pace that significantly threatens a recession, points out Wilsons.

Quality defensives such as consumer staples and healthcare tend to represent a safe place in such an environment, according to the broker, as evidenced during June's share market correction.

The earnings for growth mega-caps in the US have held together reasonably well, and Wilsons expects the US reporting season will be an important milestone. The pandemic-induced fall in interest rates accentuated an initial outperformance for Growth, further boosted by unusual demand patterns.

In weighing-up reporting season results in the US, the broker feels market participants will need to weigh latent cyclicality of earnings versus earnings resilience. That is, the potential headwind for corporates from revenues pulled forward into the covid earnings boom, versus an ability to pass on cost pressures.

Morgan Stanley slashes forecasts for asset managers

Morgan Stanley cuts its FY23 earnings forecasts by -10-30% across its coverage of the Australian Asset Manager sector, due to lower assets under management (AUM).

Outflows are the key reason the broker reduces its valuation multiple for the sector.

A broad recovery to inflows is unlikely and growth options are limited, according to the analysts, despite an improved investment performance across the group and less competition from passive investing in Australia compared to the US.

In seeking out limited growth options, Morgan Stanley suggests exposure to alternative asset classes, which may best be attained by investing in Macquarie Group ((MQG)), which is outside the broker's asset manager coverage.

ESG offers perhaps the best growth option within the broker's coverage, and the analysts suggest Perpetual ((PPT) and Pendal Group ((PDL)) for this exposure. Product customisation/solutions offer another growth angle, with Janus Henderson ((JHG)) and Pendal Group recommended.

Morgan Stanley's preferred asset manager under coverage is the Overweight-rated Perpetual, while the least preferred is Magellan Financial Group ((MFG)) which is rated Underweight.

The broker likes Perpetual for expected growth in Corporate Trust funds under administration (FUA) and ongoing flows in Private Wealth. The Investments business also offers increasing global distribution, strong relative performance and progress on several growth options. These include broad ESG growth options and active ETF channels for retail.

Following Perpetual in order of preference (and with an Equal-weight rating), are Platinum Asset Management ((PTM)), Pendal Group and Janus Henderson.

The lower target prices set by Morgan Stanley may be viewed on the FNArena website, under Broker Call for July 26.

Lower claims growth for private health insurers

Claims growth is currently well below provisions set by insurers, which implies to Macquarie sizeable givebacks over the coming 12-18 months.

Using an in-house methodology, the broker estimates Private Hospital claims growth of 1.1% in the June half, compared to the 4.7% trend rate experienced pre-covid.

Macquarie expects net margins for the industry to contract by around -30bps this half compared to the June half, before increasing through FY23 as deferred claims liabilities are unwound.

While margins and claims for Medibank Private ((MPL)) and nib Holdings ((NHF)) are expected to outperform private health insurance (PHI) trends, the broker retains a Neutral rating for both companies on full valuations.

nib Holdings is preferred by Macquarie, given its skew to Travel and personal health information, which both have more rebound potential in the wake of covid.

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