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Stories To Read From FNArena

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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 journo's
Greg Peel
Eva Brocklehurst

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Material Catalysts Ahead For Afterpay Touch

Afterpay Touch is on the threshold of a substantial market opportunity and brokers eagerly await several potential positive catalysts.

-Frequency of use reflecting customer loyalty and credit quality -Afterpay continues to broaden its service offering -Full valuation and competition concerns limit some broker views

By Eva Brocklehurst

More and more, brokers are contemplating the exceedingly strong growth path ahead for payments company Afterpay Touch ((APT)). Several catalysts are expected before the end of the year including further news on new markets and verticals, an update on trends and number of merchant clients, as well as further details on the collaboration with Visa International.

Goldman Sachs calculates a $1.0trn market opportunity for Afterpay Touch and suggests frequency of use should drive strong operating leverage in the medium term despite the expenditure being undertaken to support growth.

Frequency of use trends in the US signal that 74% of the company's transaction value in June 2019 was from returning customers. Moreover, Australasian users that have been on the platform for three years are engaging in transactions over 20 times per annum.

This is the most important value driver of the platform, in the broker's view, reflecting loyalty and credit quality. Users cannot transact frequently if they default, or regularly end up paying late payment fees. This resonance with existing users is also likely to procure turnover in receivables.

Goldman Sachs does not forecast on the same basis but its modelling remains consistent with Afterpay Touch's numbers. Wilsons calculates an online and in-store share in Australasia of 20%, highlighting the company's first-mover advantage and brand recognition locally.

The company has broadened substantially, now servicing department stores, salons, health and travel industries while retaining its original depth in the fashion & beauty channel and a focus on the female millennial customer.

The in-store channel, launched in FY18, has grown rapidly with sales up over 315% in FY19 versus online sales growth of 78%. Goldman Sachs expects there are many more adjacent retail verticals but the core categories serve as a reasonable starting point for assessing the opportunity in the US and UK.

Competition?

Goldman Sachs remains conscious of the rising number of competitors, particularly as the most likely basis for competition will be to offer lower fee rates to merchants. Yet, in its assessment, the value to merchants will not be based on the fees being charged but on how many consumers are brought to the retailers' tables, and how frequently they engage.

Afterpay Touch has guided to total transaction value greater than $20bn by FY22 and Bell Potter estimates $29.1bn. The broker, not one of the seven monitored daily on the FNArena database, prioritises customer growth in its valuation methodology, particularly as gross margin and retention rates are healthy, maintaining a Buy rating and $41.61 target.

Goldman Sachs, also not one of the seven. does not apply an earnings multiple over the forecast period, assessing that the trends are consistent with an improvement in the quality of earnings which near-term PE metrics do not adequately capture.

The broker incorporates the option value in its analysis to account for a new market opportunity, as the company is actively seeking new markets. Goldman Sachs elects to upgrade to Buy with a target of $42.90.

US/UK

Afterpay Touch is launching in-store services in the US and UK markets. While these regions will be more competitive than Australasia, Goldman Sachs points out the company is at least as well resourced as many of its peers, and the size of these markets will allow more operators.

Wilsons has a 10% share slated for the US online market and 8% for the US in-store market. The broker acknowledges significant momentum in the US, with recent gains including brands such as Madewell, Haus Labs, Shiseido, Cie de Peau, Laura Mercier and Buxom.

The company received a boost in August, with its inclusion on the Apple Store as an "App of the Day". As a result, there appears to have been a deceleration in customer addition run rates in September in the US, although Goldman Sachs anticipates around 2.4m customers by the end of the month.

In the UK, Goldman Sachs believes the market can develop network effects more rapidly because of the population density and the skew to London and the south-east, which account for 27% of the population. London generates 22% of total UK GDP, according to reports the broker cites.

Clearpay, the company's brand in the UK, will be launching a mobile app shortly which Wilsons expects can drive market share. Wilsons assumes a 10% online market share in the UK and an in-store share of 6%.

The broker notes Afterpay Touch is up against a tough competitor in the UK, Klarna, which has a first-mover advantage. Citi, too, observes Klarna is spending heavily to convince UK shoppers they should use the Buy Now Pay Later service more often, which can only be of benefit to Afterpay Touch.

The question is whether Afterpay Touch will need to counter the Klarna campaign with increased expenditure of its own. Citi remains concerned that investment could be higher than the market is contemplating.

Wilsons, also not one of the seven, maintains a Hold rating with a target of $34.07, balancing the strong operating performance and momentum with a full valuation and some residual concerns that merchant fees may be pressured by competition.

Wilsons acknowledges finding the stock difficult to value, given the stellar growth rates and the continually expanding market, and believes that, in time, the company, along with its rivals, will have to evolve from a mono-line provider (Buy Now Pay Later) to a more holistic offering.

AUSTRAC Enquiry

The interim report from AUSTRAC (Australian Transaction Reports and Analysis Centre) has not found any money-laundering or terrorism financing on the company's platform to date. As a result, Bell Potter reduces its discount to valuation to -7.5% from -15.0%, assessing that the previous discount was excessive.

This is based on the expectation the outcome of the enquiry is not expected to detract from the growth profile, as there are no recommendations from AUSTRAC at this stage nor any immediate action. The final report is due one November 23 so the broker accepts no assumptions can be made regarding any recommendations.

Goldman Sachs takes no view on the outcome of the audit but notes it may have an impact on its business model ranging from nothing material to a fine to changes in compliance processes. FNArena's database has two Buy ratings and one Hold (Citi). The consensus target is $33.52, signalling -6.3% downside to the last share price.

See also, Afterpay Touch In The Box Seat on September 24 2019.

Brokers Urge Caution Until Fonterra Performs

Fonterra Shareholders' Fund is dealing with a raft of problems and brokers take a cautious stance until there is evidence of traction in the proposed solutions.

-Lower contribution from ingredients business flagged for FY20 -Long-term issues surrounding competitiveness in milk -Move to a debt-related dividend policy

By Eva Brocklehurst

Better outcomes may be ahead but brokers remain frustrated by the slow pace at which NZ dairy co-operative Fonterra Shareholders' Fund ((FSF)) is dealing with its problems.

Credit Suisse highlights the value destruction that has occurred through a series of poor investments which have forced the company to act, although welcomes the direction being taken. Macquarie asserts Fonterra will need to start delivering on several aspects of its strategy before the market regains confidence.

At this stage, the benefits from asset disposals are limited, as funds are required to strengthen the balance sheet. Substantial structural changes are also a possible outcome, brokers note. A capital structure review, including milk prices, has commenced with no set timeframe.

There are long-term issues surrounding the company's competitiveness in milk, which Credit Suisse hopes the review will focus on, as well as its ability to grow the ingredients business given the benign outlook for milk supply growth and surplus capacity.

The broker acknowledges the company's intention to remediate the situation but lacks confidence in the action so far, although recognises it is a complex task. There is too much debt and the number and trajectory of asset sales being undertaken is uncertain.

Guidance for FY20 signals a lower contribution from ingredients in FY20, which UBS assesses reflects the inability to pass on cost increases in price-sensitive markets and categories, as NZ and Australian milk prices are above those in Europe and the US.

Even against a more depressed market valuation, Credit Suisse believes Fonterra needs to generate higher free cash flow, and sustained discipline around expenditure will be a key element in its success.

Any positives? Export competition out of Europe should moderate, as inventory levels are reduced and milk production flattens. Moreover, food service gross margins recovered in the second half of FY19 amid price increases in China and Asia.

There are also positives, brokers note, regarding the planned five-year path to normalised earnings, on a footprint that will mean businesses that have dragged on Fonterra, such as Beingmate and China Farms, will be excluded, although so will positive contributors such as Tip Top and DFE Pharma.

FY20 forecasts earnings (EBIT) of NZ$600-700m compare with NZ$811m in FY19. Macquarie notes this reflects the impact from lower allowable returns under the milk price manual, as well as the sale of DFE Pharma and generally more normal assumptions around returns.

In the second half of FY19 a recovery in prices and a better cost performance allowed margin pressure to moderate. Nevertheless, UBS points out a fall in the regulated returns from milk has impeded profitability for ingredients, which has meant margins have started to decline again.

Credit Suisse is concerned regarding the lack of clarity on a sustainable base level for earnings in the ingredients business, or the investment required over the longer term. Any strategy that will revolve around a reduced footprint and the prices realised for non-core assets will influence valuation outcomes, the broker adds.

Review & Outlook

Brokers assess the decision to focus on NZ-made products and reduce global operations is sensible. The company will focus on five categories: dairy, food service, paediatrics, sports and medical. Market development will be concentrating on the Asia-Pacific in food service and the consumer. South America, particularly, will be downsized.

The company has sold Tip Top, Inlaca, DFE Pharma, foodspring and, its Venezuelan consumer joint venture. This takes sale proceeds to around NZ$1bn. Potential future asset sales include the shareholding in Beingmate, China Farms and Dairy Partner Americas.

Still, the company does not appear unified or committed to singling out specific non-core divestments and Credit Suisse is concerned about the lack of clarity regarding a sustainable base level for earnings in the ingredients business and the investment required over the longer term.

UBS asserts product development and environmental aspirations - Fonterra has introduced environmental targets across greenhouse gas emissions and water use - clash with the desire to reduce capital expenditure to NZ$500m per annum over the next five years.

Dividend Policy

The company has also moved to a debt-related dividend policy, lowering the pay-out to 40-60% from 65-75%. As Fonterra has flagged further asset sales UBS expects pressure on the balance sheet will be significantly reduced by the end of FY20. A dividend is expected to be reinstated in FY20 albeit at a low level.

While the new policy is more conservative, Macquarie considers it somewhat tax inefficient given the deductibility of distributions paid to farmer shareholders. Macquarie's rating is Underperform with an NZ$3.30 target.

Credit Suisse, while confident debt levels can be reduced to more manageable levels, complains about a lack of supporting detail for how the company will arrive at a sustained turnaround. The broker maintains a Neutral rating and NZ$3.85 target. UBS has a Neutral rating, along with an NZ$3.50 target.

Sale Of Sth America Assets Revitalises Nufarm

Nufarm has addressed a vulnerable capital position with the sale of its South American crop protection business and investors can now focus on fundamentals.

-Transaction reduces likelihood of Sumitomo takeover of Nufarm -Caution prevails on outlook, given ongoing drought in Australia -Brokers await reinstatement of dividend policy as debt is reduced

By Eva Brocklehurst

Nufarm ((NUF)) has caught a wind, selling its South American crop protection business at an attractive multiple. With gearing reduced, the company can confront the challenges posed by difficult seasonal conditions.

Nufarm reported FY19 underlying operating earnings (EBITDA) of $420.3m and net profit of $89.1m, largely in line with guidance. However, this was overshadowed by the announcement the South American operations have been sold to Sumitomo for $1.19bn. Sale proceeds will be used to pay down debt. After the divestment, the company will operate in five areas: Europe, North America, Australasia, Asia and seed technologies.

The master agreement for product development and commercialisation with Sumitomo has been renewed to 2025. Nufarm will still provide procurement services and certain products to the South American business and has been confirmed as the preferred commercialisation partner with Sumitomo for proprietary fungicides Pavecto and Indiflin in Germany, Poland and the UK.

Credit Suisse believes these agreements are noteworthy as they reinforce the company's strategic importance. Glyphosate sales will drop to 7% of gross profit post the divestment, which the broker believes is also important, given the nature of the issues surrounding that product.

In one flourish, Nufarm has addressed a vulnerable capital position and brokers observe that by selling the South American asset, the company's earnings profile will be less volatile. Macquarie points out, while Latin America is a high-growth region, it was also intensive in terms of working capital. The company had negative free cash flow from the business over the last five years and also exposure to FX volatility.

The deal remains subject to regulatory approvals and a shareholder vote, with completion expected in the first half of FY20. Morgans understands Sumitomo was seeking distribution capacity as it prepares to launch new products into South America, and notes the Nufarm Nuseed assets are not included in the sale.

The broker also suspects the transaction reduces the likelihood that Sumitomo will take over Nufarm in full. Nufarm will undertake a review of corporate costs to target future savings following the completion of the transaction.

Outlook

Management has reiterated expectations that Australasia can return to $50-60m in earnings (EBIT) over the medium term. Morgans remains dubious, noting the Australasian business has also been affected by increased competition following industry consolidation and more imports from China.

While lowering estimates for earnings per share by -23% in FY20 and -22% in FY21, Ord Minnett suggests, if weather conditions improve, Nufarm is likely to experience earnings upgrades into FY21. However, this is a limited call given the current grim outlook for Australasia.

Australasian earnings backtracked in FY19 and the temporary closure of manufacturing plants was unprecedented, resulting in unrecoverable overhead costs. The company asserts it has addressed a significant overhang in inventory from drought conditions and made progress in re-setting the cost base.

The company's performance improvement program is ahead of schedule in Australasia, Macquarie agrees, with $10-15m and incremental operating earnings expected in FY20 as opposed to prior expectations for March 2021.

Adverse weather conditions in Europe as well as supply problems in the acquired portfolio also affected the FY19 result. The acquired European portfolio contributed $75m in operating earnings versus the business case of $110-115m. While the company has addressed some of the transition issues an impact on supply is still expected in FY20.

Morgan Stanley believes, having cleared some of the issues, investor enthusiasm for the Omega-3 business will gain momentum as various revenue and profit milestones are passed.

The sale of the South American division means the company is under less pressure to monetise Omega-3 in the short term and can extract better value from the approvals process and commercial sales as a result, in Macquarie's view. The broker estimates $40m in Omega-3 earnings in FY22, which represents $1-1.20 per share of potential value. First commercial sales are expected in FY20.

Dividend Policy

Ord Minnett would be interested in a timeline for reinstating the dividend policy as the balance sheet is repaired and working capital unwinds, while Morgan Stanley expects Nufarm to return to paying a dividend in FY20. Macquarie assumes no final dividend following suspension of the interim dividend, although acknowledges capital management can be explored following the sale of the South American business.

The board will want the company to achieve working capital targets before taking any action on funding capital management or growth opportunities, Morgans asserts. A reduction in corporate costs is considered highly likely following a simplification of the business model.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, calculates, on a post-divestment basis, the stock is trading on an FY20 enterprise value/EBITDA of 8.3x, which appears fair. The broker has revised its rating structure and has a Market Weight rating and $5.79 target for Nufarm.

Macquarie upgrades to Outperform from Neutral to reflect lower net debt, capital expenditure and a better ability to generate cash. FNArena's database has four Buy ratings and two Hold. The consensus target is $6.48, suggesting 12.3% upside to the last share price. Targets range from $5.35 (Ord Minnett to $8.30 (Credit Suisse).

See also, Better Conditions Ahead For Nufarm on August 2 2019.

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GUD Holdings Flags Cost Cuts & Price Hikes

GUD Holdings has successfully coupled cost reductions with price rises and reiterates guidance for modest earnings growth in FY20.

-Sales trends improve yet remain negative on a like-for-like basis -Guidance retained for "modest" earnings growth in FY20 -Strong potential for further acquisitions in a fragmented market

By Eva Brocklehurst

Automotive aftermarket supplier GUD Holdings ((GUD)) has impressed several brokers with a trading update, as its performance across several units has improved and there has been early success with cost reductions. UBS found the investor briefing incrementally positive regarding the opportunities for cost reductions coupled with price rises, while reinforcing the strength of the company's brands.

GUD Holdings has highlighted a mixed outlook for the automotive aftermarket industry, citing regulatory changes affecting electric vehicle adoption rates and original equipment manufacturer (OEM) warranty changes.

Wilsons was encouraged by the update, noting margins will have benefited from price increases across most business units as well as some reductions in the cost of goods sold (COGS). The broker was particularly keen on the company's insights into the filtration category, along with the positioning of Ryco and Wesfil and market research data highlighting the strength of these brands.

The broker, not one of the seven stockbrokers monitored daily on the FNArena database, retains an Overweight rating with an $11.05 target.

FY20 sales trends have improved across some categories but remain negative on a like-for-like basis. Given currency pressures, new competition in the filter market and major customer supply consolidation, UBS suspects FY20 guidance will be difficult to achieve without any contribution from acquisitions.

Guidance has been retained for "modest" earnings (EBIT) growth in FY20, although the US dollar continues to strengthen and this will require price increases for various products, the broker points out. Around 75% hedging is in place until March 2020.

Management anticipates domestic cost inflation will be offset by various measures, including supplier cost reductions and operating efficiencies, confident sustainable growth will be supported by a buoyant Australian automotive aftermarket.

Acquisitions

There is substantial potential for acquisitions across product lines the company does not cover as well as export opportunities. Three areas are in focus: further reductions in COGS and logistics, organic growth opportunities and acquisitions.

GUD Holdings remains on the look-out for acquisitions although it has bypassed four since June because of either a lack of strategic fit or perceived inability to reach the required financial hurdles.

Ord Minnett is not surprised, given the major issues faced by the acquisition of AA Gaskets. UBS flags significant acquisition potential, with around $90m in headroom at up to 2.5x net debt/operating earnings (EBITDA) without the need for fresh equity.

Most brokers on FNArena's database are yet to cover the trading update. The database has one Buy rating (Ord Minnett), three Hold and one Sell (UBS). The consensus target is $10.66, suggesting 2.9% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 5.5% and 5.9% respectively.

See also Caution Uppermost For GUD Holdings on July 29, 2019.

Mayne Pharma Expands In Women's Health

A new specialty female oral contraceptive will grace the portfolio of Mayne Pharma, providing a substantial growth opportunity in the medium-long term.

-Theoretical oral contraceptive market is large while risk structure of the deal is low -Mayne Pharma to be Mithra's commercial partner for its two largest women's health products -Timing mismatch could mean earnings softness in FY20 stemming from generics

By Eva Brocklehurst

Mayne Pharma ((MYX)) will expand its women's health portfolio with a new specialty oral contraceptive, signing an exclusive 20-year licence and supply agreement with Mithra Pharmaceuticals.

Mayne Pharma will commercialise a combined oral contraceptive in the US for a total consideration of US$295m, assuming performance hurdles are met. The product should be launched in the second half of FY21 subject to US FDA (Food & Drug Administration) approval.

Credit Suisse believes that having a female specialty asset will allow Mayne Pharma to leverage patient distribution channels and further expand in women's health. The broker values the deal at $0.30 a share and expects earnings in FY22 and beyond will benefit.

The drug presented strong efficacy results in its phase 3 trials and Credit Suisse estimates around US$200m in sales by FY25. The broker includes this forecast in its modelling, resulting in a -9% downgrade for earnings per share in FY21 and a 43% upgrade in FY22.

UBS agrees the licensing deal makes sense in order to build the oral contraceptive offering. It is also attractive because this is a branded product which will not face generic competition before the end of 2029.

The theoretical market size is large, with the US branded combined hormonal contraceptive market valued at US$2.25bn. UBS notes a relatively low risk structure in the deal, with a modest upfront cash payment and equity issue and a manageable net debt position.

However, Mithra still needs to submit a regulatory file and obtain approval from the FDA, and then Mayne Pharma needs to commercialise the drug. UBS makes material downgrades to earnings per share estimates in FY20-22 because of the equity dilution and amortisation expense, with accretion of around 35% modelled from FY24 as revenue builds.

Assuming the drug is launched, Mithra will hold 9.6% of the Mayne Pharma share capital and Mayne Pharma would be its US commercial partner for its two largest women's health products.

Macquarie envisages the agreement provides an opportunity for both growth and diversification. In estimating the impact on valuation, the broker assumes peak sales are achieved in FY24 and there is an operating earnings margin of 50% with amortisation of US$15m per annum and contingent/milestone payments from FY24.

In sum, Macquarie estimates a valuation of $0.20 per share, raising the target to $0.66 from $0.51 and, with an implied total shareholder return of 5% based on the new target, upgrades to Neutral from Underperform.

Now Mayne Pharma has three core drugs that should drive earnings growth including Tolsura, generic NuvaRing and this latest one: E4/DRSP. Still, the market requires evidence of successful execution in some of these products, in Credit Suisse's view, before factoring in the full earnings benefit, particularly given the challenges over the short term and the volatility in generics.

UBS assesses growth in specialty brands can only partially offset the competitive pressures in generics and a timing mismatch could mean continued softness from generics in FY20 as several of the company's new specialty products take time to ramp up. E4/DRSP is considered unlikely to provide any offset until FY22.

E4/DRSP

E4/DRSP is a novel, new generation combined oral contraceptive with 50mg of Estetrol and 3mg of drospirenone. Why is this different? Estetrol is a native oestrogen produced by the human foetal liver during pregnancy. Mithra can now produce this at scale through a complex production process as a result of 20 years of R&D.

Because of the perceived safety and health concerns linked to hormone-related therapies many women continue to avoid oral contraceptives. Studies have underlined an unmet need for an oestrogen with an improved benefit/risk profile and the researchers indicated Estetrol could address this.

If launched, the combined drug will be the first native oestrogen approved in a contraceptive product in the US in the first new oestrogen introduced in the US in 50 years.

Mithra is also completing phase 3 trials for two other possible uses of its E4/DRSP, in peri menopause and menopause. Hence, Mayne Pharma could be in a strong position to win any potential supply & licensing agreements for other drugs in the pipeline.

FNArena's database has four Hold ratings for Mayne Pharma. The consensus target is $0.64, signalling 1.2% upside to the last share price. This compares with $0.54 ahead of the announcement. Targets range from $0.50 (Citi, yet to comment on the announcement) to $0.73 (Credit Suisse).

Banks Under Intense Scrutiny As Rates Dive

As a record low cash rate prevails, amid weak consumer and business sentiment and only muted improvements in housing activity, Australia's major banks are being squeezed mercilessly.

-Banks more cautious about offsetting lost income from rate reductions -Rise in mortgages does not mitigate the challenges for banks -Major banks may need to change approaches to capital management

By Eva Brocklehurst

As the Reserve Bank of Australia sends the cash rate to a record low of 0.75%, and the market prices in at least one more cut, the banking sector is increasingly in the spotlight. All the major banks responded to the cut to official rates in October by announcing changes to residential mortgage rates, and all have re-priced investor interest-only loans by more than other lending rates.

Standard variable rates have been reduced in a range of -13-30 basis points in response to the RBA's latest reduction of 25 basis points. Shaw and Partners compares this with cuts in standard variable rates ranging from -43-45 basis points in response to the prior two 25-point reductions to the cash rate.

The banks have clearly become more concerned about their ability to achieve reductions in funding costs in order to offset the lost income. If the RBA continues to cut the cash rate then banks will be confronted with paying less on transaction deposits and that's something they do not want to face, the broker asserts.

If current trends persist, Macquarie deduces there is downside risk to credit growth forecasts. In theory, interest-rate reductions should lift borrowing capacity which, in turn, should be positive for property prices and credit growth.

However, the broker believes APRA's (Australian Prudential Regulatory Authority) requirement to incorporate debt-to-income serviceability limits will become a severe constraint on the banks. The Reserve Bank of New Zealand capital proposals also remain an overhang for the major banks and Macquarie suspects APRA will look to limit capital outflow to New Zealand.

Moreover, the valuation discount in the bank sector of -10%, relative to the long-term average versus the all industrials, only partially incorporates the headwinds, the broker adds.

Weakness Continues

Weakness is expected in the near term, and without a surge in credit supply Morgan Stanley agrees it is unlikely the banks can fully offset margin headwinds. The broker's earnings model for the financial sector continues to deteriorate as rate reductions occur alongside declines in business and consumer sentiment.

Brokers are on the lookout for any unconventional policy given, Morgan Stanley suggests, that to be effective the RBA is likely to focus on bank funding costs. The broker puts the bank sector at Equal-weight, believing the headwinds from the interest-rate cycle are finely balanced by overall dividend yield attraction. Furthermore, the credit pulse is the swing factor in the bank scenario.

Investor approvals have fallen considerably over the past couple of years, JPMorgan notes, tracking the decline in house prices. This would suggest that lowering investor interest-only rates in isolation would be unlikely to produce a response in demand. However, given the recent uplift in house prices, the changes to mortgage rates (the gap between investor interest-only rates and other products has reduced) could provide some support for investor growth in the future.

UBS counters this argument by noting that a lot of good news has already been priced into the banking sector. A pick-up in housing lending may be positive, as industry data indicates mortgage approvals have risen 10% from the lows, but this does not mitigate the increasing challenges faced by banks.

Even if mortgage approvals re-accelerate to levels experienced at the height of the housing bubble, which UBS considers unlikely, housing credit growth will only grow to around 5.5%.

Moreover, the benefit to bank revenues would be offset by interest margin pressure given the rate reductions required to re-stimulate the housing market to these levels. With ongoing revenue pressure, UBS expects further dividend reductions and banks to re-base their target returns on equity to more realistic levels.

JPMorgan also points out the changes in bank mortgage rates reflect increasingly large inflexible deposit balances, noting Commonwealth Bank ((CBA)) referenced $160bn of deposits for which the full rate reduction could not be passed on.

Which Bank?

Morgan Stanley asserts the major banks will need to go further and change their approach to capital management, targeting higher capital levels and lower pay-out ratios. This stems from more onerous capital requirements from both APRA and the RBNZ. Moreover, each of the four are likely to respond differently in terms of dividends, reinvestment plans and buybacks.

For ANZ Bank ((ANZ)), the broker expects a -10% reduction in dividend in FY20 and no buybacks. ANZ appears the most affected by the RBNZ proposals. Morgan Stanley has upgraded its rating to Equal-weight, noting the bank has underperformed other major banks by -5-10% over the past six months. Investor expectations may be low but the challenges are understood and the broker suggests the relative PE (price/earnings) multiple provide some support.

Shaw and Partners points out ANZ's performance in terms of investor loans has been particularly poor and the bank still has the highest investor interest-only mortgage rates, signalling market share in these loans is likely to continue to slide.

Westpac Bank ((WBC)) is likely to cut the dividend by -15% in the second half of FY19 and underwrite the dividend reinvestment plan to raise $2bn in capital, Morgan Stanley asserts, as it has the highest pay-out ratio and a pro forma CET1 ratio of less than 10.5%.

A flat dividend and $2bn in future buybacks (down from $3bn) is forecast for Commonwealth Bank and Morgan Stanley expects the board will look to hold the dividend steady, given a relatively strong capital position.

Morgan Stanley has downgraded its rating for National Australia Bank ((NAB)) to Underweight becomes number four in the order of preference, as the outlook for revenue is deteriorating and further reinvestment is probably required. The broker suspects the bank will continue to use the dividend reinvestment plan to build capital and there is a risk of another dividend reduction in FY20.

NAB has recently announced additional remediation charges of $1.19bn, bringing its overall remediation provision in FY19 to $2bn. Macquarie considers these charges are low-quality items and, while not incorporating them directly in valuation, acknowledges prior conservative estimates have proven to be consistently low. Hence there is the risk of more remediation beyond FY19.

Recognising the capital implications, and the pending impost from RBNZ, the broker increasingly envisages a need for National Australia Bank to lift its CET1 capital, likely via underwritten dividend reinvestment plans. This will make it difficult to grow earnings.

Morgans forecasts a discounted dividend reinvestment plan in respect of the bank's 2019 final dividend and has always suspected that the rally in the share price since the reduction in the dividend in May was unjustified.

UBS assesses it will take some time for National Australia Bank to rebuild confidence but remains encouraged by the new executive team, agreeing nonetheless the outlook is increasingly challenged in an ultra-low interest rate environment, and the earnings risk appears heavily skewed to the downside.

Silver Continues To Gain In Tight Market

By 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.

How much silver is in the world?

The rarity of both precious metals becomes apparent when we consider how little gold and silver have been mined throughout history - just 190,000 tonnes of gold and 1.6 million tonnes of silver. Or in ounce terms, 6.1 billion oz of gold and 51.3 billion oz of silver. All the gold ever mined in the world could fit into a cube 21.6 meters on each side, and all the above-ground silver could fit into a 52m cube.

According to the Silver Institute's annual silver survey, in 2018, the latest data available, there were 2.457 billion ounces of silver being held in vaults, silver ETFs or ETPs [exchange traded funds/products] , government silver holdings and industrial silver stockpiles.

There are just slightly more than 6.1 billion troy ounces of gold above ground. Approximately 50% of gold is jewelry, and 40% is .999 fine bullion - or 2.5 billion ounces of gold currently available for investment purposes.

The all-time estimated mined Gold-Silver ratio is about 8.8.1 - for every 8.8 ounces of silver mined we have mined 1 ounce of gold. We would expect there to be roughly eight times more silver than gold. But there isn't, instead above ground stocks of investment grade gold and silver bullion are virtually even.

Industrial demand for silver is the reason for the flip-flop. The white metal is used in a mind-boggling 10,000 industrial applications.

While most of the mined gold is still around, either cast as jewelry, or smelted into bullion and stored for investment purposes, the same cannot be said for silver. It's estimated around 60% of silver is utilized in industrial applications, leaving only 40% for investing. And of the 60% demanded by industry, 8 of 10 ounces is either used up in manufactured products or discarded in landfills. Some silver researchers say closer to 90% has been lost to landfills. Perhaps we should be mining them?

In sum, both silver and gold have roughly the same amount above-ground supply available for investment purposes. However, since very little gold is used by industry, it trades as an investment commodity - moving up and down in relation to factors like the US dollar, inflation, interest rates and sovereign bond yields.

In comparison, silver has a relatively small amount for investment, just 40% of total supply. Because over half of global supply is needed for industrial applications, silver trades much more like an industrial metal than an investment commodity. As we shall see in the section below, when gold is over-valued compared to silver, investors take advantage of the arbitrage opportunity, by selling some of their gold holdings to buy silver.

This also explains silver's volatility. Because the investment market for silver is so small (60% is locked up in industrial uses) it swings up and down wildly with relatively low volumes.

Companies that are buying silver as a manufacturing input can't risk buying it on the spot market; this would be too unpredictable.

Record demand

A record amount of silver was sought in 2018. According to the Silver Institute's annual survey, total physical demand last year rose 4% to 1,033.5 million ounces - a three-year high. The need for silver was driven mostly by purchases of bars and coins, jewelry and silverware.

Unlike gold which serves primarily an investment function and as material for jewelry (known as "the fear trade and the love trade"), silver's properties make it ideal for a number of applications - almost as many as oil. The metal is strong, malleable and conducts heat and electricity better than any other material. Gold also has these properties but it is too expensive to use in circuit boards, solar panels, electric cars, etc.

Over 50% of silver demand comes from industrial uses like solar panels, electronics, the automotive industry and photographic applications.

Despite the increased imperative for installing solar power as a means of moving away from carbon-intensive coal and natural gas, silver's use in the photovoltaic sector actually dropped 1% last year. According to the 2019 World Silver Survey, that was due to "reduced silver loadings in solar modules", but the drop was compensated for by solid demand from electronics, brazing alloys and solders.

And while companies have managed to reduce the amount of silver in solar panels, a practice known as "thrifting," photovoltaics will remain a critical sector for silver, says Johann Wiebe, lead analyst at the GFMS Team/Refinitiv, the research firm behind the survey.

"Solar power capacity is expected to continue to grow and that is going to have a stronger impact on demand than the effects of thrifting," he told Kitco News.

The solar power industry currently accounts for 13% of silver's industrial demand.

Falling mine supply

The amount of silver produced from mines fell by 21.2 million ounces last year, the third consecutive drop after 13 years of uninterrupted supply growth. The 2019 World Silver Survey attributes the 855.7Moz loss to falling production at lead and zinc mines; 75% of silver is mined as a by-product, mostly of gold, copper, lead and zinc.

Two examples are the suspension of the mining license at Tahoe Resources' Escobar mine in Guatemala - the world's third largest silver mine - and reduced output due to a fire at Teck Resources' Trail smelter in British Columbia. Unexpected maintenance issues and lower grades at the Fire Creek and Kid Creek mines drove US silver production down by 5.7Moz, 17% less than 2017.

As for 2019, mine supply from the top three silver-producing countries, Peru, Chile and Mexico, all dropped in the first half of this year. Data collected from each country showed Peru's H1 silver production was down 10%, Chile fell 7% and Mexico saw a 4% decrease from January to May.

Analytics company GlobalData crunched the silver numbers and came out with a positive outlook for silver producers, right up until 2023. The firm says that year, global silver production should top a billion ounces (compared to 920Moz in 2018), with 50 new projects in the pipeline expected to produce silver either as a primary or secondary metal. The largest mines to come online in the next three years include the El Cajon mine in Mexico, Lundin Gold's Fruta del Norte and the Mirabel mine in Ecuador, plus the Oernoe and Udokan mines in Russia.

Silver output in 2019 is expected to decline to 913.5Moz.

The gold-silver ratio

We can use the gold-silver ratio to find out how silver prices compare to gold, since the two precious metals have roughly the same amount of above-ground supply - 6.1 billion ounces, and around the same level of 0.999 fine bullion used for investments - 2.5Boz.

The gold-silver ratio is simply the amount of silver one can buy with an ounce of gold. Simply divide the current gold price by the price of silver, to find the ratio.

On June 12, the gold-silver ratio hit a 26-year high by breaking through the 90-ounce mark - meaning it took over 90 ounces of silver to purchase one ounce of gold. The higher the number, the more undervalued is silver or, to put it another way, the farther gold is pulling away from silver, valued in dollars per ounce.

Over time, this is exactly what has happened.

A reading of history tells us that in ancient Egypt, the two metals were practically equals, with only 2.5 parts silver equivalent to 1 part gold. Meaning that in 3,200 BC, you could trade 5 ounces of silver for 2 oz of gold. Imagine that! If somebody took that trade today, 5 oz of silver valued at $15 per ounce would cost the buyer $75, and the seller would be parting with 2 oz of gold worth $2,800.

When the Spanish conquistadors raided the Aztec empire the gold-silver ratio established in the Edict of Medina was 10.07 parts silver for 1 part gold. In the Middle Ages it was 12:1, and under France's monetary standard in the 19th century, the ratio was set at 15.5:1. After silver was demonetized, in favor of the gold standard, silver took quite a hit; the ratio spiked to 30 at the beginning of the 20th century and has averaged 58.5 since the dollar peg was removed from the gold price by President Nixon in 1971, reports Bullion Vault.

So what does the gold-silver ratio mean and how can we use it? In the simplest terms, the gold-silver ratio tells us, as precious metals investors, which is under-valued, silver or gold? Which is over-valued, silver or gold?

The way to make money is to trade "on the extremes" of the ratio. For example at the current ratio of 84:1, a trader who has an ounce of gold could sell his gold for 84 ounces of silver.

The Balance explains this rather well, and gives a couple of historical examples.

Watching the silver to gold ratio can provide extremely useful insights into both precious metals.

Historically, it would have taken approximately 30 to 40 ounces of silver to buy one single ounce of gold.

This typically means that a ratio above 60 represents undervalued silver, while a ratio below 20 demonstrates undervalued gold.

In 1915, you could have traded 38 ounces of silver in exchange for one single ounce of gold. In 1940, near the beginning of World War II, gold soared as a safe haven asset, and the ratio was 97 to 1.

With inflation running wild in 1979, the Federal Reserve Chairman, Paul Volcker, raised interest rates to 21 percent. This resulted in driving down prices of gold, which eventually created the lowest-ever silver to gold ratio of 14.

While trying to predict future moves in the prices of the individual metals can be difficult, it may be much easier to invest based on the relationship between the two. When the silver to gold ratio is low (less than 30), then silver itself will typically rise faster than (or fall slower than) any moves you see in gold.

Gold and silver prices can move dramatically when the gold-silver ratio compresses.

Silver companies?

Recall that only 25% of silver production originates from primary silver mines. The rest is mined as a by-product of gold, copper, zinc and lead deposits. Silver exploration companies with pure-play silver projects are therefore rare, and typically trade at a premium to gold equities.

Companies with polymetallic mines that produce silver as a by-product are also highly desirable as an investment, especially during the current period of falling silver mine production.

Adam Hamilton over at Zeal Intelligence does a great job of analyzing the silver sector's performance in the second quarter, which coincides with gold's recent run. Hamilton notes that Q2 numbers are a bit skewed because it took a while for traders to be convinced that gold's up-leg was real. But he is optimistic about the third quarter especially considering how undervalued silver is right now. Here's Hamilton:

The bottom line is the major silver miners had a challenging Q2. Silver languished the entire quarter, on its way to horrific quarter-century-plus lows relative to gold. Silver didn't start perking up until mid-July, after gold's decisive bull-market breakout had lasted long enough to convince traders gold's upside was real and sustainable. So silver miners' operating cash flows and earnings were way down last quarter.

That will really change in Q3 as long as silver doesn't plummet into quarter-end. It's incredible how fast silver miners' fundamentals improve with higher silver prices. And silver's upside potential is enormous, as it has a vast way to go to normalize relative to prevailing gold prices. The more that precious-metals sentiment improves, the more capital will flow into the tiny silver sector catapulting miners' stocks far higher.

Conclusion

This article has hopefully shown how silver, despite being 17.5 times more abundant than gold in the earth's crust, is just as rare, maybe even rarer than gold, when it comes to the availability of investment-grade, 0.999 fine bullion. There just isn't a lot of it out there, given that 60% of silver is used by industry.

Both metals each have about 2.5 billion ounces currently available. The difference between them is that 60% of silver's supply is going to be used by industry - not bought by investors - and either lost to manufacturing or landfilled.

Demand for silver has never been better and mined supply is shrinking, which should put a floor under silver prices, which have seen a bottom-to-top gain (spot silver) of 28% over the past six months.

At Ahead of the Herd, we believe that the best way to benefit from silver prices going up is to invest in quality juniors that are either exploring for silver or have projects with silver as a by-product. History has shown that investing in silver juniors is the best leverage against a rising silver price.

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

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

US Shale May Be The Latest Oil Shock

Is US shale oil the key ingredient in the latest "oil shock", putting the global oil market into surplus?

-The "oil shock" of the last decade largely emanating from US shale production -US shale oil supply expected to surprise to the upside in 2020 -US oil prices well above median break-even for shale producers

By Eva Brocklehurst

Anxiety about world oil supply has increased following the attacks on Saudi Arabia's oil processing centre. The action brought back memories (for those old enough) of the "oil shocks" of the 1970s when the price of oil soared as geopolitical tensions in the Middle East escalated.

Is the same about to happen now? Probably not, given the latest attacks provoked only a relatively modest response in the oil price. Despite the kingdom being the world's largest supplier of crude oil, the disruption to global markets is likely to be remedied much sooner than it would have been back in the 1970s.

Moreover, the current disruption has occurred during a period of high global oil inventory, augmented by the rapid growth in US shale oil over the past decade. This is the main differentiating feature, Longview Economics Research argues.

That said, the analysts acknowledge there is a risk that similar disruptions such as what occurred in Saudi Arabia will happen again in coming months and, as always, each circumstance requires close attention.

The US remains the world's largest oil consumer and the "oil shock" of the past decade has largely been one emanating from an additional source of fuel oil – US shale. Without growth in US shale oil, Longview Economics points out the global market would have experienced an annual supply deficit of -4.1mbpd on average between 2012 and 2019.

Instead, the US has grown its shale oil supply such that the annual surplus has averaged 0.5mbpd over that period. Hence, the researchers assess that the oil price has been in a structural bear market since 2011, the time when US production of shale oil accelerated.

One of the main factors in determining the direction of oil prices over the next 12-18 months is US crude production. Official estimates expect growth of just under 1mbpd in 2020. Yet, the analysts suspect US shale supply will surprise (again) to the upside and grow by at least 1.4mbpd in 2020 (scenario 1).

This is based on the Longview Economics model of US shale production, and a number of conservative assumptions are included. Assumptions such as well completions and well productivity are unchanged from

current levels in the model.

Yet, shale oil companies are starting to tap into their DUC (drilled but uncompleted) well inventory. Current estimates suggest there are over 8000 DUC wells available for completion. Rig counts have been steadily falling over recent months, Longview Economics observes, and oil prices have dropped back to 2017 levels, while well completion rates have actually grown by over 60%.

Another factor is the price of oil is currently above break-even (even more so if DUC wells are being tapped). This means oil companies are profitable and likely to grow production.

The analysts assess oil prices (WTI price around US$65/bbl) are currently US$12 above median break-even levels in key shale basins and, in this scenario, 75% of shale oil producers are making a profit. Permian well productivity is also accelerating and has been rising consistently since early 2017, which is expected to persist as producer expenditure is constrained.

These factors all combine to enhance suspicions that US growth may be in excess of assumptions. Longview Economics asserts that shale oil companies are generating positive cash flow for the first time since 2014/15, a period when the oil price slumped.

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

Material Matters: Coal, Iron Ore & Base Metals

A glance through the latest expert views and predictions about commodities. Coal; iron ore; steel; base metals; and gold.

-Thermal coal prices dogged by Europe's LNG glut as supply switches to Pacific -US producers likely to succumb if supply reductions in coking coal are required -Iron ore supply rising, likely to dampen prices -A US/China trade deal likely to lift copper and pressure gold

By Eva Brocklehurst

Coal

Thermal coal prices ex Newcastle have resumed a downward trend and are now in the low US$60/t price range. The short term reprieve to the downward spiral stemmed from a temporary recovery in the European gas price, Morgan Stanley points out, amid a risk of disruption to Russian gas exports and possible nuclear closure in France. This closed the European discount to Australian thermal coal prices.

A substantial recovery in the price of thermal coal is not expected until the glut of LNG entering Europe from Russia ends. This glut is devastating demand for thermal coal in Europe, Credit Suisse notes, already under pressure from renewables. The broker has given up any hope of a significant recovery in the near term and does not expect the Newcastle price to break back above US$70/t before 2021.

The US and Columbia may have cut exports as Europe's thermal coal demand has fallen rapidly but, since the downturn in 2014/16, when annual US exports declined by around -30mt, the US is shipping a higher share of its coal to India. Meanwhile, Russia is still expanding coal exports, of which 49% are sold in the Atlantic basin, and there has been a shift to the east as Pacific prices are on average higher than the Baltic export price.

While Russia cannot fully act as a balancing factor between the two coal basins, Morgan Stanley envisages rising exports of low calorie coal out of Indonesia will also support abundant supply in the Pacific market, more than offsetting any production cuts from the Americas. Moreover, as the European market has closed to coal imports Columbia has begun shipping some coal to the Pacific as well, especially Korea and Taiwan.

In 2021 Credit Suisse expects spot LNG pressures may start to ease, allowing imports to Japan and Southeast Asia to lift. Growth in these two regions is expected to reduce the 2021 surplus and put the market back into deficit in 2022.

Morgan Stanley envisages only a very modest recovery in the thermal coal price in the coming northern winter. There is a possibility China will slow imports as annual quotas will soon be reached and demand for coal is likely to finish the year on a low.

High imports of metallurgical (coking) coal, in order to support surging steel production have caused China's ports to breach the quotas, yet a slump in metallurgical coal prices is a feature of regulation rather than supply and demand, Credit Suisse suggests.

Uncertainty is growing in China. Buyers now require discounts of over -US$40/t to risk buying seaborne coal which they may not then be able to discharge. The new year should mean new quotas and hence the price could lift.

Therefore, Australian coking coal is not expected to experience renewed discounting such as occurred this year. Nevertheless, China's total metallurgical coal demand is expected to slide -6.3%, which should reduce the demand for seaborne coal. On reducing coal price forecasts, Credit Suisse downgrades estimates for earnings for coal stocks in 2019 and 2020.

The broker envisages India will be one of the few regions of growth for metallurgical coal. Recently the country has diversified its sources, having relied on Australia, and has taken supplies from the US, Canada. Mozambique and Indonesia. Russia is also making headway in India. If India decides to participate in Russian projects this will reduce its reliance on Australian metallurgical coal, Credit Suisse points out.

If supply reductions are required in the metallurgical coal market, the broker assesses it will be US producers that succumb. US mines largely occupy the top of the cost curve and have no currency offset to assist in cost reductions.

JPMorgan also notes some sign US exports are starting to fall amid lower prices. Long-term metallurgical coal prices of US$140/t are considered appropriate. At this level US exports start to decline but there is still an incentive for Australian capacity to expand.

Spot hard coking coal prices have fallen to US$140/t, from US$185/t at the start of the year and JPMorgan considers this a function of the availability of Australian coal and weak demand from the world outside of China. The broker does not believe prices need to be that low and forecasts 2020 coking coal prices of US$154/t, pointing to a 10% improvement.

The market now appears relatively balanced to JPMorgan, as Chinese steel production growth is strong while steel production is down -3% in the rest of the world. If growth in Chinese steel production continues and Indian imports pickup following the monsoon the broker believes spot prices for metallurgical coal have some upside risk.

Furthermore, the analysis shows the US drops out of the market at around US$150/t while the next wave of Australian projects have an incentive price of US$135/t or more.

Iron Ore

Credit Suisse reduces forecasts for iron ore prices, noting increasing supply from both Brazil and Australia and potential for demand to moderate from China. The broker expects prices to remain relatively firm above US$85/t out to mid 2020 and then slide as a surplus builds.

A floor price is expected to be US$60/t, a level where steel and iron ore producers can make modest profits. Although there are no concerns for the Fortescue Metals ((FMG)) balance sheet and there are two projects that are driving growth, the broker downgrades to Underperform from Neutral. This is on the basis of the iron ore outlook, as in a falling price environment it will be difficult for the stock to outperform.

Steel

In 2020 Credit Suisse expects China's steel output will fall -4% and the share in electric arc furnace production is likely to increase. The broker expects China's steel production will peak in 2019 and then reduce at around -2.5-3.5% per annum. Current steel demand in China is driven by property and property-related construction and the property construction boom that commenced in 2018 is expected to be fading by 2021.

Base Metals

A change in Indonesian government policy to bring forward a ban on nickel ore exports to January 2020 has lifted the nickel price. UBS estimates this ban will remove around 200,000t of nickel from the market.

The broker raises nickel price forecasts for 2020 to US$7.50/lb which drives a 43% uplift to the net profit forecast for Western Areas ((WSA)). While this is a positive, the broker suggests the improvement in the nickel outlook is now recognised in the share price, as this is up 60% since June, and downgrades to Sell as a result.

UBS also downgrades near-term earnings estimates for OZ Minerals ((OZL)) , although notes the stock continues to stand out, with a large number of options for capital to be deployed and Carrapateena de-risking rapidly.

OZ Minerals and Independence Group ((IGO)) remain the broker's preferred stocks in base metals. Should the US and China reach a trade deal, UBS expects copper prices could rise towards US$3/lb and copper equities would increase around 10-20%.

Gold

UBS favours Alacer Gold ((AQG)) in the gold sector as it is still trading at a -20% discount to valuation. The broker anticipates upside risk to oxide production estimates over the next 12 months.

Gold prices have rallied 20% in the year to date on a combination of trade tensions and weakening global economic momentum as well as a decline in bond yields. A US/China trade deal is likely to cause a correction in gold and gold-exposed equities, but if bond yields remained low and geopolitical troubles continue there should be some support for the gold market, UBS suspects.

Weekly Ratings, Targets, Forecast Changes - 27-09-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday September 23 to Friday September 27, 2019 Total Upgrades: 5 Total Downgrades: 12 Net Ratings Breakdown: Buy 37.85%; Hold 45.95%; Sell 16.20%

If recommendation upgrades and downgrades from stockbroking analysts are our guide than the mood surrounding the Australian share market decisively soured last week.

Not only did FNArena register only five upgrades against twelve downgrades for individual ASX-listed stocks, eight of the downgrades shifted to Sell.

Delivering some offset is the observation four of the five upgrades moved to Buy.

So who is responsible for all those fresh Sell ratings? Mining companies, mostly, plus High PE high flyers a2 Milk and REA Group.

Retailer Premier Investments received one new Buy and Sell rating each.

Newcrest Mining and National Australia Bank are the only ones worth mentioning from a subdued looking table of positive revisions to valuations/price targets.

The negative side isn't exactly a source for excitement, but the numbers are larger led by a2 Milk, followed by New Hope Corp and Whitehaven Coal, continuing the mining theme.

Positive revisions to earnings estimates are plenty, with mining stocks at the centre, leading to sizeable increases. Fonterra and Premier Investments equally make their presence felt.

This time the numbers are of lesser magnitude on the negative side with a2 Milk leading the week's table which remains dominated by the mining sector, interspersed by Webjet and Qube Holdings.

Upgrade

IOOF HOLDINGS LIMITED ((IFL)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/3/1

Following the Federal Court decision that IOOF directors and executives did not contravene the Act, Macquarie upgrades to Outperform from Neutral.

Risks around completing the OnePath deal remain, although a material impediment has been removed.

While there is still work to be done, Macquarie believes the steps taken by IOOF to regain the confidence of the market are encouraging. Target is raised to $7.00 from $5.80.

ILUKA RESOURCES LIMITED ((ILU)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/4/0

Macquarie upgrades to Outperform from Neutral, reflecting a view that the share price over-reacted to the downside risk in the zircon market. The broker calculates Iluka Resources is now trading on free cash flow yields of 13-15%.

Target is raised to $8.70 from $8.50. The broker assesses material upside risk to forecasts running at a spot price scenario.

MONADELPHOUS GROUP LIMITED ((MND)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/2/1

Following the recent underperformance of the share price, UBS upgrades to Buy from Neutral. The broker expects Monadelphous to return to sales growth in FY20 as it transitions into iron ore replacement and sustaining capital projects from LNG construction.

Updated analysis indicates that up to 87% of the broker's FY20 sales forecasts may already be secured by long-term maintenance contracts or construction projects awarded through FY19 and FY20 to date. Target is reduced to $18.15 from $18.50.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/1/1

Macquarie found the FY19 results strong in the context of a challenging market. The company's multi-channel strategy exceeded the broker's expectations and earnings visibility has improved.

Further clarity on the wholesale channel trajectory is likely to be a positive catalyst and wholesale remains the source of upside risk, in Macquarie's view.

Rating is upgraded to Outperform from Neutral and the target raised to $20.00 from $17.20.

See also PMV downgrade.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/3/1

Morgan Stanley introduces a new valuation system for its gold stocks under coverage to better capture value and more accurately represent the current value.

The broker points out gold miners under coverage have continually found new resources and reserves and extended mine life, which is particularly pronounced for the mid-cap miners which operate assets with short lives.

The broker raises estimates for FY20 by 8% for Regis Resources and upgrades to Equal-weight from Underweight. Target is raised to $5.20 from $4.65. Industry view is Attractive.

Downgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/2/1

Citi remains convinced margin pressure will make consensus forecasts look too optimistic and the analysts have now downgraded to Sell from Neutral. The target price declines to $12.20 from $15.15.

Citi finds a2 Milk needs to increase investment in order to pursue growth in China and the US, and this translates into margin pressure. In addition, the analysts find the daigou channel is no longer reliable to drive growth and competition is increasing.

Forecasts have been reduced following incorporation of lower margins. Target price decrease also includes a reduction in valuation premium.

CLOVER CORPORATION ((CLV)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/0

In FY19 growth occurred in all regions, and while cash flow was weak it improved in the second half. UBS continues to believe the outlook strongly favours the company but, following the share price appreciation of 98% since February, most of the positive outlook appears factored in.

Hence, the rating is downgraded to Neutral from Buy and the target raised to $2.75 from $2.15.

The broker forecasts European revenues to increase out to FY21 as new regulations come into effect while any new competitor is at least 2-3 years away. There is also upside risk to forecasts should China mandate DHA increases.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 2/3/2

Morgan Stanley acknowledges Fortescue Metals is a high-quality company but the stock is now 13% above the target. The broker expects the headline iron ore price and 58% price realisation will recede from current highs in the first half of 2020 as supply rises.

Rating is downgraded to Underweight from Equal-weight. Target is raised to $7.85 from $7.65. Industry view is Attractive.

NATIONAL AUSTRALIA BANK LIMITED ((NAB)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/4/1

Following the relative outperformance in the shares over the last quarter Macquarie observes National Australia Bank's discount to its peers has narrowed. While the bank is less exposed to challenging retail banking trends, the broker envisages minimal growth in earnings per share.

With the new CEO starting later this year Macquarie also assesses the potential upside from material cost reductions is limited. Hence, the rating is downgraded to Neutral from Outperform. Target is raised to $30 from $28.

NEWCREST MINING LIMITED ((NCM)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/4

Following the recent rally in the share price Macquarie has downgraded to Underperform from Neutral. Target is $35.

NEW HOPE CORPORATION LIMITED ((NHC)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 2/1/1

Macquarie reduces thermal and coking coal price forecasts for 2019 and 2020, which weakens the outlook. Moreover, uncertainty surrounding the future of New Acland adds to the pressure on the stock.

Rating is downgraded to Underperform from Neutral. Target is reduced to $2.10 from $2.20.

OROCOBRE LIMITED ((ORE)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 3/2/1

Macquarie downgrades to Underperform from Neutral. Target is $2.50.

PREMIER INVESTMENTS LIMITED ((PMV)) Downgrade to Sell from Neutral by Citi .B/H/S: 3/1/1

Citi analysts have downgraded Premier Investments to Sell from Neutral with a slightly higher price target of $16.80 (was $16.40). The analysts don't see further re-rating happening because they don't believe earnings upgrades will happen.

With wholesale channels now the key earnings driver for Smiggle, and core retail sales slowing, Citi believes past the next six months, momentum is unlikely to stay strong.

On Citi's assessment, reported FY19 proved slightly ahead of market consensus. They also believe the share price is now trading at a premium to other discretionary retailers.

See also PMV upgrade.

REA GROUP LIMITED ((REA)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/2/1

Ord Minnett has checked depth penetration data, finding overall Premiere advertising penetration has increased to 20.0%, up from 19.4% in late August. Total depth penetration was up 44.1% for REA Group.

The broker downgrades to Lighten from Hold on valuation, with the stock trading well above the $90 target.

SOUTH32 LIMITED ((S32)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 5/1/1

Reductions to alumina and coking coal price forecasts have weakened the earnings outlook for South32 and Macquarie downgrades to Underperform from Neutral.

The broker notes the company has started to materially underperform both BHP Group ((BHP)) and Rio Tinto ((RIO)).

The absence of iron ore in the portfolio and the declining alumina and aluminium prices have combined to drive the underperformance, in Macquarie's view. Target is reduced to $2.60 from $2.70.

SANDFIRE RESOURCES NL ((SFR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/3/0

Following the recent rally in the share price, Macquarie downgrades to Neutral from Outperform. Target is steady at $6.80.

WHITEHAVEN COAL LIMITED ((WHC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 5/1/0

Reductions to 2019 and 2020 coking coal estimates and 2019 reductions for thermal coal have weakened the outlook and Macquarie downgrades to Neutral from Outperform. Target is reduced to $3.40 from $4.00.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ILUKA RESOURCES LIMITED Buy Neutral Macquarie 2 IOOF HOLDINGS LIMITED Buy Neutral Macquarie 3 MONADELPHOUS GROUP LIMITED Buy Neutral UBS 4 PREMIER INVESTMENTS LIMITED Buy Neutral Macquarie 5 REGIS RESOURCES LIMITED Neutral Sell Morgan Stanley Downgrade 6 CLOVER CORPORATION Neutral Buy UBS 7 FORTESCUE METALS GROUP LTD Sell Neutral Morgan Stanley 8 NATIONAL AUSTRALIA BANK LIMITED Neutral Buy Macquarie 9 NEW HOPE CORPORATION LIMITED Sell Neutral Macquarie 10 NEWCREST MINING LIMITED Sell Neutral Macquarie 11 OROCOBRE LIMITED Sell Neutral Macquarie 12 PREMIER INVESTMENTS LIMITED Sell Neutral Citi 13 REA GROUP LIMITED Sell Neutral Ord Minnett 14 SANDFIRE RESOURCES NL Neutral Buy Macquarie 15 SOUTH32 LIMITED Sell Neutral Macquarie 16 THE A2 MILK COMPANY LIMITED Sell Neutral Citi 17 WHITEHAVEN COAL LIMITED Neutral Buy Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 FSF FONTERRA SHAREHOLDERS' FUND -33.0% -50.0% 17.0% 3 2 ILU ILUKA RESOURCES LIMITED 33.0% 17.0% 16.0% 6 3 MFG MAGELLAN FINANCIAL GROUP LIMITED -71.0% -83.0% 12.0% 7 4 APE AP EAGERS LIMITED 90.0% 88.0% 2.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 APT AFTERPAY TOUCH GROUP LIMITED 67.0% 100.0% -33.0% 3 2 NHC NEW HOPE CORPORATION LIMITED 25.0% 50.0% -25.0% 4 3 ORE OROCOBRE LIMITED 33.0% 50.0% -17.0% 6 4 NCM NEWCREST MINING LIMITED -67.0% -50.0% -17.0% 6 5 A2M THE A2 MILK COMPANY LIMITED 8.0% 25.0% -17.0% 6 6 SFR SANDFIRE RESOURCES NL 42.0% 58.0% -16.0% 6 7 WHC WHITEHAVEN COAL LIMITED 64.0% 79.0% -15.0% 7 8 QUB QUBE HOLDINGS LIMITED -40.0% -25.0% -15.0% 5 9 S32 SOUTH32 LIMITED 57.0% 71.0% -14.0% 7 10 NAB NATIONAL AUSTRALIA BANK LIMITED 7.0% 21.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NCM NEWCREST MINING LIMITED 31.252 30.652 1.96% 6 2 NAB NATIONAL AUSTRALIA BANK LIMITED 27.214 26.929 1.06% 7 3 ILU ILUKA RESOURCES LIMITED 8.942 8.867 0.85% 6 4 MFG MAGELLAN FINANCIAL GROUP LIMITED 49.171 49.033 0.28% 7 5 APT AFTERPAY TOUCH GROUP LIMITED 33.517 33.425 0.28% 3 6 ORE OROCOBRE LIMITED 3.628 3.620 0.22% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 A2M THE A2 MILK COMPANY LIMITED 13.888 14.625 -5.04% 6 2 NHC NEW HOPE CORPORATION LIMITED 2.650 2.738 -3.21% 4 3 WHC WHITEHAVEN COAL LIMITED 4.000 4.121 -2.94% 7 4 QUB QUBE HOLDINGS LIMITED 2.976 3.020 -1.46% 5 5 S32 SOUTH32 LIMITED 3.204 3.240 -1.11% 7 6 SFR SANDFIRE RESOURCES NL 6.950 6.967 -0.24% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ORE OROCOBRE LIMITED 1.516 0.472 221.19% 6 2 FSF FONTERRA SHAREHOLDERS' FUND 23.449 12.903 81.73% 3 3 IGO INDEPENDENCE GROUP NL 33.788 27.938 20.94% 4 4 WSA WESTERN AREAS NL 29.540 25.273 16.88% 6 5 PMV PREMIER INVESTMENTS LIMITED 91.562 80.950 13.11% 5 6 APE AP EAGERS LIMITED 45.374 43.868 3.43% 5 7 ILU ILUKA RESOURCES LIMITED 70.467 68.533 2.82% 6 8 SFR SANDFIRE RESOURCES NL 82.583 81.000 1.95% 6 9 EVN EVOLUTION MINING LIMITED 24.671 24.386 1.17% 7 10 TAH TABCORP HOLDINGS LIMITED 20.217 20.050 0.83% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 APT AFTERPAY TOUCH GROUP LIMITED 2.433 6.200 -60.76% 3 2 WHC WHITEHAVEN COAL LIMITED 23.763 27.920 -14.89% 7 3 WEB WEBJET LIMITED 67.124 78.204 -14.17% 5 4 NHC NEW HOPE CORPORATION LIMITED 21.845 25.445 -14.15% 4 5 OZL OZ MINERALS LIMITED 45.294 47.909 -5.46% 7 6 S32 SOUTH32 LIMITED 21.278 22.410 -5.05% 7 7 AWC ALUMINA LIMITED 18.071 18.606 -2.88% 6 8 QUB QUBE HOLDINGS LIMITED 8.508 8.725 -2.49% 5 9 RIO RIO TINTO LIMITED 985.596 1007.758 -2.20% 7 10 NCM NEWCREST MINING LIMITED 161.769 165.027 -1.97% 6 Technical limitations

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Uranium Week: Not A Pretty Picture

It was another slow week in the uranium market, while Macquarie has dissected the demand/supply equation going forward.

-Cuts on both demand and supply sides -Uranium supply surplus to continue -Activity again subsides

By Greg Peel

Macquarie Group's commodity analysts estimate global uranium demand, from power generators and investors combined, will fall -1.9% in 2019 and a further -4% in 2020. Currently the largest consumers of uranium are the US (30%), France (14%), China (12%) and Russia (8%). China's consumption is expected to increase by 5% per year for the next five years.

On the supply side, 2018 saw an unprecedented -10% annual drop in production, which, net of inventory drawdowns, resulted in an -8.5% reduction in total supply, mainly due to Cameco's indefinite closure of its McArthur River mine and Key Lake processing facility in Canada. Cameco has an annual production capacity upward of 30mlbs per annum but will likely produce only 18-20mlbs in 2019, Macquarie forecasts, representing an -8-10% cut in global supply.

On the balance of reductions in both demand and supply, Macquarie anticipates a 2-3% surplus of uranium in 2019-20, sufficient to keep the price capped at current levels. The analysts have a long term forecast price (inflation-adjusted) of US$32/lb.

Supply

Production cuts by Cameco, Kazakhstan's Kazatomprom and Australia's Paladin Energy ((PDN)) together cut 2018 production by -24mlbs U_3O_8, or -15% of 2019 supply.

Paladin's Kayelekera mine in Mali remains shuttered while moves are underway to restart operations at the company's flagship Langer Heinrich mine in Namibia. Management is optimistic about uranium prices ahead. Cameco is currently buying uranium in the spot market to satisfy delivery contracts as it is cheaper than the cost of production and has no plans to do otherwise until prices improve. Kazatomprom is the world's swing producer and recently extended its cap on production through to 2021.

Cameco and Kazatomprom together provide the greatest impact on the supply side of the equation.

Demand

The Fukushima disaster of 2011 still reverberates in today's global energy industry, Macquarie notes, with Germany planning to shut down seven reactors and Belgium seven reactors – just to name two – representing -4% of global demand, in a backlash against the dangers of nuclear power.

For the US, reactor closures are a commercial decision, given lack of competitiveness in the country's energy mix. Six reactors have closed since 2013, eight are scheduled to be closed by 2025, while two new reactors are being built with government support. The US currently has 97 operating reactors, providing 20% of US electricity supply.

In Japan, only nine of a fleet of 39 reactors still able to be operated post-Fukushima have restarted generation, with another 17 seeking restart approval. The Japanese federal government is targeting a return to at least 20% nuclear in its energy mix by by 2030 but the pace of restarts has been, and no doubt will continue to be, hampered at the local government level due to public protest.

Were the pace of Japanese restarts to pick up, it would be positive for market sentiment, but given Japanese utilities are for the most part still sitting on their uranium inventories there is little chance of a near-term spike in demand.

Global nuclear power generation has fallen to 10% of global electricity supply, Macquarie notes, from 14% pre-Fukushima. There are 444 reactors currently operating across the globe and 55 being built.

The swing player on the demand side is China, which has 47 reactors now in operation, representing 4.2% of the country's electricity production, and another 11 currently under construction.

Nothing to see here

The uranium market once again fell into the doldrums last week. Industry consultant TradeTech reports only 500,000lbs U3O8 equivalent changing hands in five transactions, which is about half of the recent weekly volume trend in what is already a weak trend in general in 2019.

TradeTech's weekly spot price indicator has fallen -US10c to US$25.70/lb.

There were no transactions reported in term markets, although several utilities are exploring potential purchases. TradeTech's term price indicators remain at US$28.00/lb (mid) and US$30.00/lb (long).

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

The Short Report - 3 Oct 2019

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

Summary:

Week ending September 26, 2019

Last week saw the ASX200 plateau before pulling back on impeachment proceedings. Nothing, of course, like what was to come this week.

In last week's Report I noted Bellamy's Australia ((BAL)) shorts fell from 15.0% to 6.6% as the share price rallied 55% on a takeover offer. It is still not a given that the takeover will receive government approval but last week Bellamy's shorts fell to below 5%.

Other moves last week of a percentage point or more include Bingo Industries ((BIN)), to 10.2% from 9.2%, and Speedcast International ((SDA)), to 9.7% from 8.5%. See below.

All other red and green moves on the table below are more minor.

For the record we might note Blackmores ((BKL)) has crept into the 10%-plus club as the market continues to sour on China-dependent retailers (Bellamy's now excluded) and we also welcome two newbies to the bottom of the table – agricultural REIT Rural Funds Group ((RFF)) and international Property REIT Cromwell Property Group ((CMW)).

Weekly short positions as a percentage of market cap:

10%+ NUF 17.4 ORE 16.3 SYR 16.2 GXY 16.1 ING 15.0 NXT 14.4 JBH 13.1 GWA 12.3 HUB 11.5 BIN 10.2 BKL 10.1 DMP 10.0

In: BIN, BKL

9.0-9.9

SDA, BOQ, CGC, MYS, IVC, BGA

In: SDA, IVC, BGA Out: BIN, BKL, BWX, IFL 8.0-8.9%

PPT, BWX, IFL, DCN, HVN, RWC, SUL, SGM, OML, CGF

In: BWX, IFL, DCN Out: IVC, BGA, SDA

7.0-7.9%

CLH, PLS, NEA, CSR, MYR

In: DCN Out: SAR, AMP

6.0-6.9%

SAR, A2M, AMP, NCZ, SFR, CUV

In: SAR, AMP Out: BAL, PGH

5.0-5.9%

RSG, CLQ, PGH, CTD, GEM, WEB, ADH, COE, NEC, GMA, KGN, MIN, BAP, MSB, RFF, SEK, NWL, FMG, LNG, CMW, EHL

In: PGH, RFF, SEK, NWL, FMG, CMW Out: ALG, JHG

Movers & Shakers

Last week waste manager Bingo Industries sold its Banksmeadow recycling facility in Sydney to private equity. One might expect, given a sudden focus on Australia's need to deal with its own waste, private equity would be quite keen but the price was less than expected.

Macquarie noted the low price reduced the company's share buyback capacity and suggested it remained unclear how Bingo was going to cope with a challenged outlook. Shorts rose to 10.2% from 9.2%.

There was no new news out of embattled satellite company Speedcast International last week but the share price continued its decline, falling -12% to our cut-off date of September 26. Speedcast shorts increased to 9.7% from 8.5%.

Over the next four sessions, Speedcast shares rallied 22%.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.6 1.0 RIO 4.8 4.9 ANZ 0.7 0.6 S32 1.4 1.2 BHP 3.3 3.4 SCP 1.0 1.2 BXB 0.1 0.1 SUN 0.5 0.5 CBA 0.8 0.9 TCL 0.3 0.4 COL 1.1 1.0 TLS 0.2 0.3 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.4 0.4 WES 0.8 0.9 MQG 0.6 0.6 WOW 0.8 0.8 NAB 0.7 0.6 WPL 0.7 0.7 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.

Summary:

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.6 1.0 RIO 4.8 4.9 ANZ 0.7 0.6 S32 1.4 1.2 BHP 3.3 3.4 SCP 1.0 1.2 BXB 0.1 0.1 SUN 0.5 0.5 CBA 0.8 0.9 TCL 0.3 0.4 COL 1.1 1.0 TLS 0.2 0.3 CSL 0.2 0.2 WBC 0.8 0.8 IAG 0.4 0.4 WES 0.8 0.9 MQG 0.6 0.6 WOW 0.8 0.8 NAB 0.7 0.6 WPL 0.7 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

The Wrap: Housing, Cash Rate & Wealth

Weekly Broker Wrap: petrol; infant formula; housing & cash rates; wealth managers; platforms; and childcare.

-Higher refiner margins slightly positive for Caltex and Viva Energy -Market growth in infant formula slows in China -Little recovery in new housing and record low credit growth -More provisions likely for wealth managers -Margins likely to be squeezed for platforms

By Eva Brocklehurst

Petrol

Regional refiner margins rose significantly over the September quarter and UBS notes second half base margins in the year to date are up $3.20/bbl to $6.55/bbl. Reasons for the jump include a decision to permanently shut the Philadelphia Energy Solutions refinery (the company has filed for Chapter 11) and temporary disruption from the strikes on Saudi Arabian oil refineries.

Overall, UBS considers this slightly positive for both Caltex ((CTX)) and Viva Energy ((VEA)). Stronger than expected refiner margins are offset by weaker retail fuel margins. UBS upgrades FY19 net profit estimates by 3-6% for both stocks and prefers Viva Energy for its medium-term earnings upside.

Infant Formula

UBS observes market growth in infant formula in China has slowed while premium and local brands are outperforming. Margin differences between channels are narrowing and the cost to operate online is rising.

Recent feedback suggests some de-stocking pressure in the daigou channel (purchases made locally for sale in China) but consolidation is likely to have a positive impact on pricing in the long-term. Overall, the broker came away from a meeting with Chinese operators more cautious about the outlook for the international mass market and more positive about premium and local brands.

The broker expects near-term volume will remain challenged and competition will increase. Meanwhile, the regulatory focus is on quality and safety and recent changes appear to be having an impact.

China's National Development & Reform Commission has announced it will strive for over 60% self-sufficiency for the infant formula market. UBS envisages local Chinese operators with strong brand positions and clear multi-brand channel strategies are best positioned followed by international premium brands such as a2 Milk ((A2M)), Danone and Nestle.

Housing & Cash Rates

Residential building approvals dropped -1.1% in August to a low not seen for more than six years. On the positive side, UBS notes, the value of non-residential building approvals has rebounded sharply, likely reflecting a lumpy public sector, such as the case with hospitals.

Despite a recovery in auction clearance rates in September the recovery in house prices is mainly driven by Sydney and Melbourne. The number of home sales have still fallen to almost the worst on record and around the lowest level in 23 years, the broker points out.

Morgan Stanley agrees volumes remain low and are unlikely to recover quickly. Current availability of credit is not sufficient to cause an acceleration in prices and turnover and this is why the broker's key indicators are not suggesting a sustained bounce in the housing market.

Moreover, given the slump in building approvals and the lag to construction, activity is likely to decline over the next 12-18 months, even though prices have picked up. This suggests to Morgan Stanley there are broader implications for jobs growth and economic activity. Loan approvals will be an important leading indicator to watch for housing market conditions, the broker adds.

UBS argues, with little recovery in new housing and record low credit growth, the Reserve Bank of Australia is likely to cut official cash rates further. The broker was a little surprised at how much the central bank strengthened its easing bias in the statement accompanying the October reduction in the cash rate to 0.75% and expects the next -25 basis points reduction will now be in November or December, not February 2020 as previously pencilled in.

On face value, the recent new macro model from the RBA implies that a 0.5% cash rate over the next few years would likely fall short of achieving the 2-3% inflation target band, Goldman Sachs observes.

The model indicates the RBA would need to implement a -1% cash rate to achieve its unemployment and inflation goals over a 2-3-year forecast horizon. Assuming the central bank refrains from implementing negative rates, the broker estimates an equivalent amount of stimulus could be delivered by lowering rates to their effective lower boundary, i.e. 0-0.25%, and implementing a quantitative easing program of around $200bn.

Goldman Sachs cautions against a literal interpretation of the RBA's dovish implications, given large economic models always have limits and carry considerable uncertainty. Still, it does underscore that risks to its base case for the cash rate to drop to 0.5% are to the downside.

Wealth Managers

National Australia Bank ((NAB)) has announced further provisions for remediation in its wealth management division and JPMorgan notes, relative to planner numbers, this is much higher than the provisions taken by AMP ((AMP)) and IOOF ((IFL)).

The broker's calculations show NAB, Westpac Bank ((WBC)) and Commonwealth Bank ((CBA)) appear to have taken the largest provisions, with IOOF and AMP lagging materially.

While acknowledging the processes employed at the different institutions for remediation may be different and there is a wide range of possibilities, the broker points out there are some risk still relating to class actions or new issues that ASIC could uncover.

Even if ASIC has previously indicated it is comfortable with the wealth managers' processes, ultimately these views may change and it is unlikely that this is the last in terms of possible one-off charges.

Platforms

Assuming HUB24 ((HUB)) and Netwealth ((NWL)) completely pass through the recent cut to official rates, net of administration fees, Macquarie calculates the majority of account holders will be generating negative cash returns. The broker envisages little ability to offset the impact with re-pricing options.

Furthermore, increased earnings pressure is expected as macro conditions present unprecedented complications for operators. The broker reaffirms Underperform ratings for both stocks.

Margins are likely to be squeezed on both sides from the reduction in the official rates and the potential risk faced by platform operators if pooled capital is unable to be classified as retail deposits via the contracts with ANZ Bank ((ANZ)).

Childcare

There were 75 new long day care centres opened in Australia in the September quarter which compares to 92 in the prior September quarter. Canaccord Genuity points out this is a -18% decline and confirms expectations of moderating supply growth.

The data signals supply growth in the year to date is 3.8% and, while meaningful, demand appears to be is more than compensating for this growth. Hence, operators are experiencing improvements in occupancy.

Recent data from the Department of Education and Training shows the number of children attending child care and the hours are increasing. Of the 75 centres, Canaccord Genuity notes 21 are located within 2km of a G8 Education ((GEM)) centre. The broker rates the stock Hold with a $2.45 target.

Only three of the newly opened centres are within a 2km radius of a Think Childcare ((TNK)) centres while Mayfield Childcare ((MFD)) has two. Canaccord Genuity rates the latter two stocks as Buy with targets of $1.31 and $0.95 respectively.

SMSFundamentals: Fat Cat Superannuation Funds Feed Off Fees

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

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

Fat Cat Superannuation Funds Feed Off Fees

A new report reveals what investors may already know, that "fees make all the difference" to final outcomes for superannuation members' retirement savings, with many funds struggling to generate returns strong enough to cover the negative impact of high investment fees.

-Investors reap the best returns when super funds charge less than 1% in fees -QSuper and UniSuper claim the largest numbers of low-fee, high-return funds -ANZ and AMP own the largest numbers of high-fee, low-return super funds -Index funds on average beat 90% of super funds.

By Nicki Bourlioufas

The 2019 research, Fat Cat Funds Report 2019 from investment adviser Stockpot.com.au, finds the best-performing superannuation funds charge less than 1% in investment fees. Stockpot calls these top performers the 'Fit Cat Funds'. This year they were led by QSuper and UniSuper. By contrast, the worst-performing funds charge average fees of more than 2%. This year these 'Fat Cat Funds' were led by ANZ Bank ((ANZ)) and AMP ((AMP)).

To come up with its ratings, Stockpot analysed 600 of Australia's largest superannuation funds to find the best and worst performing funds. It then ranked the funds on how they performed after fees over five years, compared to other funds in the same asset category.

Super members come out best when fees less than 1%

High fees affect everyone, regardless of their age or stage. A member of a superannuation fund that charges less than 1% in investment fees would be $200,000 better off at the end of their working life than someone in a fund that charges 2%, the report found.

The people worst affected will be those now aged in their 20s and 30s who have more years of work ahead of them. However, people nearing retirement are also badly affected by fees. Although their investment strategies usually become more conservative, and thus fees drop, the larger size of their portfolios means they are losing a big slice of their returns.

Across the industry, superannuation funds charged the highest fees for aggressive funds, followed by growth, balanced and moderate risk funds. However, the total average fee charged across these four categories by the best-performing funds - the Fit Cats - was less than half that charged by the worst-performing funds - the Fat Cats.

The Fit Cats charged a total average fee of 0.93% across the four risk categories - 1.08% for aggressive management, 1.01% for growth funds, 0.82% for balanced and 0.81% for moderate risk funds.

The Fat Cats charged a total average fee of 2.07% across the categories - 2.61% for aggressive, 2.38% for growth, 1.79% for balanced and 1.5% for moderate.

"Our analysis shows that there is approximately $7 billion sitting in the largest 40 Fat Cat Funds, costing Australians $150 million in fees every year!" Stockpot says.

ANZ and AMP the worst of the Fat Cat Fund managers

ANZ/OnePath topped the list of Fat Cat Funds for the seventh year running, Stockpot says, being responsible for 11 out of the 40 worst funds. ANZ shares the honours with AMP, which also had 11 Fat Cat Funds. As well, Stockpot gave Fat Cat Fund ratings to four Perpetual funds, three MLC funds and three Zurich superannuation funds.

By contrast, Stockpot gave its Gold Fit Cat Fund Award to QSuper, which manages nine Fit Cat Funds. QSuper manages $100 billion in superannuation investments.

The Silver Fit Cat Fund award went to UniSuper, which won gold in 2018. Bronze went to AustralianSuper, which has four Fit Cat Funds. AustralianSuper is the country's largest with $160 billion under management for 2.2 million members.

“Despite having different investment strategies, the one factor these three funds all had in common was investment fees of well under 1%,” Stockpot says. “Every Fit Cat Fund had fees of less than 1% with an average fee of 0.76%.”

Indexing the answer to high fee drag on member returns

Stockpot argues superannuation funds should use indexing investing, noting the “index funds on average beat 90% of super funds”.

“Investing is one of the few places where the more you pay, the less you get,” the report says.

“Because indexed portfolios are low cost, they beat almost all higher cost funds over the long run,” the report says.

Investing in an index means buying shares in all companies that make up that index, in the same proportion. This passive investment strategy aims to mimic, or replicate, the performance of the index.

Stockpot argues that superannuation managers choose not to index because of conflicts of interest that remain despite several government inquiries into the financial services industry.

“All of the players in the super game have a vested interest to appear to be ‘active’ in making adjustments to their recommendations from year to year,” the report says. “Consultants to superannuation funds want to earn recurring fees, and fund managers need a reason to justify their high six or seven figure salaries.”

Stockspot.com.au bills itself as “Australia’s most experienced investment adviser”, established with the aim of doing away with the “high fees, confusing jargon, endless paperwork and lack of transparency” that give the wealth management industry “a bad name”.

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