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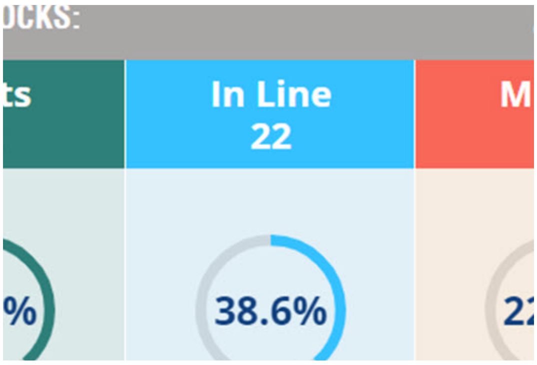

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FNArena
Financial News, Data & Analysis
GPO Box 3145 - Sydney NSW 2001
info@fnarena.com

Your editor:
Rudi Filapek-Vandyck
Your dedicated team of journo's:
Greg Peel, Eva Brocklehurst & Sarah Mills

AUSTRALIA

Telstra Dials Up Dividend Speculation

After years enduring headwinds from the roll-out of the NBN, Telstra is currently enjoying strong free cash flow. Is it time for a hike in dividends?

-Many positives emerging amid earnings growth for the first time in 4-5 years
-Focus now on restructure, 5G and health opportunities
-Mobile key to delivering Telstra's FY23 ambitions

By Eva Brocklehurst

It has been a while since Telstra Corp's ((TLS)) results inspired so much confidence. After several years of questioning the sustainability of dividends, brokers are now more confident the pay-out will be easily supported by operating earnings in FY22 and FY23.

Free cash flow is running ahead of expectations and Credit Suisse is now of the view this can justify an increase in the dividend from the current $0.16. Admittedly, this could be constrained by the availability of franking credits but the focus now turns to whether an increase is appropriate rather than whether the current dividend is sustainable.

Several items were a "positive surprise" to Morgan Stanley amid mobile revenue and earnings growth for the first time in 4-5 years. These include FY22 growth guidance and the share buyback, as well as the continued exploration of options to unlock value in infrastructure.

UBS asserts an inflection point has been reached following several years of pressure from the NBN. The broker is comfortable that guidance can be underpinned by cost savings, mobile revenue growth (a large part of which will be post-paid growth), a rebound in network application/services income and around $30m of extra recurring NBN income.

The announcement of a $1.35bn on-market buyback was consistent with the company's promise as part of the sale of the towers segment in June.

The highlight for Morgans in FY21 was mobile services revenue and the fact that for the first time in years Telstra delivered a "good, clean result". Underlying operating earnings (EBITDA) of $6.7bn was down -9.6%, yet in line with broker forecasts and above the lower end of prior guidance.

Management remains pleased with the amount of cost reductions and the strong performance of mobiles, noting a diminishing financial impact from the rolling out of the NBN.

<u>Guidance</u>

Underlying FY22 operating earnings guidance is $7.0-7.3bn, which at the mid point of the range is up 6.7%. This has not allowed for any additional customer support relating to the pandemic, although the company is not expecting FY22 will shape up the same way FY20-21 was affected.

Guidance does not assume a reversal of the $380m in pandemic-related headwinds contained within the FY21 base, UBS reflects, while it assumes a degree of normalisation in FY23.

The company believes the path has been cleared for $7.5-8.5bn in underlying operating earnings and a return on investment of around 8% by FY23. This includes around $50m in non-cash accounting from in-sourcing Telstra-branded retail stores.

FY23 guidance also includes no return to international roaming and Credit Suisse suggests any reversal of these items in FY23 would mean that only limited organic growth would be required to reach the lower end of earnings aspirations.

<u>Opportunities</u>

Macquarie sounds a note of caution regarding Telstra's ambition to reach a mid-teens NBN re-seller earnings margin in FY23, as this requires a number of things to go right, including consumers taking out higher plans, add-ons and cost benefits from digitisation.

Still, the company has exceeded its target for recruiting new capabilities in areas such as software engineering, data analytics, cyber security and artificial intelligence, hiring an additional 1500 personnel.

Telstra is in the process of creating three separate legal entities comprising fixed infrastructure (NBN, fibre & property), towers and the service company. Ord Minnett notes, after the recent sale of the towers, the next monetisation opportunity is fixed line infrastructure.

The broker calculates a value of $46bn, which would be more than Telstra's market capitalisation if it is undertaken at a similar multiple to the towers sale. UBS suspects the investor briefing on September 16 could be the catalyst, as the company will unveil its post-tower strategy.

The broker also expects further detail on 5G opportunities and the fixed infrastructure spin off. Telstra has also indicated it may focus on its health division at the strategy update.

Macquarie notes health is expected to experience organic revenue growth in the high teens in FY22 and Telstra has entered into a binding agreement to acquire Medical Director, a provider of practice management software to GPs. Telstra's "ventures" segment has also invested in 74 start-ups.

Morgans flags the improving industry dynamics and believes **Telstra's sum of the parts is now worth more than the current share price**. Further steps to extract value include the legal restructure and. while Telstra was aiming to obtain a vote ahead of the AGM on October 12 2021, the broker suspects the may occur later in the year.

<u>Mobile</u>

More rational industry pricing has surfaced in mobiles and UBS is hopeful this will be maintained, observing a more stable environment is being reflected in the relatively low net additional mobile subscribers in the second half.

In a 5G world UBS believes, with consumer revenue growth currently playing out and materialising upside for enterprise revenue, there is potential for a valuation of Telstra above $4.00. Macquarie points out Telstra's 5G network is now more than twice the size of its nearest competitor.

UBS assesses the market is broadly pricing in Telstra attaining its medium-term aspirations, along with some recognition of the value of infrastructure, and other potential positives such as changes to NBN pricing or more substantial 5G mobile upside are yet to be reflected in the price.

Credit Suisse understands, division-wise, mobile will be key to delivering FY23 ambitions. Mobile now accounts for more than 50% of underlying operating earnings. Also, the broker points out, post-paid net additions in the second half, while less than competitor Optus, did not decline compared with 2020 levels as the latter did.

Credit Suisse recognises the upside for Telstra is not as compelling as it was, say, 12 months ago, but the stock is still trading below valuation and offering a 4% dividend yield. FNArena's database has four Buy ratings and one Hold (UBS). The consensus target is $4.22, suggesting 5.2% upside to the last share price.

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AUSTRALIA

Pinnacle Scales Higher Peaks

While FY21 results for Pinnacle Investment Management prompted some downgrades to broker ratings, target prices rose materially and offshore expansion opportunities beckon.

-Pinnacle increases FUM by 52%
-Distribution is gaining traction in international markets
-Macquarie expects ongoing performance to exceed market expectations
-Successfully exporting the model should provide longevity to the growth

By Mark Woodruff

Pinnacle Investment Management ((PNI)) recently reported FY21 results, revealing higher than average funds under management (FUM), which should generate a strong start for FY22.

The company holds equity interests in 16 boutique investment managers that collectively manage assets across a diverse range of asset classes. It provides the managers with access to capital, distribution capability and infrastructure.

Pinnacle holds minority equity interests (typically 23-49%) in the affiliated firms, which include some names that may resonate with the reader, such as Hyperion Asset Management, Firetrail Investments and Coolabah Capital Investments.

The company stands to benefit as affiliates grow FUM and as new affiliates are added to the platform.

In FY21, group FUM climbed 52% on the previous corresponding period to close at $89.4bn, driven by net inflows of $16.7bn and investment performance of $14.0bn.

Other features of the result included a **107.1% year-on-year rise in profit, which beat consensus by 7.2%**. Affiliate gross revenue and margin performance also climbed and were considered the standout metrics by Wilsons. Pinnacle's share of affiliate's profit of $66.7m was an increase of 75% versus the previous corresponding period.

Retail FUM flows were also encouraging, with the monthly net flow average increasing materially year-on-year and likely to continue, predicts the broker. This is considered typical when funds achieve positive ratings with agencies and asset managers.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, increases its target price to $16.50 from $11.90. Upside from post-result earnings upgrades leaves room to lift its rating to Overweight from Market Weight. This is due to the good position of affiliates, offering current net margin upside. Additionally, **distribution is gaining traction in international markets** and the aforementioned growing retail FUM flows are achieving a higher margin and exhibiting more stickiness.

Meanwhile, Macquarie maintains its Outperform rating and increases its target price to $15.33 from $12.28.

Despite upgrading its FY21 forecasts by more than 80% during the second half, the company still reported FY21 EPS around 6% ahead of the broker's expectation.

The broker expects **Pinnacle's earnings performance will continue to exceed market expectations**. It has the potential to add accretive M&A and there's also an attractive organic growth outlook. The latter is backed by net flows, performance fees and operating leverage, and continues to support upside risk to the broker's estimates in FY22 and beyond.

While maintaining a positive outlook, both Ord Minnett and Morgans downgrade respective ratings as the stock is now trading in line with valuation. The former downgraded to Accumulate from Buy and raised its target price rise to $15.20 from $12.50 after a strong beat across all of its forecasts. Meanwhile, Morgans downgraded its rating to Hold from Add and increased its target price to $14.48 from $11.85.

Offshore expansion?

Pinnacle has stated **offshore opportunities are becoming compelling**. The inability to travel is currently impeding progress and Morgans envisages distribution and smaller 'build' opportunities are likely to feature nearer term.

While successfully exporting the model offshore will provide longevity to the growth profile, the broker believes there is significant further scale to be achieved within the current stable of managers and via the addition of further affiliates.

Ord Minnett points to $155m of "dry powder" cash and equivalents for further acquisition opportunities in both Australia and offshore markets.

Performance Fees

Affiliates achieved gross performance fees of $85.9m in FY21, resulting in a second half net fee to Pinnacle of $8.4m. Wilsons remains comfortable with the investment manager's risk-weighted approach and forecasts gross/net performance fees of $50m/$13m in the medium-term.

This essentially builds into forecasts the potential for $25m in gross fees to not eventuate for the 15 strategies outside of the affiliates Palisade, Coolabah Capital Investments and Metrics, which have more certain performance fees.

FNArena's database has two Buy ratings and one Hold for Pinnacle Investment Management with a consensus target price of $15, which signals -4.1% downside to the last share price.

AUSTRALIA

Mirvac's Earnings Wired To Apartment Resurgence

While Mirvac's guidance reflects the need to be cautious against the covid backdrop, brokers expect the "real" growth story awaits the resurgence in apartments a year from now and beyond.

-Brokers suspect covid-led uncertainty in FY22 is masking longer-term growth upside
-Timing of future earnings benefits subject to the pending launches of new projects, plus future capital partnering arrangements
-Double-digit growth forecasts in FY22/FY23 driven by substantial apartment pre-sales

By Mark Story

Despite the cautious nature of Mirvac Group's ((MGR)) below consensus FY22 earning (EPS) guidance, for 7% growth to 15.0c, and distribution of 10.2c a security, brokers appear confident the developer is gearing up for stronger longer-term growth than it is currently brave enough to admit.

There were no surprises from Mirvac's mixed FY21 result, highlighted by a -9% fall in operating profit to $550 million, and a 61% leap in statutory profit to $901m due to revaluation gains across its portfolio of retail, CBD office blocks, and residential holdings. Due to revaluation gains, Mirvac's net tangible assets (NTA) increased 5% to $2.67m from $2.54m in FY20.

What did surprise brokers was the group's highly conservative outlook especially given the group's strong residential performance. However, Macquarie believes Mirvac's willingness to provide (any) guidance against the current backdrop highlights the resilience of the group's commercial portfolio, driven by long WALE (weighted average lease expiry) retail assets and certainty in development earnings.

It is too early to tell what impact lockdowns will have in FY22. Nevertheless, Morgan Stanley suspects the group's underwhelming guidance, which assumes 3-6 months of disruptions from lockdowns, **gives ample room for Mirvac to lift expectations later in the year.**

Two key drags on guidance compared to brokers' expectations were additional rental relief, given the uncertainty surrounding the length of current lockdowns, and the announced $600m divestment of non-core assets expected in FY22. Mirvac confirmed the sale of the Tucker Box Hotel Group for $620m being a 19% premium to carrying value.

Mirvac is also understood to be factoring for around $20m of provisioning related to covid in first half FY22, with this moderating in second half FY22.

While Mirvac's guidance was -4% below UBS's expectations, the broker's FY22-FY24 forecasts remain unchanged based on the underlying health in the business and the group's history of conservative guidance. UBS is forecasting 12% growth in each of FY22 and FY23 based on an improving backdrop for commercial development and substantial apartment pre-sales.

Despite some conservative assumptions around covid impacts, Credit Suisse is also optimistic that investment net operating income will trend higher due to the impact of development completions. Based on plenty of visibility over the composition of the commercial and mixed-use development pipeline, which could provide a combination of recurring income plus trading profit, the broker still thinks the "real" growth story starts in FY23.

Beyond this point, Credit Suisse expects apartments to again make a meaningful contribution to earnings, plus the full-year contribution from completed active commercial developments, and most brokers tend to be in broad agreement.

Stronger residential earnings are the major driver of upgrades to Citi's EPS forecasts, with management highlighting that 90%-plus of FY22 residential earnings has been secured, a record for this point in the year.

Highlights of Mirvac's FY21 result included new sales of 3,400, including $300m of apartments, and 2,526 settlements versus guidance of 2,200.

Improving residential earnings aside, **other potential earnings tailwinds highlighted by Citi include stronger commercial development profits, additional net operating income from development completions, declining debt costs, and ramp-up in build to rent (BTR).**

Despite the roll-off in commercial profits, Macquarie expects FY23 operational EPS to grow by 10% due largely to apartment completions and no rental relief. Consistent with previous expectations, Macquarie expects to see an improving outlook for the group's apartment developments, with pre-sales aiding earnings visibility into FY23 and beyond.

The broker currently expects development profits of $79m in FY22 to roll off in FY23 given limited future committed developments. However, the broker notes Mirvac has several potential opportunities to backfill these earnings - via office, BTR & industrial - and expects the group to be active on this front.

Apartments

Mirvac is the largest developer of high-density apartments and will release an additional 1100 new dwellings in the coming year across seven new sites along the eastern seaboard. Around half of these sites are earmarked to be for sale off-the-plan at its Willoughby project in Sydney's north.

Credit Suisse expects the launch of the group's seven apartment projects to drive pre-sales to grow in FY22 and this remains a key driver of the broker's positive FY23 outlook. Credit Suisse expects material contribution from projects such as Waverley, Green Square, and Willoughby, and more in FY24. The broker also sees more meaningful profit potential as/when redevelopment works are undertaken at Harbourside, noting approval for 45,000sqm of gross leasable area for residential development.

Overall, Credit Suisse sees Mirvac's $10bn commercial and mixed-use development pipeline as a key profit driver over the medium to long term. However, the broker notes the timing of any earnings benefit is to be determined pending launches of new projects as well as any capital partnering arrangements.

While Mirvac is targeting a gross profit margin of 18-22%, Macquarie notes apartment margins are typically towards the bottom end of margin expectations, while master-planned communities are typically higher. Assuming a 15% margin results in $645m of earnings, a 20% margin would result in $829m of earnings.

While Citi expects weaker office and residential earnings near-term, the broker believes Mirvac's residential pre-sales provide a degree of support in a more challenging environment following covid.

However, the broker notes if the impact on the company from any risk factors – including covid-related earnings and asset value impacts, or capital-intensive and development exposure to the residential property market -- proves to be greater than anticipated, the stock will struggle to achieve the broker's target price of

$2.97.

Build-to-rent pipeline

Mirvac will also pursue opportunities to develop more BTR projects to offer more affordable apartments across the country. While the group currently has one operating BTR asset with 315 lots, 80% leased, there are two further BTR projects in the development pipeline.

While practical completion for the BTR assets are spread from FY22-25 a further two BTR developments are in planning stages.

UBS believes Mirvac is well placed to lead the Australian BTR sector given significant work to date. However, the broker notes current targets require proof of operational success in leasing up the existing secured projects, the introduction of external capital, continued supportive government policy, and further acquisitions.

For Mirvac to reach 5,000 BTR units over four years, UBS thinks the group will need to acquire two projects a year (assuming 425 units per project) which is less than current run rates. The broker estimates Mirvac can see earnings upside of 5% in FY23 if the group can introduce 50% capital partners on two BTR projects at a 4% yield.

FNArena's database has four Buy ratings and two Hold. The consensus target is $13.13, suggesting 3.1% upside to the last share price. The dividend yield on FY22 and FY23 forecasts is 3.4% and 3.8%, respectively.

AUSTRALIA

Baby Bunting To Bounce?

Despite an adverse initial share price reaction to FY21 results for Baby Bunting, brokers maintain an eye on the long-term opportunity.

-Baby Bunting achieved a 34.6% increase in FY21 underlying profit
-Significant store roll-out and operating margin enhancement opportunity
-Well positioned for market share growth
-Free cashflow leverage limited by logistics investments

By Mark Woodruff

Despite the initial negative share price reaction on the day of Baby Bunting's ((BBN)) FY21 results last week, brokers are far from throwing out the baby with the bathwater.

The company operates a network of 60 stores across Australia and plans to add 10 stores in FY22, eight in Australia and two in New Zealand, as it expands to its overall target of 110 stores.

Baby Bunting primarily caters to parents with children from newborn to three years of age, with more than 6,000 products procured from a wide-range of third-party brands and suppliers. This is in addition to private label and exclusive brand products. There are 900,000 children up to three years of age in Australia and 600,000 families are active members of the company's loyalty program.

The general feeling by brokers is **the share market was spooked on results day by comparative sales figures** showing potentially negative covid impacts, with a slow first six weeks of the new financial year. By not providing any forward guidance due to covid uncertainty, the company potentially exacerbated any negative reaction.

However, lockdowns are temporary and there is plenty of evidence that demand is deferred, not lost. If you are having a baby, you may be able to defer some spend in the very near term, but ultimately, these purchases are non-discretionary, notes Morgan Stanley.

In addition, Medicare scan volumes rose 4-6% in the second half, which results in FY22 tailwinds on a six-month lag basis.

Like-for-like sales have also been improving over the past few weeks and the broker thinks sales on a comparison basis would be positive to start FY22, but for the lockdowns.

Key features of the FY21 result included **a 34.6% increase in FY21 underlying profit, and a 15.6% increase in sales**, with comparable store sales growth increasing by 11.3%, well above the 4.9% in FY20.

Underlying earnings (EBITDA) also increased 20%, while margins rose 50 basis points to 15%.

Despite Ord Minnett's investment thesis remaining on track, FY22 and FY23 forecasts were lowered by -7.6% and -7.3%, given the adverse recent impact of lockdowns. The broker lifts its target price to $6.65 from $6.50 and retains its Buy rating.

The analyst expects **growth will be driven by organic sales growth opportunities through market share gains, increased online sales penetration and add-on services. The significant store roll-out opportunity and operating margin enhancement via improved scale and investment will also assist.** Macquarie echoes this thesis.

Despite FY21 profit exceeding its expectations by 3%, Morgans downgrades its rating to Hold from Add as the share price had come within 10% of valuation.

The broker's FY22 and FY23 EPS forecasts are lowered by -2% and its 12 month target price falls to $6 from $6.39. However, Baby Bunting is considered very well positioned to further grow market share and compound growth for investors.

Macquarie increases its target to $6.15 from $5.80.

Ord Minnett highlights strong second half gross margin expansion comfortably offset higher operating expenses. **Mature store level margins now sit at 19% from 17% previously, which provides upside to the long-term group earnings (EBITDA) margin target of 10%, which is now estimated to be 12%.**

Citi also believes long-term growth prospects are still intact. Should the impacts of covid-19 continue for longer than expected, Baby Bunting is considered better placed than most other listed retailers given the category's non-discretionary nature.

However, like Morgans, the broker lowers its target price on forecast earnings changes and downgrades its rating to Neutral from Buy on concern FY22 multiples don't adequately reflect the risk of covid-19 disruption.

The broker's target price falls to $5.90 from $6.22, despite citing like-for-like sales have improved into the positive since week four of the new financial year, and noting **the opening of eight stores over FY22 should offset the New Zealand rollout delay.**

<u>Where's the long-term opportunity?</u>

Baby Bunting has grown sales 29% over the period FY19-21, improved its unit economics and aggressively reinvested. Morgan Stanley believes **the main prize is for potentially over $1bn in sales at low-mid-teens margins.**

Additionally, there is **loyalty dominance**. The 25,000 new monthly members spend 36% more than non-members, and a more targeted loyalty version is anticipated by September.

Finally, **e-commerce sales grew 91% to 19% of total sales** in FY21. The company fulfills 90% of metropolitan online delivery orders on the same day. When this is combined with loyalty and the more than 40% of private label and exclusives sales, Morgan Stanley concludes it's hard to compete with Baby Bunting.

Given strong pre-natal scan data and an aversion toward used goods during covid, Morgan Stanley lifts EPS forecasts for FY22 and FY23 by 2% and 3%, respectively, and raises its price target to $6.90 from $6.30.

Concerns

As covid has clearly impacted the company's ability to roll-out new stores on time, Morgan Stanley shifts the benefit of the FY22 roll-out more into FY23.

While the company has doubled sales over the past five years, this has required **significant digital and physical logistics investment**. Some investors rightfully point out that it limits free cash flow leverage though Morgan Stanley feels the incremental return on invested capital (ROIC) is compelling.

FNArena's database has five broker ratings with three Buys, two Neutrals and a consensus target price of $6.32, which signals 16.8% upside to the last share price.

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AUSTRALIA

New Product Drives Confidence In Carsales

Carsales.com is confident the business can recover most of the pandemic-induced weakness once retail re-opens, noting consumer demand remains strong

-Dynamic pricing helped offset weakness in H2 listing volumes
-New and enhanced products expected to drive growth
-Monetisation of Carsales Select will take time

By Eva Brocklehurst

Carsales.com ((CAR)) continues to develop new products to entrench its dominant position in the Australian vehicle advertising market. Mobility restrictions are creating uncertainty yet management is confident the business can be positioned to recover most of the weakness once retail re-opens.

Carsales has indicated FY22 growth will likely be weighted to the second half, noting consumer demand remains strong although domestic inventory has started to build.

UBS found the outlook for FY22 positive, yet anticipates lockdowns will create uncertainty over the short term and the **absence of JobKeeper will likely drive FY22 cost growth above the rate of revenue growth**.

Ord Minnett believes the impact of lockdowns has been well managed. Despite new car shortages, advertising expenditure on automotive brands has been improving steadily. Dynamic pricing is also assisting, probably helping to offset weakness in second-half listing volumes.

Given the eventual re-opening of the economy, Ord Minnett expects FY22 and FY23 online advertising revenue will increase 2.5% and 3.3%, respectively.

There was a significant reduction in total inventory on site since the beginning of the pandemic, Macquarie points out, amid a significant reduction in time to sell coupled with new car production constraints.

The broker highlights the benefit from this favourable demand/supply mismatch in the automotive market yet considers Carsales' valuation relatively full, while Morgans suggests the results and outlook have justified the recent run-up in the share price and pulls back to Hold from Add.

Morgans makes more substantial changes to longer-term estimates amid increased confidence in the transaction opportunities in all businesses. The broker suggests new and enhanced products, such as Dealer Direct and Instant Offer, as well as business-to-consumer certified listings and international expansion, will drive growth.

The company has introduced dynamic pricing for private customers, allowing for yield expansion. Trader Interactive revenue grew 12% in the second half, benefiting from price rises in April which translated to an operating earnings (EBITDA) margin of 104%.

Ord Minnett considers the stock, trading on an FY22 multiple of 35.2x, is stretched compared with historical averages. Yet there are a number of considerations which make the broker incrementally more positive, including the Select business and the meaningful contribution by FY23 implied by the update to Trader Interactive.

<u>International</u>

International business continues to grow as a percentage and Macquarie notes, if Trader Interactive was consolidated, the international segment would be 35% of revenue.

On the less positive side, volumes in the tyresales online portal declined because of the impact of the pandemic. The company still believes an opportunity exists over the longer term but Macquarie asserts there needs to be more evidence of profitability.

<u>Carsales Select</u>

Carsales Select suggests to Goldman Sachs the company is looking to be the "go-to" digital platform, aggregating its traditional inventory. Over the longer term Select should allow Carsales to move to a transaction-based model from a lead-based model, resulting in a financial benefit to dealers.

Carsales Select will allow dealers to bring more car buying online and the company will spend the next 6-12 months optimising the product before rolling out phase 1, with phase 2 to include trade-ins, finance and home delivery.

As the company is not launching just yet, planning to build a product first, Macquarie points out the contribution will only be meaningful over a longer period. It will allow consumers to purchase used vehicles directly from dealers and thereby reduce commission costs for dealerships, to be replaced by Carsales transaction costs.

Goldman Sachs also believes the transaction structure will drive dealer uptake as there is scope to raise pricing over time, as new inclusions are launched and the product reaches critical mass. The broker does not offer a rating the stock.

While pricing and monetisation has not been provided, UBS believes **Select can be a meaningful contributor to earnings** and could double the Carsales yield per transaction.

Credit Suisse finds the Select opportunity interesting, too, as Carsales has a natural advantage over competitors with an already-established audience. Yet monetisation will take time, as is evidenced by limited penetration in offshore markets where dealer digital models have been in place for a number of years.

FNArena's database has two Buy ratings and three Hold. The consensus target is $24.03, signalling -0.3% downside to the last share price.

AUSTRALIA

Weak Production Casts Doubt Over Beach Energy

While most analysts are willing to look past a lower production outlook for Beach Energy, not all brokers are willing to factor in quality growth prospects until future exploration success is proven

-Greater clarity expected at September Strategy Day
-FY22 expected to mark Beach Energy's trough production year
-Otway and Waitsia projects underpin Beach's production beyond FY23

By Mark Story

Beach Energy ((BPT)) did little to ingratiate the market when it slashed the value of its Otway Basin reserves while simultaneously reporting a significantly lower FY21 profit, down -36.6% on the previous year, courtesy of reduced volumes from its problematic Cooper Basin Western Flank fields.

Citi argues that an FY22 production guidance miss overshadows a 4% earnings beat versus the broker's forecast. The beat flowed through to FY21 core net profit of $363m, which beat Citi and consensus expectations by 12% and 11% respectively.

However, much of this beat was due primarily to an arbitration win against Genesis in relation to carbon tax payments from Kupe.

Citi takes the view that after exhausting the negative news flow that has weighed on the oil and gas producer's share price, there's reason for optimism leading into what is expected to be a positive Strategy Day in September.

Much of Citi's confidence in Beach comes from an expectation the company will use Strategy Day to instruct the market that FY22 represents the bottom of their production profile, with growth to resume in FY23 (up 11%) as Waitsia and the Otway ramp-up.

In an attempt to preempt Strategy Day, Citi has upgraded its Waitsia valuation on stronger LNG contracting expectations and highlights exploration upside in the Perth basin, Western Flank, and the Otway Basin.

As a result, Citi has upgraded Beach to a Buy from Neutral rating and argues that the weakened share price has factored in FY22 lows, without paying for what the broker views as quality growth prospects. The broker's new target price of $1.27 implies a 12-month expected total return, including dividends, of 18%.

Given heightened investor skepticism of management's ability to execute, Ord Minnett admits it may be some time before Beach trades at fair value. But despite weak production guidance highlighting the impact of well interference issues at Western Flank, Ord Minnett maintains a Buy recommendation with the stock still trading at a sizeable discount to the broker's $1.70 target price.

The broker believes if all of Beach's plans come to fruition, the company should offer significant production growth. Despite growth being materially tested in recent months, the broker believes the internally funded outlook at Waitsia and Otway could potentially result in a 30–40% increase in production over time.

Despite weak FY22 guidance, Bell Potter also believes Beach continues to advance major growth projects that support near-term production and earnings growth. The broker cites the Victorian Otways where two new wells are expected to come online in mid-FY22 and a third in second half FY23 to raise production to plant capacity.

While Bell Potter has lowered its target price to $1.60 from $1.85 to reflect the weaker production outlook, the broker maintains a Buy and expects Beach's strong balance sheet to support its growth ambitions, given the company's net cash position and available liquidity.

LNG markets buoyant

Meanwhile Jarden, which also has a Buy rating and a target price of $1.55, reminds investors that the reserves downgrade was limited to Western Flank, while LNG markets remain buoyant.

Jarden believes Waitsia LNG volumes are being marketed at an opportune time and suspects LNG pricing could surpass expectations (US$8/mmbtu). Jarden also notes, a US$1/mmbtu increase in price would increase the broker's valuation by 5cps.

Jarden also expects FY22 to be Beach's trough production year, with a modest uptick in FY23 before ramping up to 35mmboe in FY26 due to Waitsia, Victorian Otway, and Trefoil contributions.

Morgans, which also has a Buy rating on Beach, suspects the company could also seek to fund its Bass gas development by selling down some of its majority position in the assets. Despite concerns about the company's reserves, the broker thinks the market is undervaluing Beach's growth program and expects increased gas production to be evident by third quarter FY21.

Goldman Sachs also notes that while investors remain focused on the Western Flank outlook - with reserve life reduced to 4 years on FY21 production rates -- the ramp-up of Waitsia with LNG sales and Otway from FY23 is expected to return the portfolio to growth.

A more cautious view

While Macquarie agrees that Otway and Waitsia projects will be key to Beach's future production beyond FY23, the broker has a diametrically more cautious view of the company.

Macquarie has downgraded Beach to a Neutral from an Outperform rating after factoring in weak production guidance and disappointing outlook commentary.

The broker believes Western Flank oil production rates decline of -15-20% per quarter through FY22 – as flagged by the company -- point to a longer production tail (lower value) for the asset and foresees negative free cash flow (FCF) in FY22 and FY23 as a $2bn capex cycle is executed upon.

Having taken a more wary stance on Western Flank oil declines and Otway forward capex, Macquarie's price target is lowered -25% to $1.20. Macquarie's earnings forecasts fall -8% in FY22 and -26% in FY23 - largely due to ongoing Western Flank oil declines.

Macquarie notes any assumed stabilisation in FY23 now appears reliant on exploration success, which the broker tends not to factor in until proven.

Unlike more favourable broker outlooks, Macquarie doesn't believe Beach is low-balling its production outlook for FY22, and the broker's FY25 production estimate is now 30MMBoe versus the 37MMboe previously guided in management's now-withdrawn five-year outlook.

While Macquarie has taken a more conservative stance on modelling of Beach's legacy oil declines and the capex intensity of its growth, the broker recognises the gas growth strategy and acknowledges there could be upside potential to the target price long term.

FNArena's database has four Buy and two Hold ratings. Goldman Sachs, which is not on the FNArena database has a Neutral rating.

The consensus target is $1.50 which suggests 38.1% upside to the last traded share price.

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AUSTRALIA

BHP And Woodside Deal For The Future

After much speculation, BHP Group has struck a deal with Woodside Petroleum to offload its petroleum assets. So what does the future look like for both companies?

-Petroleum merger not dependent on approval of the BHP Group unification plan
-The deal should allow Woodside Petroleum to self-fund growth at Scarborough
-BHP Group now squarely focused on future-facing metals

By Eva Brocklehurst

As BHP Group ((BHP)) makes a concerted effort to lift its environmental credentials, the deal that many suspected would be forthcoming has been announced: the merger of BHP Petroleum with Woodside Petroleum ((WPL)).

Citi had been forming the view that BHP and oil were not well suited, recently speculating that Woodside could take over the Australian petroleum assets. The broker believes, while fast paybacks are possible for brownfield oil expansions such as Mad Dog 2 and Atlantis 3, this is more difficult for greenfield developments such as Trion and T&T North.

The offloading of the petroleum assets will be undertaken via an all-scrip merger with Woodside Petroleum, with Woodside shareholders owning 52% and BHP shareholders receiving Woodside shares to the equivalent of 48% of the enlarged base.

While the ratio is better than Macquarie feared it does erode some of the upside for Woodside, and has been agreed regardless of movements in commodity and share prices. **Yet, the deal could face push-back from**

some shareholders as the merger ratio does not appear to fully factor in standalone asset valuations.

Woodside aims to execute a sale agreement by October with shareholder approvals in early 2022. The company was not willing to disclose its view about end-of-life remediation liabilities being taken on from BHP Petroleum and this is a critical variable, Macquarie estimating liabilities could be in the US$2-4bn range.

The main risk is that shareholders may reject this merger and, while the ratio of ownership appears reasonable, UBS agrees unknown factors could be material to valuation such as remediation costs and synergies. There is also the possibility of an interloper making a play for BHP Petroleum.

BHP has lifted medium-term petroleum guidance to 109mmboe. Macquarie notes the petroleum business will not take any cash or debt when merged and, therefore, not create additional financial burden for the BHP balance sheet. The company has put its net debt target under review and expects the transaction will unlock pre-tax synergies of at least US$400m per annum.

Dual Listing

BHP Group intends to unify its company structure under a single Australian entity via a 1-for-1offer to UK shareholders. This approach was selected, Morgans points out, to create unchanged dividends for UK shareholders.

Costs incurred will be US$400-500m in stamp duty and this will occur ahead of the proposed merger of BHP Petroleum and Woodside, simplifying the process. This is a considerable reduction from prior estimates of US$1.2bn, Morgan Stanley notes.

The structure is expected to allow strategic flexibility and BHP requires 75% of UK-based shareholders to cast a vote in favour of unification. Macquarie points out the merger of the petroleum businesses is not dependent on approval of the unification structure.

Further, whether franking credits related to petroleum can be maintained within BHP is yet to be confirmed by the Australian Taxation Office, although Morgan Stanley does not envisage any shortage of credits given the high tax payments in the iron ore business.

Ord Minnett notes, prior to the announcement, the spread between the UK and Australian listings stood at 21% and this is likely to close. BHP will retain a standard listing on the FTSE and a secondary listing on the Johannesburg Stock Exchange.

Macquarie believes the unified structure will allow BHP to conduct M&A activities with a greater degree of flexibility. The broker points out the company has made only cash acquisitions since the establishment of the dual-listed structure.

What's In It For Woodside?

Oil that is. The announcement de-risks UBS' investment thesis on a number of fronts. Primarily, **concerns regarding the ability to fund the Scarborough final investment decision without additional capital are dampened**, as the merger should reduce gearing to 12% and be supportive of free cash flow, providing a diversified portfolio of higher-return oil products.

This should allow Woodside to self-fund its growth and sustaining capital expenditure, providing stable distributions. On the other hand, if the transaction were to fail, gearing could rise in 2022 to 39% and likely require additional capital.

As a result, UBS believes the merger scenario offers a better value proposition. Investor concerns appear to centre on earnings being diluted via the merger yet the broker calculates, on a pro forma estimate, that 2023 accretion of 9% is probable. Still, UBS recognises the risk that higher rehabilitation costs could overhang until more detail is provided.

Macquarie agrees the deal removes the need for equity to fund Scarborough, which is the company's only organic growth option. It also provides diversity and a better growth pipeline as well as more resilient cash flow. Hence, the broker concludes that Woodside gains more than it gives up.

Woodside has granted BHP a put option over its 26.5% stake in Scarborough, exercisable in the second half of 2022 for US$1bn, with an additional US$100m upon any future final investment decision at Thebe.

What Will BHP Group become?

Just because the company is moving out of petroleum does not mean automatic pursuit of M&A given current asset valuations, Morgan Stanley points out. BHP will grow via its investment in Jansen potash, which has now made final approval.

Macquarie notes, interestingly, construction time has been extended at Jansen by one year to six years, which is an indicator of challenging weather conditions in this part of Canada. Meanwhile, iron ore will remain a key driver for the stock.

Macquarie also notes **nickel continues to screen as the most attractive commodity in BHP's decarbonisation scenario** and there is an intention to expand exposure to this commodity. Around 85% of nickel production is sold into the battery market.

Removing petroleum is one move in a series which Morgans expects will inevitably involve some larger acquisitions in future-facing metals such as nickel, copper, iron ore and high-quality metallurgical coal or potash.

The broker understands why management would not want to announce an open cheque book regarding M&A but interprets the commentary to mean there is plenty of capacity on the balance sheet for BHP to strike at the time of its choosing.

There is no clear rationale for a re-rating of BHP, Citi asserts, as BHP Mining will trade at a modest premium to global mining peers post this deal. The broker acknowledges net debt would reduce to around US$1.4bn by the end of FY25, enabling sustained high dividend pay-out ratios. Yet BHP Mining's underlying net profit would decline to around US$12bn in FY25 from US$26bn in FY22 as iron ore prices retrace.

FNArena's database has one Buy (Macquarie) and four Hold ratings for BHP Group. The consensus target is $48.38, signalling -0.4% downside to the last share price. The dividend yield for FY22 and FY23 on present FX values is 7.4% and 5.3%, respectively.

For Woodside Petroleum there are five Buy ratings and one Hold (Citi). The consensus target is $27.48, suggesting 34.8% upside to the last share price. The dividend yield on present FX values for 2021 and 2022 is 6.6% and 6.5%, respectively.

AUSTRALIA

Market Misunderstands Breville's Strategy

While Breville Group faces short term supply chain risks, brokers focus on the longer-term growth opportunity and attractive margins.

-Breville Group delivered a 20.5% year-on-year earnings increase
-Gross margin fell -15bps due to higher freight costs and FX headwinds
-A significant opportunity to gain market share in Europe
-Global expansion and higher reinvestment underpins the long term
-Supply chain and transitional demand risks

By Mark Woodruff

In a result that was difficult to fault, Breville Group ((BRG)) reported a 20.5% year-on-year earnings increase that was in line with company guidance, though marginally below consensus forecasts.

Increased consumer demand driven by work-from-home, coupled with successful geographic expansion, offset the impact of intermittent supply challenges.

The company designs, develops and sells small electrical appliances branded either as Breville, Sage or a third party brand.

The Global Product segment sells products designed and developed by Breville that may be sold directly or through third parties. The Distribution segment markets products that are designed and developed by a third party, which may be sold under a brand owned by the company (eg Breville or Kambrook) or may be distributed under a third party brand, like Nespresso.

A key feature of the FY21 result was **37% constant currency revenue growth for the Global Product segment**, with all regions contributing strongly. This included a 27.6% rise for the Americas, 58.4% for Europe, Middle East and Africa (EMEA), and Asia Pacific (APAC) climbed by 37.4%.

A final fully franked dividend of 13.5 cents was declared. While down from 20.5 cents in the previous corresponding period, management had previously reduced its dividend target payout ratio to 40% from 70%, on a full year basis. This was to allow continued funding of growth opportunities on a ‘sustainable cash-neutral’ basis.

Gross margin fell -15 basis points reflecting higher freight costs and foreign exchange headwinds, which was partly offset by lower promotional spend and an improving premium product mix.

Management noted no noticeable change in consumer behaviour in regions with well-progressed vaccine rollouts (US and Europe) and the company’s products are still being supported by the continued work-from-home trend.

UBS believes investors should focus on the impressive top-line momentum and the incremental investment of -$49m. This was incurred on research and development, marketing and IT, which are mainly of a 'discretionary' nature and could have been dialled-down to drive a material beat over consensus forecasts. The broker retains its Buy rating and $35.70 target price.

Future drivers are expected to come from strong industry demand, a return to 'equilibrium' of inventory over FY22 and increased new product commercialisation. Additionally, there's expected to be a continued ramp-up in EMEA and a greater portion of marketing spend towards demand generation, via digital content and direct engagement.

While expecting top-line sales growth to moderate for APAC in FY22, Ord Minnett believes this should be offset by growth in the Americas and EMEA. The broker lifts its target price to $30.50 from $28 and retains its Hold rating.

Credit Suisse broadly agrees and sees a return to forecast trend growth in the second half of 2022 for the Americas Global Product segment and in FY23 for APAC.

The broker sees **a significant opportunity to gain market share in Europe** and retains its Neutral rating, while reducing its target price to $30.98 from $32.01, largely as a result of adjusting working capital forecasts.

Morgans highlights the strength of the balance sheet and suggests it provides optionality for new markets and possibly even M&A. The analyst marginally increases its target price to $34.00 from $33.90 and keeps its Add recommendation.

<u>Deserving of a valuation premium?</u>

Breville Group's **peers largely include mature international companies** such as Whirlpool, Electrolux and Newell Brands. Hence, Wilsons thinks a premium is warranted due to the company's growth focussed strategy and attractive gross margins.

The company should achieve earnings (EBIT) growth of 10-15% year-on-year over the long-term as regional locations are added in Europe. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, retains its Market-Weight rating on valuation concerns only, and lifts its target price to $26.69 from $25.18.

In full agreement with Wilsons, Macquarie points out the appeal of the group remains the duration of the growth trajectory, which is supported by internal initiatives, over and above market demand. It's thought earnings can grow sustainably in FY22 given the pull forward of marketing initiatives, new product development and geographic expansion.

The broker maintains its Outperform rating and lowers its target price ever so slightly to $34.37 from $34.80.

Challenges/risks

Gross margin headwinds in FY22 are likely due to a weaker US dollar, supplier cost increases and logistics inflation, expects Morgan Stanley.

The analyst estimates -$20-30m of sales were missed in the fourth quarter due to supply constraints (mainly transport delays). This implies second half sales growth would have been 24-28% versus the 19% that was delivered. Importantly, those sales are expected to be captured in the first half of 2022, once supply normalises.

Given the **supply chain risks and a potential transitional demand outlook**, Bell Potter lowers growth forecasts and decreases its target price to $30.50 from $32.25.

Inventory constraints stem from supply chain delays, supplier chain cost pressures and parts challenges. Additionally for those countries that are opening up, consumers may begin to spend on services as opposed to goods.

The broker, not one of the seven stockbrokers monitored daily on the FNArena database, is mindful of near-term macro risks and the company's high valuation and retains its Hold rating.

While Macquarie highlights capital inventory and receivables are temporarily suppressed, resulting in elevated cash, management is planning for a working capital rebuild in FY22.

Perhaps Morgan Stanley summarises things best by concluding that despite several short-term concerns, **the group continues to strengthen its long-term position via global expansion and higher reinvestment.** The broker encourages investors to stay Overweight and edges up its price target to $36 from $35.

FNArena's database has six broker ratings with four Buys and two Holds (and equivalents) and a consensus target price of $33.59, which signals 9% upside to the last share price.

AUSTRALIA

Uncertainty Prevails For CSL

Timing will be everything for CSL, which is endeavouring to keep up the flow of plasma while collections activity remains beset by the pandemic

-Plasma collections recovering but still well below FY19 levels
-Impact on gross margin is the main risk to earnings recovery in FY23
-Any prolonging of the pandemic adds material uncertainty

By Eva Brocklehurst

The trajectory of CSL Ltd ((CSL)) earnings remains tied to the timing of a recovery in plasma collections and any further delays or difficulties in this area could have major implications for the stock.

Timing is everything, brokers assert, given the lengthy manufacturing cycle for immunoglobulin, derived from plasma, as well as higher costs amid the ongoing pandemic. Management is optimistic that conditions will normalise during the current fiscal year and the recent increase in donor fees should enable collections to be maintained.

Yet Ord Minnett suggests the risk for demand destruction exists, as treatment of some patient groups could be switched to other, possibly inferior, products if immunoglobulin supply cannot hold up.

That said, the broker is confident plasma collections can surpass pre-pandemic levels before the end of 2021 and procure a strong lift in earnings in FY23. There has been some necessary drawing down of inventory, Goldman Sachs points out, although at this stage although there is no material problem with demand.

Guidance implies material headwinds associated with lower plasma collection, with an improvement in the volume collected in the December quarter and 2022 required to meet FY23 forecasts, Macquarie points out.

CSL achieved 3% immunoglobulin growth in FY21, through optimising pricing and supply across geographies and channels and has guided to constant currency revenue growth of 2-5% in FY22.

Raw plasma volumes declined -20% in FY21 and while collections continue to recover they are well below FY19 levels. Given the 9-12 month production cycle, each day that collection deficits persist this produces further challenges to the FY23 recovery, Goldman Sachs asserts,

Management is currently not taking on new customers for immunoglobulin to ensure sufficient inventory available for existing patients. Credit Suisse expects earnings will continue to be affected by the pandemic, even if collections recover back to pre-pandemic levels in the next six months.

This stems from the higher cost of collections (donor fees), which is likely to be sustained. The broker expects net profit in FY23 of US$2.6bn, with gross margins still below pre-pandemic levels at 55.4%.

Citi agrees the main risk to FY23 is the pace of recovery in plasma collections and the resultant risk to gross margin. Guidance implies a FY22 earnings decline of -5-9% and CSL expects to open 40 new plasma collection centres in FY22.

R&D expense will be around 10-11% of revenue as those projects halted during the pandemic ramp back up. CSL achieve 3% immunoglobulin growth in FY21 with initial analysis suggesting the main way this was achieved was through optimising pricing and supply across geographies and market channels.

Uncertainty

Morgan Stanley asserts **the magnitude of any rebound in FY23 is the most important issue for the share price** rather than any first-time guidance for FY22, suspecting another round of downgrades to consensus expectations.

The broker downgraded the stock just prior to the pandemic and acknowledges now, after a trough year in FY22, the shares could trade to $308, as confidence in the rebound gains momentum and negative revisions to earnings cease.

As Morgan Stanley has more confidence in the pace of supply recovery in immunoglobulin by FY23 compared with the pace of demand recovery and, amid a possible prolonged imbalance, reiterates its base case and an Equal-weight rating with a $280 target.

Goldman Sachs finds many reasons to like the stock but believes the current valuation does not reflect the extent of uncertainty. Moreover, FY22 earnings guidance subdued as, even assuming typical conservatism, it implies a 4% growth rate from FY19-22 and this profile lags other large manufacturers.

Hence, Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, maintains a Neutral rating with a $302 target yet still anticipates plasma collection volumes will exceed FY19 levels at some stage in FY22.

In contrast, Wilsons, also not one of the seven, maintains an Overweight rating and $320 target and believes plasma collections will not support a full recovery in immunoglobulin supply growth until FY23. The database has two Buy ratings and five Hold. The consensus target is $308.84, suggesting 5.1% upside to the last share price.

Ord Minnett also postpones expectations for the earnings recovery by several months which results in a -10% reduction to earnings forecasts for the Behring division in FY23. This reflects weaker sales in the early part of the year because of constrained supply and associated cost and margin headwinds.

Despite the revisions the broker is confident of a strong rebound by the second half of FY23 as supply of immunoglobulin normalises. Ord Minnett also highlights the threat of further delays to a plasma collection recovery and surging coronavirus cases in some US states amid a lack of clarity on the Mexican border issue.

Citi finds FY23 difficult to forecast because of the fluctuating revenue and costs depending on how the pandemic evolves yet believes CSL is better positioned than peers in terms of collections, continuing to gain market share.

Morgans, while acknowledging the timing of a turnaround is uncertain, agrees CSL is a core holding and **in the best position versus peers to meet growing patient demand**.

Other Business

The vaccination business, meanwhile, is set to sustain or exceed performance in FY22. Seqirus, in Macquarie's view, is currently the most valuable source of growth and diversification for the company.

Influenza vaccine revenue rose by 41% in FY21 with a record 130m doses distributed globally and a shift towards higher value products. There is slower growth in specialty products with hospital projects affected by reduced elective procedures during the pandemic.

Macquarie points out CSL will commence phase 1 of the next-generation self-amplifying mRNA vaccine in 2022 and first patients have now been enrolled in the Garadacimab phase 3 trial for the prevention of hereditary angioedema.

Phase 3 for CSL112 has now been enrolled and as recruitment has slowed first results are expected in October 2022. A phase 2 QIVc influenza vaccine trial has also commenced.

See also, Is CSL's Plasma Recovery Now Priced In? on June 23, 2021.

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COMMODITIES

Material Matters: Iron Ore, Oil & Lithium

A glance through the latest expert views and predictions about commodities: iron ore; oil; aluminium; and lithium

-Slowing steel end use in China heralds a slump in iron ore prices
-Delta wave of coronavirus casting a pall over the oil market
-Power shortages in China drive downgrades to Macquarie's forecasts for aluminium
-Lithium could tighten further; emerging spot market triggering price rises

By Eva Brocklehurst

Iron Ore

Iron ore prices have slid, down -29% over August matching a move in Chinese steel prices. Macquarie notes during August rebar futures have fallen -US$85/t.Spot iron ore prices are now down more than -US$100/dmt from a high of US$233/tmt on May 12, a fall of -44%. Lump prices have fallen further, down -46% from the peak of US$267/dmt.

Morgan Stanley believes the correction in the rebar price could point to a softening demand environment, as industrial production in China for July highlights a significant slowing of steel end-use, notably in property and infrastructure. Although China's steel demand could pick up as construction activity improves in September on a seasonal basis, a swift improvement is required to offset current market weakness.

Wilsons asserts forecasting iron ore prices is about as difficult as forecasting the gold price, noting specialty commodity forecasters at investment banks have dwindled over the years and the market is increasingly using a combination of spot and long-term estimates of US$65-75/t.

On the broker's aggregation of iron ore forecasts, the metal is gliding from current levels down to US$75/t by 2024, closely matching the Chinese iron ore futures strip, which implies US$120/t by the end of June 2022.

While not formally forecasting the iron ore price, the broker is increasingly worried about the risk to its view that prices would remain higher for longer, and asserts the Chinese administration's policy change is a "big deal".

A combination of 90mt of unwanted iron ore and 60mt of increased mine supply could mean the market is in balance in the second half of this year, representing a significant risk for the price. Australian and Brazilian portfolios, meanwhile, are yet to show any reaction to a change in China's policy.

Within the materials sector, Wilsons is underweight iron ore-exposed names and lowers its exposure further by reducing its **BHP Group** ((BHP)) percentage on the focus list to 8%. Yet BHP, with a more diversified asset base, should continue to outperform **Rio Tinto** ((RIO)) and **Fortescue Metals** ((FMG)), in the broker's opinion.

Macquarie estimates the share prices of BHP, Rio and Fortescue are factoring in flat iron ore prices into perpetuity a US$70/t, US$80/t in US$85/t, respectively. At spot prices these three are trading on FY22 free cash flow yields of 15%, 14% and 8%, respectively.

A material decline in the share prices over the past week has largely been on the back of the iron ore price, although relatively the stocks are outperforming. BHP Group has fallen more than the other two, largely, because of the pending removal of the dual listing structure.

The broker reiterates a positive view of the stocks, believing Rio Tinto is the cheapest and, having already traded ex dividend, is likely to outperform.

Morgan Stanley believes the sell-off in iron ore is accelerating, having just marked the fastest correction in the price on record when it shed -US$23/t in a day. The broker is surprised at the speed at which the normalisation of the price is playing out and, given China's weak steel end-use demand, still envisages further potential downside from the current US$130/t levels.

The broker calculates, if China's July steel output level of 87mt persists through the remainder of the year, steel output in the December half could decline by a around -7% half on half, implying an annualised decline in iron ore consumption of more than -100mtpa, half on half.

<u>Oil</u>

The Delta variant of coronavirus is casting a pall over the **oil** market, ANZ analysts observe, and concerns regarding the sustainability of the global economic recovery have been raised. A deteriorating situation across Asia has already meant mobility has dropped away while China's zero tolerance strategy means travel is restricted in several major cities.

As a result, the analysts revise September quarter oil demand forecasts for Asia down to 12.9mb/d. Asia accounts for around 35% of global oil demand, half of which stems from China.

Elsewhere demand is more robust. Mobility continues to improve in Europe and the US as governments rely on high vaccination rates. This should mean the market stays tight and a further drawdown occur in inventory in the second half of 2021. Rising vaccination rates should then lead to improvement in sentiment.

<u>Aluminium</u>

Market fundamentals have improved and Macquarie upgrades its outlook for **aluminium**. Still the fundamentals are challenging. Slower Chinese supply growth has combined with growing demand which means the market has move to deficit from surplus.

2021 is now expected to show a deficit of -700,000t compared with the previous estimate of a surplus of 700,000t. Undersupply is expected to persist through to 2025. Hence, the broker upgrades aluminium price forecasts 3-16% over the medium term. Power supply shortages in China have been a key driver of the downgrade to expected production in 2021.

Even after such shortages ease, Macquarie notes it will take 2-3 months for a full recovery. China is also expected to reach a capacity cap of 46-47mtpa from 2023 onwards. Macquarie believes it will be hard for the government to relax this cap given the carbon reduction determination, unless higher aluminium prices start to damage the downstream industry.

Ex China, primary aluminium demand has increased, amid a strong recovery in Asia and the Americas. Without new capacity, the broker currently projects a -1.4mt deficit in 2024 and -1.8mt in 2025.

<u>Lithium</u>

Macquarie upgrades its outlook for **lithium** to reflect a further tightening of the market fundamentals and the emergence of a spot market for spodumene and forward market for lithium carbonate. The emerging spot market has provided a positive catalyst for prices, which the broker notes were already rising from positive market fundamentals.

Previous peaks are expected to be reached in the next six months. Chinese chemical grade lithium carbonate prices have risen to RMB94,000/t over recent weeks and battery-grade lithium carbonate to RMB99,000/t. Meanwhile, spodumene prices have risen to over US$850/t.

Macquarie lifts forecasts for spodumene prices in 2022, 2023 and 2024 by 46%, 34% and 21%, respectively. Moreover, the decoupling of spodumene from lithium carbonate should enable spodumene to hit a new peak of US$1350/t in the September quarter of 2022.

That said, the broker still maintains a relationship between the two, increasing the ratio to 6.5% from 6.0%, which translates to a 13% upgrade to long-term price forecasts for spodumene of US$850/t.

New projects are progressing and early-stage equity funding is accelerating yet several projects have suffered minor delays. The main risks to the tightening outlook are new discoveries or faster advancing of developments, Macquarie suggests.

The potential for re-use and recycling of batteries could also affect the market balance, although this is more about reducing widening deficits from 2027 and beyond. Beyond 2027 the broker considers the supply deficit will widen significantly.

Macquarie maintains a preference for Australian producers with **IGO Ltd** ((IGO)) and **Pilbara Minerals** ((PLS)) key picks as both offer strong near-term production growth. Meanwhile **Orocobre** ((ORE)) offers unique exposure to both lithium brine in South America and spodumene production in Australia.

ESG FOCUS

ESG Focus: Europe’s Getting ‘Fit for 55’

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

Europe’s Getting ‘Fit for 55’

In a post-pandemic Europe, climate change is front and centre of political agendas across the continent. The EC has proposed necessary changes to enact in the next decade to reach previously agreed to climate change goals.

-‘Fit for 55’ policy package is a proposed pathway for EU members to achieve a -55% reduction in greenhouse gas emissions by 2030
-The policy package is an initial step towards achieving net zero emissions by 2050
-Proposals include expansion of the emissions trading scheme and the introduction of carbon tariffs
-The EU estimates it will spend EUR503bn on its climate change agenda in the next decade

By Danielle Austin

Amidst a number of climate change related extreme weather events, including severe flooding in Germany, Belgium, the Netherlands and Italy, wildfires in Spain, France, Finland and Greece and the rapid melting of ice in Greenland, the European Commission (EC) has identified an increasing urgency to address emission reductions.

The EC has released its ‘Fit for 55’ policy package, outlining suggested policies for the European Union’s (EU) 27 member states to enact to achieve a reduction of net greenhouse gas emissions of -55% compared to 1990 emissions by the end of the decade.

This proposes a significant emissions reduction target increase from the current -40% in the same time frame, and could drive **the EU to becoming a global leader in the carbon emission reductions race**.

The proposal includes expansions to the current emissions trading scheme and the introduction of a carbon tariff. Additionally, the EC is proposing targeted use of renewable energy needs to be increased to 40% by 2030 from the current target of 32%, and the phasing out of petrol and diesel vehicles by 2035. Analysts note emissions reforms are likely to put long-term upward pressure on carbon prices.

The proposals are dependent on approval from member states and the European parliament, a process which could take months and may see amendments made to the policy package. Bringing proposals into legislation is a process that could take as long as two years.

Impact of CBAM on Australian exports

Of particular note in the 'Fit for 55' policy package is the **introduction of a carbon border adjustment mechanism** to take full effect from 2026.

The mechanism is aimed at evening the playing field for offshore producers who aren't required to follow the same stringent emission policies as domestic players, and discourage high-emission industries from relocating offshore to avoid carbon costs.

The goal of the Carbon Border Adjustment Mechanism (CBAM) is to reduce carbon leakage, the term given to the displacement of locally-low-carbon-produced products by imported products produced using higher emission technology where emissions have not been correctly priced.

Under the mechanism, EU importers will be required to purchase carbon certificates that correspond to the carbon price that would have been paid had the goods been produced under the EU's carbon pricing structure. Where importers can prove carbon pricing has already been paid during production the price can be deducted.

According to the EC's policy package, the CBAM will initially only be applied to direct emissions. However, tariffs on embedded emissions will be applied to imported goods from 2026, allowing for a transitional reporting period on embedded emissions from 2023.

The initial products to be included in the CBAM are aluminium, iron ore, steel, cement, fertilisers and electricity, which to Europe represent only 3.5% of Australia's total exports.

According to Macquarie analysts, while the EC's proposed carbon tariffs won't initially have substantial impact on Australian exports, the list of goods covered by the mechanism is likely to expand over time.

A successfully implemented tariff by the EU may also see similar mechanisms adopted by other countries, with the US, UK, Japan and Canada already reportedly considering border tariffs.

Expansion of the Emissions Trading Scheme and a united approach

The EU’s existing Emissions Trading Scheme (ETS) has been the key driver of reduced emissions in the EU since 2005 and is set to be expanded under the EC’s proposal.

The policy package suggests an extension of the ETS to include aviation and shipping, as well as introducing steeper increases to annual emissions cap reductions and the implementation of an additional emissions trading scheme for the building and road transport sectors.

This new ETS, set to come into play in 2026, would aim to regulate fuel suppliers rather than consumers. While analysts note it is not yet clear who the responsibility for this scheme would fall on, if refineries were responsible it would likely lead to increased fuel prices to offset the necessary purchase of additional carbon credits.

The proposed policy is underpinned by a united approach by all EU member states to achieve a common goal, and the proposed updates to the existing ETS include the introduction of an effort sharing regulation which would see larger emission reduction targets handed out to member states based on per capita gross domestic product.

Further to this, the EC has proposed the creation of an integrated green employment framework to support labour market shifts in a greener economy.

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ESG FOCUS

ESG Focus: Social And Sustainability Bonds

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ESG Focus: Social And Sustainability Bonds

As the green transition and fourth industrial revolution spawn massive social disruption, two new types of bond have been developed to “save the day” – the social bond and the sustainable bond.

-Vehicles to serve the S in ESG
-A matter of principles
-The geopolitics of social bonds
-Sustainability bonds may dominate

By Sarah Mills

This final article in our green, social and sustainability (GSS) use-of-proceeds bond series covers the social and sustainability bond market.

Billed as the saviours of the society and the common man from the impending disruption spawned by the green transition and fourth industrial revolution; social and sustainability bonds are among the more novel financial concepts hitting the market.

The reality is more nuanced and FNArena examines their implications for investors and geopolitics.

We will save our examination of a related use-of-proceeds bond type – the social impact bond – for the final instalments of our series on impact measurement.

Show me the money

Of all the ESG investment opportunities, social investing has drawn the most cynicism from investors.

Investments in health infrastructure such as hospitals and education are more easily graspable concepts, but how does one monetise often not-for-profit social care?

Enter ESG finance.

Even before the pandemic hit, a report by the Business and Sustainable Development Commission estimated that achieving the United Nation’s Sustainable Development Goals (SDGs) could open up $12 trillion of market opportunities in food and agriculture, cities, energy and materials, and health and well-being, while creating 380 million new jobs by 2030.

In one sense, meeting the SDGs can be viewed through a wealth-distribution lens – big capital has achieved one of the greatest transfers of wealth in human history, and it may have to put some back just to keep the capitalism ball rolling.

But if this is the case, it is going to be extremely selective and strategic about how it distributes this largesse.

Through this strategic lens, the SDGs appear to represent something of a business proposition – a form of privatisation of the social remit, and a vehicle for building secured social infrastructure in developing nations – the next frontier for financialisation.

A third lens views social impact bonds (a particular type of social bond) as a backdoor neoliberal tax on the care and general social functions of the state:

“At their core, SIBs are a more expensive, privatised financing model for services that could be financed publicly at a lower cost," writes *Policy Note*.

Perhaps sustainable and social bonds can be viewed through all three lenses – a financial instrument aimed at pursuing social as well as financial value that can play a critical role in fostering growth and progress in developing Asia while further financialising the care industry and a risk redistribution mechanism.

This is the lens we adopt for this article.

Through this lens, the ESG investment philosophy elevates values rationales (financial decisions grounded in moral judgment) that rival that of the traditional value rationale (solely basing financial decisions upon financial metrics).

Within this new investment paradigm, managing ESG risks translates to superior returns but investors will need to understand the rules of the game.

<u>What is a social bond</u>

Social bonds are blended-finance use-of-proceeds instruments that deploy capital into social endeavours such as improved health to education to employment.

The Asian Development Bank complains that most ESG investors don't understand the value of ESG social bonds, and gives an example:

A transport company could issue social bonds to upgrade transport and then pass the costs on to passengers.

In the past, the transport company had to pay for the upgrades itself, the cost of which is also generally passed on to consumers and taxpayers, and if that failed equity investors bore the risk.

Now the transport company can pass those capital expenditure costs away from equity investors to social bond investors at possibly a lower cost of capital.

If the investor chooses wisely, everyone wins.

If it fails, well a lot would depend on collateral agreements and bond covenants.

A benefit of social bonds is that they offer a vehicle that can be used by a range of investors, boosting liquidity and fungibility of certain bond types across industries, increasing the "social" industry's access to capital while offering investors a vehicle to invest in a country's future or causes that interest them.

Corporations and private investors constitute one group, as outlined above.

Philanthropic investors can also invest in providing concessional working capital loans and guarantees of principal to help reduce the risks and costs of social bonds for issuer and investors.

Multilateral organisations such as development banks and sovereigns can also either issue or invest in the market.

Smorgasbord of potential projects

Investors and issuers are spoilt for choice when it comes to eligible projects under the International Capital Markets Association's (ICMA) Social Bond Principles.

Nearly every form of government expenditure, with the exception of defence, could be defined as social.

Mooted social projects include:

- public housing;
- lending;
- student aid;
- affordable basic infrastructure – which also falls under the sustainability bond banner (such as clean drinking water, sewers, sanitation, transport, and energy);
- access to services such as education and vocational training, health care, financing;
- financial services;
- affordable housing;
- employment generation and programs designed to prevent and/or alleviate unemployment stemming from socioeconomic crises, including issuing microfinancing, small, and medium-sized loans to affected businesses;
- food security and sustainable food systems (providing physical, social, and economic access to sufficient, safe and nutritious food);
- improved agricultural practices;
- reduction of food loss and waste;
- improved productivity of small-scale producers; and
- socioeconomic advancement and empowerment (such as equitable access to and control over assets, services, resources, and opportunities; and equitable participation and integration into the market and society, including the reduction of income inequality).

The latter point, combined with the education options do raise some concerns about the potential of indentured servitude, so much will depend on the way this plays out.

ICMA's Social Bond Principles nominate the following target populations:

- those living below the poverty line;
- excluded and/or marginalized populations and/or communities;
- people with disabilities;
- migrants and/or displaced persons;
- the undereducated;
- the underserved (owing to a lack of quality access to essential goods and services);
- the unemployed;
- women and/or sexual and gender minorities;
- racial minorities; and
- ageing populations and vulnerable youth.

A brief history

The first social bond – it was a social impact bond – was launched in 2010 but few issuers came to the market until ICMA launched its social bond principles in 2017.

Danone was the first multinational to issue a social bond in 2018, and a few companies followed suit.

But social bond issuance remained anaemic until covid gave the market a leg-up.

Total issuance of global ICMA-compliant social bonds surged by 720% in 2020 to the equivalent of $149.4bn in 2020, compared with $18.2bn of issuance in 2019.

European and supranational issuers dominate the market followed by Asia, North America, Latin America and the Middle East.

The Asian Development Bank (ADB) reports that the social bond structure proved popular and well-suited to Asian markets during 2020 and several Asian issuers sampled the market.

The ADB reports that Asian social bond issuance in 2020 has grown 22.3 times since 2017, notes the ADB.

This compares with 9.8 times for Europe and 14.3 times for the rest of the non-Asian world.

Global issuance has been dominated by government-related agencies and wealthy countries; but India, the Phillipines, Thailand and a handful of Latin American issuers tapped the market post-covid.

For many years, social bonds severely lagged the green bond market, until covid.

Corporate issuers have to find assets on their balance sheets or eligible projects that meet the issuing principles, which is easier for green projects, given the assets in question are generally easier to ringfence.

Then in June 2020, ICMA expanded its list of eligible projects and target communities relevant to social bonds in response to the rapid growth of the social bond market due to covid.

Most covid relief bonds are not technically social bonds because they do not adhere to ICMA social bond principles, which among other things require transparency in the form of confirmed utilisation of bonds proceeds for projects with social benefits.

<u>The matter of principles</u>

Social bond investors share the same investment challenges as do green bond investors.

Lack of standardised metrics can lead to “social” washing, a lack of volume and diversity (more supranational and government agency issuers than corporates and sovereign); and a lack of training among financial advisers to help bring products to market.

As with other ESG finance markets, ICMA has produced a set of principles to guide issuers and investors.

The ICMA 2021 voluntary social bond principles include four core components:

- Bond issuance must be use-of-proceeds bonds;
- Must included a process for project evaluation and selection
- Outline how the proceeds will be management
- Include a reporting process and schedule

To enhance transparency, issuers should employ:

- Social Bond Frameworks; and
- External Reviews

And then there is the overarching rule of ESG investing: “do no harm”.

To date, most issuers also lack a social bond framework, which is considered critical to help investors assess the value of a proposition.

But frameworks are becoming increasingly evident, a trend that is likely to continue.

Frameworks take time, money and human resources to develop, and professionals with ESG skill-sets are thin on the ground.

Development of a social taxonomy similar to Europe’s green taxonomy, which was recently approved, is also on the drawing board.

Observers expect the EU will put its mind to a social taxonomy that aligns with its green taxonomy by the end of 2021, given eligible social projects are not yet specified under its “build back better” plan.

Asian markets have adapted the ICMA principles to suit what they describe as local differences and developed the ASEAN (Association of Southeast Asian Nations) Social Bond Standards.

<u>Ratings and issuance</u>

In this section, we include covid issuance as part of the total social-bond issuance, given the huge boost to the social market in 2020.

The ADB estimates the weighted average credit rating of the global social bond market is AA, compared with a weighted average of A+ in the global green bond market and AA- in the global sustainability market.

“Broken down by issuer credit rating from international rating agencies, the social bond market almost entirely comprises investment grade (BBB – or better) issues at 99% of total outstanding bonds,” reports the ADB.

“However, the social bond market shows an even higher concentration of the prime AAA and AA sectors at 79% of the market, compared with 37% for green bonds reflecting higher government agency and supranational bond issuance.”

Australia’s National Housing Finance and Investment Corporation hit the market in 2020 with a $A562m bond for affordable housing, which meets SDG8.

NHFIC has since issued another $1.5bn, taking total social bond issuance to June to $2bn.

In the euro market, France's National Professional Union for Employment and Trade (Unedic) and Cades issued a social bond to support the unemployed and the social security system in France.

According to Global Capital, Unedic raised E19bn in medium and long-term debt, of which E17bn involved the issuance of social bonds.

The 10-year tranche, which included measurable reporting, was 14x oversubscribed.

Across the Atlantic, US-based Ford Foundation issued a US$1bn social bond in June 2020 – the first by a US non-profit foundation in the taxable corporate bond market.

It was AAA-rated and 5.8 times oversubscribed.

The bonds, with 30-year and 50-year maturities, carried a fixed-rate coupon of 2.415% and 2.815% respectively.

The funds were earmarked to support and strengthen non-profit organisations hurt by the pandemic.

"The foundation's primary goal will be to stabilise and strengthen key organisations that are advancing the fight against inequality when communities that are most vulnerable have been hit hardest by the pandemic," said the foundation in a press release.

<u>Charities present their own peculiar risks</u>

"The road to hell is paved with good intentions." – Henry G. Bohn, 1855.

Charities of the size and repute of the Ford Foundation are considered excellent credit risks.

However, the Ford Foundation's has a chequered past, most notably with its association with the Pinochet dictatorship in Chile which "disappeared" at least 1,248 people and tortured another 9,800 political prisoners.

While the foundation did eventually depart from Pinochet's Chile, it is a prime example of the many charities that include in their portfolio less-than-altruistic activities.

The Rockefeller Foundation, for example, one of the main supporters of ESG, was also involved in Chile.

Even recently, India's Modi government cracked down on more than 13,000 NGOs, of which Ford Foundation was one, wary of foreign meddling in internal affairs.

Times Now reported that the Gujarat police had asked the Ministry of Home Affairs to look into whether the Ford Foundation had violated rules governing foreign donors and whether the foundation had acted in conflict with "India's national interest".

The Ford Foundation was placed on Prime Minister Nahendra Modi's watch list.

The point here is that many NGOs have well-established records of involvement in the affairs of the countries in which they the operate, part of which occurs naturally through the charity interface.

But these boundaries are often blurred and sometimes deliberately transgressed, creating risks for ESG investors, which we discuss later.

A *Philanthropy News Digest* review of *Foundations of the American Century: The Ford, Carnegie, and Rockefeller Foundations in the Rise of American Power* includes the following quote about the book's central thesis:

"Far from being independent "third sector" institutions committed to solving problems of human suffering, the "Big Three" (Carnegie, Ford and Rockefeller) foundations have instead acted as champions of pro-American free-market capitalism and opponents of "nationalistic/leftist philosophies and alliances".

<u>Geopolitics of social bonds</u>

When viewed through the lens of geopolitics, social bonds present a different game.

Social bonds could harness masses of "non-aware" capital to fund international policy agendas and policies that may undermine the very goals some investors are attempting to reach.

It opens serious questions about the ability of social bonds to be used in geopolitical cold warfare.

Social bonds can easily end up serving the charitable foundations of those countries with the deepest pockets – whether it be China, the US, Europe, etc.

The big three foundations are not the only charities that have received scrutiny.

Many extremely respected health charities around the world have been found to be at the behest of pharmaceutical companies, experiencing a conflict of interest when it comes to developing cheap universal cures as opposed to expensive, often recurring, treatment of symptoms.

It is a similar situation for many other sector and industry-related charities.

While the proceeds are earmarked for certain projects, the receipt of ”social” funds would still free up a charity's other funds to deploy to its own agendas.

And it is not a situation that is likely to change. As *Philanthropy News Digest* continues:

"In short, Parmar sees little reason to believe that American foundations can or will change.

"While foundation trustees are now more representative of the general population, and while new institutions such as the Bill and Melinda Gates Foundation have begun to overshadow the Big Three, Parmar believes that US foundations are "hard-wired" to support the status quo by virtue of the interconnected nature of government, business, academia and private philanthropy in the US."

<u>Know thy charity</u>

We use Ford example, because it highlights a risk for ESG for social funds that support charitable "agendas".

Such concerns are unlikely to bother socially neutral investors (those whose motive for investing in social bonds is purely financial), or those who believe the goals of American/Chinese/Russian/European hegemony (depending on the issuer) might be in global interest; but not all investors will feel the same way.

In theory, it also demonstrates the democratic nature of social bonds in that investors can choose to invest in a range of charities of their choice, even if that includes those that offer defacto geopolitical interference.

In reality, the concentration of funds in the hands of a few people or nations have the potential to undermine democracy.

And there is also the ESG investing principle of "do no harm" to consider.

Most passive investors will be leaving the nitty gritty of those decisions to fund managers.

One would assume the big three foundations would represent an excellent credit risk in nearly all circumstances, but there is always the ball from left field.

Lesser charities could represent greater risks and prove problematic for ESG fund managers, should they find themselves at the centre of a scandal that conflicts with their investment guidelines.

These funds might be forced to sell positions, which could have a systemic impact.

Or a sovereign nation may punish a fund.

Genuinely concerned social investors may need to dig deeper to ensure issuance matches their priorities.

In the spirit of the ESG investment catchcry "Who Cares Wins", it is a reminder that the easy days of investing may have had their day.

Teasing out the web of control structures and activities within the private and charity sectors is a diabolical task, and as they say, the road to hell is paved with good intentions.

Much will depend on the original intentions of the architects of ESG and those driving its implementation.

As always, it is buyer beware; and the best advice to investors is to know thy charity.

<u>Emerging and developed markets in Asia</u>

The above issues gain even greater significance viewed through the SDG lens of aiding developed economies.

Do the UN's Sustainable Development Goals represent aid, financial exploitation, a vehicle to promote western hegemony, or all three?

If so, they represent a gnostic-worthy universal entanglement of good and bad.

While the SDGs apply globally, much of the emerging markets focus is likely to be on the highly populous and semi-industrialised nations of Asia.

ESG finance will definitely allow investors to build a stake in the future growth of nations, which is not necessarily a bad thing depending on whether investment is of benign or sinister intent.

For example, the International Finance Facility for Education, launched in 2020 in support of SDG goal 4 (education), aims to galvanise at least $10bn in bonds for education finance issued by multilateral development banks, appears on face value to be relatively benign, ring-fencing education spending in lower-middle-income countries.

"Through grants and guarantees of principal, these efforts are expected to lower borrowing costs and risks, providing benefits for issuers and investors alike," says Brookings.

Meanwhile, the Asian Development Bank reports that Australia has the highest outstanding social bond issuance in Asia thanks largely to the National Australia Bank ((NAB)) and the Australian government.

China follows, mainly through the Bank of China and the Beijing Infrastructure Investment Co; then India's corporate and transport issuers, Japan's corporate and government related issuers, Philippines corporate issuers then Korea's corporations and government.

Asia was slow to issue social bonds until it developed the ASEAN Social Bond Standards, that specified all issuance must have a geographic or economic connection to ASEAN countries.

Meanwhile, harking back to the use of social bonds for crisis capitalism in our previous article, the SURE (support to mitigate unemployment rate in an emergency) Programme should reach a total of E100bn.

The African Development Bank also launched a US$3bn "Fight covid-19" social bond, becoming the world's largest dollar-denominated social bond transaction to date.

Sustainability bonds

Sustainability bonds are use-of-proceeds debt instruments for which the proceeds are exclusively applied to financing or refinancing a combination of both green and social projects or general sustainability themes.

They are designed for issuers that are mainly or entirely involved in sustainable activities, but whose bonds may not align to the four core components of the social or green bond principles.

Many issuers have been exhibiting a preference for sustainability bonds over social bonds and increasingly are issuing social bonds, and green bonds for that matter, through sustainability bond frameworks.

These are not to be confused with their "floating-rate" brothers – sustainability-linked bonds, which we discuss in future articles.

Market trends over the past five years have suggested that many issuers prefer the flexibility of sustainability bonds to social bonds.

The value of sustainability-bonds issuance is also gaining ground on the more established green bonds.

The Climate Bonds Initiative reports that in 2020, the total size of the sustainability bond market hit US$316.8bn, inching out the social bond market at US$315.6bn (which had been buoyed by covid-related issuance).

Demonstrating faith in the market, many countries are now jostling for pole position as a trading centre and offer exchanges for sustainability bonds.

Sustainability bond exchanges are offered by Stockholm, Nasdaq, the International Stock Exchange, Nigerian Stock Exchange, and the Toronto Stock Exchange and more.

ICMA has developed Sustainability Bond Principles, which mimic the social bond principles listed above.

ICMA encourages issuers to establish Sustainability Bond Frameworks and to adopt, where possible, the relevant best practice of the green and social bond principles.

In our next series, we shift our focus to sustainability-linked finance.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 13-08-21

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

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday August 9 to Friday August 13, 2021
Total Upgrades: 6
Total Downgrades: 15
Net Ratings Breakdown: Buy 53.83%; Hold 38.51%; Sell 7.66%

For the week ending Friday 13 August, there were six upgrades and fifteen downgrades to ASX-listed companies by brokers in the FNArena database.

In the wake of FY21 result announcements, there were two broker ratings downgrades apiece for Commonwealth Bank, Goodman Group and Aurizon Holdings.

Credit Suisse downgraded earnings estimates for Commonwealth Bank because of a lower net interest margin and higher expenses. Given the shares are trading on high multiples the broker sees little upside, and downgrades its rating to Underperform. Meanwhile, Citi downgrades its rating to Sell, suggesting excess liquidity is having an adverse effect on the ability to generate revenue. The analyst expects only 1% revenue growth in FY22, and notes underlying core earnings are declining.

Both UBS and Ord Minnett downgraded Goodman Group's rating to Neutral and Accumulate, respectively, based upon valuation only, and considered the result was in line with estimates.

For Aurizon Holdings, Morgan Stanley anticipates continued share price underperformance as reliance upon fossil fuel will impact investor appeal and downgrades to Underweight. Morgans also reminds investors of the balance between long-term sustainability issues facing the Coal and Network divisions, and the generation of strong cashflow to support a pivot into Bulk. However, despite downgrading to Hold the broker acknowledges the FY21 result beat the analyst's expectations.

There were no material reductions in target prices by brokers in the FNArena database last week.

James Hardie headed up the table for the largest percentage increase in forecast target price in the FNArena database last week. First quarter results beat the expectations of four of the six brokers covering the stock. While the company continues to experience cost pressure across the business, they are being more than offset by price, mix and savings from the company's LEAN manufacturing initiative, points out Ord Minnett. Macquarie notes the stock continues to trade at a discount to the historical price earnings ratio relative to the ASX200 Industrial index.

Next on the table was Pilbara Minerals after Ord Minnett raised its long term spodumene price assumption by 31%. The analyst notes the lithium commodity complex is one of the few remaining in the broker's coverage where it sees meaningful potential upside in the medium-term, given the strong demand backdrop. The broker raised its rating to Buy from Hold, with the target price increasing to $2.50 from $1.60.

Commentary from Macquarie was generally positive. The analyst noted rising spot lithium prices present the key upside risk to base case forecasts. Despite again heading the list last week, there was still nothing to contradict the positive tone of the prior week, as evidenced by the above paragraph pertaining to target price.

AGL Energy also saw a material percentage fall last week in forecast earnings. While FY21 underlying EPS was in line with Morgans' expectations, FY22 guidance for underlying profit fell -36% short. Morgan Stanley anticipates near-term underperformance for the stock, while UBS still expects margin compression as east coast gas prices are expected to rise through to FY23-24 as supply tightens.

Transurban Group had the largest percentage rise in forecast earnings by brokers in the FNArena database last week, as target prices were both raised and lowered.

Morgans assumes that traffic will recover to trend by 2022 (one year further covid-delayed for the airport-linked roads), and will grow at 2% thereafter, until capacity constrained. Ord Minnett also suggests traffic will rebound quickly when lock downs in Australia end.

A maximum of seven brokers cover Insurance Australia Group. Five raised target prices, reflecting the company's second place on the list for percentage earnings upgrades.

Citi highlighted the company has scope to drive improvements in intermediated margins, while Macquarie believes gross written premium growth targets of 'low single-digit' in FY22 are too low. Meanwhile, the final dividend was slightly ahead of Credit Suisse forecasts and the broker is now more confident on the outlook, given the extra detail disclosed on underlying claims improvement and industry tailwinds.

Next up was News Corp. After releasing FY21 results, Morgan Stanley suggests the performance and outlook for Move Inc/Realtor.com and Dow Jones are encouraging. Credit Suisse assessed there's limited downside risk to its FY22 estimates, forecasting that growth will be supported by payments from Facebook/Google and a number of acquisitions.

GrainCorp's forecast earnings by brokers also rose, following a second FY21 profit upgrade. FY22 outlook commentary was considered upbeat by Morgans, due to the planted area and favourable outlook for the 2021/22 winter crop. It's also thought benefits will derive from upgraded carryover grain. UBS also noted demand for Australian grain is booming amid supply challenges in the northern hemisphere, which is driving higher exports, stronger supply chain margins and elevated levels of forward contracted sales for the company.

Finally, forecast earnings upgrades and QBE Insurance Group do not normally appear in the same sentence. However, last week's first half result was met with general applause by brokers, and was even described as 'cracking' by UBS after a 32% EPS beat.

There was considered to be strong rate-driven gross written premium growth (GWP), higher margins and a cash return on equity (ROE) of 11.9%. In further good news, GWP growth was not only rate-driven, as around 7% came from new business and higher retention, pointed out the broker.

Total Buy recommendations take up 53.83% of the total, versus 38.51% on Neutral/Hold, while Sell ratings account for the remaining 7.66%.

Upgrade

AGL ENERGY LIMITED ((AGL)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/3/2

Credit Suisse upgrades its rating to Neutral from Underperform and raises its target price to $7.30 from $6.70, now that consensus and guidance are consistent with forward prices.

The broker estimates FY21 earnings (EBITDA) were in-line, with higher Customer earnings being largely offset by lower Wholesale Gas. The midpoint of FY22 guidance was -5% below consensus, while FY22 profit guidance -12% below, explains the analyst.

DOWNER EDI LIMITED ((DOW)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 5/1/0

Ord Minnett lifts its rating for Downer EDI to Hold from Lighten and increases its target price to $5.60 from $5.30, after FY21 underlying net profit came in 10% ahead of the analyst's forecast. An unfranked final dividend of 12 cents was declared.

The broker highlights earnings (EBITA) margins in the second half were returned to the company's five-year pre-pandemic average (FY15–19).

To get more positive on the stock, Ord Minnett would look for continued execution of the urban services strategy and further margin expansion.

JAMES HARDIE INDUSTRIES PLC ((JHX)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/1/0

The first quarter result revealed a strong uptake of high-value product amidst volume growth. Citi expects earnings momentum will remain in the company's favour amid a multi-year recovery in US housing.

While expectations are running high the broker still considers the stock attractive on a PE relative basis and upgrades to Buy from Neutral.

The medium-term prospects of Colorplus and textured panels underpin forecasts for ASP growth of 6.8% and 6.3% in FY23 and FY24, respectively. Target is raised to $56.20 from $46.20.

MINERAL RESOURCES LIMITED ((MIN)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 3/1/1

Ord Minnett has raised its long term-lithium spodumene price assumption by 31% to US$850 per tonne from US$650/t.

Ord Minnett has also launched a new supply-demand model, highlighting a tight market for the foreseeable future, leading to an increase in the broker's medium-term price forecasts.

After factoring in higher price forecasts, the broker's valuations have increased materially for the lithium miners. Ord Minnett notes the lithium commodity complex is one of the few remaining in the broker's coverage where it sees meaningful potential upside in the
medium-term, given the strong demand backdrop.

Based on these updates, Ord Minnett has upgraded Mineral Resources to Buy from Hold, with the target price lowering to $59.03 from $66.00.

PILBARA MINERALS LIMITED ((PLS)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/2/0

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medium-term, given the strong demand backdrop.

Based on these updates, Ord Minnett has upgraded Pilbara Resources to Buy from Hold, with the target price increasing to $2.50 from $1.60.

SUNCORP GROUP LIMITED ((SUN)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/4/0

FY21 results were very strong, Credit Suisse observes. Suncorp Group has maintained guidance for an FY23 return of 10-12% and a costs-to-income ratio of 50% for the bank.

Credit Suisse expects further growth in earnings and distributions, given the excess capital. With mortgage processing times now better than most major banks and a higher retention than market average, the broker expects strong growth from FY22 onwards while benign bad debts should add further upside.

Rating is upgraded to Outperform from Neutral and the target raised $14.00 from $12.20.

See also SUN downgrade.

<u>Downgrade</u>

ARB CORPORATION LIMITED ((ARB)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/3/0

Citi considers there is long-term potential in the US expansion yet a 53% rise in the share price over the year to date means the rating is downgraded to Neutral from Buy.

Risks in terms of a slower-than-expected contribution from the Ford partnership or weaker conditions in the Australian aftermarket as well as the supply chain challenges are not adequately factored in, the broker suggests. Target is $47.15.

ACCENT GROUP LIMITED ((AX1)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/2/1

Citi envisages the current multiple of 22x FY22 price/earnings reflects little risk stemming from recurring lockdowns, disrupted sales and casual employment. There is also less stimulus in the economy compared with the same time in 2020 amid increasing supply chain risks.

For example, key supplier Adidas has recently indicated it was affected by factory lockdowns in Vietnam.The broker now expects like-for-like sales in the first half will decline by -7.5%.

Rating is downgraded to Sell from Neutral and the target reduced to $2.50 from $3.10.

AURIZON HOLDINGS LIMITED ((AZJ)) Downgrade to Hold from Add by Morgans and Downgrade to Underweight from Equal-weight by Morgan Stanley.B/H/S: 3/2/1

Aurizon Holdings FY21 result beat Morgans expectations, while first-time FY22 earnings guidance was in-line. The broker lowers its rating to Hold from Add on recent share price strength and lowers the target price to $4.06 from $4.09.

The anlyst reminds investors of the balance between long-term sustainability issues facing Coal and Network, and the generation of strong cashflow to support a pivot into Bulk.

The second half dividend of 14.4 cps (70% franked) was above Morgans forecast of 13.7cps.

While Aurizon Holdings' near-term earnings and growth outlook are sound, it is Morgan Stanley's view that a fossil fuel reliance will impact investor appeal. The broker anticipates continued share price underperformance.

Morgan Stanley highlights Aurizon Holdings' high earnings linkage to fossil fuels of around 88% will see the stock excluded from many investor mandates.

The company reported underlying earnings for FY21 for $903m, up 1% on Morgan Stanley's forecast, with net profit of $533m, a 6% beat on the broker's forecast.

The rating is downgraded to Underweight and the target price decreases to $3.92 from $4.03. Industry view: Cautious.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Sell from Neutral by Citi.B/H/S: 0/1/5

Following the FY21 result Credit Suisse downgrades earnings estimates by -1.3% because of lower net interest margin and higher expenses.

The bank underperformed expectations in FY21 despite the investment in technology providing some operating leverage, and the broker envisages little upside for a stock trading at 21x PE.

As a result, Credit Suisse downgrades to Underperform from Neutral and maintains a $95 target.

Citi reports excess liquidity has enabled balance sheet normalisation for Commonwealth Bank of Australia, with a $6bn off-market buy-back, approximate 75% dividend payout ratio and provision write backs.

Despite this, the broker notes excess liquidity is also having adverse effect on the ability to generate revenue. The broker expects only 1% revenue growth in FY22, and notes underlying core earnings are declining.

Citi has downgraded cash earnings forecasts for FY22 and FY23 by -6-7%, and increased underlying cost growth.

The rating is downgraded to Sell and the target price decreases to $94.50 from $96.75.

FLIGHT CENTRE TRAVEL GROUP LIMITED ((FLT)) Downgrade to Neutral from Outperform by Macquarie
.B/H/S: 0/6/1

Macquarie reviews forecasts ahead of the FY21 result on August 26. The earnings recovery is pushed out by 6-9 months because of prolonged border closures.

More emphasis is likely to be placed on the corporate business where Macquarie anticipates gains in market share.

The business remains loss-making for the short term and break-even is now expected in FY23. Target is reduced to $15.50 from $17.50 and the rating is downgraded to Neutral from Outperform.

GOODMAN GROUP ((GMG)) Downgrade to Accumulate from Buy by Ord Minnett and Downgrade to Neutral from Buy by UBS.B/H/S: 5/1/0

Goodman Group reported an FY21 operating profit of $1.22bn, or 65.6c per share, up 14% on FY20 and in line with Ord Minnett's $1.21m forecast.

The result was underpinned by a 25% increase in development earnings, with development work in progress (WIP) lifting from $4.1bn two years ago to $10.6bn.

Ord Minnett believes this should result in strong increases in development earnings over the next two to three years, in turn driving strong assets under management (AUM) growth.

The broker believes Goodman carries material built-up development and performance fee profits, which have been held back for future years, and expects more than 10% earnings per share (EPS) growth in each of the next three years.

An unfranked final dividend of 15c was declared, taking the full-year payout to 30c per share.

Ord Minnett downgrades the rating to Accumulate from Buy and the price target increases to $24 from $21.

FY21 earnings growth of 14% was in line with UBS estimates. The key metrics that are driving the medium-term earnings outlook suggest guidance for growth of 10% is very conservative. The broker forecasts 14% and anticipates upgrades to guidance throughout FY22.

UBS points out the new 10-year investment plan is market-leading in its alignment with security holders but comes at a cost. The company has extended the testing period to four years and the vesting period to 10 years and included more challenging hurdles and ESG targets.

The broker downgrades to Neutral from Buy on valuation grounds and higher market expectations. Target is raised to $22.50 from $21.20.

KELLY PARTNERS GROUP HOLDINGS LIMITED ((KPG)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

Despite reporting an underlying FY21 profit (NPATA) rise of 27.5% on the previous corresponding period, Morgans downgrades the rating to Hold from Add, as the stock is trading in-line with its upgraded valuation. The target price rises to $3.44 from $2.35.

FY21 revenue growth of 7.5% was primarily driven by acquisitions of 4.8%, with accounting organic growth contributing 1.5% and complementary businesses 1.2%.

Total dividends (including specials) for the year were 5.84 cents, up 8.3%. Management commented that the group was "inundated" with further acquisition opportunities and further partnerships remain core to the strategy.

MEGAPORT LIMITED ((MP1)) Downgrade to Sell from Hold by Ord Minnett .B/H/S: 1/1/1

FY21 saw some lumpy growth, notes Ord Minnett, as it was affected by currency movements and covid-19, although the company finished on a high note with record fourth-quarter growth.

The broker lowers the rating to Sell from Hold and the target price falls to $15 from $15.50, as growth investment may take time to bear fruit. These investments include in the indirect sales channel and the continued focus on new product developments.

In a largely pre-released result, the company reported FY21 revenue of $78.3m, up 35% on FY20 and in-line with the broker's forecast. The reported net loss of -$55m widened on a year ago, driven largely by unrealised currency losses, explains the analyst.

NATIONAL AUSTRALIA BANK LIMITED ((NAB)) Downgrade to Hold from Add by Morgans .B/H/S: 2/4/0

Due to recent share price strength the broker lowers its rating to Hold from Add and the $27.50 target price is unchanged.

Morgans sees a marginal benefit in the wider context, of the agreement to purchase Citigroup's Australian consumer business. Pre-tax cost synergies of circa -$130m pa are expected to be realised over three years, with the majority expected to be achieved in the first two years.

RESMED INC ((RMD)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/4/0

Earnings in the fourth quarter were slightly below Macquarie's estimates. Management has indicated potential upside from the recall of the Philips device.

Combining expectations for higher market share with revised assumptions in relation to masks/accessories revenue for new patients associated with the recall, Macquarie raises the target to $37.40 from $34.85.

As a result of a 14% outperformance to the ASX200 since June, Macquarie downgrades to Neutral from Outperform.

SPARK NEW ZEALAND LIMITED ((SPK)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/3/0

Credit Suisse expects Spark New Zealand will deliver operating earnings at the top end of guidance when it reports on August 18. As part of the results, management is also due to update the market on a review of the infrastructure assets.

Other areas the broker will be scrutinising include commentary on the shift from pre-paid to monthly payment subscribers and the resulting revenue benefit, as well as the take-up of fixed wireless plans.

With the stock now trading through valuation the broker lowers the rating to Neutral from Outperform. While the upcoming infrastructure review has potential to be a positive catalyst Credit Suisse does not expect immediate monetisation. Target is steady at $4.50.

SUNCORP GROUP LIMITED ((SUN)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/4/0

Following Suncorp Group's strong rally and with further significant improvement unlikely before second-half FY22, Citi pulls back to Neutral from a Buy and the target price lifts to $12.80 from $11.80.

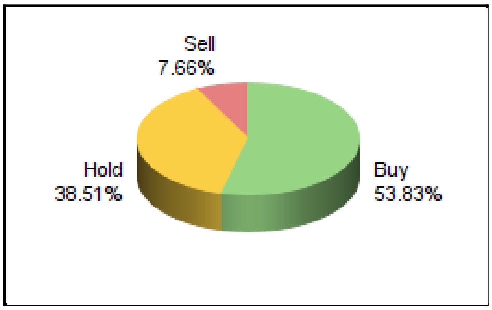
Following underlying insurance margins of 7.4% in second half FY21, the group has now clarified that it expects margins to remain broadly in line or "hopefully a little better" in first-half FY22, before expanding in second half FY22 as strategic initiative benefits kick in.

While Citi still believes the group's banking target of a 50% cost to income ratio will be hard to achieve, the broker sees the return to growth in mortgage lending as a positive sign.

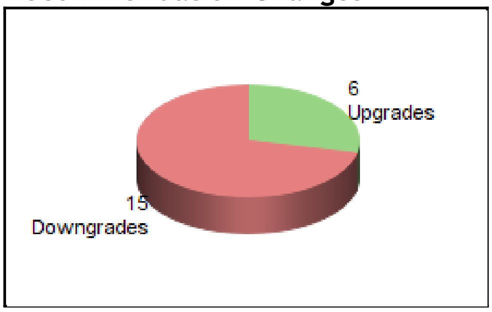
The $250m buyback is largely as anticipated and is now factored into Citi's forecasts, and the broker continues to expect the group to
deliver on its FY23 margin guidance of 10%-12%.

See also SUN upgrade.

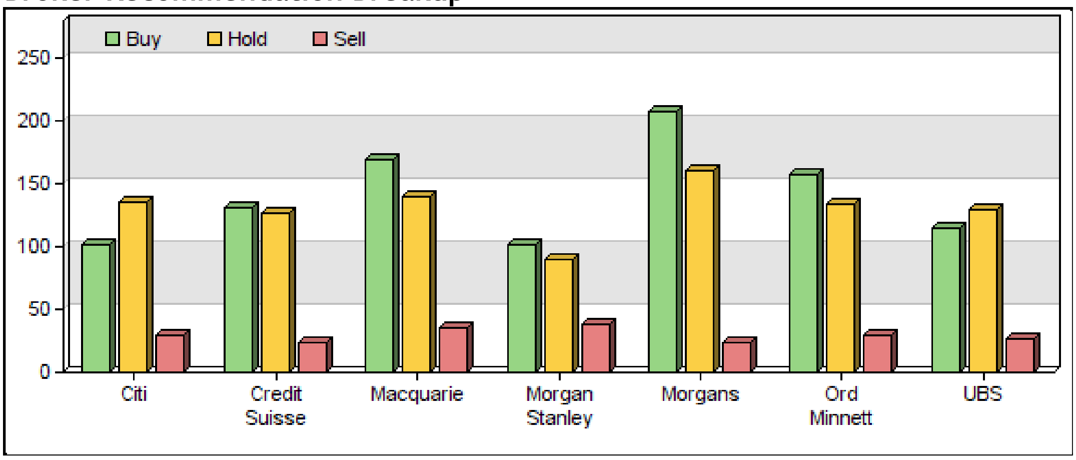
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				

1	AGL ENERGY LIMITED	Neutral	Sell	Credit Suisse
2	DOWNER EDI LIMITED	Neutral	Sell	Ord Minnett
3	JAMES HARDIE INDUSTRIES PLC	Buy	Neutral	Citi
4	MINERAL RESOURCES LIMITED	Buy	Neutral	Ord Minnett
5	PILBARA MINERALS LIMITED	Buy	Neutral	Ord Minnett
6	SUNCORP GROUP LIMITED	Buy	Neutral	Credit Suisse
Downgrade				
7	ACCENT GROUP LIMITED	Sell	Neutral	Citi
8	ARB CORPORATION LIMITED	Neutral	Buy	Citi
9	AURIZON HOLDINGS LIMITED	Sell	Neutral	Morgan Stanley
10	AURIZON HOLDINGS LIMITED	Neutral	Buy	Morgans
11	COMMONWEALTH BANK OF AUSTRALIA	Sell	Neutral	Citi
12	COMMONWEALTH BANK OF AUSTRALIA	Sell	Neutral	Credit Suisse
13	FLIGHT CENTRE TRAVEL GROUP LIMITED	Neutral	Buy	Macquarie
14	GOODMAN GROUP	Neutral	Buy	UBS
15	GOODMAN GROUP	Buy	Buy	Ord Minnett
16	KELLY PARTNERS GROUP HOLDINGS LIMITED	Neutral	Buy	Morgans
17	MEGAPORT LIMITED	Sell	Neutral	Ord Minnett
18	NATIONAL AUSTRALIA BANK LIMITED	Neutral	Buy	Morgans
19	RESMED INC	Neutral	Buy	Macquarie
20	SPARK NEW ZEALAND LIMITED	Neutral	Buy	Credit Suisse
21	SUNCORP GROUP LIMITED	Neutral	Buy	Citi

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	PLS	PILBARA MINERALS LIMITED	50.0%	25.0%	25.0%	4
2	MIN	MINERAL RESOURCES LIMITED	40.0%	20.0%	20.0%	5
3	AGL	AGL ENERGY LIMITED	-40.0%	-60.0%	20.0%	5
4	SGM	SIMS LIMITED	67.0%	50.0%	17.0%	6
5	CSR	CSR LIMITED	67.0%	50.0%	17.0%	6
6	BSL	BLUESCOPE STEEL LIMITED	67.0%	50.0%	17.0%	6
7	RWC	RELIANCE WORLDWIDE CORP. LIMITED	67.0%	50.0%	17.0%	6
8	JHX	JAMES HARDIE INDUSTRIES PLC	75.0%	58.0%	17.0%	6
9	PMV	PREMIER INVESTMENTS LIMITED	42.0%	30.0%	12.0%	6
10	DOW	DOWNER EDI LIMITED	83.0%	75.0%	8.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	AZJ	AURIZON HOLDINGS LIMITED	33.0%	67.0%	-34.0%	6
2	CBA	COMMONWEALTH BANK OF AUSTRALIA	-83.0%	-50.0%	-33.0%	6
3	PNI	PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED	67.0%	100.0%	-33.0%	3
4	ARB	ARB CORPORATION LIMITED	13.0%	38.0%	-25.0%	4
5	SPK	SPARK NEW ZEALAND LIMITED	25.0%	50.0%	-25.0%	4
6	GMG	GOODMAN GROUP	75.0%	100.0%	-25.0%	6
7	HDN	HOMECO DAILY NEEDS REIT	75.0%	100.0%	-25.0%	4
8	BLD	BORAL LIMITED	-30.0%	-10.0%	-20.0%	5
9	NAB	NATIONAL AUSTRALIA BANK LIMITED	33.0%	50.0%	-17.0%	6
10	RMD	RESMED INC	33.0%	50.0%	-17.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	JHX	JAMES HARDIE INDUSTRIES PLC	55.050	46.442	18.53%	6
2	PLS	PILBARA MINERALS LIMITED	1.795	1.570	14.33%	4

3	PNI	PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED	15.003	13.227	13.43%	3
4	RMD	RESMED INC	37.490	33.462	12.04%	6
5	GMG	GOODMAN GROUP	24.397	22.318	9.32%	6
6	BSL	BLUESCOPE STEEL LIMITED	28.232	26.123	8.07%	6
7	RWC	RELIANCE WORLDWIDE CORP. LIMITED	5.660	5.340	5.99%	6
8	BLD	BORAL LIMITED	7.050	6.660	5.86%	5
9	CIP	CENTURIA INDUSTRIAL REIT	3.930	3.773	4.16%	6
10	SGM	SIMS LIMITED	19.000	18.567	2.33%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	AGL	AGL ENERGY LIMITED	7.392	7.824	-5.52%	5
2	AZJ	AURIZON HOLDINGS LIMITED	4.508	4.587	-1.72%	6
3	MIN	MINERAL RESOURCES LIMITED	59.440	60.040	-1.00%	5
4	CSR	CSR LIMITED	6.350	6.362	-0.19%	6
5	HDN	HOMECO DAILY NEEDS REIT	1.558	1.560	-0.13%	4

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	TCL	TRANSURBAN GROUP LIMITED	12.006	-1.907	729.58%	6
2	IAG	INSURANCE AUSTRALIA GROUP LIMITED	27.429	15.183	80.66%	7
3	NWS	NEWS CORPORATION	96.683	69.123	39.87%	4
4	GNC	GRAINCORP LIMITED	57.300	41.215	39.03%	4
5	QBE	QBE INSURANCE GROUP LIMITED	77.863	63.989	21.68%	7
6	RMD	RESMED INC	85.521	70.532	21.25%	6
7	DOW	DOWNER EDI LIMITED	35.467	30.132	17.71%	6
8	GMG	GOODMAN GROUP	75.483	65.200	15.77%	6
9	GXY	GALAXY RESOURCES LIMITED	4.887	4.225	15.67%	6
10	AQZ	ALLIANCE AVIATION SERVICES LIMITED	26.360	22.870	15.26%	3

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	PLS	PILBARA MINERALS LIMITED	-0.690	-0.268	-157.46%	4
2	AGL	AGL ENERGY LIMITED	43.183	85.348	-49.40%	5
3	CRN	CORONADO GLOBAL RESOURCES INC	3.081	3.596	-14.32%	4
4	EHE	ESTIA HEALTH LIMITED	1.350	1.550	-12.90%	4
5	WSA	WESTERN AREAS LIMITED	-2.793	-2.507	-11.41%	7
6	REG	REGIS HEALTHCARE LIMITED	7.100	7.600	-6.58%	4
7	SXY	SENEX ENERGY LIMITED	9.717	10.317	-5.82%	6
8	MIN	MINERAL RESOURCES LIMITED	606.960	633.020	-4.12%	5
9	BLD	BORAL LIMITED	19.880	20.713	-4.02%	5
10	NST	NORTHERN STAR RESOURCES LIMITED	41.625	42.958	-3.10%	6

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: Small Modular Reactors In The News

As the uranium spot price slides nearly -5%, the US senate and the Australian government separately focus upon small modular reactors.

-Bipartisan Infrastructure Deal passes in the US senate
-Spending directed, in part, toward small modular reactors
-Uranium spot price falls by -4.7% for the week

By Mark Woodruff

Last week, the US Senate passed a US$1trn infrastructure bill, also known as the Bipartisan Infrastructure Deal.

The bill includes $73bn in grid modernisation, as well as provisions for investment in advanced reactor demonstration projects and research hubs for next-generation technologies, such as carbon capture and clean hydrogen.

For the US nuclear power industry, the legislative package **targets ageing power plants as well as proposed small modular reactors (SMRs)**. It allocates US$6 billion for the US Department of Energy (DOE) to spend on nuclear facilities that are under threat of being shut down due to economic factors.

It also dedicates $6bn in funding for microreactors, SMRs and advanced nuclear reactors.

Meanwhile, the governments of Australia and the UK have signed a letter of intent to establish a partnership on low emissions solutions including clean hydrogen and small modular reactors (SMRs).

Australia's Technology Investment Roadmap, which was released last year by the Australian government, **identifies SMRs as a "watching brief technology**". That is, a prospective technology with transformative potential.

Company news

ASX-listed **Alligator Energy** ((AGE)) has completed the issue of new shares under a $10.7m placement.

CEO Greg Hall said the company can "now aim to advance the Samphire Project through scoping and into feasibility work in an improving uranium market". The project is near Whyalla, South Australia.

The additional funds also enable work to be fast-tracked on the Nabarlek North Project within the Alligator Rivers Uranium Province in the Northern Territory.

Uranium pricing

TradeTech's Weekly **Spot** Price Indicator fell to US$30.50/lb, a -US$1.50 decrease from last week.

The Indicator, which had climbed nearly 7% this year, is now only 0.3% higher than at the beginning of 2021. The average Weekly Spot Price Indicator in 2021 is US$30.49/lb, US$0.78 above the 2020 average.

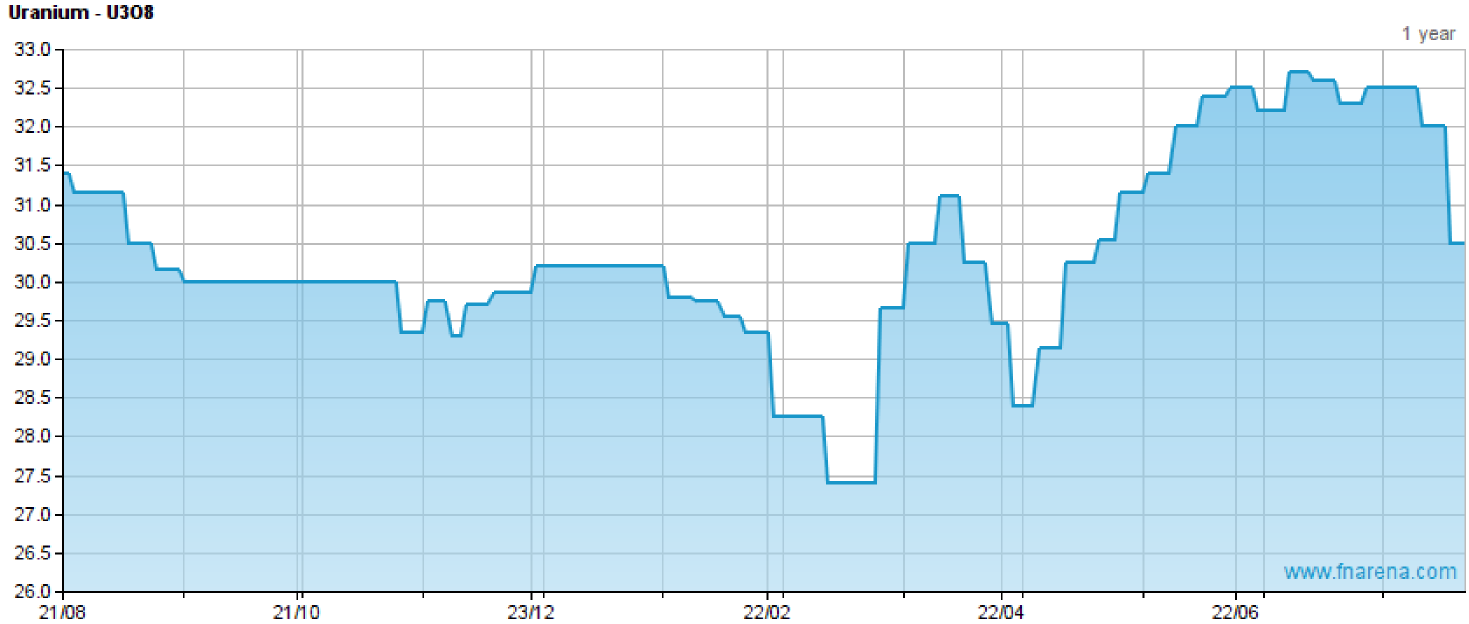
A total of six transactions were recorded for the week.

After a long summer of limited demand and growing uncertainty surrounding the fate of the Byron and Dresden Nuclear Power Plants in the US State of Illinois, several sellers were left with unsold inventory.

According to TradeTech, the decline in the spot uranium price last week was the end result of this unsold inventory meeting multiple sellers eager to conclude business, after losing out on competitive offers with a utility earlier in the week.

TradeTech's **term** price indicators are US$33.50/lb (mid) and US$35.00/lb (long).

The trend in the term uranium space toward smaller purchases for shorter and nearer-term deliveries continues, according to TradeTech. This is alongside the more significant enriched uranium product (EUP) purchases that have been a mainstay, particularly among non-US utility buyers.



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FNArena is proud about its track record and past achievements: [Ten Years On](#)

WEEKLY REPORTS

The Short Report - 19 Aug 2021

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

Summary:

By Greg Peel

Week Ending August 12, 2021.

Last week saw the ASX200 continue to climb further into blue sky, with a negligible amount of corporate earnings reports in the week having minimal impact.

This week the index peaked out on slower Chinese growth and reporting stocks being hit harder to the downside than those enjoying upside responses. And now we have Wall Street throwing a (mini) taper tantrum.

Looking at the table below, one might think short-side players were rabbits in the headlights last week. But shorting activity has been slowing substantially as the ASX200 has pushed further into blue sky, and this week's ramp-up of earnings reports provides good reason for shorters to stay out until results really start to flow through.

The only movement worth noting is that of Redbubble ((RBL)) making an appearance at the bottom of the table. The company is not dissimilar to US-based Etsy, providing an online marketplace for artists, designers and crafts people to sell their creations.

One of those products is masks, hence Redbubble has recently been in the spotlight, and its share price has been extremely volatile over the past month without really going anywhere.

Until today. Redbubble has reported and is down -11% at the time of writing, so shorters got it right.

Weekly short positions as a percentage of market cap:

10%+
WEB 11.0

No changes

9.0-9.9

FLT, Z1P

No changes

8.0-8.9%

EOS, KGN, ING

No changes

7.0-7.9%

TGR, PNV

No changes

6.0-6.9%

IVC, A2M, TPW, MTS, RSG, MSB

In: RSG

5.0-5.9%

COE, BGL, AMA, RBL, PLL

In: RBL Out: RSG

Movers & Shakers

Nothing this week.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.1	0.2	MQG	0.2	0.2
ANZ	0.8	1.0	NAB	0.9	0.9
APT	1.8	1.9	NCM	0.1	0.1
BHP	4.1	4.2	RIO	0.2	0.3
BXB	0.4	0.5	TCL	0.6	0.6
CBA	0.5	0.6	TLS	0.2	0.2
COL	0.6	0.6	WBC	0.8	0.9
CSL	0.2	0.2	WES	0.2	0.3
FMG	0.5	0.6	WOW	0.3	0.3
GMG	0.2	0.2	WPL	1.0	1.0

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

RUDI'S VIEWS

Rudi's View: August, It's A Joke

In this week's Weekly Insights

-August: It's A Joke
-September Index Reviews
-Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

August: It's A Joke

Corporate reporting season in Australia; in most investors' mind that is only February and August, every year.

In practice, however, the bulk of companies tends to release its market update in the second half of each month, so we might as well call it the second-half-of-August reporting season.

I am not even exaggerating, not by the slightest. When the team at FNArena started updating the **Corporate Results Monitor**, some eight years ago now, we had to account for a lopsided schedule from day one, but -for reasons unknown- things have only grown even more lopsided since.

From memory, eight years ago we'd end up with some 100 companies having reported by mid-month, which meant there were a further 150-plus left for the closing two weeks of the season. The numbers have since gradually become slimmer and slimmer for the first two weeks, and thus larger and larger for the second half. Also because the stockbrokers we monitor have broadened their coverage over time.

Four years ago, we'd have 80-plus companies in the Monitor by mid-month. Last year that number had shrunk to a little over 50. This time around we ended up with 44. At this pace -dropping -50% in four years- we might as well shorten the whole season to two weeks only from next year onwards. Nobody's going to notice the difference!

Post-2018, my suspicion had been this shift to reporting later in the season was due to more and more local companies having to report bad news for shareholders. If it wasn't a big miss on forecasts, it'd probably involve a capital raising, or a dividend reduction, or a large write-down (non-cash, thus not-so-bad).

But if this were the case over the past three years, businesses clearly do not feel optimistic or confident enough to pull forward the timing for their financial results release. See the numbers this year. Or maybe this is simply a case of: it'll never revert back to a more spread-out scheduling worthy of its common label.

Once we've created a new habit, maybe there is no turning back from it.

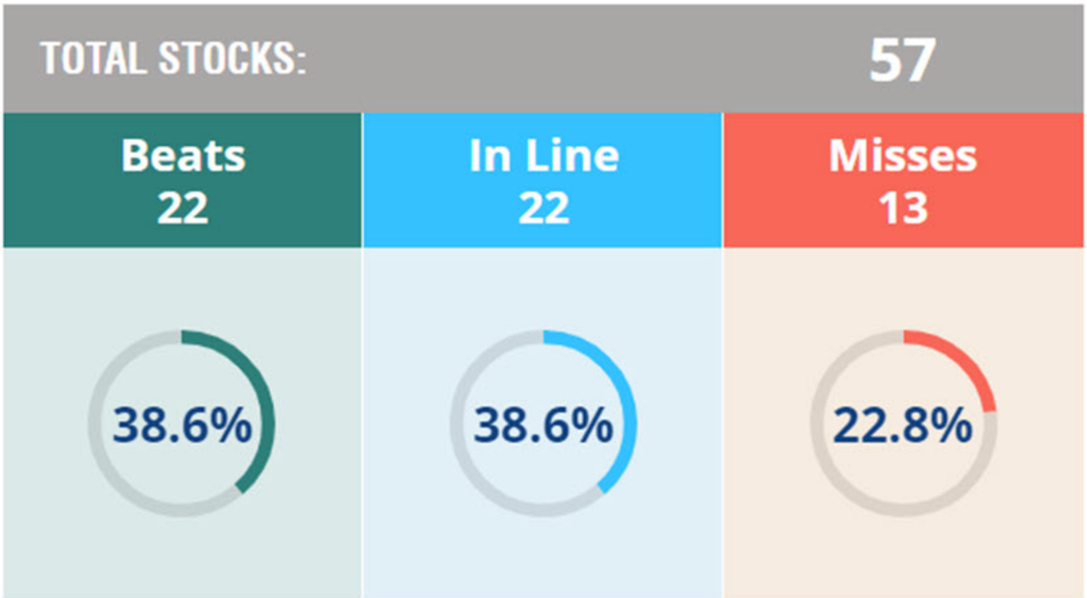
Is two weeks long enough to talk about a results "season"?

What this lopsided scheduling does prevent is the ability to draw in-depth, far-reaching conclusions at the half-way point. By early September we expect to have covered off on circa 350 companies. So far, we have hardly scratched the surface in terms of numbers.

Hence, it's getting busy from here onwards. I do not precisely know what the coming two weeks might bring, nor what the exact impact will be on writing Weekly Insights on the coming two Mondays.

I'll do my best.

Figures shown as at 17 August 2021



Meanwhile, I happily refer to my previews and early observations from the past three weeks:

-Early Days, But Plenty Of Signs

https://www.fnarena.com/index.php/2021/08/12/rudis-view-early-days-but-plenty-of-signs/

-August Bonanza, But What's Next?

https://www.fnarena.com/index.php/2021/08/05/rudis-view-august-bonanza-but-whats-next/

-August Results: Anticipation & Trepidation:

https://www.fnarena.com/index.php/2021/07/29/rudis-view-august-results-anticipation-trepidation/

Here is the link to the FNArena Corporate Results Monitor (from now on updated daily):

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

September Index Reviews

Inclusions and exclusions for a leading share market index can have quite the noticeable ramifications for share prices, in particular for small caps throughout the immediate market response.

Past data analysis by **Morgan Stanley** shows the most pronounced impact usually involves the ASX200. Fresh inclusions tend to outperform the broader market by 7.4% over the twenty days prior to the announcement made at a success rate of no less than 81%.

Index changes can equally have a rather large affect on stocks inside the Small Ordinaries as the pending removal of Orocobre ((ORE)), for instance, can shake-up the sector weights in the index. Australia's pre-eminent producer of lithium can potentially be elevated to the ASX100, which implies automatic removal from the Small Ordinaries (and thus from every institutional portfolio with a mandate of only investing in small caps).

Spin-offs and mergers and acquisitions are playing a major role ahead of the upcoming index rebalancing review, think Woolworths-Endeavour, but also Orocobre-Galaxy Resources and acquisitions of Vocus and Bingo Industries, and we may as yet hear more from Sydney Airport, Iress, Tabcorp, AGL Energy, as well as from Afterpay, Santos/Oil Search, BHP Group and others.

M&A activity is so busy these days, I might have forgotten a few. a2 Milk is also rumoured under corporate interest.

Analysts at Morgan Stanley, for their part, believe both ResMed ((RMD)) and Seek ((SEK)) might be entering the ASX50 next month with a2 Milk ((A2M)) and Ampol ((ALD)) expected to lose their spot. There is a chance that Tabcorp ((TAH)) might also replace AGL Energy ((AGL)) but this scenario is seen as a lower probability.

It is remarkable in itself there are so many changes expected for what is traditionally a rather stable index, as is the ASX20, soon to be upended by the acquisition of Afterpay. See also Wilsons' predictions further below. Both the ASX50 and the ASX100 will lose one more stock than can be added because of Woolworths spin-off Endeavour Group ((EDV)).

The ASX100 is expected to lose Boral ((BLD)) and maybe Beach Energy ((BPT)) too. Only in the second scenario are Orocobre and Steadfast Group ((SDF)) seen as potential replacements.

As flagged earlier, the most important changes tend to involve the ASX200 and here NRW Holdings ((NWH)), G8 Education ((GEM)), Westgold Resources ((WGX)) and Spark New Zealand ((SPK)) are all considered prime candidates to be booted out in a few weeks' time, with Nuix ((NXL)) and Omni Bridgeway ((OBL)) not out of the question either.

Considered potential candidates to fill up the looming vacancies are Pinnacle Investment Management ((PNI)), Lifestyle Communities ((LIC)), SeaLink Travel Group ((SLK)), De Grey Mining ((DEG)), and potentially Imugene ((IMU)) and Event Hospitality & Entertainment ((EVT)).

All changes are to be announced on Friday, September 3 and changes will kick in after the close of trading on Friday, September 17th.

Analysts at **Wilsons** have a few different scenarios on their mind. While admitting such an outcome remains unlikely, they nevertheless have been toying with the idea the ASX20 might be ripe for a true shake-up that could see each of Coles ((COL)), Newcrest Mining ((NCM)) and Brambles ((BXB)) removed in favour of Xero ((XRO)), Sonic Healthcare ((SHL)) or James Hardie ((JHX)).

More probable, in Wilsons' view, is that BlueScope Steel ((BSL)) will be added to the ASX50, with Seek seen as a possible candidate, and ResMed and Evolution Mining ((EVN)) as lesser probability additions. Those biding their time, apparently, are a2 Milk, AGL Energy, possibly Ampol, and to a lesser extent Aurizon Holdings ((AZJ)) and Origin Energy ((ORG)).

Wilsons has other candidates for the ASX100 too with Steadfast Group seen as a potential inclusion and Seven Group ((SVW)) and Iluka Resources ((ILU)) as less likely options. Those about to be dropped are Beach Energy, probably, Boral potentially and Link Group ((LNK)) and Orora ((ORA)) under less likely scenarios.

For the ASX200, Wilsons shares some of the same favourites for inclusion as Morgan Stanley; Pinnacle Investment Management, SeaLink Travel Group, De Grey Mining and Event Hospitality & Entertainment, but then Piedmont Lithium ((PLL)) is also considered a valid candidate, with a lesser probability given to Lifestyle Communities, Tyro Payments ((TYR)), Arena REIT ((ARF)) and Sandfire Resources ((SFR)).

Prime candidates to be booted out include Nuix, NRW Holdings, G8 Education, and Westgold Resources, with Spark New Zealand a possibility. Might retain their inclusion, according to Wilsons, but are certainly seen as a potential exclusion: Omni Bridgeway, Kogan ((KGN)), Nearmap ((NEA)), and Redbubble ((RBL)).

Wilsons equally sees a list of changes taking place for the ASX300 where Bubs Australia ((BUB)), Synlait Milk ((SM1)), Integrated Research ((IRI)), Maca Ltd ((MLD)), Medical Developments International ((MVP)), and Humm Group ((HUM)) are all considered future index orphans, with SSR Mining ((SSR)) a potential candidate too.

Could well be removed too, but are likely to retain their membership, at least for now, are AMA Group ((AMA)), AACo ((AAC)), Jupiter Mines ((JMS)), Alkane Resources ((ALK)), and Carnarvon Petroleum ((CVN)).

Most likely candidates to fill the voids include Paladin Energy ((PDN)), Imugen, Liontown Resources ((LTR)), Betmakers Technology Group ((BET)), Dubber Corp ((DUB)), PPK Group ((PPK)), Novonix ((NVX)), Johns Lyng Group ((JLG)), Strike Energy ((STX)), and Australian Strategic Materials ((ASM)).

Syrah Resources ((SYR)) could be added too but is given a lower probability, with an even lower probability ascribed to Jervois Mining ((JRV)), Vulcan Energy Resources ((VUL)), HomeCo Daily Needs REIT ((HDN)), PWR Holdings ((PWH)), as well as Adriatic Metals ((ADT)).

Conviction Calls

I think the following quote from **US equity strategists at Citi** is self-explanatory:

"*... despite bumping our numbers higher (belatedly), we are in the broader 10% correction camp with a reminder that seasonally, September is not the best month to be invested in the S&P 500*".

Citi analysts have been blown away by the manner in which corporate America managed to grow profits, once again beating market expectations with gusto, but they also believe valuations have limits:

"*...we do not anticipate an equity collapse though we suspect that the combination of higher taxes (tied to a reconciliation bill this year), potentially more persistent inflation, Fed taper talk and possible margin compression all support the probability of a correction.*"

Citi analysts also emphasise this is all they are talking about: a correction. Not a collapse, and neither is a new bear market imminent, in their view.

Market strategists at Morgan Stanley expressed a similar view recently.

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No changes made means **Morgan Stanley's Australia Macro+ Focus List** still comprises of ten stocks:

Ansell ((ANN)), APA Group ((APA)), BlueScope Steel, Downer EDI ((DOW)),Qantas Airways ((QAN)), QBE Insurance ((QBE)), REA Group ((REA)), Scentre Group ((SCG)), Telstra Corp ((TLS)), and Westpac ((WBC)).

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One change was made to **Wilsons' list of Conviction Calls** in the removal of Whispir ((WSP)) due to a too high level of uncertainty.

Have thus been retained: ARB Corp ((ARB)), Collins Foods ((CKF)), Pacific Smiles ((PSQ)), Aroa Biosurgery ((ARX)), ReadyTech ((RDY)), and Plenti ((PLT)).

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Analysts at **Morgan Stanley** remain in awe of favourable market dynamics for BlueScope Steel ((BSL)), expecting a very strong FY21 performance but equally a better-than-priced in guidance for FY22 which should extend the stock's positive momentum.

Their outlook for Boral is the exact opposite as the company's share buyback is about to end while suitor Seven Group has achieved its goal and will therefore not continue to support the share price now that the offer to acquire Boral shares has not been extended beyond the July 29 deadline.

Morgan Stanley suspects once the market's focus returns to Boral's operations, the balance of risk reverts to the downside.

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(This story was written on Monday 16th August, 2021. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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