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Friday, 8 November 2019

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AUSTRALIA

Orica Poised For Better Year Ahead

Brokers remain comfortable with the FY20 outlook provided by Orica but suspect the share price already reflects an earnings recovery.

-Recent breakthrough in WebGen usage in large open-pit mines
-Ammonium nitrate market now emerging from a period of oversupply
-Uncertainty on costs and/or shortfall in obligations endangers FY20 outlook

By Eva Brocklehurst

Orica ((ORI)) has provided a positive outlook, with the main focus for the next six months being the re-commissioning of the Burrup plant in Western Australia. Management has guided to higher earnings in FY20, supported by the take-up of its technology and increased demand for its products.

The company has also rewarded shareholders by providing reasonable growth over FY19, in the context of a challenging broader market. Brokers are comfortable with the outlook but suspect the share price already reflects an earnings recovery.

FY20 volume growth of around 5% is expected, supported by new contracts in Europe and Canada as well as good growth in the Asia-Pacific region. The company believes a higher gold price will support volume growth for explosives and cyanide.

A renewed focus on customer engagement is also expected to improve penetration of the company's products and technology. Morgans assesses the company should benefit not only from volume growth and a better manufacturing performance but, potentially, price rises.

Citi notes the company's wireless technology recently made a significant breakthrough, which could pave the way for usage in large open-pit mines and provide a significant earnings contribution. The WebGen technology has passed muster in underground mines but now the trial with BHP Group's ((BHP)) Poitrel open cut mine in Queensland has been successfully completed.

However, Ord Minnett remains cautious about the outlook, given some recent checking of channels indicated a -30% discount on electronic blasting system (EBS) contract pricing in a developing market, supporting

suspicions of potential volume-for-value trading, affecting margins.

The broker expects ammonium nitrate volumes will increase 4.2% in FY20, amid strong demand globally. UBS assesses global ammonium nitrate markets are emerging from a period of oversupply and the recovery in demand will be underpinned by a normalisation of mine activity.

Firming dynamics in the market will drive more favourable contract re-pricing into FY22 and, as Macquarie points out, ammonium nitrate leverage will be in focus as the contract book is substantially locked in until then.

The broker notes there was no reference to the outlook for ammonium nitrate pricing vs the "firm" pricing forecasts in the first half result in May. Hence, prices are expected to be broadly flat in FY20. Earnings growth is expected but with a skew to the second half that is greater than normal because of the ongoing losses from Burrup in the first half.

In FY19, volume increases in the Americas, improved earnings for Minova and a full year contribution from GroundProbe were offset by weaker pricing and increased sourcing costs to Pilbara customers, as well as temporary disruption to the Newmont gold mine in Mexico. As FY19 was less disrupted, Credit Suisse assumes the company is getting on top of its manufacturing problems.

Burrup

Orica delivered a positive update on its Burrup project, noting rectification works are running to schedule. Cash flow will be affected by an increase in inventory because of the rectification works and a build up in safety stocks in advance of the SAP system going live. Nameplate capacity is expected to be achieved through the second half of FY20 and Macquarie forecasts 40% utilisation over FY20.

Burrup is an even larger swing factor in FY20 now, Credit Suisse assesses, as the company requires additional volume to fulfill the BHP contract. The timing of the re-start is important, as the cost of any delays increases with the additional volume resulting from the commencement of the BHP contract in early 2020.

Ord Minnett agrees that uncertainty regarding costs and the sourcing of any shortfall to obligations endangers the FY20 earnings outlook, irrespective of strong industry trends elsewhere.

While Burrup appears more promising by the day, the broker is not expecting a stabilisation in the near term and remains cautious about the commissioning timeline. Orica is likely to source from Yarwun and a third party while freight will be a key consideration for additional contract tonnage.

The broker forecasts Burrup production of 135,000t in the second half and utilisation of around 45% in FY20 moving to 88% in FY21. Ord Minnett considers the less-than-certain outlook for Burrup as well as headwinds in Mexico are reasons why the premium in the stock vs its rival Incitec Pivot ((IPL)) is unwarranted.

FNArena's database has six Hold ratings and one Sell (Ord Minnett). The consensus target is $21.91, suggesting -7.8% downside to the last share price. Targets range from $17.00 (Ord Minnett) to $24.50 (Citi).

See also, Orica's Technology Advantage Key To Upside on July 31, 2019.

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AUSTRALIA

Infrastructure Growth Underpins Macquarie

Is Macquarie Group simply being its usual conservative self, or are there real concerns about the ability to improve on the FY19 result?

-Benefiting from commodity expansion and shift towards lower tax jurisdictions
-Focus on infrastructure, technology and renewables
-Relative appeal acknowledged, given the challenges facing Australia's banks

By Eva Brocklehurst

Macquarie Group ((MQG)) has stuck by guidance after the first half result and, for the first time since May 2009, forecasts an earnings decline over the year ahead. The question is whether management is simply being conservative, as usual, or whether there are real concerns about growth. Guidance is for FY20 to be "slightly down on FY19".

Yet first half cash earnings rose 11%, revenue grew 8%, there was 22% growth in Macquarie Asset Management and an 8% rise in base fees. Commodities and global markets revenue rose 15% while banking and financial services revenue fell -3%. UBS points out global oil, gas & power, agriculture and metals & mining all provided strong support.

Arguably, Macquarie Group is in a better position to exceed guidance, Citi suspects, although this is not a base case, assessing the company is benefiting from being in the right place at the right time, given heightened geopolitical tensions and unexpected tight supply in US natural gas. Meanwhile, a shift in revenue towards lower-tax structures and jurisdictions has delivered a easing of the tax rate for the group to just 20.5%.

FY19 benefited from gains on sale and buoyant commodities but Morgan Stanley believes **the business can absorb lower gains on sale and commodities revenue and still meet guidance**, forecasting a -1% decline in earnings in FY20, although subsequently the business should remain in an earnings growth cycle. The broker is more confident the business will ultimately meet, or beat, guidance as it continues to evolve its business mix.

Bell Potter observes the market also appears to have glossed over the strong performance in higher-returning annuity-style asset management and market facing commodities and global markets.

However, Shaw and Partners points to numerous revenue lines which showed little growth. These include net interest income, brokerage, M&A, advisory and underwriting. Therefore, the investment case is becoming increasingly reliant on the company's skill in identifying high-returning infrastructure investments.

Alternative Investments

Macquarie Group is looking to focus on areas of strength, such as moving away from using its own capital in the aircraft leasing business and reducing its US and European equities, and Morgan Stanley is increasingly confident in the structural growth options available in infrastructure, renewables and technology, estimating the portfolio has grown by another $500m at the start of the second half on the back of the Formosa offshore wind farm investment.

The alternative asset management division, MIRA, is expected to increase base fee revenue, generated by 10-year closed-end funds operating in a structurally growing segment, as institutional investors look to increase allocations to real assets.

Moreover, Macquarie Group generates two thirds of its revenue outside Australia and Morgan Stanley is more positive about the near-term outlook for the global economy vs Australia underpinned by the company's track record and expertise in infrastructure and energy markets, including renewables.

Shaw and Partners points out the dividend pay-out ratio is in a range of 60-80% and, given a forecast for a $3bn profit in FY20, there should be $1bn in additional capital available for investment.

Macquarie Capital invested $1.4bn in the first half in a range of debt, conventional energy, infrastructure and green energy projects with green energy being the most dominant. The broker assesses it is **becoming more difficult for Macquarie Capital to achieve its financial objectives by investing in mature infrastructure projects**.

Bell Potter not one of the seven stockbrokers monitored daily on the FNArena database, notes an outstanding track record in beating expectations over the past 12 years and upgrades to Buy from Hold, increasing the target to $149 on the back of a better surplus capital position. Morgans, too, still considers the stock relatively inexpensive and appreciates the exposure to the long-term structural growth areas such as infrastructure and renewables.

Credit Suisse on the other hand downgrades to Neutral from Outperform as the shares are trading close to its target. While the broker considers Macquarie Group a quality business, upside appears limited for the near term. The stock is no longer overly cheap, and there is only modest potential upside, although, given the challenges being experienced by most banks, Ord Minnett acknowledges there is some relative appeal in Macquarie Group.

Shaw and Partners, also not one of the seven, has a Buy rating and $136 target. All up, there are three Buy ratings and three Hold on the database. The consensus target is $134.65, signalling 0.4% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.4% and 4.5% respectively.

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AUSTRALIA

Will Westpac's Relative Discount Close?

Low interest rates, weak loan growth & wealth income are weighing on the major banks and brokers consider Westpac's measures to shore up its balance sheet are prudent.

-Some of the weakness in FY19 considered self-inflicted
-Extent of capital raising puzzles some brokers
-Is Westpac's discount to peers likely to close?

By Eva Brocklehurst

As predicted by most brokers, Westpac Banking Corp ((WBC)) delivered a subdued outlook with its FY19 results, signalling weak loan growth, lower wealth income and modestly higher costs.

Reductions to official interest rates and a flat yield curve are weighing on profitability and Morgan Stanley forecasts a -3 basis points margin decline in FY20, although this is -8 basis points ex remediation. The broker also envisages **downside risk to forecasts if there are further cuts to official cash rates**, or the bank does not lower its deposit rates to limit a squeeze on spreads.

The main surprise for Ord Minnett is the extent of the margin impact from lower cash rates at a time when competitive pressures in the mortgage industry are intense. As was the case with ANZ Bank ((ANZ)), the headwinds to net interest margins for the first half of FY20 are greater than forecast.

Shaw and Partners agrees current revenue and expense trends are likely to continue into FY20, with little or no loan growth and softer non-interest income and retains a Hold rating and $27.00 target. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, assesses the reasons for Westpac's declining revenue stem from holding onto its life insurance and wealth management businesses for too long.

Wilsons, also not one of the seven, agrees some of the weakness was self-inflicted, with home lending, a traditional strength for Westpac suffering because of execution errors.

Morgans notes stressed exposure as a percentage of total committed exposures was 1.2% in September, only marginally higher than in March. Yet, what did disappoint the broker was the contraction in the home loan book over the fourth quarter. The bank has indicated it has addressed the issue but expects continued contraction over the first half of FY20.

The negative items that dragged on revenue are transient, Morgans notes, and the underlying result is, therefore, stronger than the headline suggests. These “transient” items include a -$41m hit to non-interest income as a result of methodology changes in derivative valuation, lower non-interest income from the revaluation of financial instruments and an increase in the run rate of regulatory and compliance expenses.

Capital Raising

FY19 cash earnings were $6.85bn, as lower revenue and higher costs were only partially offset by lower bad debts. A reduced final dividend of $0.80, fully franked, was declared. The bank has announced a $2.5bn capital raising, with a fully-underwritten $2bn share placement at a fixed price of $25.32.

The extent of this capital raising puzzles Morgans, because it will take the pro forma CET1 ratio to 11.25% at level II and 11.21% at level I, which makes the bank appear over-capitalised. Westpac has stated the increase in its capital buffer is designed to create flexibility in dealing with potential litigation or regulatory action.

However, the broker believes these are contingent issues and holding extra capital for this reason, therefore, does not resonate. Shaw and Partners also finds the bank's capital raising action odd in that it takes the CET1 ratio substantially above the 10.5% hurdle.

This is particularly strange in the context of the bank expecting hardly any loan growth over the next year. The broker posits a reason in ongoing remediation charges and potential litigation and the possibility that Westpac fears these amounts will be substantial.

Jefferies Australia, not one of the seven, has initiated coverage of Westpac with an Underperform rating and $26.10 target and finds it difficult to envisage how the bank can regain its previous PE (price/earnings ratio) premium.

The broker questions whether the bank is adequately capitalised even now, as the sub-peer housing risk weighting creates a relative residual capital sufficiency risk should APRA adopt tighter floor constraints under its implementation of Basel 4.

Discount To Peers

The "buy" thesis for Westpac is a PE re-rating on the back of reduced uncertainty, in Credit Suisse's view. Westpac is trading at a -17% discount to Commonwealth Bank ((CBA)) vs a 10-year average of -8% which provides relative upside, given capital and dividend issues have been dealt with.

Macquarie also envisages scope for Westpac's relative valuation discount to close, although the ongoing pressures in the sector provide for limited upside. **Banks have been attempting to meet aggressive cost-to-income targets which appear increasingly unattainable in the current environment**.

UBS is cautious about the banking industry, particularly noting the subdued loan growth and ultra-low interest rate environment. Fee income is expected to fall and credit impairment charges rise.

That said, the broker believes Westpac's decision to reduce the dividend is prudent but this will mean the pay-out ratio eventually rises back to the mid 80% level. This may be sustainable in a low credit growth environment but if the Reserve Bank cuts the cash rate further, or there are additional regulatory imposts and remediation charges, a further reduction in the dividend may be required.

One interesting aspect of the results announcement, Macquarie points out, is Westpac's partnership with 10x, a European cloud-based banking system. These types of technology service providers present a competitive threat to the major banks over the medium to long-term, the broker suggests.

FNArena's database has two Buy ratings, four Hold and one Sell (UBS). The consensus target is $27.84, signalling 5.1% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 6.1% and 6.2% respectively.

Disclaimer: the writer has shares in the stock.

AUSTRALIA

Brokers Tick Iluka's Review But Doubt Outlook

While reviewing the structure of its principal operations, Iluka Resources anticipates a market deficit in zircon and tight feedstock supply should underpin a positive outlook for 2020.

-Brokers still expect subdued zircon market
-Challenges continue at Sierra Rutile, Cataby
-Review of MAC royalty may lead to favourable changes

By Eva Brocklehurst

Iluka Resources ((ILU)) will review the corporate and capital structure of its two principal operations - mineral sands and the Mining Area C (MAC) royalty from Western Australia.

The review is welcomed by the broking fraternity as UBS notes, in the case of the latter, many have questioned whether the market is correctly valuing the royalty. This is not the first time Iluka Resources has looked at ways to monetise the royalty, although previous attempts have encountered tax obstacles.

Meanwhile, the company remains constructive on the outlook for zircon, expecting a market deficit because of declining supply, although conditions continue to be affected by global economic uncertainties.

Demand in the key markets of China and Europe is soft and customers have been reducing zircon inventory across the supply chain. Still, amid declining supply from key producers, including depletion of the Jacinth-Ambrosia mine, a deficit should emerge, in the company's view.

Yet, while zircon substitution has not been evident in recent years, **increased thrifting has been a feature of the market**. The use of thinner tiles and ultrafine grinding has had an impact. Customer inventory of zircon may have been reduced but remains above historical levels, Citi points out.

Moreover, Indonesian zircon exports are currently annualising at around 70,000tpa vs 30,000tpa in 2017. Indonesia produces zircon-gold concentrates and higher gold prices have encouraged production.

Macquarie suspects the near term outlook for zircon is subdued and reduces sales forecast for the December quarter, downgrading the stock to Neutral from Outperform and assessing that a forecast step-up in zircon sales without further impact on prices is unlikely.

Iluka has recently announced loyalty rewards and adjusted its product mix, which has started to affect the company's realised zircon price. Also, a more conservative staged development at Sierra Rutile is expected to limit output.

The company is reviewing the development plan for Sierra Rutile's Sembehun, which has effectively been brought back to the scoping study stage, and Macquarie suspects Iluka will use the development to extend mine life rather than grow production.

Operations at Sierra Rutile continue to be below Morgan Stanley's expectations, although expansion projects at Lanti and Gangama are now complete and should drive zircon production higher in 2020.

Citi amends its forecasts for Sierra Rutile, lowering nameplate production over 2022-23 ahead of the assumed transition to Sembehun in 2024 and expecting a drop in production as the company will only operate one mine ahead of the eventual start-up.

Citi believes Sierra Rutile has not lived up to expectations and logistics remain the largest challenge. The company has conceded it significantly underestimated the difficulties in operating in Sierra Leone.

Titanium Dioxide

Iluka also expects an upturn in pigment demand for feedstocks by mid 2020. Titanium pigment accounts for a more than 80% of feedstocks demand.

At Cataby, Western Australia, where commissioning began in January, ramp-up has been affected by the use of refurbished equipment as well as labour availability. **The near-term challenge will be to get mining rates to target levels by March in order to ensure sufficient feed for the synthetic rutile kiln 2.**

In November, the company will undertake rectification work. The re-start of the company's synthetic rutile kiln 1 remains an option, Citi notes, although ilmenite feed would need to come from Cataby or third parties.

Another issue at Cataby is water. Macquarie notes a significant proportion of the reserve is located below the water table and rainfall can also affect the operation. The broker expects Iluka will mine well ahead of processing rates during the summer and build a stockpile ahead of the next winter.

Mining Area C

Morgan Stanley suggests a review of the MAC royalty is a strong positive development. The company has appointed a third party to review the structure of the royalty, with a de-merger or dividend stream being considered.

Macquarie does not doubt the review is a positive catalyst but considers it outweighed by the softness in near-term demand for the company's products and the risks to volume and price.

The potential spin-off of the royalty is likely to force a review of the MAC valuation parameters, and Ord Minnett envisages a number of possible benefits such as a favourable change to the dividend policy, should the tax consequences be overcome.

The company believes it can de-merge the royalty in a tax efficient manner. For the Australian Taxation Office to grant rollover relief from capital gains tax under a de-merger of the royalty to a new company commercial efficacy needs to be proven, rather than just the ability to distribute earnings, Citi points out.

Iluka intends to advise the market of the outcome of the review by February. Citi assumes $100m in debt would be transferred, allowing Iluka Resources to go forward with no net debt. While the valuation metrics for the de-merged mineral sands scenario are low, the broker notes they are in line with its forecasts for both South32 ((S32)) and OZ Minerals ((OZL)).

FNArena's database has one Buy (Morgan Stanley) and five Hold ratings. The consensus target is $9.19, suggesting 4.5% upside to the last share price. Targets range from $8.10 (UBS) to $11.15 (Morgan Stanley).

AUSTRALIA

Claims Costs Hurt Medibank Private

The trajectory of Medibank Private's margins is worse than many anticipated, after the company flagged higher claims inflation.

-Downside risk to the dividend heightened for FY20
-Difficult for government to obtain an approved premium rate increase under 3%
-Are industry pressures catching up with all health insurers?

By Eva Brocklehurst

Claims inflation has provoked Medibank Private ((MPL)) to shore up reserves in FY20. This implies underlying claims trends in FY19 were worse than previously estimated, signalling margin pressure.

This is the second consecutive half-year of reserve increases, Credit Suisse points out, following 10 halves of reserve releases, and implies underlying claims growth per policy unit was 2.4% in FY19 vs the 2.0% reported at the results.

Medibank Private has flagged an under-provision of -$21m as of June 30 and revised claims inflation in the second half to 2.8%, a level expected to persist through FY20. Hence, UBS calculates revenue growth per policy will contract to around 1.5% in FY20. The trajectory of margins without any further action is worse than Ord Minnett had assessed and a slight improvement in expenses and volumes is only a small offset.

Macquarie asserts there is downside risk for the FY20 dividend. Moreover, if the claim cycle has now turned, a PE multiple de-rating for the sector would also be appropriate. The next round of premium price increases are due for submission to the health minister on November 12.

Macquarie believes investors have been attracted to the stock because of consistent earnings and a high fully-franked dividend yield. Based upon its forecasts, Medibank Private would need to pay out around 90% of FY20 earnings to maintain its dividend.

Credit Suisse explains, while there is standard volatility in health insurance claims quarter to quarter, the ability to absorb this becomes more difficult at the top of the cycle. The broker points out insurance cycles run through a standard pattern, where the profit margin gradually increases to an elevated level and quickly steps back down. Then the process repeats.

Picking the exact timing of a correction is always difficult, the broker adds, and does not believe the shares have pulled back far enough for Medibank Private, given the near-term earnings risk. While appreciating a potential takeover premium may exist in the share price the broker finds it hard to ascribe to to such an investment thesis.

Claims

Medibank Private believes the higher claims are being driven by the increase in average benefits per private hospital episode. The company stressed that this was an issue of mix, with stronger growth in high-cost procedures and a contraction in low-cost procedures.

Morgan Stanley agrees a behavioural response to prosthetics reform, i.e. a lift in volume, has meant savings have largely disappeared and little weight is likely to be placed on the next $100m of planned benefits ensuing from February 2020.

Medibank Private has blamed a failure by government in procuring prosthetics savings. Ord Minnett suspects there has been a meaningful reduction in inflation in prosthetics but perhaps not the deflation Medibank Private was assuming. **Lengthening payment patterns from hospitals have also been cited**.

Ramsay Health Care ((RHC)) has highlighted a new claims processing system slowed its cash collection and this may have hurt insurers, although Medibank Private believes the issue is industry-wide.

Medibank Private does have levers to manage the pressure, Ord Minnett points out, including product rationalisation and reducing payments to private patients treated in NSW public hospitals. Still, the pressure on premium rates appears very stark.

Citi agrees it will be difficult for the government to obtain an approved premium rate increase under 3% and allows for 3% vs the 2.85% forecast previously. The broker suspects the insurers will request a higher increase. Morgan Stanley opts for a 3.0% premium increase in its forecasts.

Macquarie's discussions with industry indicates the issue of claims inflation is widespread, while UBS cites recent feedback from unlisted hospital operators which provides a more mixed operating outlook, although subdued trends are expected to continue. Brokers note Medibank Private is yet to finalise a new agreement with Ramsay Health Care.

Nib Holdings View

Ord Minnett highlights nib Holdings ((NHF)) has maintained FY20 guidance in response to the downgrade by its competitor, although has also made reserve increases. The company has noted an increase in underlying margins stemming from mental health costs, as opposed to the prosthetics which Medibank Private cited as its main concern.

The broker suggests **nib Holdings is in a stronger position in FY20 vs Medibank Private, having been more conservative in calculating guidance** , which allowed the late reporting of claims to be absorbed without downgrading the margin outlook. Still, Ord Minnett believes industry pressures are catching up with all health insurers and underlying margins will likely trend lower.

Morgans suspects Medibank Private was less across the issue of an uptick in claims inflation compared with its peer and considers the former's more optimistic outlook at the FY19 result raises some questions about reporting systems and processes.

Still, this is a minor bump in what is been an otherwise impressive turnaround and the broker continues to like the exposure to longer-term structural growth areas, although acknowledges margins remain elevated vs historical levels. FNArena's database has three Hold ratings and four Sell for Medibank Private. The consensus target is $2.99, indicating -2.8% downside to the last share price.

AUSTRALIA

Amazon Puts Zip Co Payments In The Basket

Payment provider Zip Co has been boosted by the announcement of a strategic partnership with Amazon Australia.

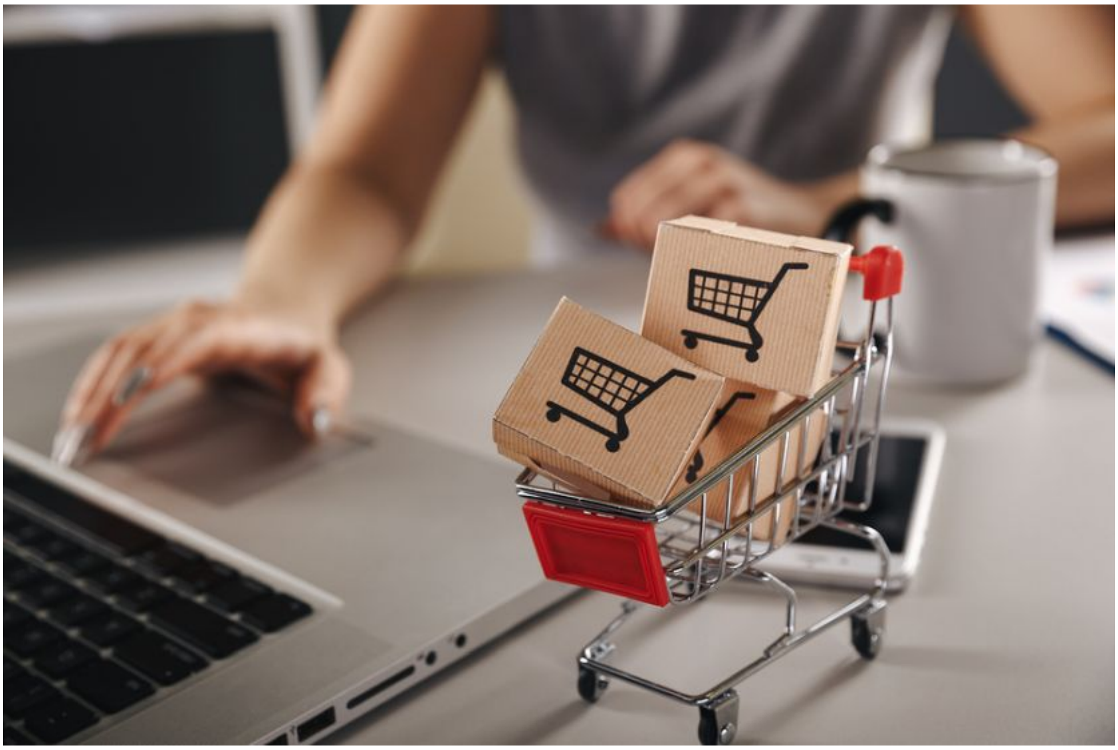
-To pay for market access Zip Co will provide warrants to Amazon
-Revenue model less reliant on BNPL than Afterpay Touch
-Can Zip Co replicate Afterpay Touch's significant offshore expansion

By Eva Brocklehurst

A major strategic partnership in the Australian online retail channel has put payment provider Zip Co ((Z1P)) in the spotlight. Amazon Australia will offer its first Australian instalment payment option on Amazon.com.au with Zip Co providing the service.

Amazon.com.au will make the Zip Co Buy Now Pay Later (BNPL) service available on all products without size restrictions. Amazon Australia appears keen to adopt new products to gain volume, Shaw and Partners observes, against the international company standard of offering its in-house payment option.

Amazon has had a slow start in Australia since its launch in December 2017 compared with expectations but Morgans notes it generated around $290m in sales in 2018 and further traction is more than likely.



Business traction data for Amazon Australia is relatively unknown as the company is quite secretive, yet Shaw and Partners estimates that on current annualised run rates and typical online check-out share, Amazon Australia could add around 15% to Zip Co's current total transaction value. It is also the perfect customer segment for targeting customer acquisition.

Upon launching with well-known retailers, Zip Co has had an immediate change to transaction value and share of check-out vs other payment options. Shaw and Partners notess Zip Co now has more than 18,000 merchants and is adding 20 per day, while average expenditure per merchant is rising more than 35% annually.

Amazon Interest

Zip Co will pay for market access, providing Amazon with warrants. The company will give 14.6m warrants to an Amazon affiliate with an exercise price of $4.70. A portion will vest immediately and the remainder is subject to milestones based on volumes. The warrants can be exercised up to seven years after the issue date. This provides significant upside for Amazon, Morgans suggests, noting the deal is not exclusive, although the strategic alignment provides some protection (hopefully).

Shaw and Partners expects an immediate economic interest that will create value for Amazon Australia if share price for Zip Co rises above $4.70. The advantage for Zip Co is the addition of a leading global e-commerce platform as a potential shareholder alongside Westpac Banking Corp ((WBC)).

Morgans believes, outside of the announcement, management has executed well and the business has re-rated strongly over the past year. However the current valuation is fair, pending evidence of traction in the offshore growth strategy.

UBS prefers Zip Co to its main rival, Afterpay Touch ((APT)), as it has less exposure to BNPL and the associated risks. Currently, the portfolio income is split 40% BNPL and 60% ZipMoney (regulated credit). The company's revenue model relies on both consumers and merchants, and the market has been more conservative in pricing in assumptions.

Offshore Potential

UBS, too, agrees this a positive development for Zip Co's prospects in the core Australasian market. Moreover, there is upside in overseas markets, although the company lacks a first-mover advantage, and from Pocketbook, a personal finance/budgeting app.

The broker acknowledges Zip Co remains a relatively early-stage and somewhat speculative investment but the current risk/reward outlook is considered favourable and, given the sell-off in the shares over the past three weeks, upgrades to Buy from Sell.

UBS flags transaction volume growth of 111% in the first quarter and notes transactions per customer were also encouraging in the lead up to the usually strong festive season.

The launch of Zip Biz and the acquisition of PartPay also have potential to transform the business. Indeed, Shaw and Partners wonders whether there is potential for Zip Co, through PartPay to launch in the UK, noting the material uptake in volume and reverse enquiries from multinational merchants that drove Afterpay Touch's US and UK expansion.

The broker, not one of the seven monitored daily on the FNArena database, reiterates a Buy rating and target of $4.78. While not covering Zip Co, Bell Potter, also not one of the seven, believes the deal with Amazon is a further endorsement of the BNPL sector, noting Afterpay Touch has an alignment with VISA in the US.

FNArena's database has three Buy ratings. The consensus target is $4.20, signalling 0.3% upside to the last share price.

COMMODITIES

Material Matters: Nickel, LNG & Land Reforms

A glance through the latest expert views and predictions about commodities. Base metals; nickel; LNG; and China's land reforms.

-Price risk for nickel veering to the upside
-Storage capacity approaching full for LNG, oversupply evident
-Steel consumption likely to remain strong in China

By Eva Brocklehurst

Base Metals

Those surveyed at Macquarie's London Metal Exchange (LME) **base metals** summit remain bearish, awaiting a macro recovery. **Nickel** has been the one metal to outperform in 2019, up 50% largely because of an Indonesian export ban. The most favoured long positions are in **copper** and nickel.

The preference for long copper positions centres on import-based demand growth in China, which is expected to remain strong amid insufficient mine supply. Around half of those surveyed anticipated that a slowdown in global demand growth would be a key factor in the price of copper falling below the US$6000/t level.

The most popular short positions are in **zinc** and **aluminium** although Macquarie notes nickel is also popular in this regard, a rare preferred long and short commodity. Even so, preferences for nickel are largely bullish. Including the very bullish participants, Macquarie calculates 57% of the survey envisages some upside to the current nickel price.

The preference for short positions in zinc is largely based on expectations for weaker demand growth while aluminium is swinging on a rapidly-changing production cost outlook. At present, with aluminium spot prices at US$1730/t, expectations are balanced.

Nickel

UBS agrees the nickel price is being supported by anxiety regarding supply. The ore export ban by Indonesia without any offset would lead to a temporary loss of -200,000tpa or around -8% of global supply.

The broker suggests the risk is mostly priced into nickel and nickel equities and maintains a forecast for a US$7.50/lb price. Indonesia's exports of nickel pig iron were up 36% in the year to the end of October and around 200,000tpa of smelting capacity is being commissioned over 2019.

The price risk lies to the upside from shifting policy and the consolidation of metal inventory, UBS suspects. Nickel inventory on the LME has halved amid a view that nickel supply will be tight in 2020.

This large decline in inventory could lift the supply anxiety and the broker observes **stainless steel** production in China has accelerated to record highs, although stainless steel inventory has also doubled. Outside of China stainless steel production is contracting.

LNG

Production of **LNG** in September was marginally lower, declining in Africa, Asia and Europe. JPMorgan notes a significant reduction in Asian exports, indicating gas could be withheld for the domestic market ahead of the northern winter.

Spot LNG prices in Singapore, up 30%, also increased sharply and the broker believes this is likely reflects rising European demand.

Yet, storage capacity is close to full and the overhang is likely to last into 2020 and potentially longer. Increasing gas demand from Europe has resulted from stronger gas-for-power requisitions along with a drop in French output because of a strike.

JPMorgan notes evidence of the long-awaited over-supply of LNG. Australian and US output grew, up 4% and 7% respectively in September. Australia's output would have been higher were it not for a partial shutdown at the North West Shelf.

China's Land Reforms

Citi asserts unlocking the land value in China should boost rural household wealth and consumption, benefiting the automotive, consumer electronics and other durables sectors as well as consumer staples and services. This will facilitate migration to urban areas and the development of affordable housing. Allowing rural construction land to enter the market also creates a new channel for urban land supply.

The country's planned land reforms could also open the door to corporate farming, as extended tenure and strengthened protection could make farmer rights to farmland more tradable. This should facilitate the start and operation of large-scale enterprises and cooperatives in agriculture.

Citi believes investor sentiment should improve amid continuing evidence the government is committed to a stable property sector as a key plank in its growth-driven reforms.

Steel consumption generally rises with income, although aggregate consumption rates are just part of the story. Consumption typically peaks when urbanisation rates reach around 70-75%. China's urbanisation rate is reported to be around 60% indicating it may be another 10-15 years before the country reaches the urbanisation threshold for steel consumption.

Importantly, history shows that urbanisation rates in other countries have remained high for more than 10 years once peak rates have been achieved. Hence, Citi suggests the conventional wisdom that China has reached a peak level in steel production and consumption could be premature.

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 01-11-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Recommendation upgrades and downgrades for ASX-listed entities were roughly in balance during the week ending on Friday, 1st November 2019. FNArena counted 11 and 12 respectively.

The not so good news is that less than half of all upgrades only moved to Neutral/Hold (5 out of the 11) but then only four of the 12 downgrades sunk to a Sell.

The fourth profit warning during this calendar year delivered Costa Group two fresh Sell ratings. On the positive side, gold producer Regis Resources was upgraded twice to Buy, while struggling scrap trader Sims Metal Management also received two upgrades, one to Buy and one to Neutral.

Lendlease and Woolworths enjoyed the largest increases to price targets during the week, both enjoying a boost in excess of 5%, followed by Blackmores and Coles whose targets increased by more than 4%.

On the flipside, we find a smaller number of stocks impacted negatively, but the numbers are higher. Costa Group, also impacted by another capital raising, saw its consensus target plummet by -31%. For Sims Metal the damage is -8.6% and for Cleanaway Waste Management it is -6.3%.

A small number of stocks enjoyed sizeable increases to earnings forecasts, led by Senex Energy, Viva Energy and Fortescue Metals. ResMed, fresh from another quarterly that beat market expectations, sits fourth on the week's table for positive revisions.

No surprise, Sims Metal and Costa Group -both issuers of multiple profit warnings this year- take the wooden spoon honours for changes to earnings estimates, followed by Sandfire Resources, Newcrest Mining, Qantas and Blackmores.

The banks are not having a great season either, with Westpac announcing a -15% dividend cut on Monday morning, after ANZ Bank lowered its franking level to 70%. This puts the market's background debate about Value vs Growth in a different perspective vis a vis overseas markets, especially since Macquarie Group's result on Friday was well-received.

So was Orica's, vindicating the strong share price performance since May. This week and next will bring more earnings results updates with representatives from both Value and Growth sides featuring prominently. See also the Corporate Results Monitor on the website.

Volatility guaranteed??

Summary

Period: Monday October 28 to Friday November 1, 2019
Total Upgrades: 11
Total Downgrades: 12
Net Ratings Breakdown: Buy 37.64%; Hold 45.97%; Sell 16.39%

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/3/3

The pullback in housing and construction activity has made it a tough 2019 for Adelaide Brighton, UBS notes. The latest data suggest approvals are bottoming but the floor in commencements has not yet been reached, implying more margin pressure ahead.

However with approvals and house prices rising, the risk of missing 2019 earnings guidance is diminishing, the broker suggests.

Upgrade to Neutral from Sell. Target falls to $3.00 from $3.15.

AGL ENERGY LIMITED ((AGL)) Upgrade to Hold from Reduce by Morgans .B/H/S: 0/4/3

First quarter generation output was 5% higher than the prior corresponding period and Morgans lifts estimates for the first half result. The broker envisages several issues in the medium term in the electricity market, as fuel costs increase and speculation mounts about the future of the Portland smelter.

However, the company's extensive vertical integration and hedging should insulate earnings from major swings in the electricity spot market over the next 12 months and the broker upgrades to Hold from Reduce, raising the target to $17.45 from $16.86.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Upgrade to Neutral from Underperform by Credit Suisse.B/H/S: 4/2/0

Management now expects first half earnings to be in line with the prior corresponding half. The reduced guidance for the first half reflects weaker economic activity, soft commodity prices and a reduction in Queensland volumes.

Benefits from price initiatives and cost reductions are likely to be skewed to the second half. Credit Suisse suspects the prior guidance may have been a little optimistic and notes the "wisdom" that suggests waiting for "at least the third profit warning before jumping in".

Rating is upgraded to Neutral from Underperform on valuation grounds. Target is reduced to $1.80 from $1.85.

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

Freelancer posted benign organic growth in the Sep Q once adjusted for currency. The company is at a challenging crossroad, UBS suggests. Underlying growth is underwhelming but changes to the platform and new currency offerings in Escrow have the potential to re-stimulate.

Penetration of Escrow payments into the second hand car market creates significant longer term potential but is as yet unproven.

The broker has reduced forecasts and its target to 79c from 88c but upgrades to Neutral on valuation.

LENDLEASE GROUP ((LLC)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 4/1/0

Having conducted a comprehensive analysis of the company's Barangaroo South development, Ord Minnett estimates this will underpin 30-40% earnings growth over the next 3-5 years.

Based on the company's expanded development backlog and capital base, the broker forecasts FY25 earnings will be at comparable levels to FY23-24, indicating materially higher earnings should be sustainable.

Rating is upgraded to Buy from Accumulate and the target lifted to $22.50 from $17.50.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Buy from Neutral by Citi and Upgrade to Add from Hold by Morgans.B/H/S: 4/3/0

Citi observes the company has several low-risk organic growth options and delivery is predictable. Moreover, the stock offers a 3% fully franked dividend yield, one of the sector's highest.

Following a pullback in the shares since mid August, the broker envisages value has emerged and upgrades to Buy from Neutral. Target is raised to $5.40 from $5.00.

Morgans changes analysts and, given recent share price weakness, upgrades to Add from Hold. The company's strategy has been to grow organically and optimise current operations.

Guidance has been met for the past five years and, the broker observes, costs are among the lowest in the industry.

The strong growth pipeline includes McPhillamys, which will add around 50% to the production profile once operational. Morgans reduces the target to $5.41 from $5.51.

SCENTRE GROUP ((SCG)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/1/2

Specialty sales growth was 1.8% in the September quarter, a 50 basis points increase on June. Ord Minnett observes Scentre Group has defensive income, improving retail sales and a superior portfolio to Vicinity Centres ((VCX)).

The management business is also considered more valuable and the broker switches preferences, upgrading its rating to Accumulate from Hold. Target is steady at $4.30.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Upgrade to Neutral from Underperform by Macquarie and Upgrade to Buy from Neutral by Citi.B/H/S: 2/2/1

The company has announced its second negative FY20 trading update, now expecting underlying earnings (EBIT) of $20-50m, with a skew to the second half. A first half loss is expected of -$20-30m followed by a second half profit of $50-70m.

Macquarie notes scrap markets have become illiquid and competitive, affecting margins. However, scrap prices have staged some sort of a recovery in recent weeks. The outlook in Turkey is less severe while US market conditions appear to be moderating.

The broker upgrades to Neutral from Underperform, assessing the likelihood of further downside is now more finely balanced. Target is reduced to $9.05 from $9.30.

Operating earnings (EBIT) are expected to fall to the lowest level in 20 years in FY20, Citi observes. Market conditions remain challenging and the company has warned of an underlying earnings loss of -$20-30m in the first half and an FY20 profit of $20-50m.

The broker notes sentiment has turned more bullish in recent weeks and Turkish scrap prices have recently rebounded from the late September lows. Sentiment in US scrap markets is also improving.

Citi upgrades to Buy from Neutral on valuation grounds, cutting the target to $10.50 from $11.50.

WOOLWORTHS LIMITED ((WOW)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/3/2

Macquarie notes supermarket like-for-like sales were up 6.6% in the first quarter and well ahead of rival Coles ((COL)). Nevertheless, this was at the lower bounds of market expectations.

The company has admitted to underpaying 5700 salaried staff and remediation costs of -$200-300m are envisaged. Macquarie notes Woolworths was already facing higher enterprise bargaining costs so the review will put further upward pressure on the wages bill.

The broker rolls forward its model and upgrades to Neutral from Underperform. Target is raised to $37.00 from $29.90.

Downgrade

ARISTOCRAT LEISURE LIMITED ((ALL)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 6/1/0

The stock has rallied recently and Credit Suisse downgrades to Neutral from Outperform. The broker assesses North American revenue share is an area where the company can surpass forecasts, particularly in the premium Class III installed base.

The broker emphasises that earnings are growing strongly and investors may be able to take advantage should the share price weaken. Target is $33.40.

BLACKMORES LIMITED ((BKL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/3/3

Credit Suisse notes Blackmores has rejuvenated its management ranks. China has been elevated to the status of having a direct CEO reporting to the company. The broker believes this could be a turnaround story and mulls whether there could even be a takeover.

Blackmores has stated it is looking for a partner to help develop the Chinese business. Growth is expected to resume in FY21 after restructuring changes, amid benefits from a new factory and a full year of cost reductions.

Rating is downgraded to Underperform from Neutral. Credit Suisse maintains a target of $69.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Neutral from Buy by Citi .B/H/S: 2/2/1

Costa Group has announced its fourth downgrade for the year, now expecting 2019 net profit of $28m and operating earnings (EBITDA) of $98m. Macquarie notes tomatoes are the only produce category to meet second half expectations.

While the company has previously highlighted the risks to the downside in blueberries, mushrooms and raspberries there is also adverse yield and size impacts in citrus and avocado.

Macquarie changes analysts and lowers the rating to Underperform from Neutral, noting that earnings visibility continues to be limited. Target is reduced to $2.51 from $3.40. Moreover, 2020 guidance seems optimistic in the broker's opinion.

Costa Group has downgraded earnings for the fourth time in 2019 and has decided to raise equity through a rights issue. Citi lowers estimates for operating earnings by -27% for 2019 and -17% for 2020.

The broker believes the company has a challenge ahead to restore its previous reputation for earnings stability, despite the inherent risks from agriculture.

The broker expects investors will stay cautious and be more reliant on external observations of improved prices in key categories. Rating is downgraded to Neutral from Buy and the target reduced to $2.90 from $4.20.

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

Credit Suisse downgrades to Underperform from Neutral. The broker forecasts no growth in Coles supermarkets in the first quarter.

With no evidence for a change in the performance relative to Woolworths ((WOW)), the broker expects the share price to outperform in the near term.

Investors should note the rating for Woolworths is Underperform. Target is $13.23.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Downgrade to Neutral from Buy by UBS .B/H/S: 0/6/0

UBS saw Domino's FY20 to date trading update as mixed, with network sales in line with consensus but new store growth as soft. Store growth is weighted to the second half but running short of expectation.

The stock has run up 34% in three months to a 26x forward PE which the broker considers fair risk/reward, hence a downgrade to Neutral from Buy. Target rises to $50.00 from $48.50.

JAPARA HEALTHCARE LIMITED ((JHC)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/3/0

Following the interim report from the Royal Commission Into Residential Aged Care, Ord Minnett downgrades to Lighten from Hold. Target is steady at $1.

The broker is concerned that Japara Healthcare's higher cost base leaves it more exposed to the sector's issue of income vs expenses growth. Spending on new facilities will mean gearing continues to rise at a time when earnings are contracting.

NOVONIX LIMITED ((NVX)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The company has exhibited a strong performance in the September quarter, Morgans observes, in anticipation of its first customer contract for the synthetic graphite product.

The broker expects the first 500tpa of production capacity will be commissioned in the current half-year and this will mean the company is likely to need funds to secure the period between commissioning and full-scale production.

The broker requires clarity on a funding package along with customer demand in order to re-assess its view and downgrades to Hold from Speculative Buy. Target is $0.65.

PILBARA MINERALS LIMITED ((PLS)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/2/1

Production was higher and sales lower in the September quarter as production was curtailed at Pilgangoora. The company has reduced December quarter sales guidance because of continued market weakness.

Macquarie notes a muted spodumene market is squeezing the company's sales volumes, and a recovery in demand in the near-term will determine whether curtailment measures are lifted as well as provide more certainty on stage 2.

Target is reduced to $0.32 from $0.60 and the rating is downgraded to Neutral from Outperform.

REGIS HEALTHCARE LIMITED ((REG)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 1/2/1

Ord Minnett notes the interim report from the Royal Commission Into Residential Aged Care was more critical than previously anticipated, raising the potential for more radical recommendations in the final report.

The broker had also not expected commissioners to clearly oppose any funding boost ahead of their recommendations. As the stock is trading close to valuation, the broker downgrades Regis Healthcare to Hold from Buy. Target is $3.15.

RHINOMED LIMITED ((RNO)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

First quarter revenue was below expectations amid continued volatility in cash flow. Morgans continues to take a cautious approach to the upside potential in the Columbia Care partnership.

Given changes to forecasts, and the dilution from the recent capital raising, the target is lowered to $0.28 from $0.38.

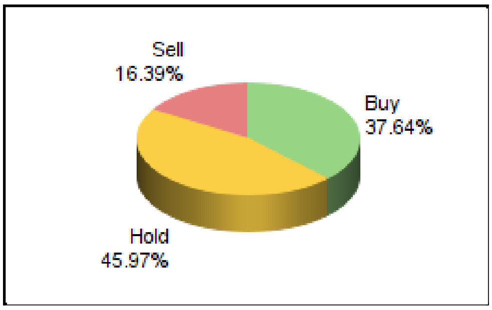
While remaining positive about the long-term view, the broker recognises increasing investor fatigue regarding the time being taken to achieve breakeven. Rating is downgraded to Hold from Speculative Buy.

VICINITY CENTRES ((VCX)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/4/1

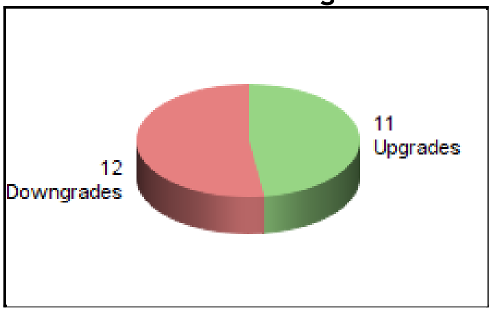
The share price has risen 7% in the past month and Ord Minnett switches retail preferences, believing Scentre Group ((SCG)) has a better portfolio.

The broker downgrades to Hold from Accumulate. Target is stead at $2.80.

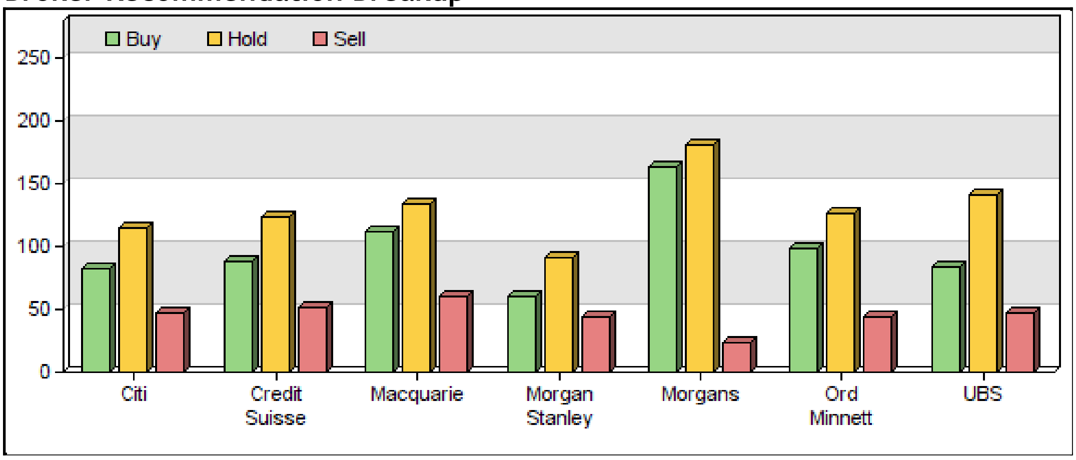
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ADELAIDE BRIGHTON LIMITED	Neutral	Sell	UBS
2	AGL ENERGY LIMITED	Neutral	Sell	Morgans

3	CLEANAWAY WASTE MANAGEMENT LIMITED	Neutral	Sell	Credit Suisse
4	FREELANCER LIMITED	Neutral	Sell	UBS
5	LENDLEASE GROUP	Buy	Buy	Ord Minnett
6	REGIS RESOURCES LIMITED	Buy	Neutral	Morgans
7	REGIS RESOURCES LIMITED	Buy	Neutral	Citi
8	SCENTRE GROUP	Buy	Neutral	Ord Minnett
9	SIMS METAL MANAGEMENT LIMITED	Neutral	Sell	Macquarie
10	SIMS METAL MANAGEMENT LIMITED	Buy	Neutral	Citi
11	WOOLWORTHS LIMITED	Neutral	Sell	Macquarie
Downgrade				
12	ARISTOCRAT LEISURE LIMITED	Neutral	Buy	Credit Suisse
13	BLACKMORES LIMITED	Sell	Neutral	Credit Suisse
14	COLES GROUP LIMITED	Sell	Neutral	Credit Suisse
15	COSTA GROUP HOLDINGS LIMITED	Sell	Neutral	Macquarie
16	COSTA GROUP HOLDINGS LIMITED	Neutral	Buy	Citi
17	DOMINO'S PIZZA ENTERPRISES LIMITED	Neutral	Buy	UBS
18	JAPARA HEALTHCARE LIMITED	Sell	Neutral	Ord Minnett
19	NOVONIX LIMITED	Neutral	Buy	Morgans
20	PILBARA MINERALS LIMITED	Neutral	Buy	Macquarie
21	REGIS HEALTHCARE LIMITED	Neutral	Buy	Ord Minnett
22	RHINOMED LIMITED	Neutral	Buy	Morgans
23	VICINITY CENTRES	Neutral	Buy	Ord Minnett

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	SGM	SIMS METAL MANAGEMENT LIMITED	8.0%	-25.0%	33.0%	6
2	RRL	REGIS RESOURCES LIMITED	57.0%	33.0%	24.0%	7
3	WOW	WOOLWORTHS LIMITED	-40.0%	-60.0%	20.0%	5
4	ABC	ADELAIDE BRIGHTON LIMITED	-50.0%	-67.0%	17.0%	6
5	CWY	CLEANAWAY WASTE MANAGEMENT LIMITED	58.0%	42.0%	16.0%	6
6	AGL	AGL ENERGY LIMITED	-43.0%	-57.0%	14.0%	7
7	NCM	NEWCREST MINING LIMITED	-50.0%	-64.0%	14.0%	7
8	LLC	LENDLEASE GROUP	80.0%	70.0%	10.0%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	CGC	COSTA GROUP HOLDINGS LIMITED	20.0%	60.0%	-40.0%	5
2	BKL	BLACKMORES LIMITED	-50.0%	-33.0%	-17.0%	6
3	COL	COLES GROUP LIMITED	-36.0%	-21.0%	-15.0%	7
4	ALL	ARISTOCRAT LEISURE LIMITED	86.0%	100.0%	-14.0%	7
5	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	-7.0%	7.0%	-14.0%	7
6	SFR	SANDFIRE RESOURCES NL	29.0%	33.0%	-4.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	LLC	LENDLEASE GROUP	19.180	18.180	5.50%	5
2	WOW	WOOLWORTHS LIMITED	33.904	32.166	5.40%	5
3	BKL	BLACKMORES LIMITED	69.333	66.517	4.23%	6
4	COL	COLES GROUP LIMITED	13.626	13.086	4.13%	7
5	DMP	DOMINO'S PIZZA ENTERPRISES LIMITED	43.963	43.284	1.57%	7
6	AGL	AGL ENERGY LIMITED	18.314	18.116	1.09%	7
7	RRL	REGIS RESOURCES LIMITED	5.187	5.175	0.23%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	CGC	COSTA GROUP HOLDINGS LIMITED	2.843	4.136	-31.26%	5

2	SGM	SIMS METAL MANAGEMENT LIMITED	9.367	10.250	-8.61%	6
3	CWY	CLEANAWAY WASTE MANAGEMENT LIMITED	2.133	2.277	-6.32%	6
4	NCM	NEWCREST MINING LIMITED	30.849	32.451	-4.94%	7
5	ABC	ADELAIDE BRIGHTON LIMITED	3.100	3.125	-0.80%	6

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	SXY	SENEX ENERGY LIMITED	0.978	-7.118	113.74%	5
2	VEA	VIVA ENERGY GROUP LIMITED	9.432	8.662	8.89%	6
3	FMG	FORTESCUE METALS GROUP LTD	186.353	173.857	7.19%	7
4	RMD	RESMED INC	59.083	56.105	5.31%	7
5	CL1	CLASS LIMITED	5.533	5.267	5.05%	3
6	ILU	ILUKA RESOURCES LIMITED	73.778	70.467	4.70%	6
7	LOV	LOVISA HOLDINGS LIMITED	38.625	37.650	2.59%	4
8	SGR	THE STAR ENTERTAINMENT GROUP LIMITED	26.310	25.963	1.34%	6
9	AQG	ALACER GOLD CORP	43.646	43.106	1.25%	3
10	LLC	LENDLEASE GROUP	135.140	134.040	0.82%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	SGM	SIMS METAL MANAGEMENT LIMITED	7.625	53.227	-85.67%	6
2	CGC	COSTA GROUP HOLDINGS LIMITED	8.516	16.036	-46.89%	5
3	SFR	SANDFIRE RESOURCES NL	75.016	82.583	-9.16%	7
4	NCM	NEWCREST MINING LIMITED	157.785	170.637	-7.53%	7
5	QAN	QANTAS AIRWAYS LIMITED	60.580	65.278	-7.20%	5
6	BKL	BLACKMORES LIMITED	287.833	304.917	-5.60%	6
7	RRL	REGIS RESOURCES LIMITED	43.869	46.258	-5.16%	7
8	CWY	CLEANAWAY WASTE MANAGEMENT LIMITED	7.265	7.617	-4.62%	6
9	IRE	IRESS MARKET TECHNOLOGY LIMITED	39.145	39.970	-2.06%	4
10	GWA	GWA GROUP LIMITED	19.783	20.198	-2.05%	4

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: Waivers Extended

The White House has extended waivers on Iran sanctions to companies working in Iran's civil nuclear program for ninety days.

-Iran sanctions waivers extended
-Uncertainty lingers for uranium
-Demand to pick up?

By Greg Peel

Aside from waiting for the recommendations of President Trump's nuclear cycle Working Group and any news on the Russian suspension agreement, the uranium market has been waiting to see what would transpire when waivers on Iran sanctions expired. The waivers have allowed foreign companies to continue working with the Iranians in their nuclear power pursuits.

Last week the White House confirmed waivers would be extended for another ninety days, upsetting the Republican representatives of Texas and South Carolina who intend to advance legislation to reverse this "misguided decision".

Not extending the waivers would have meant sanctions on European, Russian and Chinese companies working in Iran, leading to up to 20% of US nuclear fuel imports being withdrawn.

But supporters of the waiver extension see a more important benefit. Given the sanctions are in place to discourage Iran's progress towards nuclear weapons, who better to keep an eye on which way the country's nuclear program is headed than those working on the inside?

The waivers will "help preserve oversight of Iran's civil nuclear program, reduce proliferation risks, constrain Iran's ability to shorten its 'breakout time' to a nuclear weapon, and prevent the regime from reconstituting sites for proliferation-sensitive purposes," a White House spokesperson suggested.

This suggests the extension may yet be increased from ninety days although there remains an element of uncertainty. For the uranium market, 2019 has been the year of uncertainty.

That uncertainty has kept utilities largely out of the market and forced sellers into ever lower offer prices, as evidenced by the -US75c fall in the spot uranium price the week before. The waiver extension announcement prompted a US45c bounce in the spot uranium price on Thursday, the last day of October.

Industry consultant TradeTech's spot price indicator thus closed the month of October at US$24.50/lb, down from US$25.70/lb at end-September. Transactions for the month totalled 3mlbs U3O8 equivalent, below the 2019 monthly average.

The spot price then promptly fell back -US35c on the Friday as sellers were spurred into action. This leaves industry consultant TradeTech's weekly post price indicator up US5c for the week to US$20.15/lb. The week's trading totalled 1mlbs of which half was transacted on the Friday.

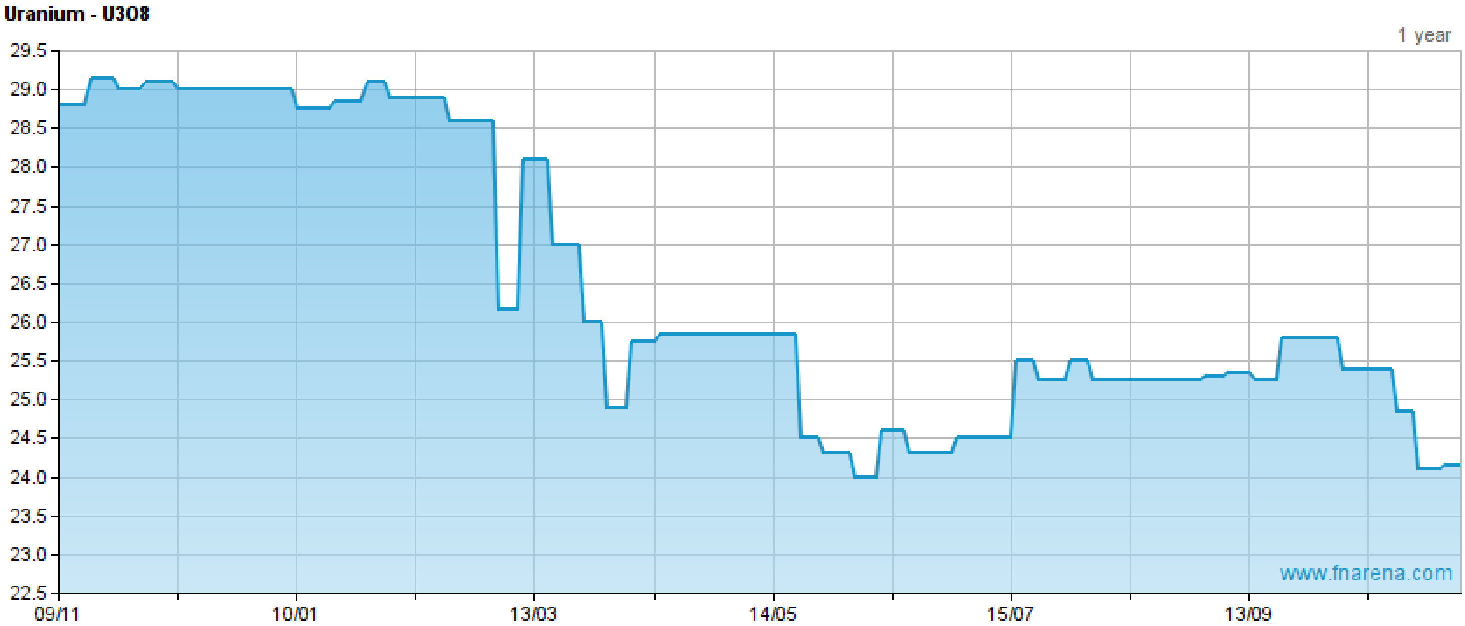
<u>Demand in Sight?</u>

Despite Friday selling, market participants did find reason to be more optimistic during the week as the Nuclear Energy Institute's International Uranium Fuel Seminar progressed in Nashville. A number of utilities expressed a willingness to consider off-market purchases for mid-term delivery.

Although this demand is not official and in preliminary stages, notes TradeTech, it is a sign to sellers that uncovered demand, particularly in the US, is substantial and that utilities are prepared to begin the contracting process to lock in supplies for delivery beyond the immediate delivery window.

Mind you, the market has been expecting utility demand to pick up for this reason for a very long time now.

TradeTech's mid-term price indicator has nevertheless risen to US$27.50/lb from September's US$27.00/lb, while the long-term indicator remains at US$31.00/lb.



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

FYI

Rise Of The Robots

How can the loss of productivity from an ageing population be reversed? Japan is setting the blueprint for other nations with its ambitious technology policies, providing a case study for The Future of Work.

-Japan facing ageing and declining population
-Japan leads the world in robotics
-Time to automate the services sector
-The world will be watching

By Greg Peel

Japan's population fell by a record -264,000 in 2018 to 126.4m. Trends suggest that by 2050, Japan's population will be less than 100m.

In 2015, 27% of Japan's population was over 65. By 2050, that number is forecast to reach 38%.

Japan has never been keen on immigration, and ANZ Bank economists note there is little prospect of immigration being high on the government's agenda.

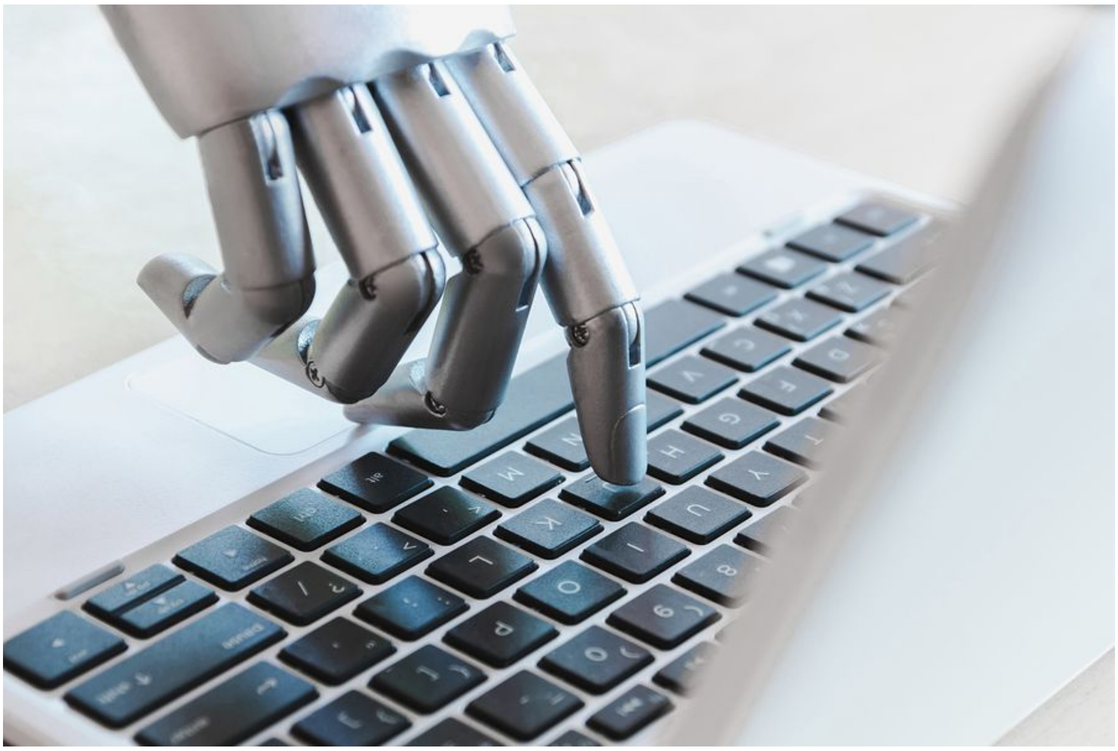
The country's current birth rate is 1.4, well below the "steady state" rate of 2.1 – enough to maintain a stable population. This lack of replacement means each year the pool of young workers diminishes in relation to retirees, hence there are fewer drivers of the economy funding an increasing drag on the economy.

This implies declining productivity.

At the same time, Japan has long been a global leader in robotics. In 2018 Japan exported US$2bn worth of industrial robots, ANZ notes – more than the next five leading exporters (Germany, Italy, France, China, Denmark) *combined*. At home, Japan has one of the highest measures of "robot density" – the number of robots relative to humans in industry.

Productivity is measured as GDP per man-hour. Thus robots increase productivity.

Whether intentionally or not, Japan has already laid the foundation for a solution to its productivity problem. But as the statistics above suggest, more needs to be done.



<u>Brave New World</u>

Hence the Abe government has unveiled an ambitious “Society 5.0” strategy. The strategy envisages the greater adoption of robotics, artificial intelligence, “Internet of Things” and big data to enhance long term productivity. Technology will help fill the void, ANZ notes, of a declining workforce and/or augment the existing workforce.

With other economies facing declining and ageing populations, ANZ believes Japan should provide a useful case study for The Future of Work.

The use of robotics in manufacturing arguably dates back centuries, if we consider any machine that does the work of humans more efficiently a “robot”. But like everything else, the field of robotics has accelerated exponentially in this century and the bulk of Japan’s investment in robotics has been in export-oriented manufacturing sectors, particularly automotive and electronics, where the robots outnumber the humans.

But while Japan is seen as an export economy, manufacturing only accounts for around a quarter of GDP, with services driving the other three quarters. There has been very little productivity growth in Japan’s services sector in recent decades, likely reflecting, ANZ suggests, the fragmented state of many service-based industries and the lack of competitive domestic pressure.

In this area, Japan has actually fallen behind. Productivity in Japan’s non-manufacturing sector is about 60% that of the US, ANZ notes. There is clearly room for improvement.

Thus Society 5.0 outlines several “ambitious”, ANZ suggests, objectives for service industry automation, including:

- self-checkout registers in retail outlets
- touch-screen menus in restaurants
- drones to deliver goods
- online medical care
- robot nurses
- self-drive vehicles

But at what cost?

What becomes of shop assistants, wait staff, delivery drivers, regional doctors, nurses and working drivers of any sort?

Quite clearly there will need to be an adjustment period. Workers in these traditional areas cannot simply switch into new-age vocations, leaving them vulnerable to redundancy, lost income and becoming the “have-nots” of a new society, increasing income inequality.

Yet technological advances boost productivity, and over time, ANZ notes, create new jobs, allowing living standards to rise. A 2017 Japanese study found increased robot density in manufacturing to be associated not only with greater productivity but also with local gains in employment and wages. The same should prove true for service sectors.

The Japanese government will nevertheless need to manage the transition very carefully, providing effective social safety nets for displaced workers and the disadvantaged, ANZ suggests. In addition, the government will need to be proactive in educating and re-skilling workers to ensure they too can be part of the new high-tech world.

An ageing population and the changing face of the workforce have long been issues for other governments, which have not moved much past acknowledging the future problem. Japan is unique as a developed nation. Aside from an ageing population, it has a declining population, forcing the government into action to future-proof the economy.

Japan's experience could provide valuable lessons, ANZ believes, for economies such as China, South Korea and Europe facing similar demographic trends.

Australia does not have the problem of a declining population – quite the opposite – although living longer and having fewer children means the Australian population is still ageing. Increasing the pension age has been one solution. Meanwhile, coal mines are becoming increasingly automated.

WEEKLY REPORTS

The Short Report - 07 Nov 2019

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

Summary:

Week ending October 31, 2019

Last week saw the ASX200 close about where it had begun, after a rally and return in between. All to do with trade optimism/pessimism.

There's quite a lot of movement evident in the table below but most if it is bracket creep, but for some exceptions.

I have covered the progress shorts in Kirkland Lake Gold ((KLA)) in the past two Reports so I'll simply note Kirkland shorts fell further last week to 7.0% from 10.1%.

Beyond that, there were three big short increases of note.

One is Costa Group ((CGC)) and another Bega Cheese ((BGA)) for similar reasons, while Webjet ((WEB)) shorts continue to rise.

See below.

Also I suggested last week we should see evidence of short covering in the lithium miners this week, but I was actually a day early. The short-covering scramble began last Friday. We await next week's Report.

Weekly short positions as a percentage of market cap:

10%+

SYR	17.8
GXY	16.5
ORE	14.4
ING	13.8
GWA	13.8
NXT	13.0
BOQ	12.8
JBH	12.2
SDA	11.1
DMP	10.5
HUB	10.4
BIN	10.3
BGA	10.2
WEB	10.0
CGC	10.0
BKL	10.0
NEA	10.0

In: BGA, WEB, CGC Out: KLA

9.0-9.9

IVC

Out: BKL

8.0-8.9%

PPT, MTS, BAL, RWC, NUF, SAR

In: BAL Out: BGA, CGC, WEB, DCN, BWX, IFL

7.0-7.9%

SUL, BWX, DCN, HVN, CLH, MIN, IFL, CGF, SLR, NCZ, A2M, MYR, KLA, OML, PLS

In: KLA, BWX, DCN, IFL, SLR, NCZ, PLS Out: BAL, SGM

6.0-6.9%

SGM, RSG, AMP

In: SGM Out: NCZ, SLR, PLS

5.0-5.9%

COE, CLQ, CSR, CUV, PGH, NEC, NWL, RFF, LNG, CTD, FMG, CMW

In: FMG Out: ADH, GEM, GMA, KAR, SEK

Movers & Shakers

This from last week's Report:

"One stock to note ahead of next week's Report is Costa Group ((CGC)). Last week Costa shorts fell to 8.6% from 9.1% ahead of this week's profit warning and announcement of a heavily discounted capital raising, which saw the stock drop -28%. Someone went a little early there."

Costa Group shorts last week increased to 10.0% from 8.6%, suggesting the shorters eschewed an opportunity to take profits, rather drooling for more.

A similar story has played out for fellow staple **Bega Cheese**. The company issued a profit warning last week amidst fierce competition in the dairy business and the stock promptly fell -20%. Shorts rose to 10.1% from 8.5%. See above.

There's been no new news out of travel agent **Webjet** lately but the share price has been recovering from early October after succumbing to the demise of Thomas Cook Travel, which went down owing Webjet money while at the same time removing that source of ongoing revenue.

Brokers de-rated the stock accordingly but have remained circumspect, expecting said recovery. The shorters have nevertheless taken the opportunity to further build positions, with shorts rising to 10.0% last week from 8.5%.?

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.6	0.7	RIO	4.4	4.4
ANZ	0.7	0.6	S32	1.4	1.4
BHP	3.4	3.3	SCG	0.3	0.4
BXB	0.2	0.3	SUN	0.5	0.5
CBA	0.7	0.7	TCL	0.5	0.3
CSL	0.1	0.1	TLS	0.2	0.2
GMG	0.1	0.2	WBC	0.8	0.8
IAG	0.6	0.5	WES	0.6	0.6
MQG	0.3	0.3	WOW	0.9	0.9
NAB	0.7	0.6	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.

Summary:

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.6	0.7	RIO	4.4	4.4
ANZ	0.7	0.6	S32	1.4	1.4
BHP	3.4	3.3	SCG	0.3	0.4
BXB	0.2	0.3	SUN	0.5	0.5
CBA	0.7	0.7	TCL	0.5	0.3
CSL	0.1	0.1	TLS	0.2	0.2
GMG	0.1	0.2	WBC	0.8	0.8
IAG	0.6	0.5	WES	0.6	0.6
MQG	0.3	0.3	WOW	0.9	0.9
NAB	0.7	0.6	WPL	1.0	1.0

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

WEEKLY REPORTS

The Wrap: QE, Aged Care, Housing & Waste

Weekly Broker Wrap: quantitative easing; US presidency & markets; supermarkets; aged care; house prices; and waste.

-Unconventional monetary policy looms closer for the RBA
-Potential for correction in equity markets on change of US president
-Dry goods inflation returning to supermarkets
-Uncertainty limits potential of listed providers of aged care
-Cost issues prevail in Australian waste & recycling

By Eva Brocklehurst

Quantitative Easing

Goldman Sachs suspects the Reserve Bank of Australia may need to engage in unconventional monetary policy to achieve its inflation and unemployment goals. The broker expects the RBA will cut the cash rate once more, probably in December, to 0.5%.

If conditions fail to improve in 2020 then a joint easing of the cash rate to 0.25% and a quantitative easing program of $10-20m per quarter is envisaged. Other measures such as direct lending to banks and/or negative cash rates are less likely, in the broker's view.

Quantitative easing is likely to kick off with the purchase of Australian government bonds and a focus on medium-term issuance, 3-5 years, given this matches the duration of bank wholesale funding costs. Goldman Sachs assesses the risk lies with quantitative easing being less effective in Australia vs other developed economies.

ANZ Bank agrees attention is turned to quantitative easing as a policy tool but does not expect the RBA will act in 2020. The analysts suggest the RBA is likely to take some time before deciding quantitative easing is necessary but its first choice is likely to be government bond purchases.

Purchases of residential mortgage-backed securities and other means to lower mortgage rates are considered very unlikely in the absence of any market disruption.

US Presidency & Markets

Macquarie notes the predictions of a significant correction in equity markets if Elizabeth Warren becomes the next US president, or is even the democratic nominee. Outside of billionaire issues of lower taxes and amplified returns with a complicit president, Macquarie asks whether there are fundamental reasons to expect a significant correction.

There are likely to be changes in regulations regarding environmental and consumer protection under a Warren presidency and more concerted attacks on share buybacks and executive compensation.

A number of these changes would simply be a correction to the extreme right policies of Donald Trump but could easily amplify volatility. So the answer to the question is yes and no. A turn to Warren in 2020 is likely to be more damaging to corporates but, unless policies are changed, inequality and social tension will continue to rise.

Hence, Macquarie asserts, corporates will need to consider that, in order to survive and mesh with society, a higher share of gross national income needs to be redistributed back to labour. The best way to do this without damaging assets, in the broker's opinion, is to raise productivity.

Supermarkets

UBS finds tangible evidence inflation is returning to supermarkets. **Coles** ((COL)) has noted dry goods prices were up in September while **Woolworths** ((WOW)) pointed to easing deflation. Importantly, UBS notes inflation is across dry goods, typically more profitable than fresh.

The broker envisages scope for the sector to outperform and has become less negative on Coles, although retains a Sell rating. Industry growth estimates are lifted to 4.5% and comparables are likely to get easier beyond the second quarter of FY20. Moreover, the broker believes an improved inflation backdrop is yet to be priced into the listed grocers and favours **Metcash** ((MTS)), based on a low implied valuation for grocery.

Aged Care

The Royal Commission into Aged Care has offered a confronting assessment of the failures in the Australian aged care industry. UBS notes the operational and financial implications will become clear after the final report but commissioners have obviously set the tone through the interim report.

The Royal Commission has stated a desire for no further piecemeal reform, making further short-term funding packaged less likely, in the broker's opinion. An urgent need has been flagged for additional home care packages. As a result, UBS suspects the current environment of negative earnings relative to costs could persist until at least FY22.

JPMorgan also found little in the report that provides direction for investors. An immediate increase in home care places would be a further challenge to occupancy but, unless higher care packages are introduced, would not unduly impact listed operators.

JPMorgan agrees a temporary funding boost now appears less likely and the sector faces at least another year of falling margins, as wage costs could rise faster than government funding. Also, given the starkly negative tone of the interim report, there is limited potential for listed providers to outperform.

House Prices

Nationally, house prices increased 1.4% in October, the strongest monthly growth since mid 2015. Prices are now up 3.7% from the June trough, although still down -6.9% from the peak in late 2017. Detached house prices grew faster than apartments and Melbourne led the way.

Morgan Stanley expects the most recent cut to the RBA's cash rate will support prices in the near term as a tight market prevails. The main driver, however, of a sustainably bullish view on the housing market will be the extent to which credit supply can increase, as this reflects the capacity to absorb both price and volume increases.

Waste

The Australasian Waste & Recycling Expo in 2019 has revealed uncertainty continues to centre on who will bear the higher costs of industry sorting and processing. Industry consolidation is also likely in order to make waste processing and recycling economic. Moreover, sufficient incentives are required to improve the purity of waste streams.

Citi believes the pricing outlook is challenging for both **Bingo Industries** ((BIN)) and **Cleanaway Waste** ((CWY)), as contract structures are unlikely to allow price increases to keep pace with costs. Risk sharing is likely to be the mechanism over the longer term by which prices can better reflect the costs that are currently borne by waste collectors.

RUDI'S VIEWS

Market Rotation? It's Complicated

Dear time-poor reader: why is the Value rotation not working so well in Australia? Plus Conviction Calls and the Fortescue mystery solved.

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

-Market Rotation? It's Complicated
-Conviction Calls
-Focus On Quality Yield
-Fortescue Is No Mystery
-**Tickets to Conference on Agricultural and Veterinary Biotechnology**
-Rudi On Tour

[*The non-highlighted items will appear in Part Two on Friday*]

Market rotation? It's Complicated

By Rudi Filapek-Vandyck, Editor FNArena

Global financial markets have priced out worse case scenarios for the world in 2020 and there are quite a number of investment experts out there who believe we might be near a turning point in terms of global growth and investor sentiment.

In simple terms this becomes: no recession, and potentially a new acceleration in growth instead.

Those who pay close attention would have noticed a few differences. The USD has weakened, bond yields have reset at a less subdued level and Emerging Market equities have, for the second time in 2019 after January, managed to outperform developed markets equities in October.

In the US, share market indices have surged to (or near) a fresh all-time high while FAANG stocks are not at all-time highs.

This can only mean three things: rotation, rotation, and rotation.

"Value" portfolios have finally enjoyed a good month of outperformance. In Australia, it has to be noted, beaten down disappointers including Amaysim Australia, CYBG, Challenger and BlueScope Steel have all sprung to life, mostly on no specific news, while a number of prior outperformers have witnessed the draw back from the switch in funds flows.

Smaller cap technology high-flyers in particular have felt the sudden impact from the switch in market sentiment. Apart from the likes of Altium, Appen, WiseTech Global and Afterpay Touch, October has not been kind to names including Pro Medicus, Jumbo Interactive and a queue of smaller cap gold producers.

But here is where things become a lot more complicated. Whereas share markets globally rose over the month, the Australian share market trod water and ultimately ended with a small loss (-0.3%). Locally, the best performing sector was Healthcare, which is very much the antithesis for a rotation into Value on the back of an improving growth outlook globally.

The worst performing sector locally were the banks, which retreated more than -4% in October, performing even worse than the local technology sector, which despite being the target of domestic and international shorters, only retreated by -3.9%. Materials and Resources equally ended October on a negative note.

So what exactly is (not) happening here?

I think what we are experiencing is more evidence of deteriorating domestic economic fundamentals, exacerbated by a stronger AUD, alongside further evidence there is no major positive impact on consumer spending from a recovery in house prices and the Morrison government's tax cuts.

Then there's also the drought. The result is that laggard stocks in the Australian share market -"Value" by any other definition- continue to punish investors who jumped on board because of macro considerations, while ignoring the micro risks that are still very much attached to these companies.

As a result, Australia is not fully participating in the portfolio rotation taking place elsewhere. Instead, companies such as Costa Group are still issuing profit warnings and raising fresh capital while banks including Westpac are cutting their dividend and equally raising fresh capital.

The end result is that healthcare -carried by CSL, ResMed and Cochlear- and Industrials, which includes bond proxies such as Transurban and Sydney Airport, have been the local outperformers in October. And it's not like these stocks have stood still since January (my attempt to inject some sarcasm).

With key portfolio exposure CSL rallying to a new all-time high during the month while the company was celebrating its 25th anniversary as an ASX-listed entity, the **FNArena/Vested Equities All-Weather Model Porfolio** gained 1.31% in October for a total gain of 5.71% over the first four months of FY20.

In comparison, the ASX200 Accumulation Index posted a negative -0.35% in October for a total gain (including dividends) of 2% thus far in FY20.

A special mention goes out to Bapcor ((BAP)), which is equally seen as a core portfolio holding. The company's trading update last week once again confirmed why I regard this company a potential true blue All-Weather Performer. In the midst of industry headwinds and intense competition, this company can still guide towards modest growth.

The current C-suite at Bank of Queensland, ANZ Bank and Westpac would sacrifice their left arm if only they were able to do the same.

Investors should note FNArena monitors Australian corporate results the whole year around:
https://www.fnarena.com/index.php/reporting_season/

Conviction Calls

Stockbroker Morgans has updated its **Best Ideas**, essentially those stocks believed to offer the highest risk-adjusted returns over the next twelve months, underpinned by an above-average level of confidence.

It's quite the list, so get set.

Best Ideas among **large cap stocks**:

-Telstra ((TLS)), Wesfarmers ((WES)), Treasury Wine Estates ((TWE)), Woolworths ((WOW)), Woodside Petroleum ((WPL)), Oil Search ((OSH)), Westpac ((WBC)) -yes, you read that correctly: Westpac remains the stockbroker's most preferred bank exposure, with conviction- Sonic Healthcare ((SHL)), Sydney Airport ((SYD)), and APA Group ((APA)).

Best Ideas among **mid and small-cap stocks**:

-ResMed ((RMD)), Cleanaway Waste Management ((CWY)), Link Administration ((LNK)), Orora ((ORA)), OZ Minerals ((OZL)), Frontier Digital Ventures ((FDV)), PWR Holdings ((PWH)), Lovisa Holdings ((LOV)), AP Eagers ((APE)), Cooper Energy ((COE)), Kina Securities ((KSL)), Generation Development ((GDG)), Pro Medicus ((PME)), Over The Wire ((OTW)), Iress Market Technology ((IRE)), Orocobre ((ORE)), Red 5 ((RED)), Aventus Group ((AVN)), and APN Convenience Retail REIT ((AQR)).

Note also US-originated **Jefferies Australia**, which has started to ramp up activities recently, this week initiated coverage on Macquarie Group ((MQG)) with a Buy rating and a maiden price target of $164. Behind these snippets hides Brian Johnson, previously at CLSA, and at JPMorgan before that.

Fortescue Is No Mystery

FNArena received multiple questions about why the Fortescue Metals ((FMG)) share price has remained unable to move decisively higher. Here's an attempt to "solve the mystery".

As a leveraged exposure to the price of iron ore, Fortescue Metals' outlook comes down to one key question: what will the price of lower quality iron ore be next year and beyond?

As is easily established through Stock Analysis on the website, the analyst community is currently highly divided on the issue.

Ord Minnett/JP Morgan and Macquarie believe a stronger-for-longer scenario is definitely possible and on this basis they have set price targets that are double digit percentage above where the share price sits in early November.

Most analysts, however, don't believe such a scenario is likely and they foresee lower prices ahead instead. On this basis, fair value for the share price might be near $8.50 or even $7.50, which implies double digit percentage losses from the current share price level.

Take your pick.

Another way of looking at it is via forecast dividend yields. Current consensus estimates put forward yield (FY20) at circa 15.5% (including current FX translation from USD) but for the following year that percentage tumbles to 6.5%. The latter is still attractive, but investors should note the numbers behind the average once again are heavily polarised, so if price momentum does go south, don't consider the 6% yield set in stone.

What does a market do that doesn't know the answer to the question? It puts the Fortescue Metals share price somewhere in the middle of the two scenarios, and waits for more clarity to arrive.

Tickets to Conference on Agricultural and Veterinary Biotechnology

Pitt Street Research, whose work can also be found on the FNArena website: https://www.fnarena.com/index.php/pitt-street-research/, is organising its inaugural **Life Sciences Conference** with the focus on Agricultural and Veterinary Biotechnology.

The Conference takes place in Sydney's CBD on November 28th and runs from 8.45am till 1pm on the day. ASX-listed companies presenting include PainCheck, Anatara Lifesciences, Abundant Produce, PharmAust ltd, CannPal, EM Vision and Osteopore.

FNArena has ten tickets available for investors who'd like to attend this event at no cost; paying subscribers receive this opportunity first. If interested, send an email to info@fnarena.com

Rudi On Tour In 2020:

-ASA Hunter Region, near Newcastle, May 25

(*This story was written on Monday 4th November 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part Two will follow on the website on Friday).*

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

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

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BONUS PUBLICATIONS FOR FNARENA SUBSCRIBERS

Paid subscribers to FNArena (6 and 12 mnths) receive several bonus publications, at no extra cost, including:

- The AUD and the Australian Share Market (which stocks benefit from a weaker AUD, and which ones don't?)
- Make Risk Your Friend. Finding All-Weather Performers, January 2013 (The rationale behind investing in stocks that perform irrespective of the overall investment climate)
- Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection)
- Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
- Who's Afraid Of The Big Bad Bear? eBook and Book (print) available through Amazon and other channels. Your chance to relive 2016, and become a wiser investor along the way.

Subscriptions cost $440 (incl GST) for twelve months or $245 for six and can be purchased here (depending on your status, a subscription to FNArena might be tax deductible):
http://www.fnarena.com/index2.cfm?type=dsp_signup

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

RUDI'S VIEWS

Rudi's View: Focus On Quality Yield

Dear time-poor investor: what is the best way to invest in equities for regular income?

In this week's Weekly Insights (this is Part Two):

-Market Rotation? It's Complicated
-Conviction Calls
-Focus On Quality Yield
-Fortescue Is No Mystery
-Tickets to Conference on Agricultural and Veterinary Biotechnology
-Rudi Talks
-Rudi On Tour

[*The non-highlighted items appeared on Thursday in Part One*]

Focus On Quality Yield

By Rudi Filapek-Vandyck, Editor FNArena

It is the subject most share market experts and commentators rather not talk about: buying cheaply priced stocks works best when interest rates are higher, economic growth and cycles are relatively robust and there is no mass-disruption from eroding barriers of entry and technological innovations.

The current environment is different. Interest rates are exceptionally low, and likely to move lower still. Economic growth the world around post-GFC has never been quite the same, and the overall pace remains low by historical standards. And change caused by innovations: where exactly do I start?

The direct result is that corporate throwbacks, missteps and failures are not necessarily temporary in nature, as was mostly the case pre-2012. At the very least, the past number of years have taught investors cheaply priced companies might find it hard to sustainably improve their operations and thus catch up with the prolonged bull market in equities.

It is but one reason as to why 80-92% (small caps - large caps) of actively managed funds in Australia, according to a recent sector update by Morgan Stanley, are unable to keep pace with their benchmark, let alone decisively beat it.

Plenty of examples to choose from. In the healthcare sector, far and away the best performing in Australia, plenty of fund flows preferred Healius ((HLS)) these past years, instead of the much more "expensive" looking Cochlear ((COH)), ResMed ((RMD)) or CSL ((CSL)). Yet it's the "cheaper" one out of these four that has, on balance, hardly performed on a five year horizon.

Amongst REITs, equally one of the better performing segments on the ASX, the likes of Goodman Group ((GMG)) have at times become the focus of short-positioning, but the share price consistently moved upwards, at least until the mini-correction in August this year.

Once upon a time, Goodman Group shares were highly sought after by income hungry retirees, but these days the shares only offer circa 2% forward looking. That can serve as an indication of how "expensive" those shares have become.

There is no doubt in my mind income seeking investors have instead been preferencing REITs such as Vicinity Centres ((VCX)), which still offers circa 6% yield. On the flip side, Vicinity shares have eroded some -23% since their peak in mid-2016 and have largely trended sideways throughout 2019 when most market indices added near 20%.

Amidst an ongoing tough outlook for industrials in Australia, investors might take heed from the observation the increasing number of profit warnings and negative market updates are accompanied by a reduction in the dividend for shareholders. Already I have seen predictions of a lower payout by Vicinity Centres in 2020, and, post this week's profit warning, Medibank Private's ((MPL)) FY20 dividend might be at risk too.

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Probably the most striking examples have come from the banking sector, in particular in Australia prominently represented in investment portfolios. If it isn't because of the dividend appeal, it's otherwise because the sector remains by far the largest on the local stock exchange with all Four Majors plus Macquarie included in the ASX Top10.

In a recent strategy update on global banks, analysts at Citi offered the following warning for investors: **Don't Buy Cheapest Banks.**

Their motivation: "*Pursuing a Value strategy within the global Bank sector has been an especially disastrous strategy. Cheap Banks in Europe and Japan have got even cheaper. More expensive Banks in the US have stayed expensive. We don't expect this valuation gap to mean-revert anytime soon.*"

In other words: when growth is elusive, and the pressure is on, investors should adjust their strategy and focus too. Cheap stocks might be lagging for very good reason.

With yield curves inverting for government bonds, economic momentum struggling and credit growth sluggish, banks globally have been lagging the bull market. Hence the recent reset in bond markets, whereby yield curves steepened, triggered a renewed interest in bank shares around the world. This is part of the rotation into "Value" career professionals like to talk about.

But Citi analysts are not buying it. They argue valuations for bank shares should stay "cheap" because the global economy remains weak and bond yields will remain low.

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In Australia, it can be argued, bank shares are not particularly "cheap", as they have benefited from the attraction of 5%-6% dividend yield in a global environment that has half of all government bonds outside of the USA trade in the negative.

But they seem "cheap" in comparison with stocks like Macquarie Group ((MQG)), Transurban ((TCL)) and Charter Hall ((CHC)); stocks that have fully participated in the share market uptrend and contributed with gusto to pushing major indices to an all-time high this year.

Yet, the October-November reporting season has left shareholders with a sour after-taste. All of Bank of Queensland ((BOQ)), Westpac ((WBC)) and National Australia Bank ((NAB)) announced a sizable reduction in their final dividends, while ANZ Bank ((ANZ)) kept its stable, but with -30% less franking. In a surprise move, Westpac raised extra capital too.

Little surprise, the local bank sector has been the worst performer of late. October delivered a general decline of -4.4% for the sector to keep the overall performance for the Australian market slightly in the negative for the month. In the words of UBS: "*It appears the market is coming to terms with the outlook of decreased profitability from lower rates and increased capital requirements*".

Observation number one, once again re-emphasised during this reporting season: a higher yield (as implied by a "cheaper" share price) does not make the better investment. It's usually the **exact opposite**.

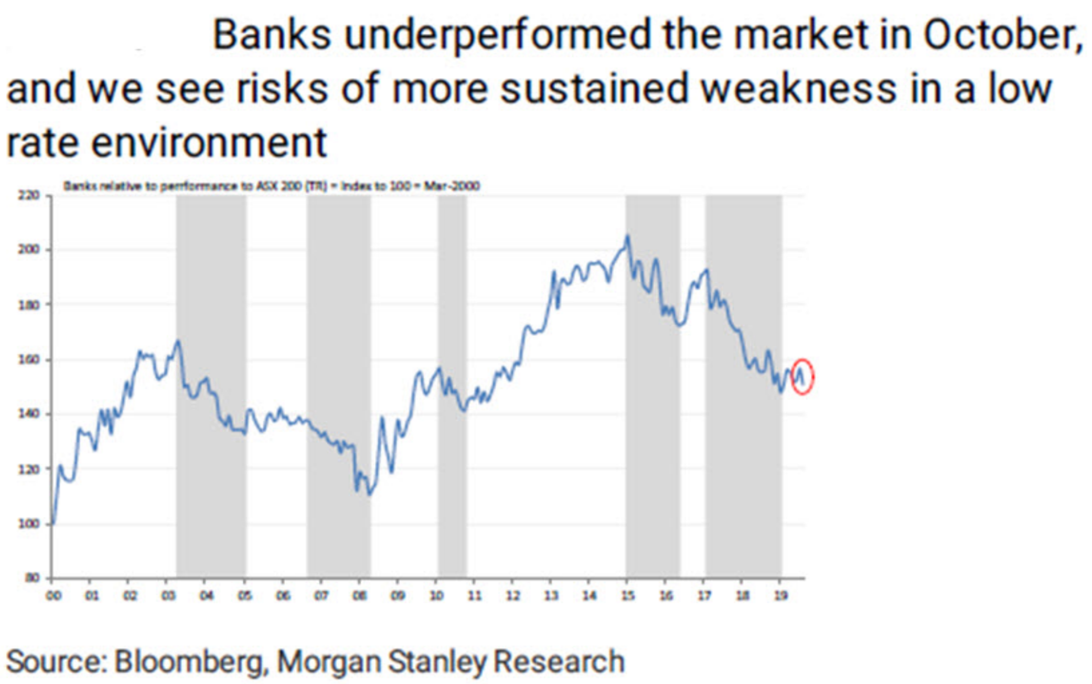
Commbank ((CBA)) shares trade at a noticeable premium vis a vis the rest of the sector (as can also be established through its lower yield on offer) but the bank is not anticipated to follow its peers with a dividend cut at the next half-yearly results update, which will be in February.

On my own historical data analysis, CommBank's premium valuation is backed up by superior returns versus The Rest over five, ten, fifteen and twenty years. Occasionally, one of the laggards in the sector might experience a catch-up rally that temporarily pushes CBA into the shadows, but the prize for consistency and absolute outperformance inside the Australian banking sector remains essentially uncontested, on the premise we do not include Macquarie Group.

This by no means implies there cannot be more negative news from CommBank or the other banks. Far from. A recent sector update by Morgan Stanley asks the question whether Australian banks are yet again facing another period of sustained underperformance relative to the ASX200.

If investors wanted more evidence the Golden Years for banking in Australia are now well and truly in the past, Morgan Stanley's research shows banks have noticeably underperformed five prolonged times since 2000, with two of the five periods occurring since April 2015. If we are presently experiencing period number three (six in total post 2000) then the frequency is in significant acceleration.

Below is the graphic depiction of the five periods since 2000 that accompanied the Morgan Stanley research report:



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What the banks have once again shown to investors is that higher yield tends to correlate with higher risk. The market is not always correct and whatever can be identified in terms of risk, it may not even impact or materialise, but there is that possibility. Investors should always weigh up whether it is worth taking the risk.

And that risk should not be solely measured in loss of capital. CommBank shares, essentially the Primus inter Pares in Australia, have done nothing but trend sideways since September 2015. Over that same period shares in Macquarie Group have appreciated by some 75%.

So for a slightly lower dividend yield on offer, backed by a superior growth profile, Australian income investors could have accumulated significantly better returns if only they weren't so afraid of paying a little more for it. Those opting for any of the "cheaper" alternatives in the sector find themselves in a much worse situation today.

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So what is an investor to do who today is sitting on some cash, looking to be deployed in the share market?

My advice has been, and still is: look for **Quality Yield**. What exactly defines Quality Yield? Pretty straightforward: it's a dividend that is most likely to rise over multiple years ahead. Admittedly, such a proposition is probably not available at 5.5% or 6% yield, but then again, investors are less likely to find themselves confronted with capital erosion and/or a dividend cut further down the track.

The FNArena website offers forwarding looking estimates and daily broker research updates, alongside a number of other tools and services, to assist investors with their quest.

It also just so happens a few analyst teams recently made a valuable contribution as well. The **property team at Morgan Stanley** last week released a 145 pager on the ASX-listed property sector with the aim of identifying the best investment opportunities in the sector.

What sets this type of research apart from the usual analysis done elsewhere is that it is not solely based upon "valuation", relative or otherwise.

Morgan Stanley prefers "manufacturers" over "collectors" and "creators" over "owners", with the team labeling itself "selective with value". Identified sector favourites are Stockland ((SGP)), Goodman Group and Mirvac ((MGR)). Sector exposures to stay away from, even though they might look "cheap", according to the team, include Scentre Group ((SCG)), Vicinity Centres and GPT ((GPT)).

Investors should note Morgan Stanley analysts agree with the view that owners of retail assets look "cheap", but they still see shopping malls coming under pressure from both tenants and consumers, which implies there could be a long tail risk hanging over this sector for much longer.

Property analysts at Credit Suisse updated sector forecasts and modeling, including a new risk free rate and equity risk premium, resulting in the forecast that AREITs in aggregate are likely to generate a total return of 4.4% over the year ahead, or plus or minus the projected average dividend payout.

Sector exposures that are expected to perform better include Scentre Group, Dexus Property Group ((DXS)), GPT, Abacus Property Group ((ABP)) and Goodman Group. Note the team at CS is less worried about broader, longer term trend risks than the colleagues at Morgan Stanley.

Macquarie has compared infrastructure stocks with utilities and AREITs and concluded utilities currently offer the superior total income profile, with infrastructure and AREITs both equal second. Risk-adjusted, Macquarie believes, infrastructure offers the highest potential return. AREITs are seen offering "a balanced yield exposure".

On Macquarie's projections, utilities such as AusNet Services ((AST)) and Spark Infrastructure ((SKI)) carry the highest income potential over the next three years, but they also come with the highest correlation with the broader share market (meaning: above average volatility in share prices).

This is most likely because they offer very little (if anything) in terms of growth. It's all high yield.

Tellingly, Macquarie's favourite yield stock is currently Mirvac, as it is seen offering 4% yield growing at a sustainable 5% per annum.

Macquarie's other favourites are Goodman Group, Charter Hall, and Lendlease ((LLC)).

My recent warnings for investors:

https://www.fnarena.com/index.php/2019/09/20/rudis-view-dividend-cuts-they-are-coming/

https://www.fnarena.com/index.php/2019/10/31/on-dividend-alert/

Tickets to Conference on Agricultural and Veterinary Biotechnology

Pitt Street Research, whose work can also be found on the FNArena website: https://www.fnarena.com/index.php/pitt-street-research/, is organising its inaugural **Life Sciences Conference** with the focus on Agricultural and Veterinary Biotechnology.

The Conference takes place in Sydney's CBD on November 28th and runs from 8.45am till 1pm on the day. ASX-listed companies presenting include PainCheck, Anatara Lifesciences, Abundant Produce, PharmAust ltd, CannPal, EM Vision and Osteopore.

FNArena has ten tickets available for investors who'd like to attend this event at no cost; paying subscribers receive this opportunity first. If interested, send an email to info@fnarena.com

Rudi Talks

This week's audio interview about portfolio rotation and what it means for the Aussie share market:

https://www.youtube.com/watch?v=bZ8AybO5aDE

We created a YouTube channel for such interviews, which was recently upgraded (technically speaking):

https://www.youtube.com/watch?v=bZ8AybO5aDE&list=PLVMOgaPqrk1s55RujzgMerIzdOX2RrXl9

Rudi On Tour In 2020:

-ASA Hunter Region, near Newcastle, May 25

(*This Part Two story was written on Thursday, 7th November 2019. Part One was written on Monday 4th November 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website*).

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- Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection)
- Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
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http://www.fnarena.com/index2.cfm?type=dsp_signup

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