13 August 2021

Shaw and Partners
Morrissey Group

MARKET UPDATE

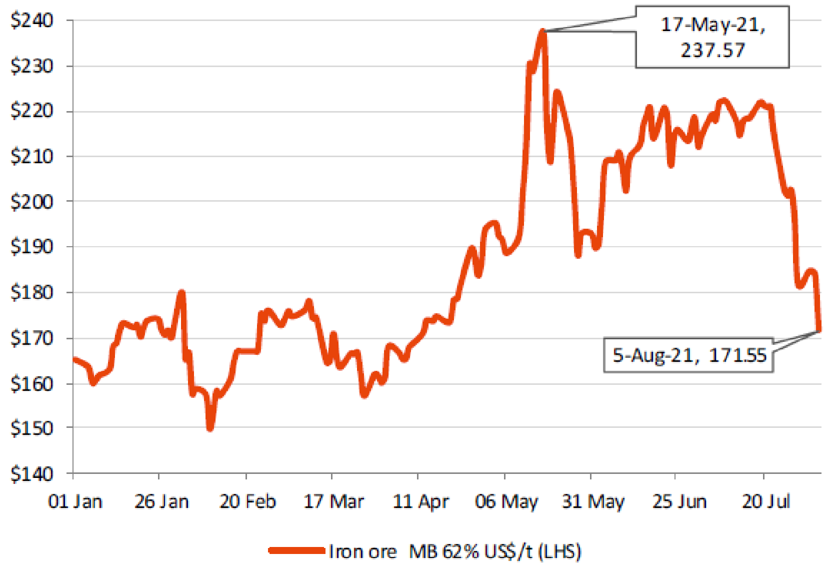
Weekly Update

Commodity prices rolling forward

On a seemingly unstoppable roll, the market rose another 1.2% this week rising to 7629. In the US their reporting season has nearly come to a close, producing some exceptional results with 87% of the S&P 500 beating earnings expectations and providing encouragement and justification to buyers. I doubt this can continue.

Locally, insurers Suncorp, QBE and IAG made large profits because they've increased premiums pretty aggressively and no one can do anything so claims aren't being triggered. Elsewhere commodity prices roll on like ocean swell, iron ore falling to $160/tonne and coal continuing its rise.

Figure 1: Iron ore price headwinds ...down ~30% from May 2021 high ...



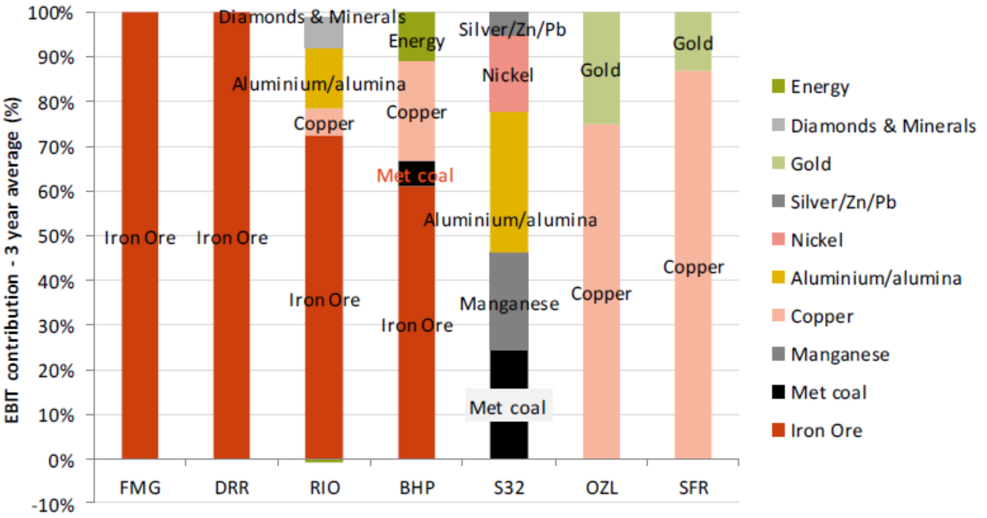
We have expected this reversal in the iron ore price for some time, and just when you think it mightn't happen...

The major beneficiaries of the previous strength in the iron ore price will obviously be the losers as it slips. Be careful of iron ore stocks paying large dividends; they won't last.

Iron ore Earnings

Big miners earnings composition/mix

Figure 2: There's a lot of iron ore at the big end of the Australian miners ... FMG, DRR and RIO the standouts (and BHP has a bit too) ...



Source: Shaw and Partners, FactSet, Company data

Dorsavi Ltd (DVL)

Last week DVL announced an extension to their ongoing agreement with Global medical device business Medtronic. The extension, which is for 5 months, is only worth a few hundred thousand dollars, but it builds on the IP and development of work over the past year.

As with many of these large customers, it's a case of slowly, slowly catchy monkey. All going well, this partnership will develop into a significant deal.

Click on link to announcement here.

Whitehaven Coal (WHC)

In a week where the world's leading authority on climate science has released a dire warning on global warming, we continue to see a lack of support for reduced carbon emissions by the countries that move the dial. All the while massive investment groups and financiers refuse to fund development of fossil fuel reserves resulting in the worst possible scenario where we become even more reliant on the small number of reserves that are producing. In other words, the prices of dirty energy are rising dramatically due to the lack of viable, commercial green alternatives that are ready to replace them.

According to our materials analyst, with thermal coal now trading at ~US$167.50/t, which is 245% higher than the post Covid low, WHC should be trading at around $7.00. Thermal coal and coal equities are on a long-term slippery slope, the gradient of which may steepen. But it is about a favourable economic cycle within a longer-term trend.

Timing issues – we note the comments from WHC, BHP and other coal related peers that the timing of capturing rapidly appreciating coal prices can take many months. Contracts could/are struck on a variety of timelines i.e. spot, 1 month, quarterly, 6 monthly and in some cases annual (Japanese FY). So the spot price today is not a reflection of earnings today so much as earnings over the next 1, 3, 6 months.

Discounting ESG and timing related issues, the WHC share price should be trading far higher. Because of their massive cashflow, don't forget they are rapidly deleveraging as well, As free cashflow builds and the company retires debt the market capitalisation will grow, because every $200m of deleveraging delivers ~20c per share upside.

Figure 1: Coal price rally continues … energy coal now at $167.50/t up 245% form 3Q 2020 low. Lower grades rallying also

Figure 2: WHC share price vs NPV spot … points to $7/share all things equal

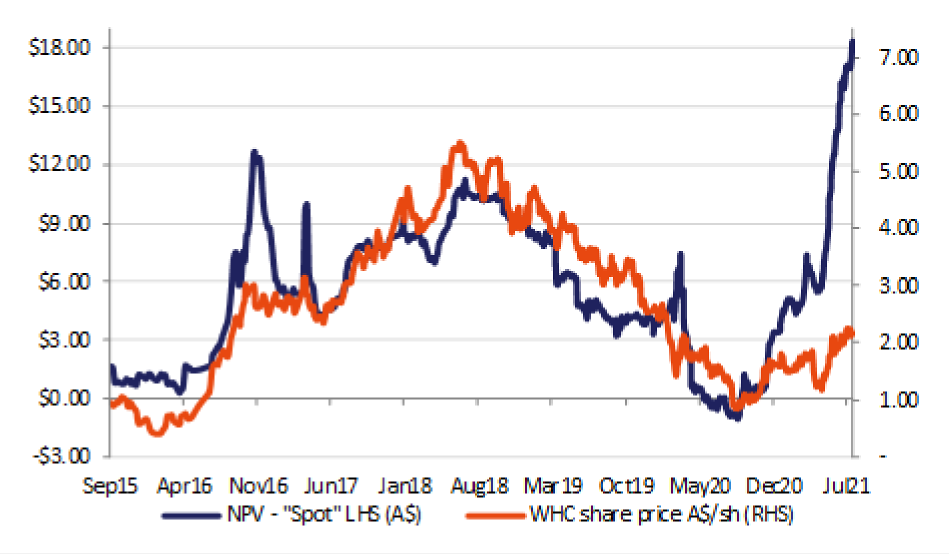
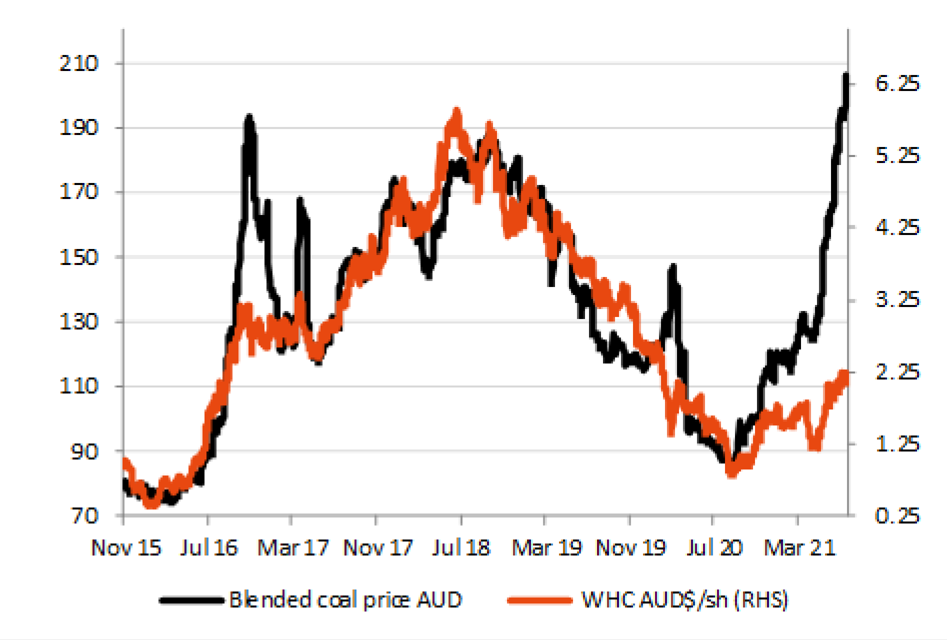


Figure 3: WHC share price vs blended AUD revenue … another pointer to $7/share



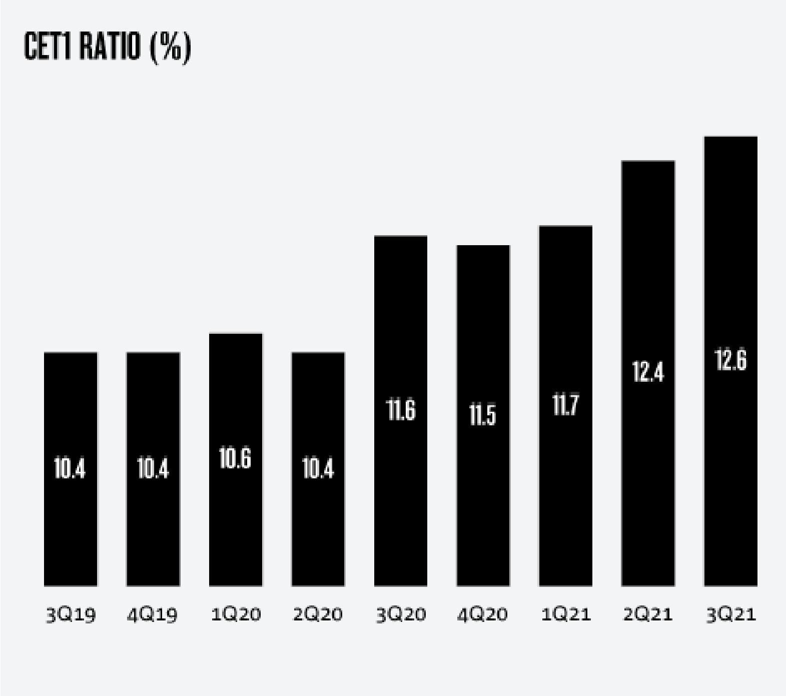
Banks

CBA released their FY ’21 result on Wednesday this week, and it was strong. NPAT up 19.7% to $8.8bn, dividends are up, a $6bn buyback and their Tier 1 Capital (CET1) ratio is up 150bps to 13.1% which will decline to 12.2% post buyback.

	FY21	vs FY20
Statutory NPAT ($m)	**8,843**	↑ 19.7%
Cash NPAT ($m)	**8,653**	↑ 19.8%
CET1 (%, Level 2)	**13.1%**	↑ 150bpts
EPS (cash, $)	**4.89**	↑ 80c
Dividend per share ($)	**3.50**	↑ 52c

NAB released their third quarter update on Thursday (they report on a different schedule to CBA). Cash earnings up 10.3% versus previous corresponding period (pcp), credit impairments down, housing and business lending up and CET1 ratio of 12.6%.

The banks are in excellent shape and importantly with their CET1 ratios above the RBA's recommended 10% level, are well placed to deal with whatever nasties this unique economic environment might throw at us.



Podcast

Based in Melbourne, the Morrissey Group find themselves back in lockdown for the sixth time; and this time round we're joined by most of the eastern seaboard.

15 million people are locked in their homes in an attempt to stop the spread of COVID-19 with so many industries shutdown creating ever mounting economic and psychological pressure. But despite our three most populous cities being closed-for-business, our stock market is trading at record highs.

We may have won the 2020 elimination battle, but at what cost? And do we now find ourselves in the unenviable position of potentially losing the war?

Listen to the episode or find us on Spotify.

Have a good weekend,

Ben and the team

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