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Brickworks Expected To Weather WA Downturn

Investments and record east coast building activity are expected to help Brickworks weather the downturn in Western Australian construction, but some headwinds are on the way.

-Medium term more uncertain because of higher energy costs and slowing residential building -Reduced building activity should be offset by income from associates and investments -Capacity constraints also envisaged affecting building product earnings growth

By Eva Brocklehurst

Building products and investments company Brickworks ((BKW)) is counting on investments and record east coast building activity to pull through the trough in Western Australia, where the business has a significant presence.

The company's first half result was well ahead of most expectations and brokers consider the short term outlook remains positive, although the medium term is more uncertain because of higher energy costs and the potential for slowing in residential building activity.

Building products were weighed down by continued weak activity in Western Australia, although bricks recorded impressive growth, Bell Potter observes. The company has a large presence in Western Australia and record levels of construction activity on the east coast work were required to almost, but not completely, offset the decline in west coast developments.

West coast developments declined 30% in the first half, the broker notes. Although suspecting the worst is now behind Western Australia and the company will emerge in better shape following a significant restructuring, Bell Potter suspects it will take some time for excess capacity to be worked through.

The broker believes the building products division still presents value when compared with listed peers, and property and investment will provide a solid earnings base in the event of a construction downturn. Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy recommendation and $14.95 target.

Interim underlying earnings rose 44% and underlying net profit rose 48% in the half. The building products division produced an improved result but the main feature was land and development (earnings up 48%), as well as associates and investments (earnings up 78%).

Austral Bricks delivered earnings growth of 17% while there was a small increase in earnings for Austral Masonry. Morgans notes this was partially offset by weaker earnings from Bristile Roofing, Austral Precast and Austwest Timbers.

The investments division is expected to deliver steadily increasing earnings and dividends over the long-term. Morgans expects land and development earnings to normalise from FY18, which will also coincide with a slowing in building activity. This should be partially offset by stable expectations from associates and investments.

The company's 17.0c per share dividend continues the record of increasing over the long-term and the balance sheet remains in good shape, Morgans observes.The broker considers the stock to be fully valued at current prices and retains a Hold rating.

Investment Earnings

Building products earnings will be challenged over the next few years as the cycle peaks but Morgans expects this to be mitigated by the company's cross holding (42.72%) in WH Soul Pattinson ((SOL)) and increased land and development activity. Dividends from the investment were up 3.3% on the prior corresponding period.

The rally in thermal coal prices was observed to be the most significant driver of the rise in earnings from the company's investments, and the sale of the Oakdale West site into the property trust added an extra $50m in earnings in the property division.

Results were also ahead of Macquarie's expectations. The broker notes that, beyond 2017, higher energy costs will impact margins and, with a projected $20m increase from energy costs looming in FY19, Brickworks continues to evaluate alternative gas and energy options. Macquarie does not expect it will be easy, especially as the full impact of higher gas prices and higher electricity costs annualise.

Capacity Constraints

The company flagged a full order book for FY17, with a long pipeline of work at higher margins in major east coast markets, yet acknowledged sales volume is failing to keep pace with orders as the housing industry is operating at capacity in the east coast and being limited by supply chain, trade shortages and a lack of titled land.

Macquarie assesses that shortages of bricklaying capacity are not the issue, rather it is the broader absorption of skills into multi-residential activity which appears to be affecting the growth trajectory. As multi-residential activity slows, the company expects this could alleviate some of the constraint in detached housing activity.

In any case, Macquarie suspects macro factors will get the better of broader growth. The broker believes the stock has progressively de-rated to a point where the valuation is well below its historical trading range relative to the ASX 200 industrials. While this appears attractive, Macquarie is wary that earnings pressures are mounting.

While it is conceivable that profits in the land and development portfolio could sustain earnings in the face of a slowing building market, the broker believes the quality of visibility associated with this profit source makes the stock less attractive when considering the overall earnings profile.

Top-line growth in building products appears increasingly dependent on price while bottom-line growth will be affected by energy costs, in Macquarie's summation. Hence, the broker maintains a Neutral rating.

Of importance for the second half, Deutsche Bank points out Western Australian housing has stabilised in the last few months. Because of seasonality, second half earnings usually increase by around 200 basis points and the broker expects solid margin expansion in the second half will be forthcoming. Deutsche Bank expects an increase of 4% in FY17 earnings, noting price increases of 5-8% is were announced for July 2017.

There is one Buy recommendation on FNArena's database (Deutsche Bank) and three Hold. The consensus target is $14.91, suggesting 5.4% upside to the last share price. Targets range from $13.62 (Morgans) to $16.08 (Deutsche Bank).

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Ernest Henry Shines For Evolution Mining

Brokers have returned from a tour of copper-gold mine Ernest Henry buoyed by Evolution Mining's purchase of a stake in a well-run asset with long-term opportunities.

-Forecasts based on the 11-year reserve at Ernest Henry may be underestimating the potential -Buying the gold stream adds production without paying a control premium -Evolution Mining could be net cash by end FY18

By Eva Brocklehurst

Gold miner Evolution Mining ((EVN)) has impressed the brokers that toured the company's Ernest Henry copper-gold operation in north Queensland. The company has taken an economic interest in the mine, which provides a base load of gold/copper production and cash flow that along with the company's other major asset, Cowal, sets a firm foundation for the portfolio.

Evolution Mining has bought into a well-run asset with top-tier infrastructure amid opportunities to lift production and gold recoveries, in Deutsche Bank's view, and valuing the stake in Ernest Henry simply on a 11-year reserve underestimates the potential to extend the mine life. The broker increases mine life assumptions to 15 years and lifts its valuation on the stock by 5%.

Canaccord Genuity also finds no obvious shortcomings in the current mine that would affect near-medium term expectations, while in the longer term there is the opportunity to increase production and extend mine life. The broker, not one of the eight monitored daily on the FNArena database, upgrades to Buy from Hold in the wake of the tour, with a target of $2.45.

Ernest Henry

Brokers observe Ernest Henry is a well capitalised asset that underpins the copper operations of Glencore, which hosted the site visit. Evolution Mining has paid for 100% of gold output over the 11-year reserve and 30% of the copper produced by the mine over its current life. This economic interest comes with 30% of the associated operating and capital expenditure.

The ore body is open at depth and the company participates in any extensions to mine life, with its share of production moving to 49% of all metal output from 2027 onwards. The company recently reported production for the year to date from Ernest Henry of 13,000 ounces, which puts it on track to meet the March quarter estimates of 21,000 ozs.

At the outset Morgan Stanley believed buying the gold stream from a copper-gold mine was a novel way to add production without paying a control premium. Yet, unlike the prior acquisitions of Mungari and Cowal, the company does not operate this mine. In the broker's opinion this limits its ability to add value through asset optimisation. Morgan Stanley adds some value to its base case after the visit but maintains other elements as upside scenarios.

The real prize, UBS believes, is exploration below the reserves that are largely untested and provide genuine upside to the mine life, but acknowledges these improvements are not going to make a large difference any time soon.

Macquarie is also under the impression that there is little motivation for major increases to the size of the mine at the current point in time, other than low capital expenditure on de-bottlenecking. Harvesting cash appears to be the main near-term goal. Nevertheless, the broker still expects Ernest Henry to be a leading contributor of cash flow to the Evolution Mining portfolio.

The reserve life exceeds the anticipated operating life of the Mount Isa mines and smelting operations of Glencore, where 2023 is the focus of the current closure plan. At that point, Deutsche Bank believes Evolution Mining could look to acquire Glencore's remaining stake in Ernest Henry, as it switches to selling to export markets, with Glencore retaining offtake of concentrate. Evolution Mining has acquired first right of refusal on any further divestment.

Production Outlook

Deutsche Bank believes Evolution's string of acquisitions over the last two years has progressively improved the company's portfolio. Both Cowal and Ernest Henry have at least 15 years of remaining operations and, given the strong free cash flow, Evolution Mining's balance sheet should be net cash by the end of FY18.

Morgan Stanley learnt that the company has limited ability to directly influence the production plan but Glencore could take mine production to 6.8mtpa from 6.4mtpa for almost no capital expenditure. Canaccord Genuity also believes there are few hurdles to achieve this target. Beyond that, the valuation benefits are less obvious.

Glencore has suggested any increase to above 7mtpa would require a further $60m in capital expenditure. In this case, such an investment would need to add at least another 400,000tpa, in Morgan Stanley's opinion. Yet, Evolution Mining could capture gold from the tailings with leaching and each 1% increase adds $16m in revenue at spot gold prices.

Macquarie believes the main catalyst for the company is likely to come from further portfolio optimisation in the form of divestments. Edna May, Western Australia, continues to be a drag on the company's performance and the broker is not convinced the underground opportunity provides a compelling reason to retain the asset. UBS agrees that upgrading the portfolio through divesting short life/marginal assets and acquiring higher quality assets is likely to be the major source of creating value.

The full seven from seven Buy recommendations on FNArena's database are an indicator of the consistency of broker views. The consensus target is $2.55, which signals 17.9% upside to the last share price. Targets range from $2.30 (Credit Suisse) to $2.80 (Citi).

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Wages Growth: Australia's Dilemma

2016 saw the lowest Australian wages growth in the history of recorded data. Commonwealth Bank modelling suggests a return to normal is still some way off.

- Record low wage growth - Record underemployment - No sign of interest rate relief

By Greg Peel

Australia's unemployment rate has remained fixed in a tight band of 5.6-5.9% for the past twelve months. Australia's economy has enjoyed uninterrupted growth for a quarter of a century since the Keating recession of the early nineties. Yet in 2016, Australia recorded its lowest annual wage growth since records began.

That was 1969. This means wage growth was lower in 2016 than it was in the GFC and Keating recession, and even the long Oil Shock recession of the seventies.

Yet not so long ago, 5% unemployment was considered "full employment". Zero unemployment is an unattainable panacea but implicitly a hindrance to the economy anyway, because there'd be no one left to hire and inflation would run amok, so a 5% buffer is considered the ideal mix.

A year ago many an economist was forecasting Australia's unemployment rate to have reached 6.5% by now, largely as a result of the downturn in mining investment. This would force the RBA into cutting its cash rate to as low as 1%, it was predicted. But that hasn't happened. The unemployment rate has remained stubbornly under 6%.

The official unemployment rate is, however, misleading. The ABS splits the "employed" into two groups, being full time and part-time. The former works a standard 35 hours a week or more, and the latter works less than 35 hours a week. Among the part-timers are those who chose to work fewer hours and are happy with that arrangement, and those who would like to work full-time or at least more hours than they currently are. The latter group is known as the "underemployed".

Underemployment

Australia's underemployment rate is currently at a record high 8.7%. Given the official unemployment rate is a measure of anyone with "a job" it provides no comparison in terms of hours worked. The underemployment rate is where we find the black hole, or what economists call "labour market slack".

This record "slack" is leading to an historically low rate of wages growth. Employers are under no pressure to increase wages in order to attract/retain the right staff. Employees are not game to ask for a wage rise when they know someone else would be quite happy to take their job.

Wages growth is a fundamental driver of inflation, the other being consumer price growth. But all is intertwined. As the economists at Commonwealth Bank point out, we think of wages growth as driving inflation but the reverse is also true. Again, if inflation is low then employers see no need to increase wages and employees cannot justify asking for a raise.

The relationship is particularly evident in award wage settings. As the CPI is an important consideration in legislated wage levels, a low CPI leads to low wage increases.

It's all a bit of a roundabout. So how does Australia get off?

As one might expect in an economy so dominated by commodities export, commodity prices are a significant indirect driver of wages growth, CBA notes. Australia's underemployment rate has been rising since 2011, which is when commodity prices began to decline. A price nadir was reached in August last year, and commodity prices have rebounded strongly ever since. Thus we should, by rights, expect a commensurate rebound in wages.

But there are two issues. One is that the rebound has still left prices well below their 2011 peaks. The other is that the rebound has not brought about a renewed surge in mining investment. It is investment in new projects and expansions that requires labour. The labour requirement of today's largely automated mining operations is limited. Indeed despite the rebound in commodity prices, investment and investment intentions are still on the decline.

Rocks and Hard Places

CBA uses a complex econometric model to forecast future wage growth. While the model “captures the trend in wages growth well”, according to the economists, the past few years have seen lower growth than the level of spare capacity in the economy (slack) than one would expect. Presently the model suggests wages should be growing at an annual rate of 2%. But 2016 brought only 1.8% growth. The ten year average is 3%.

Based on March quarter data to date, the model forecasts 0.5% wage growth for the quarter, implying a tick up to a 1.9% annual rate in 2017. CBA is forecasting a gradual fall in both the unemployment and underemployment rates from here. Such a fall would take the underemployment rate down from 8.7% to 7% by 2019, lifting wages growth to the average 3%. A return to 3% wage growth in 2017 would require a fall to 5%.

Which is not about to happen. CBA’s forecasts are consistent with those of the RBA, which suggest only a slow return to target inflation. Currently the RBA believes inflation will remain below the target 2-3% comfort zone until 2019, and wage growth will not begin to recover until at least the end of 2017.

The RBA could, of course, hurry things along by again cutting interest rates. But the counterbalance to high underemployment is the historically high level of household debt. And ever-rising house prices. Cutting rates would only serve to further fuel those two bubbles and risk disaster down the track.

CBA does not, therefore, expect further rate cuts, and the economists are not alone in that view. The minutes of the last RBA meeting made it abundantly clear the board is concerned over housing market risks and high levels of debt.

A return to “normal” wages growth is thus some way off, if there is such a thing as “normal” anymore. One is reminded of Donald Trump’s pledge, pre-inauguration, to provide government subsidy to a US air conditioning factory that was otherwise set to move to Mexico, in order to save American jobs. Interviewed after the pledge was made, the CEO declared that the funds provided by the government would be used to automate the factory.

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Will Telstra Need To Cut Its Dividend?

Will Telstra need to cut its dividend? Brokers have asked this question for some time now and several revisit the prospect.

-Pressure on investment capital in the industry as a whole -Organic growth needs to offset the impact of Telstra's earnings loss from the NBN -Dividend expected to hold steady in the near term but under increasing pressure

By Eva Brocklehurst

Will Telstra ((TLS)) need to cut its dividend in the near future? The question has been forming in broker views for some time, given the earnings gap from the rolling out of the National Broadband Network that the company needs to fill. The Australian telecommunications market has experienced challenging conditions of late, with mobile industry earnings declining by around -8% in the first half reporting season and fixed data industry earnings declining around -9%.

Meanwhile, the sector is entering a period of elevated capital expenditure, as companies invest in their core or expand networks, lay submarine cables and build, in the case of TPG Telecom ((TPM)), a mobile network in Singapore.

To Cut Or Not

Deutsche Bank, as a result, forecasts returns on investment capital in the industry declining in FY17-18 before recovering in FY19. In the case of Telstra's fixed data margins, these declined 6% in the first half because of the costs associated with the NBN.

Deutsche Bank expects Telstra's operating earnings (EBITDA) will decline to $10.2bn in FY22 and the main driver of this will be the impact of the NBN, offset by organic growth in core segments, productivity and benefits from the company's capital expenditure plan. Based on the broker's calculations, Telstra should be able to maintain a 31c dividend in FY17-25.

UBS believes the company should cut the dividend as a matter of prudence. There is the issue of the $2-3bn gap in earnings from the NBN and the company's desire to maintain an A credit rating band ahead of a sizeable upcoming refinancing obligation. There is also capital requirements to take into consideration, such as a $3bn strategic expenditure plan, spectrum and 5G. A fourth mobile entrant is a potential threat.

UBS concedes that whether Telstra will actually cut the dividend, given its high retail and income fund shareholder base, is another matter. Hence, with a capital allocation review still under way, the broker believes Telstra is likely to hold its dividend steady at 31c in the near term, i.e. in FY17 and potentially FY18.

UBS, however, aligns its FY19 dividend with a long-term forecast for earnings per share (EPS) of 29c. The broker considers this forecast already generous, as it assumes around $2bn of the earnings gap is filled by $1bn of net productivity gains, $600m of network application services (NAS) growth and a $400m swing in new business contributions.

This is predicated on the status quo in core businesses being maintained, such as flat mobile earnings. There are risks to all these factors, even without the potential entry of TPG Telecom as the fourth mobile operator.

In simple terms, the broker notes the NBN agreement is an asset sale and after the roll-out Telstra should bear less debt relative to the $16bn it holds today. Debt considerations could, therefore, constrain capital allocation outcomes. Even if recurring NBN payments are securitised, UBS suggests Telstra should earmark a portion of excess free cash flow - around $1.5-2bn - for debt repayment versus equity returns, contingent on how much of the earnings gap is filled.

Credit Suisse believes the sustainability of the dividend is at risk. Core recurring EPS is expected to fall significantly over the next 2-3 years, although reported EPS will remain high because of one-off NBN payments, which will support cash flow and probably prevent an immediate cut to the dividend.

The broker forecasts core recurring earnings to fall as low as 23.2c per share in FY19, before picking up as growth in mobile, NAS and fixed line cost savings start to fill the earnings gap.

Nevertheless, Credit Suisse expects it will take some time for core recurring EPS to rise above the 31c that is required to support the current dividend. This presents a problem for Telstra. If it sticks with the current policy, the broker expects the dividend to be cut in the outer years, as it will not be supported by sustainable earnings.

Yet, Telstra could change its policy and pay a dividend above EPS for a period, to give earnings from areas such as mobile and NAS time to grow and catch up with the pay-out. Regardless, even if the dividend is not reduced, the broker expects investors will start to worry about its sustainability.

Credit Suisse envisages dividend risk as the medium-term issue, with history revealing that the company's yield tends to rise, i.e. the share price declines, when there is concern about long term dividend sustainability. The latest corporate plan for the NBN shows completion by 2020.

FNArena's database shows five Hold ratings and three Sell. The consensus target is $4.79, suggesting 3.8% upside to the last share price. Targets range from $4.40 (Citi) to $5.35 (Ord Minnett). The dividend yield on FY17 and FY18 forecasts is 6.7%.

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Challenges Continue For Bank Of Queensland

Bank of Queensland has flagged a more positive outlook for the second half but brokers believe this will not be without challenges.

-Net interest margins expected to improve but seen offset by lower fee income and expenses -Share price is envisaged to be building upside from expectations for mortgage re-pricing -Capital is strong but the bank may need a buffer to protect dividends

By Eva Brocklehurst

Bank of Queensland ((BOQ)) has promised net interest margins should expand in the second half but caution prevails among brokers. The expansion is expected to stem from abating competition in term deposits and this outlook was the main driver of an ultimately positive reaction in the share price after the first half results.

Ord Minnett upgrades to Hold from Lighten, now envisaging the risk/reward balance is more appropriate. The result marks the low point in the regional bank's earnings trajectory, in the broker's opinion, given the prospects for better margins, volumes and cost performance.

While the mortgage book again contracted in the first half, the broker cites recent evidence of reductions in front-book discounting by peers, as well as growth in the specialist book and a new Virgin Money-branded product, which suggests the bank will be better positioned to return to growth.

The main problem for brokers is the bank's vulnerability on non-interest income. Fee income remains under pressure and trading income has also been re-based.

Improving Margins

Deutsche Bank expects an improvement in margins in the second half should drive earnings growth, but remains concerned that the bank continues to lead on price in most of its markets, including retail deposits and Bank of Queensland branded mortgages. Moreover, the efforts to size the branch network appropriately are expected to drag on volumes.

Deutsche Bank considers the stock fairly valued. In the medium term, the broker is unsure whether the bank can successfully grow its lending book close to system levels, while maintaining margin control, for any length of time.

The key to success in this matter is better harvesting of deposits. Although management has pointed to better data analytics as a support, Deutsche Bank believes this will not be enough.

Morgan Stanley acknowledges the delicate balance of delivering on margin and mortgage volume but remains positive about the potential from repricing, a strong capital position and attractive dividend yield.

Mortgage application volumes are up around 30% over the past six weeks and, if sustained, the broker estimates around 4% annualised growth in home loans in the second half could materialise. The broker forecasts housing growth of around 3.5% annualised half on half and then a recovery, although that remains below system at around 5% in FY18 estimates.

Mortgage Re-pricing

The current share price appears to be building in upside from the repricing of mortgages, which Morgans asserts may not eventuate. Many of the bank's peers have repriced home loan books over recent weeks but the broker believes it unlikely that Bank of Queensland will reprice to the same extent, if it reprices at all.

The reason is that the bank's home loan price points appear to be sitting 20-30 basis points higher than its main competitors prior to the recent repricing. The gap has narrowed, allowing Bank of Queensland to be more competitive. Hence, the broker calculates, if the bank reprices to the same extent as peers, it will again risk its home loan book contracting in the second half.

The results were not unexpected, as Citi notes investors had braced for a poor result. The broker observes the BOQ share price had missed out on the recent optimism, brought about by current and expected mortgage repricing.

The broker believes the environment is rapidly changing for the bank, as other bank stocks have strengthened and, accordingly, left the broking community less bullish on their recommendations. In contrast, Bank of Queensland appears to have improved its fortunes and the benefit is yet to be recognised in the share price.

All major banks have repriced investor mortgages by an average of 25 basis points and Bank of Queensland is yet to move, although Citi believes it should eventually reprice higher, as new macro prudential measures for investor mortgages are implemented. This should disproportionately benefit the regional bank, as it has a highest portion of investor mortgages in the sector.

The mortgage book faces material headwinds, UBS believes. Owner-managed branches have fallen to 115 from 198 in FY12. As these branches are closed the loan and deposit books should begin to amortise at an accelerated rate, while many other loans are often refinanced around 3-5 years after origination.

To UBS, this is effectively the reverse of a "store roll out". While a pick up in front book applications should help alleviate the pressure, the broker believes it will be challenging for the bank to stabilise the declining proprietary mortgage book.

As a result, UBS believes Bank of Queensland will become increasingly reliant on brokers and the rolling out of Virgin Money Australia to prevent its mortgage book from continuing to shrink. An easing of competition and a tightening of underwriting standards by peers should help, but the broker believes any growth at all in the mortgage book will be a good outcome.

Macquarie agrees the uncertainty lies with the ability to grow volumes without sacrificing margins. The broker expects the front versus back book pricing gap will be a drag on profitability in the medium term. Macquarie expects regaining of confidence in the broker channel and running off of the portfolio from branch closures are likely to take time and, therefore, lending growth trends are likely to underperform in the near term.

Ultimately, the broker believes the bank should be able to grow ahead of system, if the flow from the broker channel increases towards the level of peers. Nevertheless, Macquarie believes the bank will need to address problems with its systems and offer more competitive and consistent pricing for this to improve.

While Bank of Queensland is yet to reprice variable investor mortgages, and this presents upside risks to earnings. Macquarie concurs with Morgans that regionals have less scope to continue to reprice because of their current elevated pricing.

The broker incorporates 10 basis points of investor repricing in May and an additional 15 basis points of interest-only investor repricing at the end of June.

Dividend Sustainability

Capital is strong at around 9.3% but Morgan Stanley expects Bank of Queensland to remain conservative until APRA clarifies “unquestionably strong” and may need a buffer to protect the dividend. Macquarie also expects no dividend growth until 2020, believing the pay-out ratio is unsustainably high at present.

UBS also suspects the bank will be unable to sustain its dividend over the next two years. The dividend pay-out ratio appears to the broker to be extremely elevated at 84%. The broker agrees the capital position is strong but highlights future rules around capital are still unclear.

With a falling profile of earnings per share UBS believes it will be challenging to maintain the dividend, especially if the bank is targeting growth in its loan book. UBS expects the dividend to be trimmed to $0.35 per share in the first half of FY18, from $0.38 previously.

Shaw and Partners believes the outlook is improving. While the bank is doing well on costs, capital and bad debts, the broker acknowledges the first half results were affected by softer top-line growth.

As the bank is guiding to a more favourable top-line outcome in the second half the broker calculates revenue growth rebounds to 4%. Shaw and Partners, not one of the eight monitored daily on the database, maintains a Buy rating and $12.10 target.

There is one Buy recommendation (Citi) on the FNArena database. There are six Hold and one Sell rating (UBS). The consensus target is $11.71, signalling -4.8% downside to the last share price. Targets range from $10.00 (UBS) to $13.25 (Citi). The dividend yield on FY17 and FY18 forecasts is 6.2%.

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Material Matters: Coal, Steel, Oil And Platinum

A glance through the latest expert views and predictions about commodities. Cyclone Debbie looms; Chinese coal policy; steel strength; iron ore outlook; oil's impact on commodities; platinum issues.

-Abbot Point and major miner Glencore the most at risk with Cyclone Debbie -Iron and steel output surges as Chinese steel demand stays healthy -Ord Minnett upgrades outlook for iron ore miners -Diminished oil prices impact bulks and metals prices, despite intact fundamentals -Deutsche Bank finds platinum starting to look cheap and a relative value proposition

Cyclone Debbie

As Tropical Cyclone Debbie hits the Queensland coast, Macquarie assesses the increased production risk for Queensland coal miners. The cyclone was a category four and, therefore. there is a risk of damage to port infrastructure as its trajectory is very close to the Abbot Point Coal Terminal.

Abbot Point terminal is owned by Adani and boasts capacity of 50mtpa, although the port is currently shipping 26-27mtpa. Macquarie estimates that thermal coal accounts for 87% of total coal exported through Abbot Point. Limited impact on global prices is expected, unless rainfall severely affects mine production in the Bowen Basin, immediately inland of Abbot Point.

Glencore is the major miner most at risk of production losses from the cyclone. South 32 ((S32)) may be a beneficiary, as it has NSW operations which will be unaffected. If there are material effects on the mine production in the northern Bowen Basin Macquarie expects to see near-term strength in spot coking coal prices.

A 10% move higher in coking coal prices translates to 6-9% upgrades to the broker's forward estimates for South 32 and 9-10% for BHP Billiton ((BHP)). There remains some risk to New Hope Corp's (NHC)) New Acland operation should rainfall head further south in Queensland.

Thermal Coal

Deutsche Bank suspects the Chinese government agency, National Development and Reform Commission (NDRC), may be reluctant to intervene further in the thermal coal market. Either that or there is a lack of viable policy options, or both. The government has stated that no measures will be taken to reduce production quantities as long as prices remain in, or above, a reasonable range.

Nevertheless, the broker notes there was also no suggestion that a further loosening of supply would be undertaken to bring prices back towards the RMB535/t mid point of the range. The reason perceived for this is that the NDRC expects coal prices to fall after the end of the heating requirements of the winter. Near-term momentum may still push prices higher, the broker believes.

Steel

Credit Suisse observes the NDRC scored early success in its attempt to talk down the steel price, as steel futures led the ferrous complex down with a 13% fall. The broker suspects it would probably be unwise to take an opposing view to a powerful agency so speculators probably cleared out.

Falling futures caused uncertainty for the steel mills and they stopped buying iron ore. Iron ore, as the result of the buyers strike, fell -8%. However, physical steel has declined only -3% because the construction season is under way and demand is still real. Therefore, Credit Suisse doubts the NDRC can hold the steel price down through the construction period.

The broker expects iron ore prices will recover while physical steel prices are firm and steel margins remain wide. Relatively, Chinese steel inventory is depleted as traders wind down inventories after the winter months.

Macquarie notes iron and steel output is booming. World steel data revealed that steel output growth slowed to 7.8% in February from 8.1% in January. If nothing else, from this base the broker expects to witness a sharper slowdown in the growth rate over the second quarter. The main question is whether this reverts to a year-on-year decline in the second half.

The key is Chinese construction activity, where Macquarie expects some signs of weakening to emerge during the next few months, but not a collapse. The broker considers the Chinese steel industry is in a healthy state at the moment and will continue that way for as long as demand holds up.

Iron Ore

Ord Minnett upgrades 2017 and 2018 forecasts for iron ore prices to US$82 and US$65 a tonne respectively, because of more constructive estimates of Chinese steel demand. These latest changes to steel demand estimates have driven earnings upgrades of 13-17%, along with significant improvements expected in the balance sheets, for major producers.

The broker notes the large iron ore miners are in the best financial shape in years. Ord Minnett retains a preference for Rio Tinto ((RIO)) over BHP Billiton, while reiterating an Accumulate recommendation for Fortescue Metals ((FMG)). The broker notes the latter's balance sheet is strong and a material uplift in dividends is expected in the near term.

Ord Minnett does not expect Fortescue to waste capital on large-scale mergers & acquisitions. The broker suggests, as the stock is not well held across large institutions, there is room for marginal buying as fund manager confidence improves.

For the two big players the broker expects Rio Tinto (Accumulate) will generate excess cash and continues to expect its US$500m buyback will be topped up progressively over the medium term, along with higher dividends. BHP (Hold) is slightly less compelling, although the metrics are considered still reasonable in isolation.

Oil Impact

Morgan Stanley suspects the re-start of US shale oil capability is a bearish inflection point for oil, following the lift to prices in January from the OPEC agreement. The shift to a US shale focus appears sufficient to limit prices for now, the broker believes. Meanwhile, the drag from weak oil prices on other commodities is by way of a general decline in the cost of production/delivery of metal and bulks.

This, in turn, undermines equilibrium prices in these commodities via a competitive supply-side response. Morgan Stanley contends that bulks are probably more exposed to changes in energy prices than the metals.

Beyond fundamentals, there is another bearish impact of a capped/weak oil price. Even though recent price performance in oil largely reflects a step-change in US supply, any price slide will likely deter investors. The broker cites an example where, in the fourth quarter of 2014, an investor exodus halved crude oil prices, which prompted a collapse in excess of 20% in metal/bulk prices despite the trade flows across all markets being intact.

Deutsche Bank observes the market share of OPEC remains well above the 2014 level, even after the production cuts. Today OPEC produces 40.2% of the world's crude oil, down from its recent peak of 41.3% in August 2016, but still considerably higher than the November 2014 level of 38.8%.

Projecting current levels of production into the next two years, the broker believes a continuation of supply discipline implies the OPEC share falling to 39% by 2019. While the broker believes market share may re-emerge as a concern, levels are not currently at a critical point for this to occur.

Platinum

Deutsche Bank continues to believe the platinum in market will be in modest industrial surplus at around 200,000 ounces in 2017. Labour relations issues in South Africa may mean that mine supply could disappoint on the downside but the broker already builds in a disruption allowance into estimates.

Also, the high grading of spent automobile catalyst substrate during 2015, when scrap steel prices were low, has meant that the current batch being recycled now has lower grades. This is reducing the amount of platinum being recycled, despite an increase in the volume is being processed.

The broker concedes that investment demand may change the supply/demand balance tilt but continues to believe that, with the exception of Japan, investment demand is very much linked to underlying fundamentals.

In this instance, the broker believes the underlying fundamentals for platinum are not strong enough to break away from the influence of gold. While the fundamentals are uninspiring, Deutsche Bank considers platinum is starting to look cheap on several metrics and makes a tempting relative value proposition.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday March 20 to Friday March 24, 2017 Total Upgrades: 7 Total Downgrades: 8 Net Ratings Breakdown: Buy 43.85%; Hold 42.11%; Sell 14.04%

Overall activity among stockbroking analysts has gone quiet while downgrades and upgrades for individual stock ratings remained pretty much in balance for the week ending Friday, 24th March. FNArena registered seven up and eight downgrades for the week.

As Morgan Stanley has been scaling back buy ratings in favour of more neutral views, only Macquarie, Morgans and now also Ord Minnett carry more Buy than Neutral ratings. Three out of eight.

Resources stocks feature through their absence from any changes in ratings/recommendations, unless we still count Downer EDI as part of the pack. Downer received one downgrade during the week following a corporate play that has many scratching their head. TPG Telecom's financial report attracted two downgrades. On the positive side of the ledger, Premier Investments' market update was good for two upgrades.

a2 Milk commanded pole position for positive changes to price targets. Changes in the regulatory regime in China triggered a boost of no less than +26.8%. Next up is Spotless, whose boost is acquisition related (the reason why Downer was downgraded). Nufarm, post result, enjoyed a boost of +6%.

A lot less fortunate were Fletcher Building (-15.8%), TPG Telecom (-8.2%) and Myer (-3%) whose market updates proved not as well received, at least among stockbroking analysts.

The table for positive amendments to earnings estimates is led by Brickworks (+18.5%) and Sigma Pharmaceuticals (+14.15%), both post financial results, followed by TPG telecom (+5.9%). On the flipside, we find Spotless Group (-76.25%) at the bottom, followed by profit warner Fletcher Building (-15.64%) and Premier Investments (-3.33%).

Upgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/2/0

Policy changes in China have caused Citi to upgrade its recommendation to Neutral from Sell. The new policy reduces the risk that the company will be exposed to a risky transition period.

Cross-border e-commerce B2C imports can now be treated as personal goods instead of merchandise from January 1, 2018. As a result, infant formula will no longer require the CFDA registration that was previously the case.

In order for Citi to turn more positive, confidence is required in the margin outlook as the company moves to a direct and sustainable model. Target is raised to $2.60 from $2.05.

FLETCHER BUILDING LIMITED ((FBU)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/0/1

The company has lowered FY17 EBIT guidance to NZ$610-650m from NZ$720-760m following a detailed review of its uncompleted contracts in construction.

Credit Suisse, while finding the downgrade unwelcome, is sufficiently comforted by the detail shared during the conference call that corrective actions are in place to ensure that losses of this magnitude are not repeated.

The broker upgrades to Outperform from Neutral and reduces the target to NZ$9.80 from NZ$10.10.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Buy from Hold by Deutsche Bank and Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/2/0

Premier's earnings result was in line with Deutsche Bank and guidance. The highlight of the result is Smiggle's emergence as now Premier's largest brand, overtaking Just Jeans. Throw in Peter Alexander and these two high margin brands account for some 40% of sales.

Smiggle's store rollout in the UK has now progressed to a point of scale and firmly establishes the brand's global credentials, Deutsche suggests. A later Easter and school holiday period locally suggests an even better second half.

Upgrade to Buy. Target rises to $15.00 from $14.25.

First-half results continue to support the expansion of Smiggle, Credit Suisse observes. Smiggle and Peter Alexander account for 55% of forecast retail EBIT in FY17.

The poor performance of the mature clothing brands did not come as a surprise to the broker. Target is upgraded to $15.38 from $14.50 largely because of the Smiggle expansion.

The recent share price weakness means the broker upgrades to Outperform from Neutral.

PRAEMIUM LIMITED ((PPS)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Morgans upgrades forecasts and valuation after reviewing assumptions about the potential growth rate for the UK business.

The recent GBP11bn takeover of Aberdeen Asset Management by Standard Life has highlighted the potential strategic value of modern UK platform operators such as Praemium.

The broker has stepped up growth rate assumptions for funds on platforms on the number of self-invested personal pensions that can be added over the next five years. The company is seen offering exposure to the growth in retirement savings accounts in both Australia and the UK.

Target rises to $0.52 from $0.43. Rating is upgraded to Add from Hold.

RAMSAY HEALTH CARE LIMITED ((RHC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/4/0

The analysts have taken another detailed look into what makes the inner-growth engine tick at Ramsay Health Care, as well as what goes on under the bonnet at peer Healthscope.

The end result is another confirmation that Ramsay, simply put, is the better performer, and is likely to continue doing exactly that. Ramsay's group estimates have received a minor cut due to international headwinds.

Tariff reductions in the UK and France as well as a stronger AUD/GBP present headwinds for FY18 earnings growth, acknowledge the analysts, but underneath it all is above industry growth in Australia. Upgrade to Outperform from Neutral. Target falls to $74.50 from $75.

SPOTLESS GROUP HOLDINGS LIMITED ((SPO)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/2/2

Following the launch of a takeover offer from Downer EDI ((DOW)), the stock price closed 6% short of the $1.15 offer price. Although Ord Minnett accepts there is potential for higher bids, the current transaction is expected to have a good chance of proceeding.

Downer shareholders do not have the ability to block the deal and financing appears secure. The main threat is Spotless downgrading its $80-90m net profit guidance, the preservation of this being a condition of the deal.

Ord Minnett upgrades to Hold from Lighten and raises the target to $1.05 from $0.71.

See also SPO downgrade.

Downgrade

AUSNET SERVICES ((AST)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/4/1

Citi believes the stock is expensive relative to its peer Spark Infrastructure ((SKI)). The dividend yield is 5.2% versus 6.5% and dividend growth is limited.

The broker downgrades to Sell from Neutral given the recent share price performance. Target is $1.44.

COLLINS FOODS LIMITED ((CKF)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 0/2/0

The company has provided second half guidance which is around -9% below Deutsche Bank estimates, driven by increased corporate cost investment, KFC Australia margin compression and weakness in WA operations.

The broker has mixed sentiment on the acquisition of 16 KFC stores in the Netherlands, as the high EBIT multiple paid is offset by the company's increased European scale, portfolio quality and the options on roll-out.

Deutsche Bank downgrades to Hold from Buy on valuation grounds.Target is reduced to $5.40 from $6.35.

DOWNER EDI LIMITED ((DOW)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/4/1

The company has made an opportunistic bid for Spotless ((SPO)) and now owns 19.99%. The all-cash offer is for 100% at $1.15 a share. This is conditional on a 90% minimum acceptance and no reduction to FY17 earnings guidance.

Macquarie believes the play is an opportunity to diversify, as the company has previously signalled, but the deal size is larger than expected.

The acquisition is consistent with a services strategy but the broker believes this needs to be balanced against the company's higher post-deal gearing and execution risk regarding turning Spotless around.

Macquarie downgrades to Neutral from Outperform and reduces the target to $7.10 from $7.60.

NUFARM LIMITED ((NUF)) Downgrade to Hold from Add by Morgans .B/H/S: 3/3/1

The first half result was materially stronger than Morgans expected. This reflected strong results in North America, Europe and Asia. Seed technologies also witnessed a material improvement.

The broker was pleased that, for the first time in a while, the company reported no material one-off items and believes the company is on track to deliver solid earnings growth in FY17.

After strong share price appreciation, Morgans downgrades to Hold from Add. The broker will revisit its view on any material weakness in the stock, believing that accretive M&A is the next catalyst. Target is raised to $10.15 from $9.65.

REA GROUP LIMITED ((REA)) Downgrade to Neutral from Buy by UBS .B/H/S: 5/2/0

The company has launched a new product, "Front Page". Financial analysis of the new product is difficult, UBS asserts, given limited disclosures. Nevertheless, pending future disclosures, the broker suspects actual upside could be much larger.

New product upside, headline price increases and continued depth penetration provide the broker with confidence that the company should at least meet FY18 consensus forecasts, which is for EBITDA growth of around 18%.

UBS downgrades to Neutral from Buy as the stock is trading in line with its revised target. Target rises to $58 from $56.

SPOTLESS GROUP HOLDINGS LIMITED ((SPO)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/2

Downer EDI ((DOW)) now owns 19.99% of the company, acquiring the latest shares at $1.15 each. An all-cash offer is made to acquire the rest of the company at $1.15 per share. This is conditional on a 90% minimum acceptance and no reduction in the company's $80-90m earnings guidance.

Macquarie envisages revenue remaining under pressure in the second half, with FY18 to experience the benefits of business development investment.

After the share price rally, the broker downgrades to Underperform from Neutral and recommends that investors sell into a bid that is subject to conditions and with relatively low risk of another bidder emerging. Target is raised to $1.10 from $0.84.

See also SPO upgrade.

TPG TELECOM LIMITED ((TPM)) Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/2/2

The first half result was ahead of forecasts. Credit Suisse retains estimates for FY17 EBITDA at the upper end of the reiterated $820-830m guidance range.

The broker does not believe the stock is expensive but the risk around its mobile ambitions is significant. Credit Suisse believes the cost of entering the mobile market will be extremely high and visibility on returns is limited.

Rating is downgraded to Underperform from Neutral. Target is reduced to $6.20 from $6.80.

Ord Minnett found the first half results mixed and believes the FTTB opportunity is now at risk, while broadband margin should begin a decline from this point onwards as the ii-Net-induced margin improvement has run its course.

The stock is envisaged trading at a significant premium to its peers on an enterprise value/EBITDA basis, as well as on a free cash flow multiple as the company embarks on its Singapore mobile venture.

While expecting the company will meet FY17 guidance the broker expects FY18-19 will be tough as the NBN migration accelerates. Rating is downgraded to Lighten from Hold. Target is reduced to $6.10 from $6.65.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 FLETCHER BUILDING LIMITED Buy Neutral Credit Suisse 2 PRAEMIUM LIMITED Buy Neutral Morgans 3 PREMIER INVESTMENTS LIMITED Buy Neutral Credit Suisse 4 PREMIER INVESTMENTS LIMITED Buy Neutral Deutsche Bank 5 RAMSAY HEALTH CARE LIMITED Buy Neutral Credit Suisse 6 SPOTLESS GROUP HOLDINGS LIMITED Neutral Sell Ord Minnett 7 THE A2 MILK COMPANY LIMITED Neutral Sell Citi Downgrade 8 AUSNET SERVICES Sell Neutral Citi 9 COLLINS FOODS LIMITED Neutral Buy Deutsche Bank 10 DOWNER EDI LIMITED Neutral Buy Macquarie 11 NUFARM LIMITED Neutral Buy Morgans 12 REA GROUP LIMITED Neutral Buy UBS 13 SPOTLESS GROUP HOLDINGS LIMITED Sell Neutral Macquarie 14 TPG TELECOM LIMITED Sell Sell Credit Suisse 15 TPG TELECOM LIMITED Sell Neutral Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 FBU FLETCHER BUILDING LIMITED 67.0% 33.0% 34.0% 6 2 PMV PREMIER INVESTMENTS LIMITED 67.0% 33.0% 34.0% 6 3 A2M THE A2 MILK COMPANY LIMITED 50.0% 25.0% 25.0% 4 4 RHC RAMSAY HEALTH CARE LIMITED 36.0% 21.0% 15.0% 7 5 MYR MYER HOLDINGS LIMITED 43.0% 29.0% 14.0% 7 6 BHP BHP BILLITON LIMITED 38.0% 25.0% 13.0% 8 7 RIO RIO TINTO LIMITED 81.0% 69.0% 12.0% 8 8 MQA MACQUARIE ATLAS ROADS GROUP 67.0% 60.0% 7.0% 6 9 APO APN OUTDOOR GROUP LIMITED 75.0% 70.0% 5.0% 4 10 CGF CHALLENGER LIMITED 21.0% 19.0% 2.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MIN MINERAL RESOURCES LIMITED 33.0% 50.0% -17.0% 3 2 SPK SPARK NEW ZEALAND LIMITED -67.0% -50.0% -17.0% 3 3 REA REA GROUP LIMITED 71.0% 86.0% -15.0% 7 4 NUF NUFARM LIMITED 29.0% 43.0% -14.0% 7 5 AST AUSNET SERVICES 7.0% 21.0% -14.0% 7 6 SPO SPOTLESS GROUP HOLDINGS LIMITED -50.0% -38.0% -12.0% 4 7 GWA GWA GROUP LIMITED -60.0% -50.0% -10.0% 5 8 AMP AMP LIMITED 36.0% 44.0% -8.0% 7 9 TPM TPG TELECOM LIMITED 6.0% 13.0% -7.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 A2M THE A2 MILK COMPANY LIMITED 2.600 2.050 26.83% 4 2 SPO SPOTLESS GROUP HOLDINGS LIMITED 0.893 0.743 20.19% 4 3 NUF NUFARM LIMITED 9.636 9.071 6.23% 7 4 PMV PREMIER INVESTMENTS LIMITED 15.612 15.165 2.95% 6 5 APO APN OUTDOOR GROUP LIMITED 6.418 6.364 0.85% 4 6 MQA MACQUARIE ATLAS ROADS GROUP 5.508 5.480 0.51% 6 7 REA REA GROUP LIMITED 59.747 59.461 0.48% 7 8 RIO RIO TINTO LIMITED 71.884 71.544 0.48% 8 9 BHP BHP BILLITON LIMITED 27.836 27.790 0.17% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 FBU FLETCHER BUILDING LIMITED 9.000 10.700 -15.89% 6 2 TPM TPG TELECOM LIMITED 7.793 8.490 -8.21% 8 3 MYR MYER HOLDINGS LIMITED 1.250 1.291 -3.18% 7 4 GWA GWA GROUP LIMITED 2.528 2.590 -2.39% 5 5 MIN MINERAL RESOURCES LIMITED 12.637 12.853 -1.68% 3 6 AMP AMP LIMITED 5.544 5.626 -1.46% 7 7 RHC RAMSAY HEALTH CARE LIMITED 76.100 76.171 -0.09% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 BKW BRICKWORKS LIMITED 123.750 104.400 18.53% 4 2 SIP SIGMA PHARMACEUTICALS LIMITED 6.730 5.896 14.15% 4 3 TPM TPG TELECOM LIMITED 48.014 45.315 5.96% 8 4 RIO RIO TINTO LIMITED 681.622 653.488 4.31% 8 5 IPL INCITEC PIVOT LIMITED 18.213 17.713 2.82% 8 6 BHP BHP BILLITON LIMITED 204.072 201.993 1.03% 8 7 NHC NEW HOPE CORPORATION LIMITED 16.500 16.367 0.81% 3 8 MTS METCASH LIMITED 19.354 19.269 0.44% 7 9 SGM SIMS METAL MANAGEMENT LIMITED 67.209 66.923 0.43% 7 10 CTX CALTEX AUSTRALIA LIMITED 221.100 220.243 0.39% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SPO SPOTLESS GROUP HOLDINGS LIMITED 2.280 9.600 -76.25% 4 2 FBU FLETCHER BUILDING LIMITED 52.442 62.164 -15.64% 6 3 PMV PREMIER INVESTMENTS LIMITED 70.778 73.218 -3.33% 6 4 NUF NUFARM LIMITED 48.386 49.643 -2.53% 7 5 KAR KAROON GAS AUSTRALIA LIMITED -13.220 -12.980 -1.85% 4 6 MQA MACQUARIE ATLAS ROADS GROUP 31.282 31.842 -1.76% 6 7 MYR MYER

HOLDINGS LIMITED 8.797 8.867 -0.79% 7 8 BSL BLUESCOPE STEEL LIMITED 121.871 122.586 -0.58% 7 9 SYD SYDNEY AIRPORT HOLDINGS LIMITED 15.492 15.575 -0.53% 7 10 BOQ BANK OF QUEENSLAND LIMITED 91.900 92.025 -0.14% 8 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.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

Uranium Week: Credit Risk

An interesting new consideration has crept into spot uranium pricing, in a week which saw prices fall back once more.

By Greg Peel

Having risen by US$1.75 to US$25.75/lb the week before, last week saw industry consultant TradeTech's weekly uranium spot price indicator fall back by the same amount to return to US$24.00/lb. Five transactions were reported totalling 700,000lbs U3O8 equivalent.

The spot price is currently experiencing a bout of volatility that is moving prices each week with the ultimate result of little progress. This likely reflects the fact utility buying interest has backed off somewhat since the price rebounded significantly from its December low, leaving the bulk of buying and selling to be conducted by intermediaries and speculators. Utilities are well stocked with material and were likely only buying opportunistically when prices were at their nadir.

But there are currently other elements at play, rendering the spot market not only volatile, but disparate. On the last day trade last week, reports TradeTech, transactions occurred at both US$24.25 and US$24.75 simultaneously.

Disparate simultaneous pricing is not unheard of, and typically relates to point of delivery. In years past it has not been uncommon for two different prices to be trading in the US and Europe for example, but even in the same market if a buyer requests a delivery point that differs from the seller's preferred delivery point then the seller will charge a premium commensurate with the additional cost required.

However last week saw another element at play. Delivery points aside, sellers were also adjusting prices on the basis of a buyer's perceived credit risk. The greater the risk, the greater a price premium required.

Sign of the times, in what is still a historically low uranium price environment?

China's Carbon Emission Reduction

In other news last week, the International Energy Agency reported global carbon emissions totalled 32.1bn tonnes in 2016 – the same level as 2015 and of 2014, despite global economic growth. China, for one, managed to reduce emissions by -1% last year as its economy grew 6.7%.

China is leading the global push to reduce carbon emissions. It would be nice to think Beijing's motives were purely altruistic but the major driver of such a push is China's own, significant air pollution problem. Just recently, the last coal-fired electricity plant in Beijing shut down.

China is replacing coal-fired generation with a mix of renewable, nuclear and natural gas energy sources. China's industrial and building sectors are being forced to switch to gas from coal to satisfy new strict emission regulations.

The growth in global nuclear energy capacity in 2016 was the greatest it has been since 1993, the IEA reports. New reactors were brought into service in China, India, Pakistan, Russia, South Korea and the US.

There were no transactions reported in uranium term markets last week. TradeTech's term price indicators remain unchanged at US$28.25/lb (mid) and US$35.00/lb (long).

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The Short Report

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:

Week ending March 23, 2017

Last week saw the ASX200 suffer a bit of a Trump Dump in line with Wall Street, as the passage of the president's proposed healthcare bill seemed destined to failure. Despite ultimately failing, the local market had already begun recovering last week before this week racing to a new recent high.

With a lot going on in the local market at the micro level recently, there was quite a lot of significant movement in shorts last week.

Last week saw Downer EDI ((DOW)) launch its unpopular takeover of Spotless Group ((SPO)). Despite the subsequent surge in the Spotless share price, shorts in the stock rose to 6.5% from 5.0%. Shorts in Downer rose to 8.6% from 7.7%.

It has now been revealed Solomon Lew's Premier Investments ((PMV)) was indeed behind the purchase of a 10% stake in Myer ((MYR)) last week. Myer shorts have fallen to 14.7% from 15.7%.

Shareholders of Quintis ((QIN)), formerly TFS Corp (TFC), have suffered a rollercoaster ride lately, mostly downward. Quintis shorts fell to 12.1% from 14.3% last week.

Harvey Norman ((HVN)) shorts have jumped from under 5% to 7.4%.

Beadell Resources ((BDR)) shorts have jumped from under 5% to 6.6%.

Orocobre ((ORE)) shorts have jumped to 19.1% from 17.5%, taking the stock to number one most shorted at the sort of dizzy heights once reserved for the likes of Myer and Metcash. Western Areas ((WSA)) shorts have risen to 18.8% for second place, up from 16.8%. Independence Group ((IGO)) has also crept back into the 10% plus club.

By contrast, Monadelphous ((MND)) shorts have fallen to 7.1% from 9.6%.

Rio Tinto ((RIO)) shorts have fallen to 5.4% from 7.2%.

Weekly short positions as a percentage of market cap:

10%+

ORE 19.1 WSA 18.8 ACX 17.6 MYR 14.5 SYR 13.9 QIN 12.1 VOC 11.6 NEC 10.8 DMP 10.6 MTS 10.3 IGO 10.0

In: IGO Out: ISD

9.0-9.9%

ISD, MYX, OFX In: ISD, OFX Out: IGO, MND

8.0-8.9%

ILU, DOW, NWS, FLT, PRU

In: DOW, NWS Out: OFX, GTY, BAL, SRX

7.0-7.9%

GTY, BAL, RWC, HVN, NXT, MND, A2M

In: MND, GTY, BAL, HVN Out: DOW, NWS, AWC, AAD, RIO, MTR

6.0-6.9%

IPD, EHE, CSV, BDR, MTR, SPO, BGA, AAD, HSO, SGH, IFL, PDN, KAR, RFG, GXL, MYO, MSB, IVC, BEN

In: MTR, AAD, BDR, SPO, KAR, RFG, GXL, MYO, MSB

Out: WOR, SEK

5.0-5.9%

CTD, SEK, AAC, SRX, WOR, RIO, AWC, OSH, BKL, AWE, CSR, LNG, JHC, SUL

In: SRX, RIO, AWC, SEK, WOR, SUL

Out: MSB, MYO, GXL, KAR, RFG, SPO

Movers and Shakers

The back-stories of lithium miner Orocobre, nickel miners Western Areas and Independence Group and resource sector services provider Monadelphous have been well covered in recent editions of this Report, so I won't go over old ground today.

Spotless is an interesting one, as we would have expected short-covering rather than an increase following the Downer EDI takeover bid. It may just be a case of the timing of reporting positions to ASIC. We'll keep an eye out next week.

The Myer story is more straightforward. Having previously denied any interest in revisiting his old company, Solomon Lew continued to remain coy last week when it was suspected he was behind a 10% stake taken in the stock. Only this week has it been revealed that everyone was right in their assumption – Premier Investments was indeed the buyer. It is still unknown whether the stake is a precursor to a full bid, but that remains the market's assumption.

Short-covering in Myer is thus evident.

Sticking with retail, aside from a lot of talk about "parasite", to use Gerry Harvey's word, Amazon moving into Australia and signalling the death of incumbent retailers, Harvey Norman is also now under investigation from ASIC, which the company initially denied, supposedly regarding accounting practices, although the company has denied that too. Either way, Harvey Norman has suddenly leapt from oblivion into the 7% shorted bracket.

Rio Tinto has fallen from the 7% bracket into the 5% bracket. This may be a capitulation following recent iron ore price-related strong gains but it could also be a simple reversal of the often popular pairs trade with rival BHP Billiton ((BHP)).

Last month's earnings report from gold miner Beadell Resources was a poor one, featuring problems with the sulphide/oxide mix. Beadell's share price has nevertheless risen alongside peers in the latest gold price rally. Over the course of the month, two of the three FNArena database brokers covering Beadell have downgraded to Hold, with the other on Sell. It appears the shorters have also taken interest.

It can't be much fun being a Quintis shareholder at present. A plunge in share price last week and a bounce-back to some degree has followed accusations that the company is everything from a "Ponzi scheme" to a takeover target. Who to believe? Either way is appears some short profits were taken last week on the initial plunge.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Banks, Housing & Australian Dollar

Weekly Broker Wrap: Mortgage re-pricing; China and Australia's housing market; Australian dollar outlook; IVF data in February.

-Re-pricing of mortgages a short-term positive for the banking sector -Severity of housing downturn to be cushioned by Chinese demand -Australian dollar expected to head lower, affected by US rate hikes, tax cuts -RBA unlikely to be in a position to hike rates before the end of 2018

By Eva Brocklehurst

Australian Banks

Macquarie estimates the recent round of repricing initiatives by the major banks has boosted earnings by around 3%. In the short term, the broker believes the ongoing ability to reprice and maintain earnings growth is a positive for the sector.

Additional pressure on the household sector is expected to ultimately have adverse implications on credit quality and hence, Macquarie believes the ability to continue to reprice is diminishing. Coupled with the rising global rates outlook, this suggests to the broker risks around investor portfolios are increasing.

Based on forecasts, Macquarie estimates the flow from off-the-plan settlements alone will underpin 5-6% of investor lending volume growth until the middle of 2018. The broker's forecasts for investor growth, running at 7-9% over 2017 and 2018, are based on domestic investors representing around 35% of new purchases.

Should this figure increase towards 50% it could result in the system level of investor growth going above the regulator's 10%. Such a scenario is expected to have an adverse impact on bank development books and, subsequently, on investor lending portfolios.

Citi notes the repricing initiatives have concentrated on interest-only loans, which make up around 40% of total mortgage portfolios. While at face value the repricing is expected to have a positive effect on bank earnings, around 3-4% on average, this is likely to be tempered by competitive market dynamics, the broker suggests. Citi maintains a cautious view on the sector and, with lending growth expected to slow, believes revenue growth from higher prices is required to deliver improved results.

China And Housing

Sydney's house prices have more than doubled since 2009 while Melbourne prices are up 90%. Credit Suisse observes residential real estate in Australia's two largest cities now rank as the second and sixth most expensive in the Western world. It remains clear that housing demand is outstripping supply and the marginal buyer of Australian housing continues to be coming from China.

The broker calculates foreigners are currently buying the equivalent to 25% of new supply in NSW and 16% in Victoria. Almost 80% of foreign demand is from China and Chinese buyers continue to settle on their purchases despite numerous impediments. Credit Suisse expects Chinese demand for Australian housing to grow, supported by wealth creation, attractive valuations and closer economic integration.

While Australian housing is at a peak in its cycle the broker believes the pace and severity of the coming downturn will be cushioned by Chinese demand. Many housing-exposed stocks are now priced for a sharp slowdown and the broker believes this is too cautious. Credit Suisse adds Adelaide Brighton ((ABC)) to its long portfolio and removes Caltex ((CTX)).

Australian Dollar

Henderson Global Investors suspects the current peak in Australia's terms of trade is likely around mid 2017, as higher commodity prices bring on more supply and eventually lead to some retracement in prices. Apart from commodity supply, leading indicators also point to a slowing in the pace of global expansion over the second half of the year.

The other impact on the Australian dollar is the prospect of two further rate increases from the US Federal Reserve this year and another three in 2018, taking the Fed Funds rate to 2.1% by the end of 2018. In contrast, Henderson expects the Reserve Bank of Australia to keep the cash rate steady at 1.5% over 2017, with the balance of risks tilted towards further easing as the housing construction cycle matures later this year.

The analysts forecast the Australian dollar to fall to US70c by the end of 2017 on a combination of easing commodity prices and slower global growth, as well as an narrowing in the cash rate differential between the US and Australia. The terms of trade are expected to move sideways through 2018.

The Australian dollar is then expected to rise to US75c by the end of 2018 as the market starts to factor in the start of a tightening cycle by the RBA. The analysts do not expect the RBA to be in a position to tighten before late 2018 given the inflation outlook.

Commonwealth Bank analysts anticipate the Australian dollar will edge down to US69c by the first quarter of 2018, driven almost entirely by strength in the US dollar. The US dollar is expected to be supported by the Fed lifting its interest rates, as all other major central banks are either easing or holding their official interest rates steady.

The main determinant for the US dollar is what the Trump administration does with the US company tax rate. If a simple cut in the rate to 15% from 35% is delivered it will be bullish for the US dollar for two reasons. First, the analysts contend, it will lift the US equity market and generate capital flows into the US economy. Second, this will cause a large repatriation of US multinational profits, in turn strengthening the US dollar.

If the House Republicans' favoured border adjustment tax package is delivered, the analysts suspect the disruptive effects of the tax package could cause the US Fed to delay raising rates and the US dollar will then decline.

On the Australian home front iron ore prices are expected to ease in the remainder of 2017, which is expected to weigh on the Australian dollar as the lift in the terms of trade recedes. The analysts expect iron ore supply to expand this year, as committed supply hits the seaborne market and China's domestic supply responds to higher prices. Iron ore prices are expected to fall to US$60/t by the end of the year.

The CBA analysts base case for Australia's cash rate is for policy to remain on hold throughout 2017 and well into 2018. The analysts believe the bulk of the drag from mining investment is almost over and the housing market activity is buoyant. Nevertheless, the central bank is not expected to be in a rush to raise rates soon.

Australia's high under-employment rate and weak wages growth suggests there is spare capacity in the labour market. Moreover, underlying CPI inflation remains benign at 1.55%, which is generating support for the Australian dollar via real interest rate differentials.

IVF Monitor

IVF industry growth rebounded in February, up 9.7%. Geographically, Queensland was the strongest performer recording total cycle growth of 31.7%.

UBS suspects it likely that Primary Health Care's ((PRY)) new bulk-bill clinic in Brisbane has begun to affect state volumes. The broker also notes that Virtus Health ((VRT)) has commenced its transition to “bulk bill plus” from “lower cost” at its TFC facility in Brisbane. Despite the rebound, the broker expects a contraction of -3.0% in Virtus Health's domestic cycle growth in the second half.

11 **FYI**

New Website: Rudi On Twitter

I am an avid follower of the fella with the sideburns, but I don't want to sign up to Twitter.

I am paraphrasing, but only a little bit, from one of the emails we received in recent weeks. Lucky for this subscriber, and for all others with similar ideas, the new website shows the latest tweets from Rudi On Twitter, on the right hand side of the front page, underneath the Search facility Search Stocks & Stories.

Rudi On Twitter is FNArena's first endeavour into social media. It acts as a communication channel, for example when there are technical problems with emails or the website, in replacement of the central messages board that stood prominently near the top of the former website, to which many of our loyal subscribers had become used to.

Investors who do follow Rudi On Twitter will appreciate the out-of-consensus remarks, and the highlights from reputable sources, but above all, the additional news flashes that compliment FNArena stalwarts such as The Australian Broker Call Report, The Overnight Report and Rudi's Views on the website.

Rudi On Twitter also allows for communication with non-subscribers, some of whom may have never heard of FNArena.

Of course, this is not where our social media ambition ends. FNArena already has built its own corporate presence on Facebook, LinkedIn, Twitter and Instagram. Next step is to successfully integrate these external social media platforms into our broadening communication channel.

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Metals X Firing On Copper And Tin

Base metals player Metals X has two key mines in Western Australia and Tasmania and brokers are upbeat about the prospects.

-Global production disruptions support the company's copper and tin mines -Brokers expect production can be boosted significantly at both Nifty and Renison -Further revenue potential exists in both nickel and cobalt

By Eva Brocklehurst

Metals X ((MLX)) offers exposure to copper and tin through its operating mines at Nifty in Western Australia and Renison Bell in Tasmania and several brokers are upbeat about their outlook.

The copper price is currently being supported by production disruptions at two of the world's largest copper mines, Escondida (Chile) and Grasberg (Indonesia). Commodity analysts are continuing to forecast higher prices and growing long-term supply deficits because of robust demand in the face of constraints on supply.

Meanwhile, tin prices have eased from two-year highs, but with low stockpiles and supply constraints, prices are expected to trend up in the face of solid demand from the electronics sector. Bell Potter notes the average realised tin price in the first half was estimated to have been 30% above the prior corresponding half, at US$8.93/lb, under the influence of reduced supply from key producers in Indonesia and China.

Now the miner's gold assets have been offloaded, Macquarie believes a leaner Metals X is better positioned to unlock significant organic growth potential. Production can be boosted by 30% at Nifty and by 20-25% at Renison within the next 2-3 years, the broker asserts. Macquarie initiates coverage on the stock with a Outperform rating and $1.00 target.

Metals X has a plan to boost production and extend the mine life at Nifty. Macquarie's site tour has signalled that prior operating issues are being addressed. Production forecasts assume that a rise in underground capital development expenditure delivers a material increase in output.

Copper production is expected to rise to over 42,000 tonnes per annum from the current rate of 31,600tpa. All-in sustainable costs (AISC) are expected to be lower at US$1.75/lb versus US$2.15/lb, although Macquarie retains cost forecasts above guidance, given the poor operating track record of the mine.

Bell Potter is also encouraged by the signs of significantly improved performance at the mine. The overall objective is to return the process plant to continuous production over the next 12-18 months. The broker, not one of the eight monitored daily on the FNArena database, has a Hold rating and $0.85 target.

Canaccord Genuity Australia maintains a favourable view on Nifty and Renison as well. The broker believes revised modelling, together with the current underground drill program, should mean a sizeable increase in the Nifty reserve at the mid-year update. The broker believes there is potential to increase production to 45,000tpa for minimal capital expenditure.

The company has produced 6,000tpa of tin in concentrate over the past five years and has identified a simple upgrading process which could lift product via the addition of an ore sorter in the front of the process plant. Ore sorting could increase the production profile by 15-20% if adopted and Canaccord Genuity expects Metals X to make an investment decision this year.

The transition to an owner-operator status at Renison, the broker notes, has resulted in an improved cost profile in the first half and, given buoyant tin prices, the company continues to explore expansion options.

The broker was lead manager to the company's recent placement of 68m shares at $1.48 a share, which raised $100.6m in August last year. Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy recommendation and $1.10 target.

Further Revenue

The company has further potential revenue streams. The Rentails project could boost tin production by around 5,000tp by processing previously mine tailings from Renison, Macquarie believes. A definitive feasibility study will be released in the next few months and the company will then consider financing options for the development of its 50% of the project. On Macquarie's estimates Rentails generates around a 22% internal return.

In the medium to long term there is potential to add nickel and cobalt production through the development of Central Musgrave. The company continues to progress this project while awaiting a recovery in nickel prices. Macquarie's development scenario generates an internal rate of return of less than 10% and, as a result, this project is not included in base case forecasts.

Pursuing growth through acquisitions is expected to remain a core part of the company's strategy although there are limited targets in base metals in Australia at this point, the broker believes.

History

The company acquired the Nifty mine in mid-2016 from Aditya Birla for $72m. The project had a poor history of operations and this culminated in a severe failure of the underground mine and subsequent suspension of the license. Macquarie has assessed that, following a site tour, the operating issues are attributable to a chronic under-capitalisation and the company's plans to boost production should be achievable.

Renison Bell was the company's sole source of cash flow from 2008 to 2013. This tin mine has a long history and first commenced production in 1968. Metals X is the operator in a 50:50 joint venture with Yunnan Tin Corp.

Gold assets were recently divested to a new listing called Westgold Resources ((WGX)). The company has two legacy positions in Brainchip Holdings ((BRN)) and RNI ((RNI)). Macquarie does not believe either investment is core to the company and expects these stakes will be disposed of in due course.

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MoU Could Signal Upside For Syrah Resources

Syrah Resources is progressing its graphite business, signing a non-binding MoU with BTR New Energy Materials.

-A subsequent more formal agreement could be a significant upside catalyst -Sufficient capital for current construction and commissioning schedule -Concerns linger regarding whether all potential production can be sold

By Eva Brocklehurst

Having been in discussions with Chinese battery anode producers for some time, Syrah Resources ((SYR)) is now progressing its graphite business with a non-binding Memorandum of Understanding with BTR New Energy Materials.

BTR is a global supplier of battery anode materials based in Shenzen, China, and has significant exposure to electric vehicle sales. Syrah has indicated the partnership relates to sales and supply chain co-operation.

While details are yet to be divulged, Deutsche Bank interprets the statement to mean that sales imply a concentrate offtake agreement and supply chain co-operation implies greater participation to allow Balama concentrate to be sold to end-markets. This could be by a toll treating arrangement as Syrah's Balama operation is ramped up.

The broker believes a more formal agreement could be the most significant de-risking catalyst for the stock to date, which has struggled to offset management changes, construction delays and concerns around the graphite market over the last six months.

Balama

Deutsche Bank considers the evidence indisputable that the company owns the world's highest quality graphite project, Balama, in Mozambique. The challenge is to identify ways of getting the product to the battery market to avoid displacing tonnage in traditional graphite markets, and influencing spot pricing.

Deutsche Bank notes the company has minimal internal expertise in developing downstream graphite processing, which makes any partnership with BTR a logical one. Overall plant construction at Balama is now 70% complete.

The company has reiterated US$193m guidance for capital expenditure and plans to have a US$50m working capital facility in place in the next quarter. Based on the current construction and commissioning schedule there is sufficient capital on hand, Deutsche Bank observes. If further delays are incurred the company is expected to draw down on the facility late in the third quarter.

Morgan Stanley is positive about the MoU and conversion to a formal offtake agreement would be an upside risk to its forecasts. The broker acknowledges the company's current relationships for the downstream products are sufficient to underpin construction of the spherical plant.

Nevertheless, flake graphite offtakes are required to generate cash flow and fund the construction of the downstream business, the broker asserts. Proportions of coated and uncoated spherical graphite are also important valuation drivers for the company's downstream strategy.

Morgan Stanley has an Equal-weight rating on the stock, maintaining its concerns regarding offtakes while also believing the valuation reflects fair value.

The broker concedes more flake graphite offtake could boost sentiment on the stock, as could a faster ramping up of spherical graphite production in light of the demand. However, the downside includes potential capital requirements for the spherical plant which may require external funding and come at a high cost.

Macquarie, yet to comment on the MoU, noted earlier this year that, while construction at Balama is on track, capital expenditure is creeping higher. This is a lingering concern as, while construction is fully funded, the level of working capital required for ramping up is a risk.

Credit Suisse welcomes the BTR name as a counter party to the company's graphite business, as it implies that significant product testing has been undertaken. While the scope of the arrangement is yet to be finalised, the broker suspects it could extend well beyond sales of flake graphite.

The broker also suggests the announcement addresses market concerns, as it implies further volume offtake. There have been concerns voiced that the company would be unable to sell its potential production.

Moreover, the broker believes the leading position of BTR in China provides a clear source to market Syrah product as this is the world's largest lithium ion and electric vehicle growth market. The company has deferred its sales and marketing update that was planned for April 4 while it seeks to advance commercial discussions with BTR.

FNArena's database has three Buy ratings and one Hold (Morgan Stanley). The consensus target is $5.21, suggesting 79.1% upside to the last share price. Targets range from $2.75 (Morgan Stanley) to $7.80 (Credit Suisse).

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Uncertainty Prevails For Tox Free Solutions

Waste business Tox Free Solutions will cease to service the Chevron Australia operations on Barrow Island at the end of FY17 and brokers are uncertain as to whether the company's earnings trajectory has troughed.

-Muted impact on earnings from the loss, countered by new contract gains -Does this signal heightened margin pressure on other contracts? -Daniels business envisaged on track but Worth may fall short of target

By Eva Brocklehurst

Waste treatment services Tox Free Solutions ((TOX)) will cease to provide services to Chevron Australia operations on Barrow Island at the end of FY17. While the contract loss is small, the news adds uncertainty to the outlook, brokers suggest, as it is unclear whether the company's earnings trajectory has troughed.

The company will continue to provide services to the other Chevron Australia operations under its master services contract. Re-tendering for contracts is always a risk, but Ord Minnett considers the earnings impact from this one is muted given Tox Free had been scaling down the Chevron contract over the past couple years.

The protracted re-tender process that was announced almost a year ago allowed much of the benefit from the high-value waste services from the construction stage to be retained by Tox Free. As such, the size of the contract from July 1, 2017, onwards is much smaller.

Given recent contract gains from the likes of Inpex, GLNG and Fortescue Metals ((FMG)), the company expects operating earnings will improve regardless of the Chevron contract loss.

The loss of the contract pushes out the trough in earnings per share to FY18, Morgan Stanley asserts, taking the opportunity to review assumptions. Morgan Stanley believed the company would be the natural winner of this contract, given its track record and existing assets on Barrow Island.

While the impact is relatively small, the broker suspects it foreshadows intensified margin pressure on other contracts. As there are no identifiable catalysts for a re-rating in the near term and the valuation appears full, the broker downgrades to Equal-weight from Overweight.

That said, Morgan Stanley's original outlook for improving earnings quality, growth and margin remains unchanged. The broker also acknowledges that the company's exposure to resources continues to reduce while the performance of the Daniels business appears to be on track.

The Barrow Island contract was the company's largest during the peak of construction in the resources sector, Macquarie observes. The loss of this part of the Chevron contract will affect FY18 operating earnings (EBITDA) by around -$1-2m.

Macquarie also re-assesses FY18 earnings estimates, noting that first half earnings fell $8.8m because of the decline in resource construction. For the company, this business was replaced by the Worth and Daniels acquisitions and $2.1m in organic growth.

Organic growth was led by the industrial services division that completed its first six months on the new Olympic Dam contract and also benefitted from east coast infrastructure work. The broker still expects earnings to grow in FY17 but suggests that Worth may fall short of its target as dry weather has affected what is largely a liquids business.

The broker expects, in all, that organic growth from recent contract wins in FY18 will be largely offset by the loss of the Chevron contract. While encouraged by the renewal of contracts in the core business, Macquarie requires earnings estimates to stabilise before becoming more confident and downgrades to Neutral.

UBS, yet to comment on the loss of the Chevron contract, noted the results last month fell short of expectations because of drier weather in NSW, the location being a significant contributor to the Worth business, and management abandoned guidance. The broker is undecided as to whether the stock has hit its cyclical low and suggests this is a question the market continues to struggle with.

There are four Hold ratings on FNArena's database. The consensus target is $2.31, signalling 0.1% upside to the last share price. Targets range from $2.20 (Ord Minnett) to $2.45 (Macquarie).

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Investor Optimism Keeps The Bull Alive

In this week's Weekly Insights:

-Investor Optimism Keeps The Bull Alive -Quintis Versus Californian Short Sellers -Marijuana Mania Hits Australian Shores -Conviction Calls: Bell Potter, CLSA and Citi -New Website: Rudi On Twitter -2016 - L'Année Extraordinaire -All-Weather Model Portfolio -Rudi On TV -Rudi On Tour

Investor Optimism Keeps The Bull Alive

By Rudi Filapek-Vandyck, Editor FNArena

So The Donald messed up one of his key election promises, beating his chest, sending his bullies to meetings of elected Republicans, but ultimately it was all to no avail, Obamacare will remain as is for a while longer.

Whether this automatically means the US healthcare system will "explode" in the year ahead, and Democrats will come begging at the White House entrance to do whatever it takes to fix it, as predicted by The Donald, remains very much to be seen.

What can be seen is that financial markets maintain little appetite for a sizeable pull back, let alone an old fashioned bull market correction, for on the presidential horizon has emerged the next promise of tax reform, including reducing the corporate tax rate to an internationally competitive rate of 15-20%.

Officially, US corporates operate under a 35% federal tax rate in the US of A. Not that anyone is actually paying that much in taxes, but that's an alternative fact, for now.

From Russia, With Love

The biggest threat to the Trump Trade, as I see it, is not a belligerent megalomaniac whose political capital might well come under serious threat sooner than anyone is expecting, but Trump's long-standing relationship with shady holders of a Russian passport.

Investors in Australia wouldn't necessarily have picked up on this, but the confidence displayed by some of the elected Democrats, who seem to know more than they can publicly divulge at this stage, that Donald's secret Russian connections will become his undoing is remarkable, to say the least.

Clearly, we haven't seen more than just a tiny tip of the iceberg and one wonders when that moment arrives of the Big Revelation a la Richard Nixon, and what then might follow next.

US Corporate Profits

In the meantime, this year's outlook for US equities, and for the rest of the world in their slipstream, is not solely dependent on The Donald's ability to massage Republicans into "phenomenal" tax reform, points out Citi's bull-du-jour, Tobias M Levkovich.

The Citi global equities strategist points out US companies are finally starting to report genuine profit growth, and it is as yet being achieved without the much hoped for cut in corporate taxes. Strip away the potential tax benefits, says the Citi strategist, and US companies are projected to grow earnings per share this year by some 6% and next year (2018) by some 5%.

As per always, there is upside risk potential if, somehow, The Donald can rejuvenate the animal spirits in the US economy. But even without such extras, Levkovich seems convinced those growth numbers are achievable and as market participants' confidence in these numbers grows, so too will be ongoing support for the present bull market.

He observes earnings estimates have again started to trend higher, further corroborating his confidence. Citi's year-end target for the S&P500 is 2425, or circa 3.5% higher.

In Hope We Live

Market strategists at Goldman Sachs agree with Citi in that they see a reasonable chance for a share market correction this year, but this bull market is not about to end just yet. Goldman Sachs believes US equities are in the final stage of a mature bull market cycle, dubbed The Optimism Phase.

Historically, this phase lasts some 25 months on average. If we assume this final phase started mid last year, it remains thus too early to anticipate its end, suggest the strategists. Average annualised returns for The Optimism Phase are 24%.

Two conclusions stand out in the latest Goldman Sachs update on the US equities bull market: Europe and emerging markets are behind in the cycle and therefore most likely to generate higher returns.

Secondly, the critical level when government bond yields start "biting" for equities and returns from equities is now "much lower" than in the past. Goldman Sachs estimates present day "biting points" are probably around 3% for 10 year yields in the US and 1% in Germany.

The US ten-year yield is currently at 2.40%.

Shorter to medium term, Goldman Sachs is anticipating higher volatility with lower returns and, as said, increased chance for a correction (but not the end of this bull market just yet).

Quintis Versus Californian Short Sellers

The company formerly known as TFS Corp changed name to Quintis ((QIN)) last week and the event was accompanied by California based short sellers Glaucus Research Group diverting all attention to their own investigative research into the company. Glaucus makes no secret of the fact it is "short" Quintis shares.

Glaucus' freshly distributed research report on Quintis reads like a guilty-as-charged crime novel. There are comparables drawn with past investment disasters like Timbercorp, Great Southern and Palandri Wines. There is what appears an overzealous marketing machine, spreading self-serving lies, Glaucus alleges, presented to the global investment community as "independent" and "non-affiliated", with alleged links to Quintis' headquarters. There is even a (alleged) phantom Chinese buyer of the company's sandalwood to prop up prices, and thus future forecasts and analysts' valuation methodologies.

Add to this an opaque agricultural market, as reflected in the assessment: "sandalwood trees are parasitic and require a host tree to grow, making yields and survival rates difficult to predict. As a result, predicting future cash flows from sandalwood trees is an opaque process which is highly sensitive to assumptions of future market price, yield and survivability of the trees".

Somewhere in between the many Chinese whispers, we even come across Phillip Shamieh, once upon a time the founder of WiseOwl, once upon a time a successful stock picking newsletter in Australia, but that was long time ago. Shamieh found a second career in the United Arab Emirates, apparently also assisting TFS/Quintis with raising funds locally.

All this is written in straight talking, don't know about euphemisms, no holds barred, blunt financial lingo, as reflected in "Ponzi-like structure", "Dubious Promises of Future Profits", "obscure firm", et cetera. The main conclusion leaves little to one's imagination: "We believe that once investors scrutinize TFS's misleading forecasts, dubious marketing materials and questionable customers, TFS will lose the confidence of the capital markets it requires to survive. Thus, we value TFS's shares at AU$ 0.00".

For good measure: that final number is zero, as in zero value.

Of course, Glaucus is talking its own book. When you are heavily short, you want the rest of the investment community to follow in your steps. Fact remains: TFS, now Quintis, has become one of the most shorted stocks on the ASX with ASIC data showing more than 14% of outstanding capital is in the form of shorts, i.e. looking to make money from a weaker share price.

See also The Short Report on the FNArena website.

No surprise, the share price has been flatlining for the past three years and now downward pressure has once again revealed itself. Subscribers looking for additional insights, send us an email at info@fnarena.com

Marijuana Mania Hits Australian Shores

Medicinal cannabis is breaking into the mainstream, including in Australia, and the result is a true blue Marijuana Mania. Already reports are circulating about stockbrokers receiving inquiries from their hairdressers about how to gain exposure to marijuana stocks on the ASX. All of a sudden, electrical vehicles and lithium-cobalt batteries are so last year.

It's not the kind of "investment" anyone would recommend for a conservative, balanced long term portfolio, but hey, who are we to prevent anyone from taking a punt, and maybe earn a well-deserved holiday budget along the way? Just make sure not too much damage is done when the tide does turn.

ASX-listed stocks that offer leverage to the theme include:

-AusCann Group ((AC8)) -Botanix Pharmaceuticals ((BOT)) -Creso Pharma ((CPH)) -Medlab Clinical ((MDC)) -MMJ Phytotech ((MMJ)) -MGC Pharmaceuticals ((MXC)) -Zelda Therapeutics ((ZLD))

Thus far, AusCann Group is leading the pack with a gain of 6000%-plus (not a typo) since late October, and 200%-plus since early February.

Perth-based stockbroker Argonaut, usually immersed into small cap mining speccies, thus all too familiar with risk and taking a punt, initiated coverage last week on Botanix with a Speculative Buy rating. The company hopes to develop a product for acne. The following sentence from the Argonaut research report summarises the proposition best: "Although it is premature to forecast revenues or cash flows, we believe the potential prize is sufficiently large to warrant a speculative buy call."

Canada's Liberal government plans to announce legislation next month that will legalize recreational marijuana use nationally by Canada Day 2018, according to media reports.

Conviction Calls: Bell Potter, CLSA and Citi

Bell Potter is one of few stockbrokers in Australia who keeps a close eye on domestic technology stocks, and publishes regular sector updates. The latest of such updates shows analyst Chris Savage is sticking to his small selection of sector favourites ("key picks"). These are Integrated Research ((IRI)), Appen ((APX)), Adacel Technologies ((ADA)) and Infomedia ((IFM)).

Interesting detail: Bell Potter last updated on its key technology picks in December and at that time made one change; replacing Melbourne IT ((MLB)) with Appen. Alas, Melbourne IT shares have since proved Chris Savage wrong.

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The Small Cap research team at CLSA reported this week on its company visits post the February reporting season. Analysts Scott Hudson, Shaun Weik, Henry Hill remain in awe with quality of the product and management's ability to grow the business at cloud SMSF software provider, Class ((CL1)). The analysts report the company continues to take market share from others, while management is identifying more growth avenues beyond accountants and advisors.

Their enthusiasm is a lot lower for Catapult's ((CAT)) ambition to expand into consumer wearables. CLSA has been a long-time close follower of Range International ((RAN)), still a minnow in the global space for pallets. Range has developed a proprietary manufacturing process that mechanically combines various forms of plastic polymers into plastic pallets and management is gearing up for an aggressive expansion across the Asia Pacific market, the analysts report.

CLSA also sees a lot of potential for Updater ((UPD)), whose app assists people when relocating. Other experts have also concluded the Updater platform could conceptually create a lot of value for its product partners, but it's early days, still.

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Analysts at Citi updated their Focus List Australia/NZ. This, in their own words, showcases the strongest Buy ideas, where analysts have strong conviction levels with no limit on the time that ideas may stay in the Focus List.

Citi's selection of Best Buy Ideas consists of AGL Energy ((AGL)), Aristocrat Leisure ((ALL)), Caltex Australia ((CTX)), MYOB (MYO)), Newcrest Mining ((NCM)), South32 ((S32)), Santos ((STO)), Sims Metal ((SGM)) and Star Entertainment Group ((SGR)).

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Note to readers: This is the fourth consecutive update on brokers' Conviction Calls. The previous three can be found in Weekly Insights from March 20, March 13 and March 6 which can be accessed via Rudi's Views on the FNArena website.

New Website: Rudi On Twitter

I am an avid follower of the fella with the sideburns, but I don't want to sign up to Twitter.

I am paraphrasing, but only a little bit, from one of the emails we received in recent weeks. Lucky for this subscriber, and for all others with similar ideas, the new website shows the latest tweets from Rudi On Twitter, on the right hand side of the front page, underneath the Search facility Search Stocks & Stories.

Rudi On Twitter is FNArena's first endeavour into social media. It acts as a communication channel, for example when there are technical problems with emails or the website, in replacement of the central messages board that stood prominently near the top of the former website, to which many of our loyal subscribers had become used to.

Investors who do follow Rudi On Twitter will appreciate the out-of-consensus remarks, and the highlights from reputable sources, but above all, the additional news flashes that compliment FNArena stalwarts such as The Australian Broker Call Report, The Overnight Report and Rudi's Views on the website.

Rudi On Twitter also allows for communication with non-subscribers, some of whom may have never heard of FNArena.

Of course, this is not where our social media ambition ends. FNArena already has built its own corporate presence on Facebook, LinkedIn, Twitter and Instagram. Next step is to successfully integrate these external social media platforms into our broadening communication channel.

2016 - L'Année Extraordinaire

It was quite the exceptional year, 2016, and I did grab the opportunity to write down my observations and offer investors today the opportunity to look back, relive the moments and draw some hard conclusions about investing in the world today.

If you are a paid subscriber to FNArena, and you still haven't downloaded your copy, all you have to do is visit the website, look up "Special Reports" and download your very own copy of "Who's Afraid Of The Big Bad Bear. Chronicles of 2016, A Veritable Year Extraordinaire" (in PDF).

For all others who still haven't been convinced, eBook copies are for sale on Amazon and many other online channels. You'll have to visit a foreign Amazon website to also find the print book version.

All-Weather Model Portfolio

In partnership with Queensland based Vested Equities, FNArena manages an All-Weather Model Portfolio based upon my post-GFC research. The idea is to offer diversification away from banks and resources stocks which are so dominant in Australia, while also providing ongoing real time evidence into the validity of my research into All-Weather Performers.

This All-Weather Model Portfolio is available through Self-Managed Accounts (SMAs) on the Praemium platform. For more info: info@fnarena.com

Rudi On TV

This week my appearances on the Sky Business channel are scheduled as follows:

-Tuesday around 11.15am, Skype-link to discuss broker calls -Wednesday, host of Your Money, Your Call Equities, 8-9pm -Thursday, 12.00-2.00pm, co-host in the studio -Friday around 11.15am, Skype-link to discuss broker calls

Rudi On Tour

Your Editor has been invited to present at the Australian Shareholders Association's (ASA) 2017 Securing Your Investing Future Conference to be held at the Grand Hyatt Melbourne from 15-16 May.

The conference details - www.australianshareholders.com.au/conference-2017

Speaker information - www.australianshareholders.com.au/speakers

Program information - www.australianshareholders.com.au/program

Those who register before 31 March 2017 will receive $70 off the registration fee. Telephone: 1300 368 448

(This story was written on Monday 27th March 2016. It was published on the day in the form of an email to paying subscribers at FNArena).

(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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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 $380 for twelve months or $210 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

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