Week
10

Stories To Read From FNArena
Friday, 10 March 2017

FNArena
Financial News, Data & Analysis

GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

© News Network 2017. All Rights Reserved. No portion of this website may be reproduced, copied or in any way re-used without written permission from News Network. All subscribers should read our terms and conditions.

Contents

Australia
1 Orocobre Output Sputters, Likely Short Term
2 Car Dealer Issue Is Soft Growth, Not ASIC
3 General Insurers Face Tight Claims Budgets
4 Major Setback For Navitas?
5 Downer Enhances NZ Capability

Commodities
6 For How Long Can Iron Ore Defy Gravity?
7 Material Matters: Base Metals, Gold & Lithium

FYI
8 Weekly Ratings, Targets, Forecast Changes
9 Uranium Week: As You Were
10 The Short Report
11 The Wrap: PRRT, Fed, Health & Infrastructure

Small Caps
12 Select Harvests Sustains Positive Outlook
13 Growth Concerns For National Storage REIT

Technicals
14 ASX200: No Man's Land

Treasure Chest
15 Treasure Chest: REA Undervalued

Weekly Analysis
16 Share Market Necessity: Know Thyself

Orocobre Output Sputters, Likely Short Term

Lithium producer Orocobre has encountered problems with its inventory and production guidance has been lowered. Brokers are reasonably confident the issues can be addressed.

-Production rates downgraded, reducing overall earnings estimates for several years -Short-term issues in a long-term project are considered surmountable -Yet, lack of clarity regarding the length of time to address the problems

By Eva Brocklehurst

Lithium producer Orocobre ((ORE)) has indicated that costs will take longer to fall and production will take longer to hit the target, as it has encountered problems with its inventory. Production guidance has been reduced at the company's Olaroz project in Argentina.

There was a shortfall in sales in the first half because of a port strike at Antofagasta, with those shipments deferred to the current quarter. The weaker average price the company received reflected the delivery of legacy contracts, which are now largely fulfilled. Otherwise, the company reports that market conditions are strong.

Morgans believes the market's reaction to the reduced production rate is overdone and maintains an Add rating. Orocobre remains a preferred investment in the lithium sector and the weakness presents a good opportunity to buy the stock, in the broker's view.

Macquarie pushes back expectations of nameplate production until FY19 and this reduces overall earnings estimates for the next several years. With the domino effect, the broker wonders whether the company should still assume it can fund its Olaroz expansion from operating cash flows. As a result, the broker delays its forecast for phase 2 by around 12 months, to avoid the joint venture going negative on cash flow.

No Call On Equity For Olaroz (as yet)

The broker finds the outlook extremely challenging although, outside of the potential delay for phase 2 at Olaroz, considers the proposal for a Japanese lithium hydroxide plant provides potential upside. No value is attributed to this plant in the broker's analysis, but Macquarie acknowledges this could ease some of the reductions in earnings that are now expected. Additionally, Macquarie assumes further shareholder loans may be necessary from Orocobre.

Citi has upgraded to Buy/High Risk. Although the downgrade to production from evaporation pond flow issues is increasing the risk profile, and raises questions over the management of operations, the broker believes these are short-term issues in a long-term project, and surmountable. The broker always believed original production guidance was unrealistic but was surprised by the magnitude of the downgrade.

Citi assumes a six month delay to the timeline and includes the expansion at an unchanged 50% probability until approved. What has changed, the broker notes, is the increased proportion of industrial grade production, as the expansion of the purification circuit has been dropped from plans.

The development signals to Citi that investors have been burned by the latest production downgrade and will not get clarity on whether management is capable of turning around the operation until the December quarter. Despite lower production, the broker does not envisage a need for the company to raise equity to fund the Olaroz expansion.

Deutsche Bank is disappointed in the update, given the company promised in the current half year to increase production and cash flow. The broker believes the phase 2 expansion should be self-funded out of phase 1 cash flow to avoid undue pressure on the balance sheet and further raising concerns among investors.

Canaccord Genuity, assuming the pond inventory problems and production curtailment can be resolved, still believes the company and its joint venture on Olaroz can fund the expansion as well as the lithium hydroxide project without the need for additional equity.

The JV has announced a proposed development of a US$30m plant for production of 10,000 tonnes per annum of battery grade lithium hydroxide to be built close to the Japanese market. The Japanese government is fronting up with 50% of the capital cost.

Orocobre had estimated it may contribute US$4m in equity for the plant. Several brokers note the company has now confirmed, after the downgrade in projected June half production, that it will not make call on equity for either the expansion or the new plant.

Canaccord Genuity recognises the strategic at value of the asset base and considers the shares oversold. The broker assumes a 9-12 months period to rectify the inventory imbalance and adjusts its FY18 production estimates to 14,900 tonnes from 16,300t. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and $5.95 target.

Inventory Issue

Unlike earlier commissioning issues that were located in the plant, this time the problem is balance. The brine inventory imbalance through the evaporation pond system has resulted in a need to reduce plant brine feed rates for at least six months. This feed equates to lithium production. Production guidance, therefore, for FY17 has been reduced to 12-12,500t (Morgans previously projected 15,050t), implying second-half production of 5,500-6,000t.

The lithium inventory in the brine ponds is at the required rate, close to 40,000t, but the level in the harvest ponds, which feed the plant, is too low for efficient operation of the plant and high recovery. Brokers are relatively comfortable with these issues and believe they can be rectified. There is less certainty as to the time required to re-balance the inventory in the ponds.

Deutsche Bank notes there is a 25% fall in lithium grades reporting to the plant and a six-month period to re-allocate brine through the ponds while allowance for evaporation times is also increased. The broker observes, while the explanation for the problem is baffling in its simplicity, there are no long-term impacts.

Nevertheless, it has an impact on FY18 production volumes and highlights, in the broker's opinion, the need for efficacious monitoring and sampling procedures. The company has reduced its capital expenditure estimate for the phase 2 expansion by 15% by removing the purification circuit.

There are three Buy ratings on FNArena's database and one Hold (Macquarie). The consensus target is $4.14, suggesting 34.5% upside to the last share price. This compares with $4.77 ahead of the results. Targets range from $3.17 (Macquarie) to $5.39 (Morgans).

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.

Car Dealer Issue Is Soft Growth, Not ASIC

ASIC has automotive dealer finance commissions in its sights. Brokers are not overly concerned about these changes and suspect a softer growth outlook for automotive retailing is more significant.

-No changes to dealer volume bonuses and few changes to fees proposed -Minimal impact envisaged for alternative distribution channels -Slowing new car sales an item on broker watch lists

By Eva Brocklehurst

The Australian Securities and Investments Commission has proposed a ban on flex commissions for finance products offered in automotive dealerships. These are the commissions earned on arranging finance for prospective buyers of motor vehicles and linked to the interest rate on the loan. Lenders will need to change remuneration arrangements so that dealers are not incentivised by commissions to set interest rates.

There were no changes proposed to volume bonuses and no material changes to fees. The proposed changes are largely in line with the expectations of both AP Eagers ((APE)) and Automotive Holdings ((AHG)) and brokers suspect they have probably already made some adjustments in anticipation.

Nevertheless, while not expecting any material earnings impact for listed companies, Morgans believes that growing earnings in this area of automotive retailing is likely to be difficult for some time. Additionally, the broker notes a decision regarding the provision of insurance at dealerships is also in the eye of regulators, with an announcement expected shortly on that front.

Such regulatory constraints, in addition to a more subdued general automotive trading environment, means that several brokers are cautious about the earnings growth outlook for the sector. Credit Suisse is one, downgrading AP Eagers to Neutral from Outperform. The broker still expects earnings growth in FY17, but a slower pace than previously forecast.

There are other challenges besides the regulatory environment facing the industry, including slowing new car sales, while vendor expectations and increased competition mean material acquisitions in FY17 are unlikely.

That said, the broker believes the company's strategy regarding Carzoos is excellent and consolidation in the long term is a theme that will benefit AP Eagers. Credit Suisse acknowledges a more rational supply environment could reduce further downside, around volume targets and incentive payments, but it is unclear whether this has changed materially and will actually drive upside.

At this point, Credit Suisse suggests lenders need to change remuneration arrangements so that dealers are not incentivised by commissions to set interest rates. The broker also observes that the finance rates at AP Eagers and Automotive Holdings are well below those highlighted by ASIC as being harmful to consumers.

In addition, there has been margin compression brought about by changing financier behaviour. Therefore, while not excluding some further negative impact and acknowledging the uncertainty and scope for change, Credit Suisse considers the assessment of the impact put forward by the companies is reasonable.

Moelis notes sale of finance is very high margin and plays an important role in dealer profitability. The broker expects sales staff will be remunerated more on a salary basis, as opposed to a commission basis going forward. This could provide another offset to lower income generated by financing.

In the case of AP Eagers, the broker reduces earnings estimates in the automotive division to capture the impact of marginally lower average interest rates. Moelis understands the company is a fairly lean operator and there is a risk the cost reductions may not offset weaker market conditions, while there is less growth likely from acquisitions. Carzoos had a slower than expected start, leading to a lower roll-out profile. Hence, Moelis expects less upside from this business in the near term.

The broker, not one of the eight stockbrokers monitored daily on the FNArena database, has downgraded its rating to Hold. Target price moves to $10.15. In the case of Automotive Holdings, the broker believes there are significant cost savings that can offset much of the impact of the cessation of flex commissions. Moelis has a Buy rating and $4.55 target.

Ord Minnett is positive about the ASIC decision, as it reduces regulatory uncertainty. While not anticipating a

material impact, the broker does highlight a continuation of modest new car sales data and a particularly weak February. Citi also flags a soft trend in new vehicle sales, noting, in 2016 private purchases fell -6% and government purchases -1.4%, while business purchases grew 13%. Total passenger vehicle imports declined -8% in the December quarter.

While dealerships are the most affected by regulatory changes to commissions, Citi believes McMillan Shakespeare's ((MMS)) retail finance service has the most direct exposure of the leasing providers to the proposed changes in commissions. The broker envisages minimal impact to alternative distribution channels such as novated leasing. Nevertheless, given the end customer is also a retail consumer, there is a risk that the scope of changes is expanded to include this channel.

The second order impact from a reduction in these commissions is more relevant to the leasing and salary packaging companies, Citi contends, as it could result in dealers looking at other avenues to recoup lost earnings. The broker envisages minimal risk directly to the corporate fleet leasing businesses of Eclipx ((ECX)), SG Fleet ((SGF)) and McMillan Shakespeare.

The Changes

From September 2018, dealerships will be required to sell these products in line with the financier's rate. Dealers will be able to discount the lenders rate by up to 200 basis points, although potentially they earn less commission by doing so, but this allows some discretion to enable them to be competitive. The draft commencement date for the cessation of flex commissions is slated for September 1, 2018.

Lenders would be solely responsible for nominating an interest rate and this would enable them to set rates according to their assessment of the risk of the transaction. While not banning origination fees, the new regulations will require lenders to set a maximum price for these fees and stipulate that intermediaries cannot vary the price according to factors unrelated to the services provided. The 18-month transition period is proposed to enable the industry to develop new pricing models and re-negotiate remuneration arrangements.

FNArena's database has four Hold ratings for AP Eagers. The consensus target is $10.00, suggesting 4.7% upside to the last share price. Targets range from $9.40 (Morgan Stanley) to $10.59 (Morgans). There are four Buy ratings, one Hold and one Sell for Automotive Holdings. The consensus target is $4.20, suggesting 6.3% upside to the last share price. Targets range from $3.15 (Morgan Stanley) to $4.60 (Deutsche Bank).

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.

General Insurers Face Tight Claims Budgets

General insurers IAG and Suncorp have outlined the expected losses from February's hail storm in Sydney. Several brokers review the impact on FY17 natural peril budgets.

-Natural peril losses close to, or exceeding, allowances for FY17 -Positive outlook for general insurance and scope to re-price some lines -Potential for Insurance Australia Group and Suncorp margins to converge

By Eva Brocklehurst

General insurers Insurance Australia Group ((IAG)) and Suncorp ((SUN)) have outlined the expected impact of the recent Sydney hail storm. Those brokers which have reviewed the latest news suggest, for Insurance Australia Group, the impact is straightforward, while there is some divergence regarding the impact on Suncorp.

UBS suspects both insurers are now likely to exceed their FY17 natural peril budgets. IAG's additional reinsurance cover could mean it escapes without an impact on FY17 earnings per share, assuming the absence of further large events. The company has stated it expects the cost of the Sydney hail storm to be $160m.

At the end of February the business had experienced $650m in natural peril losses compared with a full-year expectation of $680m. With current reinsurance treaties the company can absorb a further $130m of natural peril losses for the remainder of FY17 and stay within guidance.

Morgans believes the worst of the peril season is behind the insurers and is optimistic that the remaining allowances are within assumptions, and that IAG remains on track for its reported insurance margin forecasts of 12.5-14.5%.

Deutsche Bank reduces FY17 estimates for IAG by -3%, to reflect the impact of the hail and an over-run for the remainder of the period. The broker remains positive on the outlook for general insurance in Australia and believes there is scope for the industry to re-price certain lines such as NSW CTP (green slip) or commercial lines.

Suncorp's expected costs for the hail storm are between $150-170m. The company's natural hazard cost has now risen to $610-630m to the end of February. This compares with a full year budget of $600m. The insurer is protected against further deterioration from large natural hazard events because of its aggregate cover. This provides $300m in reinsurance protection once natural hazard losses exceed $460m.

For the current year, the company's total natural hazard losses are between $420-440m. As a result, Deutsche Bank expects Suncorp to be protected from further deterioration at this point.

The deterioration in Suncorp's natural peril costs have surprised Citi, which notes the company has already used 87% of the second half budget with four months of the year to go. The broker was not surprised by the hail storm cost but by attrition in claims of $75m in just two months. Citi expects Suncorp will, yet again, exceed its hazard allowance in the second half and questions the adequacy of the recently-reduced hazards allowance, and the validity of the underlying margin calculation.

Ord Minnett believes, because of seasonality, that Suncorp would have allocated around 20% of its perils allowance for the last quarter of the financial year and is inclined to expect there should be greater reinsurance protection for the remaining months until the end of FY17. Morgans is more in Citi's camp, suspecting Suncorp is likely to exceed its second half hazard allowances overall and now forecasts hazard losses of $50m above allowances in the second half and a reported insurance margin of 10.7%.

Outlook

At this point in the cycle Morgans continues to believe the insurers are fair value. The broker would like further evidence of upside from price increases in order to become more bullish. UBS flags possible indirect impacts for Suncorp: motor claims inflation is likely to be further aggravated and this was a key challenge for the sector in the first half; and upcoming reinsurance renewals could be less beneficial compared with recent years.

Macquarie notes Suncorp won market share in the first half, with the majority of this in CTP, while IAG grew home and motor insurance in NSW & Victoria. The broker expects IAG's top-line growth will strengthen in FY17 but slow in FY18, while Suncorp should grow in both years with pricing and market share in CTP the key drivers.

As far as margins are concerned, the broker expects these will converge for the two companies. IAG has a highest margins in what Macquarie describes as the second most profitable general insurance market in the world. The broker expects margins will continue to decline amid an oversupply of global capital as well as local economic headwinds. At the same time, the broker expects Suncorp to take more market share and improve margins through self-help.

Macquarie believes the window for abnormal growth is also closing for the insurers. To combat claims cost inflation challenger brands moved first to raise premium rates around 12-18 months ago. This helped established insurer growth and market share in the first half, but the broker believes this opportunity will diminish after FY17.

FNArena's database has seven Hold ratings and one Sell (Macquarie) for IAG. The consensus target is $6.00, signalling -2.1% in downside to the last share price. The dividend yield on FY17 and FY18 forecasts is 4.8% and 4.5% respectively.

For Suncorp, there are five Buy ratings, to Hold and one Sell (Morgan Stanley, yet to update on the hail storm). The consensus target is $13.73 suggesting 4.4% upside to the last share price. The dividend yield on FY17 and FY18 forecasts is 5.6% and 5.8% respectively.

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.

Major Setback For Navitas?

Brokers have differing views over the extent of education provider Navitas' latest setback.

-Higher concentration of risk than previously envisaged -Potential for less favourable terms on upcoming contract renewals -Tightened student visa restrictions limiting the outlook

By Eva Brocklehurst

Just as hopes emerge education provider Navitas ((NVT)) is gaining some clear air and has moved past the loss of the Macquarie University contract, another setback is delivered. The setback, albeit more minor than the university contract loss, centres on a much reduced contract to deliver the Adult English Migrant Program (AMEP) for the Commonwealth Department of Education & Training (DET) .

This will not be renewed in most regions upon expiry on June 30, resulting in a permanent reduction in operating earnings (EBITDA) of $12-14m from FY18. The company has been named preferred tenderer in some small regions where it does not currently have a presence.

Navitas has never previously disclosed earnings from AMEP. Credit Suisse was surprised that AMEP is responsible for the majority of the professional and English language program (PEP) earnings, which provides a higher concentration of contract risk than previously estimated. The loss of the Macquarie University contract created a $30m hole in earnings and resulted in little growth over the last two years, despite positive macro trends.

A return to growth in FY18 now appears unlikely and Credit Suisse downgrades to Underperform, highlighting the downside risks facing a company that is predominantly a contractor to public sector entities. The broker's rating had been moved to Neutral after the full year results, to reflect potential for a re-rating in the expectation of a return to growth in FY18.

Credit Suisse now estimates that FY18 earnings will be below FY15. This is the second major contract loss in under three years and the two are now estimated to have cost at least $40m in recurring earnings, or more than one quarter of the current earnings base. The broker expects the market to ascribe little value to Professional English Programs (PEP) going forward, with the division now comprising the remnants of the AMEP contract and a collection of vocational training assets. The company will provide an update on the AMEP contract at the investor briefing in April.

Competitor Also Lost Share

For Macquarie, the loss of AMEP is not a quality issue. While worse than anticipated, and with a forecast 60% decline in FY18 PEP earnings, the broker notes the loss reflects the government's intention to diversify providers rather than a lack of quality from Navitas.

Anecdotal evidence suggests a major competitor also lost share. The broker considers the stock price at a level which implies no earnings growth from PEP or the acquired SAE Group (which offers programs in film, television, audio, animation and gaming through 50 colleges in 27 countries), leaving strong valuation support and upside potential.

UBS estimates the company can grow its core earnings at around 9% compound over FY18-21. Combined with other attractive attributes such as a high return on capital, strong cash flow conversion and a low geared balance sheet the broker finds the stock attractive at current levels.

Moelis suggests there are now clouds around upcoming contract renewals with six due in 2017, representing around 30% of the University program division student numbers. Deakin, Curtin and Manitoba (Canada) all mature in December and make up the bulk of student renewals. The broker assumes that all contracts are re-signed but highlights the risk of less favourable terms.

Moelis believes Navitas should trade closer to a market multiple given limited earnings growth between FY15-18, regulatory risk around international student visa regimes and the potential risk for contract renewals. Tight student visa restrictions in the US in the UK are likely to remain in the next 12 months, while funding changes in Australia limit PEP segment growth.

Australia retains the greatest potential in university programs, given limited partner capacity in Canada.

Australasia forms the bulk of these sales, with North America now 20%. Moelis, not one of the eight stockbrokers monitored daily on the FNArena database, finds the stock expensive and has a Hold rating and $4.32 target.

FNArena's database has two Buy ratings, two Hold and one Sell (Credit Suisse). The consensus target is $4.73, suggesting 16.5% upside to the last share price. This compares with $5.03 ahead of the news. The dividend yield on FY17 and FY18 forecast is 4.9% and 4.8% respectively.

See also, Brokers Upgrade As Navitas Finds Clear Air on February 2, 2017.

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.

Downner Enhances NZ Capability

Engineering & construction services company Downer EDI has expanded its network in New Zealand with the acquisition of Hawkins. Brokers assess the prospects.

-Enhances NZ capability and bridges the reduction in Oz oil & gas work -Downer EDI screens more positively than Monadelphous for Macquarie -Deutsche Bank envisages revenue downside for Hawkins as Christchurch activity ebbs

By Eva Brocklehurst

Engineering & construction services company Downer EDI ((DOW)) has added another construction business with the acquisition of Hawkins in New Zealand. The private company is a bolt-on acquisition, which will make Downer the number two integrated construction player in New Zealand behind Fletcher Building ((FBU)).

Macquarie observes that while construction is higher risk than services or maintenance, Downer has large experience in managing the risks across its mechanical/electrical engineering, as well as in its wind farms/solar utilities segment. In addition to enhancing NZ capability, the acquisition should bridge a drop-off in Australian oil & gas work.

Macquarie estimates over NZ$50bn will be invested in the non-residential construction market over the next five years. The broker expects the NZ construction market to undergo large changes, with a regional shift in activity away from Christchurch to Auckland. This year becomes a general election year in the country and government expenditure is expected to support volume growth.

Downer is estimated to still have over $300m in potential capacity for further acquisitions and/or buy-backs and the most prospective targets are in the services/recurring revenue areas of unlisted businesses. Macquarie compares Downer EDI favourably to Monadelphous ((MND)) in that it is less exposed to the resources capital expenditure cycle.

Downer's EC&M (engineering construction & mining) revenue is 25% of its total versus 56% for Monadelphous. Downer's mining exposure comprises 27% of Macquarie's FY17 revenue estimates but the broker believes this is less about capital expenditure and more about volume/production. Downer EDI also has more diversity among its end markets in the services business.

Citi remains attracted to the high-quality balance sheet, which is not only linked to the defensive aspects of the business but also future growth options. The broker believes the ability to deliver growth via acquisitions offsets the risks to growth, as the company continues to transition to public/private infrastructure work from resources.

Citi estimates New Zealand will account for roughly 20% of Downer's revenue post the transaction. The broker assumes the three-month contribution from Hawkins in FY17 is fully offset by transaction and other integration costs but assumes a contribution in FY18, which enhances earnings per share by around 3-4%. The acquisition adds to capabilities and increases the company's penetration of the NZ non-residential construction sector.

While the share price has run hard, the broker believes management is skillfully re-positioning the business and this should mean a continuation of strong support. Citi remains a holder of the stock because of the robust fundamentals and attractive outlook for growth.

Deutsche Bank calculates the acquisition will be around 2% accretive in FY18-19, but suspects there are minimal synergies. While the medium term outlook for non-residential construction activity looks positive, the broker is cautious about the longer term as current activity is being buoyed by the re-building of Christchurch.

Deutsche Bank assumes the acquired revenues are maintained at peak levels until FY19 before declining. The Hawkins acquisition will help mitigate the roll-off in resources construction revenues in FY18-19, but the broker expects it to experience revenue reductions in FY20 and FY21 which suggests the acquisition is likely to be neutral to earnings per share in FY21.

Morgan Stanley is also more cautious. The broker expects a small uplift to FY18 earnings and notes a minimal impact on gearing, but questions the strategic aspect of the acquisition - in vertical construction - given Downer's historical move away from this exposure. The broker agrees there is limited ability to generate synergies with Downer's existing NZ business.

Hawkins

Hawkins is a well-known business for Downer, which is only acquiring the NZ arm, not the offshore business. Downer did not disclose the acquisition price but indicated it was in the range of $50-100m. Assuming the mid point of that range Morgan Stanley estimates the deal to be 2% accretive in FY18 and lifts gearing marginally to around 4%.

Hawkins is involved in the non-residential and civil construction space and has a number of projects in the re-building of Christchurch, as well as the SH16 Lincoln to Westgate upgrade, the construction of Auckland's Park Hyatt hotel and the Pier B extension at Auckland Airport. Citi assumes a acquisition cost of $75m for Hawkins, which suggests an acquisition multiple of 6-7 times, broadly in line with other recent transactions in New Zealand.

There are one Buy (Macquarie), three Hold and one Sell (Credit Suisse, yet to update on the acquisition) on FNArena's database. The consensus target is $6.26, signalling -13.4% downside to the last share price. Targets range from $4.01 (Morgan Stanley) to $7.60 (Macquarie).

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.

For How Long Can Iron Ore Defy Gravity?

Iron ore prices have rallied as Chinese steel consumption has surprised to the upside. Will the heady prices last?

-Steel prices remain strong and likely to support iron ore pricing in the first half of 2017 -However, iron ore prices unlikely to defy the fundamentals forever -First danger period for iron ore prices expected in late northern summer

By Eva Brocklehurst

Iron ore prices are in the spotlight. Chinese steel consumption has surprised on the upside, as have Chinese steel prices. Steel producer margins are high and forward order book expectations are rising. Brokers believe this is a factor that has driven iron ore prices well above expectations.

Heading into seasonally strong demand, Credit Suisse does not expect that steel prices will give way, just yet. The broker believes steel prices can support a US$90/tonne iron ore price throughout the first half of 2017. Credit Suisse raises its FY17 earnings estimates for BHP Billiton ((BHP)), Rio Tinto ((RIO)) and Fortescue Metals ((FMG)) by 8%, 34% and 20% respectively. The broker upgrades Fortescue Metals to Outperform.

Credit Suisse observes the surge in the iron ore price has left clients wondering whether now is time to exit the sector. The broker's initial suspicion is that it's too early, because this is a demand story and the iron ore price is tracking Chinese steel rather than its own fundamentals. Moreover, the construction season, with peak steel demand, is yet to come.

Still, supplies are more than adequate and iron ore is not expected to defy fundamentals forever. If soft demand, as construction eases, causes an extended slide in the steel price then the broker suspects a buyers' strike on iron ore cargoes is likely. This would lead to a rapid unwinding of the iron ore price, as steel mills worry about margin compression and become wary of the risks in bidding for spot cargo.

In the September quarter, the typical rebound in construction is expected and iron ore prices could be volatile albeit generally lower than the first half. Credit Suisse forecasts US$70/t.

UBS observes sentiment remains the key driver of price. This is positive in the short term, underpinned by infrastructure, property projects and government policy. Chinese mills are showing greater interest in high-grade iron ore, because of the high price of metallurgical coal. As a result, low-grade material and lump is building at the ports.

The broker believes the spot price of US$90/t is unsustainable, and risks a lift in supply. Nevertheless, seasonal demand and high Chinese steel prices and margins should support the price at around US$80/t throughout the first half, before UBS forecasts it to ease to US$60/t in the December quarter.

Credit Suisse agrees in that, while there is still too much iron ore supply, this is not the focus of steel mills and traders right now. They want to re-stock and want higher grades and are willing to pay, given steel margins are wide and there is plenty of room at the ports. This is not to say that ignoring iron ore supply will continue to be a feature of the market.

The first danger period for iron ore prices will be the late northern summer, when heat slows construction in China, Credit Suisse believes. The broker's forecasts still indicate oversupply for iron ore of 50mt across 2017. A lower price is suspected to be the trigger at some point in the year to force mine closures. Credit Suisse forecasts US$55/t in the December quarter.

The broker continues to expect 3% growth in Chinese steel demand in 2017 but considers a sharp spike in steel pricing unlikely. While infrastructure and housing construction are lifting demand, this is a clearly different rate to the frenetic pace of construction that occurred prior to the global financial crisis.

In 2018, the broker expects a slowing down of infrastructure projects and this may cut demand by -1-2%. Nevertheless, this does not support a price collapse for steel or iron ore, just signals 2018 should be weaker than 2017.

Shipping Rates

A significant decline in Western Australian iron ore shipping rates during January and February probably also contributed to the recent strength in iron ore prices, Macquarie contends. While shipping rates have started to recover, the wet season is not over and the risk of supply interruptions remains. Based on guidance by the major Pilbara iron or producers, a normal wet season would mean the shipping rate is around 780-810mtpa, which is broadly in line with the January and February averages.

Macquarie notes steel mill margins continue to improve, helped in some degree by the easing of coking (metallurgical) coal prices in recent months. Chinese steel output traditionally rises strongly from March through to May, peaking in May or June before steadying over the second half.

Inventory build has been minimal, despite the optimistic outlook for orders, and this optimism is probably better reflected in steel trader inventory, Macquarie asserts. Trader inventory levels are at their highest in nearly three years. Credit Suisse also makes the point that stocks at the ports are growing at the same time as shipments from Brazil and Australia are relatively weak.

Will China's Mines Re-start?

UBS notes that Chinese iron ore miners appear reluctant to re-start operations because of the cost, as well as being sceptical regarding the sustainability of high iron ore prices. Yet, with a stronger price, there remains a risk that domestic output will rise. Credit Suisse cites a common estimate for domestic mine costs of US$70-80/t and, as the iron price has now exceeded this, this brings a risk of re-starts.

What is less clear is whether there are any operations that are suitable for re-starting. The broker notes no one is sure how many were dismantled, had permits forfeited or are just left in decline. The broker believes there is a need to watch future data regarding capacity utilisation, and whether this lifts above the recent high of 65.7%, noted back in November.

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.

Material Matters: Base Metals, Gold & Lithium

A glance through the latest expert views and predictions about commodities. Sentiment on base metals; upbeat zinc miners; US dollar impact on metals; gold outlook; lithium demand.

-Ord Minnett upgrades forecasts for base metals amid strong data and production curtailments -Zinc prices likely able to take another leg higher in the short term -US dollar rally to continue but unlikely to appreciate strongly -Persistent doubt about the outlook for global growth underpinning gold -Global lithium demand to lift strongly and new projects will provide incremental supply

By Eva Brocklehurst

Base Metals

Ord Minnett's commodities analysts have raised near-term price forecasts for base metals on the back of positive settlement, supply disruption and strong demand. The largest changes include increases of 15% and 26% for copper price estimates in 2017 and 2018 respectively, and increases in estimates for aluminium of 21% and 15% in the same respective periods.

As a result, Ord Minnett raises its recommendation for Sandfire Resources ((SFR)) to Speculative Buy from Hold and Western Areas ((WSA)) to Hold from Lighten.

Ongoing strength in Chinese economic data, the curtailment of inefficient production across a range of sectors and ongoing strength in global purchasing manager indices, leads the broker to be bullish on the mining sector from a top-down perspective. Balance sheets are also rapidly de-gearing, suggesting there is significant capacity to increase shareholder returns via dividends and/or buy-backs at the August results.

The broker's preference is for bulk commodity exposure over base metal names, given more favourable valuation metrics, higher near-term free cash flow yields and greater capacity for expectations to change. Gold is the broker's least preferred exposure, with valuations continuing to screen expensively and the commodity view essentially flat in the medium term.

Zinc

Zinc miners are upbeat, Macquarie observes, given the shortage of concentrate in the market which has sent spot treatment charges falling to multi-year lows. At the annual conference in California, demand was considered to be reasonable in most areas, if slow for this time of year. In Asia, premiums have begun to rise slightly, although the broker is not sure whether this reflects anticipation of tightness in China or actual shortages.

The shortfall in raw material suggests to Macquarie that zinc prices can take another leg higher as refined tightness kicks in. Despite new mines, China's is expected to be short the metal and come to the international market for feed for its smelters. This means more zinc will need to be imported and Macquarie understands traders have been positioning material over the last few weeks towards Asia.

One spanner in the works is the industrial action at the Valleyfield smelter in Quebec. At present the smelter is being operated by management at 25-30% of capability. This smelter is the second largest in the region and regional premiums have climbed.

For the next 18 months or so Macquarie remains bullish, but beyond this period believes zinc's tenure at an elevated spread to aluminium will drive a reduction in demand for low-and die-cast alloys and other zinc-majority products, thus allowing prices to retrace later in the decade.

Metals And US Dollar

The US dollar is pushing higher and Macquarie expects further gains. This could pressure metal prices, although the impact should be mitigated by greater economic optimism. The broker does not envisage a major shift higher in the currency, although US trade and tax reforms remain a wild card. The main gains for the US dollar post the US election were against the Japanese yen but this has been reversed since mid January.

The broker notes the US dollar has now been strong for over two years and has recently rallied as investors become relatively more positive about the US economy. The rally is expected to continue for some time further,

given a more hawkish stance from the US Federal Reserve, and this should pressure metals prices, particularly gold and silver.

Nevertheless, Macquarie does not envisage another large appreciation in the US dollar without some major structural shift, and does not expect a major acceleration in the US economy.

Mathematically, when the US dollar is rising against other currencies it means the US dollar price of metal is falling relative to the price of the metal in those other currencies. The converse is also true. Gold typically shows the most sensitivity to this dynamic, yet the broker acknowledges this does not explain gold's rally in February.

Gold

Despite the talk of material-intensive growth in the US, Morgan Stanley observes demand for gold has held up. Since the US election, gold has bounced 10% to a peak of US$1257/oz by February, tracking a similar lift in US yields and the US dollar. The broker observes the last time all these signals moved together was in the confusing months of the global financial crisis.

Some factors behind the robust demand for gold include persistent doubt about US plans for infrastructure building and uncertainty about the US Fed's resolve to curb inflation, as well as the risks posed to global growth and the US implementation of new trade/immigration policies. Fed chair Janet Yellen, in signalling a March rate hike, not only boosted the US dollar but also capped the gold price rally and restored the gold-US dollar/yield inverse relationship, for now, the broker notes.

Morgan Stanley expects the Fed to lift its funds rate by 25 basis points in March and raise rates in another two instances in 2017, to take the rate to above 1.25%. While a long-term bear on the gold price the broker suspects there is more short-term support to come as gold, offering little return beyond the preservation of wealth, provides an excellent reason for those investors who are unsure about the global economic outlook.

Lithium

Deutsche Bank calculates global lithium demand rose 15% to 212,000 tonnes in 2016. In 2016 electric vehicles totalled around 800,000, slightly below the broker's previous estimates. Battery costs continue to fall, supported by the improving economics of electric vehicles. Incremental supply from Australia and Argentina and stricter Chinese subsidies for electric vehicles has meant Chinese lithium prices have fallen 31% since mid-2016.

The broker expects global lithium demand will increase 24% in 2017, driven by electric vehicle sales. New projects such as Mt Marion, Mt Cattlin and La Negra II will provide incremental supply, lifting global production by 30% year-on-year. The broker expects lithium pricing will remain elevated relative to historical averages, but retrace 15% on average versus 2016 levels.

The broker believes the medium-term outlook is improving and lifts 2019 demand forecast by around 20% to 380,000t. The medium term outlook is strengthening, as global automotive companies set ambitious sales target for electric vehicles from 2020 onwards.

Deutsche Bank also estimates US$4.5m of capital needs to flow into upstream lithium markets to meet 2025 demand. Hard rock projects and downstream refinancing capacity have responded the fastest and the broker estimates 75% of incremental lithium supply over the next three years will be from hard rock projects.

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.

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 February 27 to Friday March 3, 2017 Total Upgrades: 23 Total Downgrades: 17 Net Ratings Breakdown: Buy 43.21%; Hold 42.81%; Sell 13.98%

The end of the February reporting season saw yet another tsunami of broker upgrades and downgrades hit the local equities market. For the week ending Friday, 3rd March 2017, FNArena registered 23 upgrades for individual ASX-listed stocks against 17 downgrades.

AWE Ltd and Super Retail received two upgrades each, while on the negative side Charter Hall and Harvey Norman received two downgrades each.

Webjet grabbed the week's pole position for largest increase in stockbroker's price targets, enjoying a gain of 12%. Next followed Tassal Group, Cleanaway Waste Management and Asaleo Care who each enjoyed circa 7.6% additional upside.

The largest negative adjustments went to Orocobre (-13%), followed by Seven West Media (-4%) and Harvey Norman (-2.9%).

Orocobre was also the recipient of largest positive amendments to earnings estimates (+355%), handsomely beating Iluka Resources (+219%) and Alumina Ltd (+129%). The largest decline in earnings estimates went to Wellard (-232%), followed by Billabong (-123%) and, at a distance, Senex Energy (-35%), Spark Infrastructure (-13.4%) and TOX Free Solutions (-10.1%).

Things are expected to slow down considerably as the stockbroking community relaxes after a hectic run of reporting season weeks.

Upgrade

AUTOMOTIVE HOLDINGS GROUP LIMITED ((AHG)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/1/1

First half operating cash flow was well below estimates. Those hoping for a quick divestment of the troubled refrigerated logistics business may be disappointed but Credit Suisse believes management's strategy to try and improve the asset is correct, whether or not it is ultimately sold.

The broker believes regulatory risk is manageable and the FY17 growth outlook achievable. Upgrade to Outperform from Neutral. Target is lowered to $4.35 from $5.20.

AWE LIMITED ((AWE)) Upgrade to Buy from Neutral by UBS and Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/2/2

AWE's loss was in line with UBS. The upper end of the FY production and sales guidance has been trimmed due to the Tui sale. The Waitsia JV is scheduled to move to font-end engineering design (FEED) in the June quarter.

The sell-off following AWE's weak quarterly production report was overdone, the broker believes. Newsflow on Waitsia will be the key catalyst going forward. De-risking the project would provide for valuation upside. UBS

thus upgrades to Buy.

Target falls to 63c from 65c.

First half results were slightly weaker than forecast. Credit Suisse finds the goals of production and reserves growth set for FY21 hard to conceptualise. It remains unclear as to how much acquisitions will ultimately need to contribute to the goals.

The broker believes all value lies in non-sanctioned projects and, outside the Tui and Lengo sales, there is little to drive a re-rating.

Credit Suisse upgrades to Neutral from Underperform, as the stock may start to appeal at a corporate level. Target is reduced to $0.50 from $0.65.

BELLAMY'S AUSTRALIA LIMITED ((BAL)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/2/1

Citi analysts have come to the conclusion that, after a -67% drop in the Bellamy's share price since October 2016, the risk/reward for owning the shares have become more fairly balanced, hence the upgrade to Neutral/High Risk.

The analysts highlight Bellamy’s turnaround strategy revolves around winning back the daigou. Citi doesn't think this is a longer term, sustainable strategy.

It is the broker's view, Bellamy’s needs to build a direct to consumer business in China, but at this point the company cannot afford to do so. Target price rises to $4.30 from $3.75 with the company seen implementing a risky turnaround strategy that will likely take an extended period of time, say the analysts.

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

Morgans found the first half results reasonable, given the amount of restructuring that is occurring inside the business.

The announcement of an on-market buy-back, and leverage to infrastructure spending in both Australia and the Americas, suggests to the broker the company is moving into a much better position.

Guidance for FY17 has been maintained. While the stock is not technically cheap, on the basis it offers not only Australian but American infrastructure exposure as well, the rating is upgraded to Add from Hold. Target rises to $1.29 from $0.73.

CROWN RESORTS LIMITED ((CWN)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/3/0

First half results were ahead of expectations, principally driven by strength in Perth and VIP. No guidance was provided. Macquarie notes the first half dividend was ahead of expectations at 30c versus 18.5c. A special dividend of 83c was declared.

The company will not proceed with the proposed IPO of a 49% interest in some of its Australian hotels and retail.The results lead the broker to upgrade to Neutral from Underperform. Target is raised by 12.7% to $12.76.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 3/3/0

First half results were slightly better than Deutsche Bank's forecasts. The company reaffirmed guidance for all operating segments to report earnings growth in FY17.

The broker has raised FY17 and FY18 earnings estimates by 7% and 4% respectively. The broker has upgraded the stock to Buy from Hold and raised the target price to $1.25 from $1.00.

DWS LIMITED ((DWS)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/0/0

The company has entered into a binding agreement to acquire SMS Management and Technology (SMX)). Ord Minnett estimates the transaction could be 20% accretive, based on just near-term synergies alone.

SMX has performed very poorly of late and the broker believes there is potential for a further $18-20m of incremental EBITDA if DWS can turn it around. Given the prospect of material synergy upside, even if terms have to be made more favourable in order to secure the business, the broker believes there is enough potential to offset the risks.

Rating is reinstated to Buy from Hold. Target is raised to $1.61 from $1.60.

EUREKA GROUP HOLDINGS LIMITED ((EGH)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Revenue of $12m in the first half was up 53.5%, supported by significant growth in contributions from sites acquired in FY16.

Morgans observes an overhang on the share price until the Terranora re-development begins to bear fruit and reduces the net debt to more reasonable levels.

The share price weakness results in a lift in the broker's recommendation to Add from Hold. Target is reduced to $0.72 from $0.84.

ERM POWER LIMITED ((EPW)) Upgrade to Hold from Reduce by Morgans .B/H/S: 0/1/2

Morgans commends the company for a clean result, in that there were no material items extracted from underlying earnings. Still, the broker finds it hard to draw conclusions given large and opposing swings in earnings and cash flows.

The reduction in the dividend may be negative but the broker believes it a sensible decision as earnings were not supporting the previous level. The FY17 outlook appears to have deteriorated.

The broker upgrades to Hold from Reduce. Target rises to $1.05 from 99c.

GATEWAY LIFESTYLE GROUP ((GTY)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

Gateway's underlying earnings were below expectation but the company is now on a firmer footing, Macquarie suggests. Settlements were down on last year but accelerated in the second quarter. The balance sheet provides scope for further acquisitions.

The broker now has greater confidence in overhead, capex and inventory assumptions, and has long been positive on the managed housing estate model, given trends in ageing, housing affordability and government support. Upgrade to Outperform. Target falls to $2.19 from $2.40.

MG UNIT TRUST ((MGC)) Upgrade to Add from Hold by Morgans .B/H/S: 1/1/0

First half result was weaker than expected. Morgans expects FY17 will be a tough year but this should be as bad as it gets as the eventual return of a more normal season and management's initiatives should turn things around.

While acknowledging the risk, the broker upgrades to Add from Hold, believing that patient investors will be rewarded by a better year in FY18. Target is reduced to $1.20 from $1.25.

MEDUSA MINING LIMITED ((MML)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/2/0

It was a weak result, as expected, comment analysts at Citi. They have reduced estimates and the price target to 38c from 45c in response.

However, the savage share price response has now triggered an upgrade to Neutral from Sell. Also, the analysts flag the company might need some near-term funding, estimated at circa US$5m, for working capital.

OROCOBRE LIMITED ((ORE)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/1/0

The company's downgrade to production guidance reflects increased risk shorter term, Citi analysts suggest, but assuming short term issues are successfully addressed, current share price weakness shall represent a buying opportunity longer term.

Citi upgrades to Buy/High Risk with a target of $3.90, down from $4.75 prior. As the company wants to avoid a new capital raising to fund the planned doubling of production capacity, Citi is now assuming a six months delay.

PERSEUS MINING LIMITED ((PRU)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/3/0

Citi upgrades to Neutral/High Risk from Sell as a seemingly much worse than expected financial performance didn't quite turn out as disastrous, once corrected for legal costs and other abnormal items.

Sissingué will require funding and Citi analysts are anticipating $30m of new debt capital, though an equity raise is not out of the question, in their view. Target price rises to 39c from 37c.

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

First half results were below expectations and the trading update on the second half suggests to Morgans a weak

sales performance in challenging retail conditions.

FY17 underlying EBITDA guidance is revised down to $85-88m. The broker believes the valuation now factors in a slowing trend and there is reasonable upside at current prices.

Morgans upgrades its rating to Add from Hold but acknowledges patience is required. Target is reduced to $1.32 from $1.51.

SOUTH32 LIMITED ((S32)) Upgrade to Buy from Neutral by UBS .B/H/S: 6/1/0

UBS upgrades to Buy from Neutral, believing metallurgical coal and manganese prices are stabilising and valuation metrics now look compelling.

The broker believes the stock offers a free cash flow yield of over 15% with out-of-cycle returns possible in the June quarter. The company has stated at its results briefing that was very close to being able to justify returns to shareholders and UBS believes this will increasingly be the case.

Target is raised to $2.80 from $2.75.

SELECT HARVESTS LIMITED ((SHV)) Upgrade to Add from Hold by Morgans .B/H/S: 1/1/0

First-half results were weaker than expected, with an adverse carry over of last year's crop at a lower realised almond price.

The company has upgraded its FY17 production estimate but, because of a lower almond price, Morgans has reduced its net profit forecast by 25%.

The broker upgrades profit forecast from FY18 onwards, to account for the acquisition of the Jubilee almond orchards. Following material share price weakness, the broker believes the valuation is now attractive and upgrades to Add from Hold. Target is reduced to $6.05 from $6.90..

SIGMA PHARMACEUTICALS LIMITED ((SIP)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/1/1

Underlying, the operational environment for Sigma remains one of many challenges, acknowledge analysts at Citi. But they do believe the company will achieve its guidance and that means the share price is too cheap.

Upgrade to Neutral from Sell as the company is embarking on a multiyear capex program to deliver more efficient distribution centres and with the analysts finding confidence in management's track record. Target price has gained 6c to $1.16.

SUPER RETAIL GROUP LIMITED ((SUL)) Upgrade to Buy from Neutral by Citi and Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 6/2/0

Reported financials were strong, but in-line nevertheless. Citi analysts found the Q2 trading update a bit underwhelming. Estimates have been increased and this is sufficient for an upgrade to Buy from Neutral.

Target price lifts to $11.90 from $10.80. Citi is projecting double digit growth for the next three years. The stock is still seen trading at a discount versus the ASX200 ex-resources.

First half results suggest to Credit Suisse the company is back on track. BCF's promotional issues appear to have been addressed and Ray's is no longer a drag on performance.

Rating is upgraded to Neutral from Underperform. Target is raised to $10.42 from $9.77.

SEYMOUR WHYTE LIMITED ((SWL)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

First half results were broadly in line with expectations. Infrastructure revenue was up 36.5%.

Morgans finds there is better clarity into FY18 and, after the passage of a weak first half, rolls forwards multiples and moves the rating back to Add from Hold.

The broker believes the stock provides investors with a cheap exposure to the infrastructure theme. Target is raised to $1.17 from $0.86.

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

Dar Group has taken a strategic interest in WorleyParsons. Macquarie believes this unexpected corporate move has lifted the investment case and likely put a floor under the share price at around $10.

Macquarie envisages a relatively low probability of a competing bid from the company's larger listed peers.The broker believes the fundamentals are likely to be less relevant in the short term, such as prior concerns regarding weak first-half cash flow and higher-than-expected net debt.

Macquarie upgrades to Neutral from Underperform. Target is raised to $10.50 from $8.28.

Downgrade

ADAIRS LIMITED ((ADH)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/0

There was a sharp decline in earnings in the first half following weak sales in the fashion bed linen category and softer trading over Christmas.

UBS suspects Kmart ((WES)) is taking market share in the fashion home furnishings category. Kmart is generally lower than Adair's typical customer demographic but the intensifying of competition is a concern for the broker, as the housing cycle is expected to slow over the coming months and this is expected to be a drag on retail sales over FY19.

UBS downgrades to Neutral from Buy given the uncertainty around the top line. Target is reduced to $1.25 from $2.20.

ADMEDUS LTD ((AHZ)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The share price has recovered towards the target and Morgans moves back to Hold from Add.

The company's restructure and review of operations has been completed and revenue guidance of $21m for FY17 has been provided. Morgans makes no changes to forecasts. Target is $0.36.

AUSNET SERVICES ((AST)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 2/5/0

Morgan Stanley has downgraded to Equal-weight from Overweight on relative valuation, as the recent move in the security price makes investment look less compelling.

The broker notes the company's transmission determination is due in late April and FY17 results in May. Target is raised to $1.59 from $1.55. Industry view: Cautious.

BEADELL RESOURCES LIMITED ((BDR)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/1/1

Financial results missed on just about every metric. Citi analysts observe mined ore is increasingly sulphide while the mill is optimised to process a higher oxide blend. New crushing capacity will likely be added to lift sulphide recovery, they add.

Citi has downgraded to Neutral from Buy. Price target declines by -9c to 32c. The analysts note management kept CY17 volume guidance for 140-150koz at AISC US$830-930/oz.

BANK OF QUEENSLAND LIMITED ((BOQ)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/5/1

Ord Minnett forecasts first half cash earnings of $171m, which incorporates a -5% downgrade. This reflects a lack of volume growth, margin weakness from deposit competition and re-basing of trading gains.

Importantly, the lack of growth in the first half means the bank can maintain the interim dividend at $0.38, despite it translating into an 85% pay-out ratio. Order Minnett downgrades to Lighten from Hold. Target is reduced to $11.00 from $11.25.

CHARTER HALL GROUP ((CHC)) Downgrade to Neutral from Buy by UBS and Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/2/2

Charter Hall posted a very strong result, 13% ahead of UBS. A high level of transaction and performance fees led to the beat but growth in investment management revenue and property income also outperformed.

FY17 guidance has been increased but attention will turn to growth in FY18, the broker suggests. Typically management starts guidance low and then upgrades throughout the year, and the broker expects this to be the case again. The stock is now well valued nevertheless, prompting a downgrade to Neutral.

Target rises to $5.40 from $5.27.

Charter Hall's first half results were as the broker expected, Guidance for the second half of 14.4cps was -7.3% down on the first half due to timing.

Management has raised FY17 EPS growth guidance to 12% from 7%.

Ord Minnett has downgraded the stock to Hold from Accumulate and raised the target price to $5.15 from $5.12.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/0/4

First half was strong, the company has started the second half well and Macquarie finds the interim result hard to fault. Yet, the broker observes some signs of the cyclical highs being reached.

Macquarie's lower valuation reflects an assumption that margins will revert back to long-run averages by FY19. Despite the company's superb execution in recent years the broker considers the risks to be building and suspects the macro will now become a headwind.

Rating is downgraded to Underperform from Neutral. Target is reduced to $5.05 from $5.38.

First half underlying profit before tax was below forecasts. Ord Minnett observes the factors that have supported earnings growth are moderating. In addition, the next leg of cost savings is less certain and the amount of capital employed is now rising.

These factors reduce the valuation of the stock and the broker downgrades to Lighten from Hold. Target is reduced to $4.60 from $4.75

MEDIBANK PRIVATE LIMITED ((MPL)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/6/2

With the recent share price performance narrowing the discount to Macquarie's price target, the rating is downgraded to Neutral from Outperform.

The broker does not believe the investment case is supported at current levels, given the combination of moderating industry premium growth and operations at, or near, peak margins.

Claims growth remains materially below long-term trends, which is a risk to the broker's view. The other risk is a structural change to address the policy-holder mix and lack of growth amongst younger members. Target is $2.95.

NIB HOLDINGS LIMITED ((NHF)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/6/0

With the recent share price performance narrowing the discount to Macquarie's price target, the rating is downgraded to Neutral from Outperform.

The broker does not believe the investment case is supported at current levels, given the combination of moderating industry premium growth and operations at, or near, peak margins.

Claims growth remains materially below long-term trends, which is a risk to the broker's view. The other risk is a structural change to address the policy-holder mix and lack of growth amongst younger members. Target is $5.50.

QBE INSURANCE GROUP LIMITED ((QBE)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 4/2/1

On Credit Suisse's assessment, QBE's financial report, underlying, missed expectations. The 2016 result benefited from discount rate gains, further reserve releases and significant profitability on the crop portfolio, explain the analysts. These are all considered one-offs.

The analysts believe the insurer needs a lot of help to achieve FY17 guidance, including further reserve releases and marked improvement in the premium environment. Needless to say, CS remains critical of general optimism about QBE's outlook. Target $12.60 (unchanged).

RHIPE LIMITED ((RHP)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 1/1/0

First half results were worse than expected. FY17 revenue guidance has again been lowered, although the EBITDA target of $4m is unchanged.

Ord Minnett points to a seemingly quick slowdown in the profitable private segment, where the broker envisaged key competitive advantages. Medium-term forecasts are reduced significantly and the rating is downgraded to Hold from Buy. Target falls to $0.46 from $1.00.

SPECIALTY FASHION GROUP LIMITED ((SFH)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/2/0

Citi analysts seem content with the reported financials. The stand-out achievement was a recovery in margins and the analysts believe there is more to come on this account.

They have lowered the probability of a take-over to 70% from 90%. Downgrade to Neutral given the share price is near the price target of 70c. Estimates have been reduced. DPS has been scrapped for FY17 and reduced to 3c for FY18.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 2/4/0

2016 results were slightly below expectations. The company has the lowest regulatory risk in Morgan Stanley's sector coverage, although regulatory risk is generally low anyway. Strong asset performance, which underpins the upside risk in distributions, is somewhat offset by uncertainty on the company's acquisition strategy.

The broker downgrades to Equal-weight from Overweight, as the recent move in the security price makes investment look less compelling, and raises the target to $2.40 from $2.21. Industry view is Cautious.

SPOTLESS GROUP HOLDINGS LIMITED ((SPO)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 0/2/1

First half results were much weaker than expected. Margins were lower and a $420m impairment suggests to Deutsche Bank earnings prospects are less than management previously envisaged.

The broker remains cautious about the high debt levels and downgrades to Sell from Hold amid concerns over the balance sheet. Target is reduced to $0.63 from $1.07.

XPD SOCCER GEAR GROUP LIMITED ((XPD)) Downgrade to Reduce from Add by Morgans .B/H/S: 0/0/1

2016 results beat forecasts. The company announced that, because of restrictions on direct investment offshore, the buy-back announced in August has been terminated. The board believes it is more important to preserve capital for potential acquisitions than to pay dividends.

Morgans considers this a major change in strategy. It appears new acquisition opportunities relate to local shoe component manufacturers. No guidance was provided for 2017.

Despite an attractive cash position and exposure to one of the fastest-growing sporting codes in China, Morgans finds it cannot recommend the company as an investment, given the cash is effectively in lock-up and dividends will not be paid for the foreseeable future.

The broker believes earnings multiples have become irrelevant as has revenue/earnings growth from a domestic investor perspective. The broker downgrades to Reduce from Add. Target is reduced to 5.9 cents from $0.15.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AUTOMOTIVE HOLDINGS GROUP LIMITED Buy Neutral Credit Suisse 2 AWE LIMITED Buy Neutral UBS 3 AWE LIMITED Neutral Sell Credit Suisse 4 BELLAMY'S AUSTRALIA LIMITED Neutral Sell Citi 5 CARDNO LIMITED Buy Neutral Morgans 6 CLEANAWAY WASTE MANAGEMENT LIMITED Buy Neutral Deutsche Bank 7 CROWN RESORTS LIMITED Neutral Sell Macquarie 8 DWS LIMITED Buy Neutral Ord Minnett 9 ERM POWER LIMITED Neutral Sell Morgans 10 EUREKA GROUP HOLDINGS LIMITED Buy Neutral Morgans 11 GATEWAY LIFESTYLE GROUP Buy Neutral Macquarie 12 MEDUSA MINING LIMITED Neutral Sell Citi 13 MG UNIT TRUST Buy Neutral Morgans 14 OROCOBRE LIMITED Buy Neutral Citi 15 PERSEUS MINING LIMITED Neutral Sell Citi 16 RCG CORPORATION LIMITED Buy Neutral Morgans 17 SELECT HARVESTS LIMITED Buy Neutral Morgans 18 SEYMOUR WHYTE LIMITED Buy Buy Morgans 19 SIGMA PHARMACEUTICALS LIMITED Neutral Sell Citi 20 SOUTH32 LIMITED Buy Neutral UBS 21 SUPER RETAIL GROUP LIMITED Buy Neutral Citi 22 SUPER RETAIL GROUP LIMITED Neutral Sell Credit Suisse 23 WORLEYPARSONS LIMITED Neutral Sell Macquarie Downgrade 24 ADAIRS LIMITED Neutral Buy UBS 25 ADMEDUS LTD Neutral Buy Morgans 26 AUSNET SERVICES Neutral Buy Morgan Stanley 27 BANK OF QUEENSLAND LIMITED Sell Neutral Ord Minnett 28 BEADELL RESOURCES LIMITED Neutral Buy Citi 29 CHARTER HALL GROUP Neutral Neutral UBS 30 CHARTER HALL GROUP Neutral Buy Ord Minnett 31 HARVEY NORMAN HOLDINGS LIMITED Sell Neutral Macquarie 32 HARVEY NORMAN HOLDINGS LIMITED Sell Neutral Ord Minnett 33 MEDIBANK PRIVATE LIMITED Neutral Buy Macquarie 34 NIB HOLDINGS LIMITED Neutral Buy Macquarie 35 QBE INSURANCE GROUP LIMITED Sell Neutral Credit Suisse 36 RHIPE LIMITED Neutral Buy Ord Minnett 37 SPARK INFRASTRUCTURE GROUP Neutral Buy Morgan Stanley 38 SPECIALTY FASHION GROUP LIMITED Neutral Buy Citi 39 SPOTLESS GROUP HOLDINGS LIMITED Sell Neutral Deutsche Bank 40 XPD SOCCER GEAR GROUP LIMITED Sell N/A Morgans Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SIQ SMARTGROUP CORPORATION LTD 60.0% 25.0% 35.0% 5 2 AHY ASALEO CARE LIMITED

67.0% 33.0% 34.0% 3 3 BAL BELLAMY'S AUSTRALIA LIMITED -33.0% -67.0% 34.0% 3 4 SUL SUPER RETAIL GROUP LIMITED 69.0% 44.0% 25.0% 8 5 TGR TASSAL GROUP LIMITED 75.0% 50.0% 25.0% 4 6 ORE OROCOBRE LIMITED 75.0% 50.0% 25.0% 4 7 PTM PLATINUM ASSET MANAGEMENT LIMITED -50.0% -75.0% 25.0% 4 8 PRU PERSEUS MINING LIMITED 40.0% 20.0% 20.0% 5 9 WOR WORLEYPARSONS LIMITED 40.0% 20.0% 20.0% 5 10 APN APN NEWS & MEDIA LIMITED 100.0% 80.0% 20.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 LOV LOVISA HOLDINGS LIMITED 33.0% 67.0% -34.0% 3 2 BRG BREVILLE GROUP LIMITED 63.0% 88.0% -25.0% 4 3 HVN HARVEY NORMAN HOLDINGS LIMITED -36.0% -14.0% -22.0% 7 4 WEB WEBJET LIMITED 30.0% 50.0% -20.0% 5 5 WSA WESTERN AREAS NL -25.0% -7.0% -18.0% 6 6 SKI SPARK INFRASTRUCTURE GROUP 33.0% 50.0% -17.0% 6 7 AST AUSNET SERVICES 21.0% 36.0% -15.0% 7 8 AWC ALUMINA LIMITED -50.0% -36.0% -14.0% 7 9 NHF NIB HOLDINGS LIMITED 7.0% 21.0% -14.0% 7 10 GNC GRAINCORP LIMITED 20.0% 33.0% -13.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 WEB WEBJET LIMITED 11.860 10.574 12.16% 5 2 TGR TASSAL GROUP LIMITED 5.195 4.825 7.67% 4 3 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 1.197 1.112 7.64% 6 4 AHY ASALEO CARE LIMITED 1.650 1.533 7.63% 3 5 BRG BREVILLE GROUP LIMITED 9.400 8.800 6.82% 4 6 QBE QBE INSURANCE GROUP LIMITED 13.173 12.405 6.19% 8 7 SUL SUPER RETAIL GROUP LIMITED 11.420 10.861 5.15% 8 8 WOR WORLEYPARSONS LIMITED 9.868 9.424 4.71% 5 9 BAL BELLAMY'S AUSTRALIA LIMITED 4.257 4.073 4.52% 3 10 LOV LOVISA HOLDINGS LIMITED 4.210 4.083 3.11% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ORE OROCOBRE LIMITED 4.143 4.765 -13.05% 4 2 SWM SEVEN WEST MEDIA LIMITED 0.700 0.730 -4.11% 4 3 HVN HARVEY NORMAN HOLDINGS LIMITED 5.003 5.157 -2.99% 7 4 MQA MACQUARIE ATLAS ROADS GROUP 5.480 5.608 -2.28% 5 5 WSA WESTERN AREAS NL 2.547 2.597 -1.93% 6 6 VOC VOCUS COMMUNICATIONS LIMITED 5.414 5.514 -1.81% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ORE OROCOBRE LIMITED 8.886 1.950 355.69% 4 2 ILU ILUKA RESOURCES LIMITED 9.148 -7.631 219.88% 7 3 AWC ALUMINA LIMITED 10.479 4.569 129.35% 7 4 MQA MACQUARIE ATLAS ROADS GROUP 31.842 18.050 76.41% 5 5 FAR FAR LIMITED -0.423 -1.290 67.21% 3 6 OZL OZ MINERALS LIMITED 55.993 37.829 48.02% 8 7 SDA SPEEDCAST INTERNATIONAL LIMITED 25.048 17.183 45.77% 4 8 OGC OCEANAGOLD CORPORATION 42.776 30.160 41.83% 5 9 PRU PERSEUS MINING LIMITED -3.270 -4.255 23.15% 5 10 BAL BELLAMY'S AUSTRALIA LIMITED 19.433 16.000 21.46% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WLD WELLARD LIMITED -2.833 2.133 -232.82% 3 2 BBG BILLABONG INTERNATIONAL LIMITED -0.300 1.300 -123.08% 3 3 SXY SENEX ENERGY LIMITED -0.740 -0.546 -35.53% 6 4 SKI SPARK INFRASTRUCTURE GROUP 8.358 9.656 -13.44% 6 5 TOX TOX FREE SOLUTIONS LIMITED 13.700 15.240 -10.10% 5 6 ISD ISENTIA GROUP LIMITED 14.067 15.400 -8.66% 3 7 CWN CROWN RESORTS LIMITED 72.199 76.810 -6.00% 6 8 JHC JAPARA HEALTHCARE LIMITED 12.140 12.720 -4.56% 4 9 QAN QANTAS AIRWAYS LIMITED 55.351 57.368 -3.52% 7 10 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 29.989 31.044 -3.40% 7 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: As You Were

By Greg Peel

Having enjoyed an uninterrupted rally of almost 50% from the December low, three weeks ago the spot uranium price fell -US$1.25 and two weeks ago another -US$2.50 to suddenly cut that rally to a mere 27%. If utilities had decided they were now sufficiently stocked, or decided that opportunistically low prices had now been and gone, things were looking grim.

Then last week the spot price rallied back US$2.50, to US$25.00/lb on industry consultant TradeTech's weekly price indicator.

Of that move, the first US$1.25 occurred all on the last business day in February. Perhaps sensing a snap-back rally, traders and intermediaries made up the bulk of the buy-side in seven transactions for the week, pushing the price up a further US$1.25 by week's end. We cannot call a resumption of the rally unless utility demand returns, but we may conclude that traders caught long with material a couple of weeks ago have managed to get out.

Otherwise, the wider picture has not much changed.

The uranium market is expected to remain well supplied through to 2020, according to the projections of the Kazakh National Wealth Fund (noting that Kazakhstan boasts the world's largest reserves of uranium), as suggested in a report published February 27. While the Fund expects price action to continue to be volatile, spot price are projected to remain depressed around the low US$30/lb mark.

Not the sort of news to make one rush out and buy uranium on February 28, but the KNWF also suggested longer term prices will be supported by rising global demand meeting supply shortages, as very few new mines will be developed at such low price levels.

Kazakhstan's state-owned producer has cut its own production target by -10% for 2017. Canada's Cameco was once the biggest single producer of uranium but spent 2016 cutting back operations. Such cutbacks may not be over yet, given the CEO last week declared the company "could look to make changes to our inventory position, our production profile and our purchasing activity".

Cameco is currently in a dispute with the Tokyo Electric Power Company, which has cited force majeure six years after Fukushima in cancelling long term supply commitments. TEPCO is the operator of Fukushima, and clearly a significant customer for Cameco, given the suggestion the company will go hard at the Japanese in court.

Among Australia's significant listed producers, the recent local earnings result season revealed BHP Billiton's ((BHP)) Olympic Dam uranium mine suffered lower than expected production in the half due to maintenance issues, Rio Tinto's ((RIO)) two-thirds owned Energy Resources of Australia ((ERA)) continues to only produce uranium from stockpiled ore, and Paladin Energy's ((PDN)) financial survival will be dependent upon stakeholders accepting a proposed debt restructure, as the company's African operations continue to burn cash at current prices.

The month of February saw 4mlbs U3O8 equivalent change hands in the uranium spot market in 27 transactions, TradeTech reports. Utilities were largely absent on the buy-side. February's closing price of US$23.75/lb compares to US$24.50/lb at the end of January but the first three days of March have taken that price back up to US$25.00/lb.

TradeTech has lifted its mid-term price indicator by US$1.00 to US$28.75/lb, leaving its long-term price unchanged at US$35.00/lb.

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.

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 2, 2017

Last week saw the ASX200 largely move into stall mode around the 5750 mark as the last couple of days of the results season played out. While the stall is reflective of a similar lull in the Trump rally on Wall Street, most notable in last week's trade was exiting of positions in the resource sector. For many, no doubt very profitable positions.

To that end, it is interesting to note that amongst a sea of red below, Independence Group ((IGO)), Alumina Ltd (AWC)), Rio Tinto ((RIO)), Iluka Resources ((ILU)), Mineral Deposits ((MDL)) and Dacian Gold ((DCN)) all featured. Within the 10% shorted club, both Orocobre ((ORE)) and Syrah Resources ((SYR)) added substantially to shorts.

Mineral Deposits and Dacian Gold are new arrivals at the bottom of the 5% plus table. Alumina Ltd jumped into the 8% bracket from the 6% bracket.

Elsewhere we see shorters moving in for the kill on Domino's Pizza ((DMP)) – a steady mover up the table since its wages troubles began – and the unfortunate Ardent Leisure ((AAD)).

Weekly short positions as a percentage of market cap:

10%+

ACX 16.7 MYR 15.6 WSA 14.1 ORE 14.1 TFC 13.7 SYR 11.9 VOC 11.7 NEC 11.2 MTS 10.3

Out: WOR

9.0-9.9%

WOR, MYX, DMP In: WOR, DMP

8.0-8.9%

IGO, AWC, BEN, OFX, NWS, AAD, SRX, BAL, MND, DOW

In: IGO, AWC, BEN, AAD, SRX, DOW Out: DMP

7.0-7.9%

FLT, GTY, NXT, PRU, ISD, ILU, BGA, MTR, RWC, RIO

In: ILU, RIO Out: DOW, IGO, BEN, SRX, HSO

6.0-6.9%

A2M, SGH, EHE, IPD, SEK, CSV, HSO, PDN, IVC, SHV, IFL

In: HSO, EHE, SHV, IFL Out: AWC, RIO, ILU, MYO, ISD

5.0-5.9%

CTD, MSB, MYO, BKL, MDL, KAR, GXL, JHC, AAC, CSR, DCN, WOW, OSH, SPO, CAB, CQR

In: MYO, MDL, JHC, DCN, SPO, CAB, CQR

Out: AAD, IFL, EHE, IPH, TGR, SUL, GMA

Movers and Shakers

Lithium and graphite are both commodities associated with the rapid development and growth of batteries and miners thereof have proven popular with investors in recent times, seeing share prices soar on the hype. But the road to production of any commodity is invariably fraught with risks and subject to setbacks, often proving a reality check for eager shareholders.

Orocobre posted an earnings report last week in line with expectations but the market was taken aback by a big cut in lithium production guidance due to problems with evaporation pools, delaying the timing to nameplate capacity and sending analysts scurrying to downgrade their earnings forecasts.

Orocobre has tracked a steady path up into the 10% plus shorted club over recent weeks and last week saw another big jump to 14.1% from 11.0%.

There has been no new news out of Syrah Resources of late since the graphite hopeful's December quarter update, which showed the cost of developing the Balama project is steadily creeping up. We might conclude shorters in this space are lumping battery-related commodities together, given last week saw Syrah shorts rise to 11.9% from 10.6%.

Also experiencing development delays is Independence Group's much vaunted Nova nickel project. Nickel price forecasting is a difficult game at present given production and exports are under the spell of the fickle whim of various governments. Last week Independence shorts rose to 8.7% from 7.6%.

If nickel is a difficult one at present, ask two mining analysts their thoughts on alumina prices and you'll get two completely different answers. Again government interference is an issue, with the Chinese government perhaps about to curtail alumina/aluminium production capacity, or perhaps not. The FNArena database shows two Buy ratings on Alumina Ltd and five Sells.

Last week Alumina shorts jumped to 8.3% from 6.0%.

While the tragedy at Dreamworld brought into question the impact on Ardent Leisure's future theme park earnings, no one was prepared for a consensus-missing result within Ardent's earnings report from the flagship Main Event business. Main Event has been the earnings driver that has offset difficulties among other businesses, and particularly the Dreamworld issue.

Ardent shorts rose to 8.1% from 5.9% last week.

While Domino's Pizza shorts only increased 0.9ppt last week, thus not rendering the company a true Mover & Shaker, it is worth noting that the once can-do-no-wrong superstar has crept steadily up the table over recent weeks and is now sitting at 9.6% shorted. Domino's is yet to resolve its wage underpayment issues, and thus earnings guidance is uncertain.

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.

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.

The Wrap: PRRT, Fed, Health & Infrastructure

Weekly Broker Wrap: Petroleum Resource Rent Tax; US Fed rate hike; health insurer valuations; gaming sector outlook; major Australian infrastructure projects.

-Risk that PRRT review is used as a means to raise revenue -Macquarie: health insurer investment case not supported at current levels -Gaming sector to benefit from several initiatives -Bottom line impact of major infrastructure projects muted for LLC and CIM

By Eva Brocklehurst

Petroleum Resource Rent Tax

The federal government is undertaking a review into the design and operation of the petroleum resource rent tax (PRRT). Citi observes, if the government is true to the stated efficiency focus of the Henry review, then changes should be small. The broker believes the regime is mostly performing as it was designed, that is to tax excess profits while not providing a disincentive to marginal projects.

The risk is that the review will be used as a means to raise revenue, which could then result in a substantial impact on valuations and future investment decisions. The broker believes the government, in seeking to increase its share of economic rent, should also consider that marginal LNG projects are becoming less competitive globally and face deferrals, while delays to planned mergers and IPO activity are being encountered amidst policy uncertainty.

The government also needs to note the higher gas and electricity prices on the east coast, given an increasing cost of supply. There is also a heightened perception of sovereign risk translating into reduced investment appetite from offshore, if only on a short-term basis. Citi concedes that predicting policy outcomes from a marginal government is difficult. The broker does note that Oil Search ((OSH)), with no Australian operations, is the only oil stock under coverage which is not exposed to PRRT risk.

US Fed Rate Hikes

Following the signals from Federal Reserve speakers over the last week, National Australia Bank analysts now expect an increase in the Fed Funds rate at this month's meeting. The analysts now expect three rate hikes in 2017 rather than just two.

This expectation comes despite some recent weakness in the data which will be used to estimate first-quarter GDP in the US. The analysts observe that weakness in the first quarter has not been unusual in recent years and surveys still show a solid underlying economy.

Members of the Fed have also indicated risks to the outlook have become more balanced, as overseas risks recede amid expectations of stimulative US fiscal policy. The main risk to a rate hike in March is the US non-farm payrolls report but this would have to be very weak to change the Fed's view, in the analysts' opinion. The Fed is not expected to be put off by a soft report particularly as other indicators of the labour market are running strongly.

Health Insurers

The investment case for health insurers is not supported at current levels, in Macquarie's opinion, given the combination of moderating premium growth that reflects structural pressure on policy-holder mix in the community-rated private health insurance sector.

Both Medibank Private ((MPL)) and nib Holdings ((NHF)) are operating at, or near, peak margins and claims growth has been below long-term trends. Macquarie downgrades both stocks to Neutral from Outperform as both stocks have closed the gap to the broker's valuation.

Claims growth remains materially below long-term trends and this is supporting profitability at present. A continuation provides a modest risk to the broker's view in the next 6-12 months. Another risk is a structural change to address the policy-holder mix and lack of growth among young members. The broker envisages very low risk of a change occurring in the next 12 months.

Gaming Sector

Despite the subdued macro environment, Deutsche Bank is positive about the gambling sector, given the initiatives companies have undertaken to enhance earnings growth. Star Entertainment ((SGR)) will benefit from the expansion of the main gaming floor in Sydney and the re-launch of its loyalty program. Crown Resorts ((CWN)) will benefit from cost reduction initiatives.

The broker's preference in the sector is Aristocrat Leisure ((ALL)), Star Entertainment and Crown. Aristocrat is trading at a 21% discount to the broker's valuation and its Buy rating is based on strong forecasts for a growth in earnings per share, an increase in recurring revenue and continued market share gains. Deutsche Bank suggests the share prices of both Tabcorp ((TAH)) and Tatts Group ((TTS)) will be determined by progress on the proposed merger between the two.

Infrastructure Construction

The value of major Australian transport projects under construction has risen to $33.9bn over the past two years and there are a further $85.5bn in projects slated to commence by 2020, Credit Suisse observes. Allowing for expected win rates, and an increasing requirement for joint ventures because of project scale, revenues from major transport projects are expected to grow by 11-15% from 2016-20 for both CIMIC ((CIM)) and Lend Lease ((LLC)).

Nevertheless, with such projects accounting for less than 10% of each company's earnings in 2016, on Credit Suisse's estimates, the impact to the bottom line is less significant than the huge value of these projects suggests. Larger projects do favour these two companies, by removing some less well-capitalised competitors from contention. Yet the increased size and complexity also tends to need joint ventures with other local or international groups.

The broker estimates that the two companies' combined share of transport project revenues has declined over the period since 2012, to 39% from 52%. This share has been picked up by international groups, primarily via joint ventures with these two. Improving transport infrastructure is just one of the several positive drivers envisaged for Lend Lease.

In the case of CIMIC, Credit Suisse believes current margins on projects are unsustainable and the recovery in mining and resource-related construction is likely to be gradual. Hence, earnings sourced from major road and rail projects need to be far larger in order for CIMIC's current pricing to be justified. The broker has a Underperform rating for CIMIC and Outperform for Lend Lease.

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.

Select Harvests Sustains Positive Outlook

Almond grower Select Harvests is facing more subdued almond prices but an accretive new orchard and improved yields suggest FY18 should be positive.

-Global almond prices have stabilised and management expects 2017 prices of $7.50-8.00/kg -Investor confidence negatively affected by potential oversupply in the US -Gearing stepping up, although there is room as cash is being generated

By Eva Brocklehurst

Almond grower Select Harvests ((SHV)) is facing a more subdued almond price in 2017 as Californian growers, the major suppliers globally, return from three years of drought. Yet following the accretive acquisition of a new orchard and improved farming practices increasing yields, brokers are quietly confident for FY18.

The company reported a first half cash net profit of $13.1m for FY17, which compares with $44.3m in the prior corresponding half. Cash operating earnings (EBITDA) were reduced to $26.5m from $61.9m. The company's food division was affected by price deflation in the trading business and a rapidly falling almond price affected that division.

Management has committed to the long-term build up of scale and has leveraged its large fixed cost base through both acquisitions and organic means. Canaccord Genuity observes this investment in growth is a drag on near-term cash, and gearing is expected to rise.

Global almond prices appear to have stabilised and management expects the pooled price for 2017 to range between $7.50/kg and $8.00/kg, which compares with $7.70/kg obtained in 2016. The price range is in line with prior estimates and around 30% of the 2017 crop is committed at $7.70/kg. the company has upgraded FY17 production estimates to 15,750-16,250t.

The results include an unfavourable carry-over of inventory. When adjusted, Bell Potter calculates a more modest 2% decline year-on-year in net profit and a slightly stronger forecast. The company has also announced a $26.5m investment in acquiring the Jubilee orchards and a 22% interest in a 10,000t primary processing facility. This should provide an additional 1,000t of almonds from FY18.

Californian shipments have increased 33% in the year to date. The Californian drought is over following record snowfalls in the previous three months but the bloom and recovery has been disrupted, potentially affecting next year's supply. Investor confidence continues to be negatively affected, the broker observes, by the potential oversupply in the US as yields improve.

Canaccord Genuity acknowledges Select Harvests has a strategically relevant asset, with an improving yield and production profile, and operating leverage will aid future profitability if and when almond prices revert upwards. The broker, not one of the eight monitored daily on the FNArena database, has a Hold rating and $6.00 target.

Morgans has also reduced crop forecasts, and net profit by 25%, because of the lower almond prices. Profit estimates from FY18 are upgraded to account for the acquisition of the Jubilee orchards. This acquisition, along with improved yields from existing orchards and two growth projects, should underpin strong earnings growth in FY18 as long as the current almond price holds up.

The main risks to the broker's forecast is falling US dollar almond prices, a rising Australian dollar and/or rain at harvest. Following significant share price weakness, Morgans considers the stock is been oversold. The focus is now on FY18 fundamentals and the broker finds the valuation attractive, trading on FY18 forecast price/earnings ratio of 11.2x. Consequently, the broker's rating is upgraded to Add from Hold. Target is $6.05.

Morgans notes the barriers to entry exist in this market, given there are few places in the world where almonds can actually be grown and there are large capital costs and long lead time to mature production.

Almond prices appear to have formed a floor, and while Bell Potter does not expect a material pick up in pricing in the near term, volume growth is expected to carry the business. With this in mind, and in light of the recent share price correction, the broker, not one of the eight monitored daily on the database, upgrades to Buy from Hold.

The stock lives for the almond price, UBS believes, and falling prices suggest estimates need to be cut. The company's cash flow was weaker than expected in the half year, although this was attributed to a large payment of tax. UBS reduces its medium-term almond price forecast to $7.50/kg.

While gearing is stepping up a notch the broker estimates there is still room on current forecasts. The company is generating cash and is expected to eliminate its existing bank debt by FY18-21. While near-term conditions support an appreciation of the almond price because of concerns around the Californian bloom, US inventory clearance needs to be maintained at record levels and FX remains a risk, in the broker's opinion.

Despite the benefits of spreading weather risk, UBS does not expect Select Harvests to pursue offshore expansion, although it could leveraged its expertise to produce other nuts or increase the target acreage for almonds over the next decade. Neutral rating retained and the broker's target is $5.43.

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.

Growth Concerns For National Storage REIT

Despite National Storage REIT's market dominance, brokers are concerned about the lower-than-expected initial yields on recent acquisitions and limited underlying growth.

-Questions over the sustainability of the high pay-out ratio -Clear advantages lie in the scale of the business -Difficulties assessing financial performance of acquisitions

By Eva Brocklehurst

Self-storage provider National Storage REIT ((NSR)) has manoeuvred well over the past year, with brokers noting the company is now the dominant player in its segment. Still, there are concerns about lower-than-expected initial yields on recent acquisitions and limited underlying growth.

Overall occupancies improved to 79% as of December last year, from 75.4% at June, although average rent per square metre declined to $261 from $272 over the same period.

Morgans notes a focus on driving occupancy levels through the first half came at the expense of rate/square metre, but prices have increased since October following lower promotional activity and active revenue management.

Shaw and Partners uses revenue per available metre as its key operating metric and this has increased to $207 from $202. This can be affected by the timing of acquisitions, especially in situations where a business is being turned around and initial occupancy is low.

The broker assumes an FY17 estimate for earnings per share of 9.3c, the mid point of guidance, and adopts a 100% pay-out ratio. The company's distribution policy is 90-100% of underlying earnings. The broker forecasts a three-year compound growth in earnings per share of 8%, which assumes around $50m per annum of, yet to be announced, net acquisitions in forecasts, funded by debt.

The only question around the outlook for Shaw and Partners is the sustainability of the relatively high pay-out ratio, in light of funding that is required to grow via acquisitions. The broker believes the organic upside opportunity for the company is through improving occupancy followed by annual rental growth.

Shaw and Partners initiates coverage on National Storage, with a Hold rating and $1.48 target. The broker, not one of the eight monitored daily on the FNArena database, believes that while the growth story is attractive, the upside is largely priced into the stock.

Growth Guidance Driven By Acquisitions

The company is guiding to FY17 earnings of $45.5-46.5m, or underlying earnings per share of 9.2-9.4c. This represents 5.8-8.0% growth over FY16. This growth is driven by the impact of acquisitions made in FY16, as well as the $285m Southern Cross portfolio that was formerly managed and fully acquired in the current financial year. Now that National Storage owns Southern Cross, fees from management services as a percentage of total revenue are expected to decline meaningfully in FY17.

Shaw and Partners believes this makes it a niche investment opportunity for those looking at alternative real estate sector exposure. The main advantage in the stock is its scale as there is only an small chance a new rival could replicate the product offering on a national scale.

Morgans expects acquisitions will continue to roll out, and also estimates around $50m of capacity on the balance sheet for further acquisitions. The broker believes upside risks relate to higher growth in yields and the underlying portfolio, as well as scale benefits. Downside risks involved increased competition/supply, low yields and general moves in the property market.

The company is not getting the returns expected from acquisitions, Macquarie asserts, despite some improvement in underlying organic growth. The broker has an Underperform rating on the stock because of its relative inability to assess the operating and financial performance of acquisitions, as well as an elevated risk in execution. Moreover, there is a limited track record of underlying organic growth.

Morgan Stanley, on the other hand, has an Overweight rating but believes the share price is unlikely to re-rate

materially until the company delivers on its FY17 guidance. Given the many moving parts and lack of detail on the drivers of guidance, the broker suspects the market is unlikely to be comfortable with the stock.

Morgan Stanley acknowledges the market understands the acquisitive nature of the business, but the speed of the acquisitions means it needs new capital on a fairly constant basis and this creates risks around dilution from either equity raising, asset sales or a reduction in the dividend.

To the broker, each of these measures make sense if it drives better cash flow and returns, but the uncertainty creates unwanted share price volatility and National Storage would benefit from a clear strategy on how its growth is funded.

National Storage is one of Australia's largest providers of storage, owning or managing 110 centres across Australasia. Following the recent acquisition of the Southern Cross portfolio, the company only has four residual centres which it manages on behalf of third parties. It is the only pure Australian-listed self-storage real estate investment trust (A-REIT).

The portfolio is geographically diversify across Australia and New Zealand (8%). The three largest weightings within Australia are in Queensland (24%), Victoria (23%) and Western Australia (17%).

FNArena's database shows one Buy rating (Morgan Stanley), two Hold and one Sell (Macquarie). The consensus target is $1.48, signalling 1.9% upside to the last share price. The dividend yield on FY17 and FY18 forecasts is 6.4% and 6.6% respectively.

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.

ASX200: No Man's Land

By Craig Parker, asset manager, Moat Capital

No man's land! That is where we are with our market sitting between the 5800 and 5600 levels as touched on in past weeks. We haven't gone anywhere this week and everyone seems to be getting a little concerned. Volatility is showing signs of breaking out to the upside which isn't a great sign for our market. The S&P 500 is over-bought and has bearish divergence on the RSI. It is looking to have that counter trend it so needs. 5% would be perfect however, it remains to be seen if Janet Yellen and her crew raise rates in March which, could cause possible further downside. The breakout immediately post Trumps speech to congress is looking like a fake move – couldn't help myself. Trump seems to have taken to the theory of tell a lie once it is a lie tell a lie a thousand times it becomes truth.

As far as our market goes I would be looking closely at the 5600 level and a break in the medium-term uptrend line which we are currently right on now. A breach of the 5600 level and things are looking weak from a technical perspective. The daily chart would be in a downtrend and the weekly chart would have a trough lower than the previous which, would be mixed news considering the peak is higher. The monthly chart would still be looking ok for the longer-term investor. Looking forward to the week ahead! Hopefully the OECD report on housing doesn't spook the market. A few negatives on the horizon.

ASX200 daily

ASX200 VIX daily

S&P500 daily

Authorised Representative Sentinel Private Wealth AFSL 344762

www.moatcapital.com.au

Important Information

This document and its contents are general in nature and do not constitute or convey personal advice. It has been prepared without consideration of anyone's particular financial situation, needs or financial objectives. Personal advice should be sought before acting on any of the areas discussed. The authors and distributors of this document accept no liability for any loss or damage suffered by any person as a result of that person, or any other person, placing any reliance on the contents of this document.

Moat Capital has made every reasonable effort to ensure the information provided is correct, but Moat Capital makes no representation or any warranty as to whether the information is accurate, complete or up to date. To the extent permitted by law, Moat Capital accepts no responsibility for any errors or misstatements, negligent or otherwise. The information provided may be based on assumptions or market conditions and may change without notice.

Reprinted with permission of the publisher. Content included in this article is not by association the view of FNArena (see our disclaimer).

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.

Treasure Chest: REA Undervalued

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. One broker suggests online real estate classifieds business REA Group is offering 25% upside in the next twelve months.

-Dominant market player -Fastest growing classifieds business -Domain listing a positive -Discount to global peers

By Greg Peel

Back in the late nineties, it appeared the internet was set to take over all aspects of our lives, immediately. Any new dotcom was seen as a must-have, even though the bulk of the investor herd still really had no idea how this world wide web contraption worked. Home computers were few.

It all came crashing down in 2000, and while the Australian stock market had been sparse on online listings to begin with, investors were no doubt now wary of investing in this strange new world of meaningless PE multiples.

That did not stop three local companies deciding to take on the long entrenched “rivers of gold” business of newspaper classifieds. Around the turn of the century, Seek ((SEK)) began making a name for itself in online job ads, Carsales.com ((CAR)) in the new and used car market, and Realestate.com, later to become REA Group ((REA)), in the real estate market.

From little things, big things grow. It’s hard to believe just how far the world has moved towards digital reliance in such a short space of time. It certainly caught the newspapers and hard copy classified magazines napping – their tardiness in recognising the rapid shift allowed the three abovementioned companies to thrive.

Fairfax Media’s ((FXJ)) Domain real estate classifieds business had long dominated the Sydney and Melbourne markets, and having finally played catch-up in the digital space, Fairfax is looking to spin-off what is basically REA Group’s only local competition into a separate (albeit still majority owned) entity. Rupert Murdoch decided a while back it was better to join them then try to beat them, hence News Corp ((NWS)) is a major shareholder in REA Group.

The local results season just passed highlighted, yet again, that the only value in Fairfax is Domain and the only value in News Corp is its REA stake. Print is dead, and even News’ cable TV business is looking like an anachronism in the face of internet TV.

The problem for Domain is that REA got the jump. “We believe the market underappreciates the dominance of REA’s website,” suggested Goldman Sachs’ analysts in a note yesterday morning, “which continues to build its audience and add greater expertise and functionality”. Ironically, Goldman suggests the listing of the number two player in the market, Domain, will prove beneficial for REA.

Domain as a standalone business is undervalued by the market because it’s wrapped up in Fairfax and encumbered by the slow death of newspapers. Once spun-off, its true value will emerge. But this will only serve to highlight the value of REA Group, Goldman suggests, by providing a domestic comparable and “highlighting the positive underlying trends in the Australian digital real estate market”.

Real estate is the fastest growing online classifieds vertical in Australia, the analysts attest, implying a comparison with jobs and cars. REA boasts the dominant website domestically as well as being the number one player in Asia and the number two in the US. The performance of the Asian business in the first half disappointed stock analysts, but there was little disagreement the Australian business posted another solid result, particularly as cooling apartment listings provided a headwind.

Goldman Sachs believes the Australian online real estate market can grow 60% from FY16 to FY20 as the increasing sophistication of websites allows them to continue taking a share of an estimated $7.7bn spend on selling property each year. The analysts see a clear pathway for growth over the next five to ten years, and see significant scope for REA to leverage its dominant platform and increase its own market share.

One can only presume such a growth profile will encourage others into the market, and setting up a business in cyberspace is a lot cheaper than setting up in real space. Goldman Sachs acknowledges competitive risk, but believes barriers to entry continue to grow as REA builds its “virtuous circle of audience and inventory while improving the customer experience”.

REA's share price peaked last August and retreated – not because the company did anything wrong, nor particularly because of warnings of the housing bubble bursting, but because the market simply switched into large cap miners and banks and out of previous high growth stocks. REA was not alone. The share price has since stabilised at a lower level, and received a bit of a kick when the company's first half earnings result was well-received. But Goldman notes the stock is currently trading at a significant discount to its global real estate peers.

Goldman believes such price weakness presents an attractive buying opportunity. The broker has a Buy rating on the stock, forecasting a 14% compound annual growth rate in yield over FY16-20. A twelve-month target price of $68.50 implies 25% upside.

Goldman Sachs is not an FNArena database broker. The seven database brokers covering REA have a consensus target of $59.46. Six rate REA as a Buy or equivalent, with one Hold.

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.

Share Market Necessity: Know Thyself

Share Market Necessity: Know Thyself

By Rudi Filapek-Vandyck, Editor FNArena

In this week's Weekly Insights:

-History, Our Guide: Third FOMC Rate Hike -Feb Reporting Season: Large Caps Come-Back Confirmed -Conviction Calls: CLSA and Morgans -Share Market Necessity: Know Thyself -2016 - L'Année Extraordinaire -All-Weather Model Portfolio -Rudi On TV -Rudi On Tour

History, Our Guide: Third FOMC Rate Hike

Amongst ongoing bullish sentiment, and market commentary, Canadian strategists at Canaccord stand out with a less optimistic outlook for US and global equities. Their view is based upon what they describe as the Three Steps and a Stumble rule.

History suggests whenever US interest rates are being raised three times in a row, with no rate cut in between, US equities experience a pull back, possibly even a (serious) correction, and are most likely to end up flat (unchanged) twelve months later.

Coincidentally, strategists at Citi observe how US indices are only 2% off from reaching targets set for year-end. Citi is not advocating investors should abandon ship, but the strategists do highlight stock picking and sector exposure are increasingly becoming key for further portfolio performance from here onwards.

Feb Reporting Season: Large Cap Come-Back Confirmed

February 2017 was the corporate reporting season that cemented the general come-back of large cap, Blue Chip stocks over their smaller sized peers on the ASX. Sure, Brambles ((BXB)) and Telstra ((TLS)) were amongst the month's stand-out disappointments, but overall the top end of the market delivered more beats and meets than misses, and underlying profit estimates went up, not down.

The latter is a unique in the post-GFC era in which every single reporting season has seen market EPS forecasts fall, never rise, when corporate Australia is unleashing financial results upon the investment community, until February 2017.

As resources and banks generated more beats than misses, strong growth forecasts remain in place, as well as the portfolio rotation that started in 2016, and the preference for large caps over smaller cap stocks.

On Goldman Sachs' calculations, more than $3bn in share buybacks have been announced in February; clearly indicating where board priorities are centred. Hint: it ain't in going out on an investment spree.

On FNArena's final assessment, some 35% of reporting companies beat market expectations. This is near the top of recent reporting seasons though both Feb-16 and Feb-15 showed slightly higher beats (37% and 36% respectively).

Equally remarkable: the 27% in recorded misses was the highest on record thus far.

In addition, the 1.4% average increase in stockbrokers' price targets was near the lowest increase registered since August 2013. Only August of 2015 showed a lower increase of 1.2%.

Overall, it appears the Australian share market is potentially en route to reporting the highest EPS growth post-GFC, could be +18% or higher, but ex-resources there remains a mid-single digit growth outlook only, which is more or less in-line with the experience of the years past.

For more details, see FNArena Reporting Season Monitor, as well as last week's Weekly Insights, February Reports: Ultimate Polarisation

Conviction Calls: CLSA and Morgans

Market strategists at CLSA have used insights from the February reporting season to implement three changes to

their Top 15 of Conviction Calls for the Australian share market. Rio Tinto ((RIO)) is now replacing Alumina Ltd ((AWC)), while CSL ((CLS)) replaced QBE Insurance ((QBE)) and Wesfarmers ((WES)) was swapped for Origin Energy ((ORG)).

The other twelve on the list remain: AGL Energy ((AGL)), Amcor ((AMC)), Aurizon Holdings ((AZJ)), a2 Milk ((A2M)), Henderson Group ((HGG)), Incitec Pivot ((IPL)), Macquarie Group ((MQG)), National Australia Bank ((NAB)), Ramsay Health Care ((RHC)), Sydney Airport ((SYD)), Tabcorp Holdings ((TAH)) and Treasury Wine Estates ((TWE)).

Stockbroker Morgans added four new stocks to its list of High Conviction Stocks; Oil Search ((OSH)), Macquarie Atlas Roads ((MQA)), Bapcor ((BAP)), and Beacon Lighting ((BLX)) while removing Westpac ((WBC)), ALS Ltd ((ALQ)), Kina Securities ((KSL)), Catapult Group ((CAT)), Evolution Mining ((EVN)) and Impedimed ((IPD)).

Juicy detail: Westpac remains Morgans' favourite pick among the local banks, indicating Morgans is not expecting much from the sector at current share prices on a twelve months horizon. Morgans is also expecting some sorts of a performance catch up from smaller caps in 2017.

Share Market Necessity: Know Thyself

Investors are used to asking the share market all kinds of questions. Where are we heading? Which stocks are most likely to fail? Is there a theme behind the madness?

This time around, however, the share market has turned the tables, asking one straight question back: what kind of investor are you?

The answer to the question has become all-important since upward momentum in what is widely described as a bull market seems confined to a select group of sectors and stocks only. Invest in the right stocks and share price gains are there for all to enjoy. Elsewhere, however, a lot of pain has fallen upon investors owning stocks that are currently out of favour.

Take a look at the twelve months price chart for Mantra Group ((MTR)) below. It wasn't that long ago this stock was pretty much considered a "must have" to seek exposure to the theme of growing inbound tourism from China to Australia. Those Chinese tourists are still visiting in ever larger numbers, but the Mantra share price stoically refuses to join the uptrend that has pushed the ASX200 near 5800 by early March 2017.

As shown on the price chart, the Mantra share price is trading well below the 200 day moving average, as well as the 60 day moving average, and some 25% below consensus price target (grey-ish background). Making matters worse is all three lines are clearly in descent, as is the share price which is trending from higher up on the left hand side towards the bottom corner on the right hand side of the chart.

I'd like to challenge anyone to find any indication of a bull market anywhere on that price chart.

There are many more price charts for ASX-listed stocks that showcase similar trends and characteristics. No profit warnings have been issued.

A New Type Of Risk

To understand what is holding back share prices for the likes of Mantra Group, we have to make a short excursion into the past.

Ever since commodity prices peaked in 2011, the Australian share market has turned into an amalgamation of opposing trends for different sectors and market segments. There's always the occasional rally, of course, but resources stocks in general terms kept trending south for five long years since. By late 2013, they were joined by the banks.

It took a while before most investors caught on to these underlying trends, but by mid-2015 it was clear to everyone there were only a few exceptions among Australia's large cap stocks that were not eroding shareholders money, like CSL ((CSL)). By early 2016 being underweight, or absent, large cap stocks on the ASX had pretty much become the new trend du jour.

A big chunk of the investment funds that would normally flow into stocks like Commonwealth Bank ((CBA)), BHP Billiton ((BHP)) or Woolworths ((WOW)) instead went into solid reliable performers such as CSL, Amcor ((AMC)) and Transurban ((TCL)), and into small cap industrials, such as Mantra Group, and APN Outdoor ((APO)), and NextDC ((NXT)).

Fast forward to late 2016 when the unexpected winner of the US Presidential election is promising to reinvigorate the world's largest economy through tax cuts, government spending (on infrastructure) and less regulation. For

investors, all that was "out" instantly became "in" and vice versa. The monies flowing out of previous winners has turned many portfolios into a war hospital filled with casualties.

In many cases, going down by -20% has simply proved a temporary pause in a much larger de-rating. Arguably, this process already started in August last year, after the Bank of Japan suggested central bank policies had reached their outer limit. It is still ongoing today.

Higher Bond Yields, Cheaper Cyclicals

Bond proxies, such as Sydney Airport ((SYD)), have quickly become a lot less popular, and share prices have suffered a blow, but the real victims in the Australian share market have been smaller cap industrials.

Problem number one is many a professional manager of funds is struggling to attract new inflows, if not battling outflows, so there are limited funds to allocate. Increasing exposure to the new momentum stocks -banks and resources- means other sectors have to be sold.

In a relatively small market as is the ASX, smaller cap stocks find there's nobody else around to jump to the rescue when professional fundies abandon ship. No natural support means lower share prices simply beget even lower share prices. Especially because after a while, they set off all kinds of technical trading signals, to the downside.

Problem number two is that, even after significant share price falls, many of the formerly much beloved yield and growth stocks still do not look particularly cheap. This point was saliently illustrated by market strategists at Citi recently.

As shown in the graph above, healthcare stocks and bond proxies are still trading on higher Price-Earnings (PE) ratios than the rest of the market ex-resources. Many of the cheaper priced companies, often cyclicals with leverage to improving conditions for commodities producers, can look forward to meatier growth in the years ahead, at least such is the present market expectation.

The above mentioned Mantra Group is trading on 15.7x FY17 market consensus estimate. Hansen Technologies ((HSN)) is on 20.5x. TechnologyOne ((TNE)) trades on a multiple of 33x.

In a global context wherein investors are trying to assess what exactly are the consequences of higher US interest rates, with cyclical growth on their mind, those stocks that proved immensely popular pre-August last year but do not form part of the market's new narrative, are likely to find there's now a much higher barrier to be part of the share market's upward momentum.

Beware The Bear Within

Investors usually do not want to hear about it, but irrespective of whether one believes Donald Trump is guiding global equities towards a new bull market, there is a nasty grizzly bear inside the ASX and his bear claws have a firm grip on smaller cap industrials.

In many ways, investors can draw comparisons with the wider-spread bear market of 2008 in that:

-in the absence of a genuinely positive catalyst, the underlying trend remains flat at best -even with a positive catalyst, upward momentum might still prove only temporary -in case of a negative event, punishment is immediate and significant -to withstand downward pressure, a company needs to remain impeccable and surprise positively -share price recoveries often occur through a prolonged bottoming process first

Even then it is not always possible to figure out why some stocks are being treated differently than others. It took a big upgrade to guidance for CSL shares to rediscover upward momentum, but Amcor's result equally beat market expectations in February, yet after the initial share price rally, the share price has ended up lower than where it was prior to the result.

Investors: Know Thyself

It goes without saying, this selective bear market too shall pass, eventually. About the exact timing, we can but speculate and guesstimate. In the meantime, holding high quality companies with many years of dependable growth ahead of them can be quite the frustrating experience. It's not part of present market momentum. Simple as that.

Which is why the share market is throwing one key question back at investors: what kind are you? Can you stomach lower prices for longer? Or do you feel safer when being part of the dominant market momentum?

Know thyself might well have become the most important strategy feature in today's ever changing context.

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 -Thursday, 12.30-2.30pm, co-host in the studio -Thursday, interview on Switzer TV, between 7-8pm -Friday around 11.05am, 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 6th 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).

****

BONUS PUBLICATIONS FOR FNARENA SUBSCRIBERS

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

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

2016, and become a wiser investor along the way.

Subscriptions cost $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

TERMS AND CONDITIONS OF USE, AND DISCLAIMERS

These Terms and Conditions of Use, and Disclaimers constitutes your agreement with News Network with respect to your use of its FN Arena website, its weekday news periodical, Australian Broker Call, as well as it's monthly periodical Australian Super Stock Report, as well as any other publications (including articles) News Network may publish on its website, or anywhere else, from time to time. Please read the contents of this page carefully as it contains important legal information and disclaimers. By entering and perusing the website, reading the Australian Broker Call or the Australian Super Stock Report, or, if you are subscriber, by entering the password protected part of the website, you acknowledge that you have read, understood and accept this agreement.

By accepting this agreement you acknowledge, understand and accept the following:

1. Reference to "FN Arena" and "News Network" means reference to News Network Ltd, its journalists, directors, other employees, affiliates, agents, associates and subsidiaries.

2. News Network Ltd is the owner of the FN Arena website and brand name.

3. Reference to "we" or "us" is reference to News Network.

4. Reference to "this website" or the "FN Arena website" means reference to www.fnarena.com, and includes reference to News Network's weekday news periodical, Australian Broker Call, as well as its monthly periodical Australian Super Stock Report, as well as any other publications (including articles) News Network may publish on this website, or anywhere else, from time to time.

5. Reference to "news periodicals" means reference to News Network's weekday periodical, Australian Broker Call, as well as it's monthly periodical Australian Super Stock Report, as well as any other periodicals News Network may publish from time to time on this website, or anywhere else, from time to time.

6. Reference to "publications" in this agreement means any material, including articles, published or put in print on the FNArena website, or anywhere else, whatsoever, and includes News Network's weekday periodical, Australian Broker Call, as well as it's monthly periodical Australian Super Stock Report, and any other periodicals News Network may publish from time to time.

7. Reference to a "visitor" means, you, a visitor to this website, and includes a subscriber to Australian Broker Call and the Australian Super Stock Report, as well as any other publications or periodicals News Network may, from time to time, publish on this website.

8. News Network is a media company which employs financial journalists to report financial news. News Network's journalists perform the required research and collect the information that is, ultimately, each day, published on this website and in News Network's news periodicals. As is obvious, the process by which the information is collected and delivered to you is a purely journalistic one and, therefore, the comments, opinions and recommendations News Network reports on this website are not the opinions of News Network or any of its journalist or other employees. News Network is ONLY and specifically a matter-of-fact reporter of industry signals suggesting price direction probability of some shares. News Network simply delivers the information – it does not create it.

9. Although News Network obtains the information published herein from sources deemed to be reliable, and given and received in good faith, it cannot and does not guarantee its accuracy. News Network does not take any responsibility either for the financial soundness or for the correctness of statement made or opinion expressed in the data or content reported by News Network, and cannot and does not guarantee the reliability and accuracy of the opinions of the brokers whose opinions, recommendations and forecasts it reports.

10. News Network publishes this website, all publications and its periodicals strictly for convenient personal, non-commercial, educational and informational purposes of its subscribers only. Our goal is to provide the subscribers with a convenient starting point of potentially useful, but not comprehensive, content that can educate or otherwise enhance a visitor's knowledge base and frame of reference.

11. News Network is NOT a stock broker or financial or trading advisor, nor is it an advisory service of any kind, and no advice or recommendations on investments or trading are made nor implied on this website. Nothing contained in this website is intended to be, nor shall it be construed as, advice or recommendation. Any investment or other decisions made by you must be based solely on your own evaluation of the targeted subject for investment, and your financial circumstances and investment objectives, and News Network will not be held liable for any such investments and decisions.

12. It is distinctly understood and accepted that the shares referred to in the FN Arena website, News Network's publications and/or periodicals have not been recommended by News Network. The content and or any comments found of this website, including the content and/or comments published in any publication and/or periodicals published by News Network, do not constitute a recommendation or endorsement by News Network with respect to any company, security, share or investment or any financial or investment product.

13. This website makes no representations, and, to the extent allowed by the law, specifically disclaims all warranties, express, implied or statutory, regarding the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any material contained in the website.

14. Before making an investment decision, you must do your own research and rely on your own examination of the share, and the risk involved, and not on what you read on the FN Arena website, or in any publication or periodical. The content of this website is provided strictly for convenient personal, non-commercial educational and informational purposes only and News Network shall not be held liable for any investment decisions, sales or purchase decisions, which you may have made based on what you have read on this website or in the periodicals published by News Network from time to time, or in any other publications News Network may publish on its website, or anywhere else, from time to time. Anyone who makes investment decisions based on what they read on this website does so at their own risk, and agrees that they cannot hold News Network responsible and/or liable for any loss whatsoever.

15. It is your responsibility to evaluate the completeness, accuracy and usefulness of any content made available on this website. If you are unsure, or in doubt about the meaning of any information, you should consult your financial advisor.

16. News Network does not guarantee any returns on investments made in any share mentioned on this website by the visitors. As any investor well knows, any investment opportunity, strategy or concept involves a degree of risk and investors should not invest any funds unless they can afford to take the risk of losing their investment. News Network strongly suggests that you consult your own financial advisors regarding the soundness of any intended investments, strategies or concepts, and discuss with such advisor your individual investment needs and goals. You may also wish to consult the broker who expressed the opinion we have reported on in the news periodicals we publish.

17. News Network shall not be held liable to any visitor of the FN Arena website, or any reader of its periodicals and/or publications, or anyone else who may have relied on this website, directly or indirectly, for any inaccuracies in the printed material found on the FN Arena website, in the periodicals and/or other publications, any typing errors, omissions, interruptions, timeliness, completeness, deletions, defects, failure of performance, computer virus, communication line failures, alterations of, or use of any content herein, regardless of cause, for any loss or damage resulting therefrom.

18. Under no circumstances, including, but not limited to negligence, shall News Network be liable for any direct, indirect, incidental, special or consequential damages that result from the use of, or the inability to use, the FN Arena website, and any or the News Network's publications and/or periodicals.

19. As a condition of use of the FN Arena Website, News Network's publications and periodicals, you agree to indemnify News Network and all those affiliated with it from and against any and all liabilities, expenses (including legal costs) and damages arising out of claims resulting from your use of the FN Arena website, News Network's publications and periodicals. If you are uncertain about this agreement or the contents of the FN Arena's website, or are dissatisfied in any shape or from, with the content of the FN Arena website, or any of the publications or periodicals, or you do not agree with these terms and conditions, your sole and exclusive remedy is to discontinue using the FN Arena website, News Network's publications and periodicals.

20. News Network may, from time to time, publish advice, opinions and statements of various third parties, other then the ten stock brokers, and various other information and content providers. News Network does not represent or endorse the accuracy or reliability of any advice, opinion, statement or other information provided by these third parties. Reliance upon any such opinion, advice, statement, or other information is at your own risk.

21. The FN Arena website may contain links and pointers to websites maintained by third parties. News Network does not operate or control in any respect any information, products or services on such third-party websites. Third party links are included solely for the convenience of visitors, and do not constitute any endorsement by News Network of any products or services provided by the third party link owners or operators. News Network has no control over any websites that we might link to and does not take responsibility for their quality, content or suitability.

22. News Network is not responsible for claims made by advertisers on the FN Arena website or in any of its periodicals. Such advertisements are included solely for the convenience of visitors, and do not constitute any endorsement by News Network of any products or services advertised. News Network does not check the accuracy of the statements made by the advertisers. You assume sole responsibility for the access and use of third party links and pointers from the FN Arena website, as well as any purchases you may make from those third parties (including advertisers).

23. All the content, information and material made available on this website are provided to you "as is" and without warranty of any kind from News Network whether express or implied, including, but not limited to, implied warranties of merchantability and fitness for a particular purpose, title, non-infringement, security or accuracy, nor does News Network endorse or take any responsibility for the accuracy or reliability of any opinion, advise or statement made through the FN Arena website, its periodicals, or for making good all or part of any loss and/or damage that may have been caused by the visitor's reliance on any information, advise, product or service obtained from a linked website.

24. News Network is not liable for any copyright infringements incurred by any outside content or information contributors, or by third parties who have links to this website, or advertise on this website.

25. News Network reserves the right to make any and all changes to the FN Arena website, including the publications and periodicals, at its sole discretion without notice to you. News Network reserves the right to deny access to this website or its information to anyone at any time.

26. This agreement shall be deemed to include all other notices, policies, disclaimers, and other terms contained in the FN Arena website, provided, however, that in the event of a conflict between such other terms and the terms of this agreement, the terms of this agreement shall prevail.

27. News Network shall have the right, at its discretion, to change, modify, add or remove terms of this agreement at any time. Changes shall be effective immediately. Notification of any such changes shall be made herein, therefore, you are strongly advised to read these terms each time you wish to access the FN Arena website or any periodical.

28. No permission is granted to copy, distribute, modify, post or frame any text, graphics, video, audio, software code, or viewer interface design or logos. The entire FN Arena website, including the publications and periodicals, is subject to copyright with all rights reserved. The information contained in the website, including the publications and periodicals, shall not be published, rewritten for broadcast or publication or redistributed in any medium, or for any other reason whatsoever, without prior written permission from News Network.

29. All original content is the copyrighted property of News Network.

FN arena
PASSIONATE ABOUT FINANCIAL NEWS

Financial News for the Bright and the Uneducated. And for everybody else in between.

FN Arena News
Building the Future of Financial Journalism

www.fnarena.com

Trials are free and without any obligation