Week
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Stories To Read From FNArena
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James Hardie Builds Hopes For Better FY18

Inefficiencies plagued James Hardie in the December quarter and FY17 guidance is downgraded. The key is whether the company continues to take US market share and secures price increases.

-Inefficiency associated with rising costs as capacity ramps up -Top line growth supported by cycle while inefficiencies expected to recede -Better plant performance in FY18 expected as expansions come on stream

By Eva Brocklehurst

Gross profit margins were weak at James Hardie ((JHX)) in the December quarter, amid supply challenges in the North American fibre cement business. Operational inefficiencies were in evidence, as the company deals with a ramp-up in capacity and the inefficiency associated with tight supply. Cost growth was ahead of broker expectations.

UBS reduces FY17 profit forecasts by -7%, to reflect poor plant performance and higher costs through the second half in the North American fibre cement business. This implies a margin of 21.5% in the March half, and overall group earnings growth of 2% for FY17. The broker continues to envisage a solid backdrop for earnings momentum in FY18, providing valuation support at current levels. Nevertheless, given the market's expectations, UBS believes there is little room for poor execution.

In the face of these headwinds, Macquarie believes securing price rises will be important going forward. The company is targeting an inflation-offsetting price increase of at least 3% going into FY18. While the broker acknowledges the frustration of another downgrade in guidance, it cautions about losing sight of the big picture. Brownfield expansion is coming to an end and this should support efficiency improvements. All of this is occurring within a growing market in which the company is taking share.

Downgrade To Guidance

FY17 guidance has been narrowed and downgraded, to a range of US$245-255m from US$250-270m. Macquarie believes top line growth is supported by cyclical factors and expects the operational inefficiencies will recede in FY18. Meanwhile, increased capital expenditure, while impinging on free cash flow, is in keeping with the company's longer-term strategy, and solid returns are expected on these investments over time.

Management is confident operations will improve as most of the expansions come on stream in early FY18. While management is pointing to a better performance in FY18, Macquarie is more interested in the step-up in FY19, driven by plant performance. Extra capacity should alleviate distribution inefficiencies but better plant performance will be the key to driving a sustaining performance.

The new plant being built in Tacoma is aimed at improving efficiencies in the north-west of the US, enabling growth in northern California, a strong market for the company.

The broker also believes that as the company moves to greenfield expansion, operational disruption associated with capacity growth should recede. The company's measure of market share is in the target range of 6-8% and this is a key positive, Macquarie's view, as it points to improved sales.

Overweight Texas

CLSA observes that, realising it was caught short as demand surged, the company accelerated its start-up capacity and now forecasts it will spend US$600m over the next three years to build this capacity. The broker points to the likelihood of an oil-induced slowdown in Texas where employment has finally turned lower and there is a slowing in single family housing production.

The company, the broker reminds, is overweight Texas earnings and, within that state, overweight Houston, where about 40% of Texan houses are built. CLSA, not one of the eight stockbrokers monitored daily on the FNArena database, retains a Sell rating and $17 target.

While trimming forecasts to reflect a deeper trough with regard to inefficiencies in manufacturing and a step-up in costs, Credit Suisse continues to believe FY18 will be better. With an unwinding of the issues in manufacturing, a return to price growth in fibre cement should pave the way for a sharp inflection in North American margins.

The broker believes there is value in the stock on a risk/reward basis but acknowledges it may be range-bound until visibility improves regarding the timing of a recovery in margins. North American volume growth of 10% pleased Credit Suisse. With primary demand growth within the 6-8% target range, and in the absence of supply constraints, the broker suspects volume growth improved in the quarter.

The broker notes the company is working through a backlog of orders and tight production capacity meant that sales orders were missed. This is now beginning to unwind. Credit Suisse has an Outperform rating. Deutsche Bank also believes that the -4.7% negative margin impact related to production costs will not be present in FY18.

As a result the broker expects FY18 US fibre cement EBIT margins of 27%. Deutsche Bank estimates primary demand growth of 5.7% in the December quarter, noting management believes this will reach mid to high single digits in FY17.

Volume Growth And Price Increases Needed

Morgan Stanley found the costs endured in the quarter surprising, given the point in the cycle, and suspects there are earnings risks still in train for FY18. Part of this risk appears to come from lower tax assumptions, where the market appears to be assuming a strong rebound in US earnings, without a commensurate increase in tax take. Having said this, the broker concedes the lower base provides easier comparables to achieve high teens growth in FY18.

While the broker considers the stock is challenged by further executive changes, solid volume growth in the core business is still expected. The broker notes, on the conference call, management acknowledged that not all costs embedded in FY17 would roll off in FY18. The 3-4% price increase indicated by management is in line with the broker's expectations.

Ord Minnett believes the December quarter results are indicative of the large task that lies ahead for the company and that price increases are needed to offset cost inflation. The reversal of manufacturing and freight inefficiencies will be pivotal if the company is to deliver margin expansion in FY18.

Citi also highlights the sub-optimal nature of manufacturing performance. The announcement of another senior management departure, Mark Fischer, who has been with the organisation since 1993, combines with many senior departures over the last few years and makes the broker questioned why a high performance organisation has been unable to retain some of its best performers.

The broker downwardly revises forecasts again for FY17 to reflect higher-than-expected plant commission costs and slightly more modest growth in the US new residential construction market. Citi suspects that while the favourable exposure to the US housing cycle remains, a materially higher-than-usual capital expenditure profile in FY18-19 poses a risk that James Hardie could miss out on leverage in, what will be, the critical growth years of the US housing cycle.

FNArena's database shows four Buy ratings and three Hold. The consensus target is $21.12, suggesting 5.9% upside to the last share price. Targets range from $18.65 (Ord Minnett) to $22.50 (UBS).

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NAB Dividends Likely Safe

National Australia Bank's first quarter update held few surprises. Revenue growth was subdued and brokers are mindful of the challenges in maintaining the dividend pay-out.

-Provisioning at lowest level in 12 months as mining, agricultural risk exposure eases -Cost growth outstripping pace of revenue growth, despite higher financial market income -Long-term value envisaged as business credit growth shows signs of improvement

By Eva Brocklehurst

National Australia Bank ((NAB)) delivered a first quarter update that held few surprises for brokers. The bank posted $1.6bn in quarterly cash earnings. Revenue growth was subdued, up 1%. Underlying margins were stable, as competition for deposits eased, while trading revenues were strong on the back of high levels of volatility. Provisioning improved relative to the second half of FY16.

Provisioning was that its lowest quarterly level in 12 months, $80m below Ord Minnett's expectations, given the non-repeating overlay for mining and agricultural exposure. The broker expects a typical seasonal uplift in the second quarter for provisioning. Elevated expenses growth of 5% is expected to improve over the year from efficiency initiatives, which should mean there is sufficient capital generated to maintain a flat dividend at an 80% pay-out ratio, in the broker's view.

Net interest margin was broadly stable in the first quarter following a decline of 11 basis points over the second half of FY16. The flat margin in the first quarter suggests to Ord Minnett that the recent re-pricing of selective mortgage products is offsetting the flowing through of higher deposit costs.

Credit Suisse was slightly disappointed with the update and believes it sets a subdued tone for the bank reporting season. The broker did not like the fact that costs growth is outstripping the pace of revenue growth, even though revenues benefitted from higher financial markets income. The broker believes banks are facing a difficult underlying profit environment, despite asset quality metrics remaining stable amid modest consumption of capital.

Dividend Should Be Maintained For Now

The stock offers some credit quality and good cost discipline in Morgan Stanley's view, but an improvement in revenue growth is needed to drive upgrades to earnings-per-share estimates. The broker does not expect housing and business loan growth to surprise on the positive side and, with margins still under pressure, now factors in subdued revenue growth of around 2% for FY17.

The broker assumes a further 10 basis points of re-pricing across the mortgage portfolio but believes this is increasingly likely to be skewed towards investment property loans. Morgan Stanley also expects a flat dividend outcome. Consensus assumes FY17 profit of around $6.6bn and the broker believes this will be a challenge, unless loan losses stay under 15 basis points or revenue growth improves.

The outlook is more positive in Macquarie's opinion, with mortgage re-pricing benefits, a more rational competitive environment and productivity benefits supporting earnings growth, and an elevated dividend is likely to be supported in the near term, especially while capital rules are being finalised. The broker continues to envisage longer-term value for the stock, particularly as business credit growth shows signs of improvement.

Morgans observes the bank continued to run off below-returning institutional exposures over this first quarter and this would have weighed on loan growth. It would also explain why the bank's Australian loan growth was well below system loan growth, despite its home loan growth being just slightly below system.

The broker's base case is that the bank will keep its nominal dividend flat for FY17 but suspects it will be reduced this year, as NAB is seen as having the most stretched dividend pay-out ratio relative to returns on tangible equity of all the major banks. Over time, the bank is aiming to reduce its dividend pay-out ratio to within its long-term range of 70-75%.

Stock Screens Cheaply

CLSA believes that the stock, having consistently performed below its peers, now trades cheaply and there is scope for it to positively re-rate. The bank remains the broker's favoured stock among the major banks. CLSA, not one of the eight stockbrokers monitored daily on the FNArena database, has an Outperform rating and $33.82 target.

Deutsche Bank was pleased with the update, as there were few surprises compared with updates of the past. While the broker believes this justifies a further re-rating versus peers, it concedes the operating environment is challenging, with revenue growth low despite a flat net interest margin. Nevertheless, with the stock looking inexpensive, and the tilt towards small business banking likely to deliver better net interest margin, the broker retains a Buy rating.

UBS is more cautious, believing the bank is progressing with its turnaround but, given the rally in recent months, the broker remains on the sidelines with a Neutral rating. UBS believes the improvement in impairments in the quarter is a "catch up" to the other banks. While asset quality trends remain broadly stable, the broker expects charges will inevitably rise from current levels throughout the year.

There are three Buy ratings, four Hold and one Sell (Morgan Stanley) on FNArena's database. The consensus target is $30.85, signalling 0.8% upside to the last share price. Targets range from $28.50 (Morgan Stanley) to $34.50 (Credit Suisse).

How Much Growth Can Transurban Deliver?

Toll road builder/operator Transurban has raised FY17 distribution guidance. While brokers acknowledge the strong growth on offer, questions linger regarding the extent of optimism in forecasts.

-Distribution growth strong but likely to be slowing from the 11% experienced since FY09 -Capital release considered a lower quality aspect to the half year result -Potential sale of West Connex a key catalyst in 2017

By Eva Brocklehurst

The run of strong growth continues at toll road builder/operator Transurban ((TCL)), with the highlight from the first half result being an increase in FY17 distribution guidance to 51.5c from 50.5c. The company remains confident of reaching financial close on the Victorian Western Distributor in late 2017, but notes the timing for funding the transaction is subject to negotiation.

The company has also confirmed its interest in West Connex, with the NSW government currently considering a privatisation process. Transurban confirmed it has not participated in the US Dulles Greenway expressions of interest at this stage but is maintaining a watching brief.

Credit Suisse expects Transurban to deliver over 10% distribution growth in each of the next five years and believes the higher distribution guidance signals management is also confident. The broker downgrades its US express lane estimates, suspecting it had previously over-estimated the revenue growth from the 495 and 95 express lanes. The broker believes the stock is attractive on a forward distribution yield basis and retains a Outperform rating.

Morgans forecasts distribution growth of 8% per annum across FY18-20, implying a slowing of growth versus the 11% experienced since FY09. The broker downgrades to Hold from Add, given the share price strength, but believes investors will continue to be attracted to the company's defensive compound growth and solid investment grade credit rating.

The broker's forecasts conservatively include an $8m capital raising to support the funding of the proposed Western Distributor, despite the CEO warning that a capital raising may not be necessary.

CLSA suspects the market is being overly optimistic in its forecasts and believes proportionate operational earnings (EBITDA) growth will be less than 10% in FY18 and beyond. While management has been good at adding growth through new concessions, the broker worries that West Connex is a "must buy", abetting concerns regarding the price that might be paid. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, has an Underperform rating and $11.10 target.

Traffic performance and margins at CityLink and Hills M2 particularly pleased Deutsche Bank, given there were traffic disruptions during the half. The broker notes no further capital returns or re-financing are expected in the second half, but the company has indicated a further re-financing could occur once North Connex is completed in FY20. The broker suspects further competition could enter the Australian market in any bidding for West Connex, given its size and scale, and these players may be prepared to bid very aggressively.

Strong Cash Flow But Quality Questionable

Free cash flow was boosted by around $170m in a one-off capital release. On an underlying basis, UBS notes cash flow was still up 10%, although accounting for a 6% rise in securities on issue, free cash flow per security was only up 3%. The broker attributes the difference to traffic disruptions and funding costs associated with CityLink and North Connex projects.

The strength of free cash flow impressed Morgans although the quality was questionable, the broker agrees, normalising for the capital release results in around 99% distribution coverage and only 3% growth in underlying cash flow. Around 8.5c per security is calculated to be related to the capital release as a result of the North Western Roads Group (NWRG) achieving North Connex construction milestones. The company has stated this cash goes back to the general funding pool to fund developments.

The broker acknowledges the company does not have access to the free cash flow from the 495 and 95 express lanes, as lenders restrict distribution of the cash flow during the interest capitalisation period. The trapped cash continues to accumulate and will ultimately be available to Transurban. Combining these items, Morgans calculates it reduces the free cash flow to 22.7c per security from 33.3c per security, providing around 91% coverage of the distribution. This is still within the targeted 90-110% pay-out range.

Macquarie also observed the capital release was a lower quality aspect to the result but, importantly, notes Transurban is not including this capital in developing its distribution guidance. Morgan Stanley also believes the company can maintain its free cash flow/distribution coverage ratio at around 100% in FY17, excluding the capital return from NWRG.

Significant Opportunity in West Connex

While debt increased, the company's net debt to EBITDA ratio continues to fall, which highlights for Macquarie the growing capacity in the balance sheet and underpins commentary that material equity may not be needed for current projects. The broker believes any capital raising is likely to be delayed until after the Western Distributor financial close, i.e. the first half of FY18.

This also coincides with a more significant opportunity, West Connex. If only stage one and two are tendered, the bidding will be similar to the QML and Airportlink, in the broker's view, in that it will centre on traffic forecasts. Macquarie believes Transurban would be at an advantage if all three stages and ancillary projects were on offer, as the company could leverage its design optimisation project delivery skills.

UBS also notes the potential sale of West Connex will play out this year and believe this is a critical issue for Transurban, both as a growth opportunity and to protect its Sydney incumbency. UBS considers the stock well supported versus other yield peers because of its strong growth, albeit with some event risk around the Western Distributor and West Connex outcomes.

Citi, too, believes concerns over higher yields are overdone, given average debt maturity of 9.3 years and the benefits to toll pricing from higher inflation. The broker continues to envisage upside for the stock as it delivers on existing growth options and manages existing operations for greater efficiency.

Demographic Trends

Morgan Stanley highlights the risk of a change in the take-up of ride-sharing services on the company's northern Virginian roads, where high-occupancy vehicles are exempt from tolls. The broker takes a look at demographic trends and notes, in Australia's case, the average age of motorists is steadily increasing in line with the general population. Of interest, while driver licence numbers in the 20-29 year-old bracket are growing, there are early signs that licences in the following cohort are falling, particularly in Victoria.

At this stage, the broker speculates that the younger cohort will make more use of taxis and ride-sharing as it enters the workforce and technologies continue to improve. In addition, the broker notes the Australian Taxation Office has issued an alert and flagged a review of certain stapled trust structures. The broker acknowledges, while the company's corporate structure includes multiple such entries, the ATO views the company as a low non-compliance risk. Still, the broker believes these are risks to monitor.

The database shows four Buy ratings and three Hold. The consensus target is $11.72, suggesting 7.7% upside to the last share price. Targets range from $10.05 (Deutsche Bank) to $12.40 (Macquarie, UBS). The distribution yield on FY17 and FY18 forecasts is 4.7% and 5.1% respectively.

Is Carsales Slowing Down?

Online automotive business Carsales.com posted a messy first half result, leaving brokers questioning whether earnings momentum is losing traction.

-Long-term potential in international market but domestic performance key to short term -Global technology players becoming more active in the company's market segments -Stratton not out of the woods yet, although not expected to deteriorate further

By Eva Brocklehurst

Is earnings growth becoming harder for Carsales.com ((CAR))? The company's first half results were underpinned by growth in the dealer segment, resilience in display advertising and rapid growth for Tyresales and Redbook Inspect. Yet higher costs appear to have put a brake on growth.

Carsales may be a very good digital company but Morgan Stanley believes incremental growth in earnings per share is becoming harder, and the first half growth of 5% will not be sustained by the current price/earnings ratio of 22x.

The broker suggests the growth rate and contraction in the first half EBITDA margin indicate a maturing business and increasing competition. A maturing business reflects the migration from print to online. This signals the key to growth will be bolt-on acquisitions, such as Tyresales, Stratton & international assets. High growth but lower quality earnings in the broker's view.

As well, Morgan Stanley believes global technology players are becoming more active. This includes eBay and Gumtree, which have already negatively affected the company's traditional price increases in its private seller division. Facebook and Google/YouTube have also crimped the broker's growth expectations for Carsales.com's display advertising.

The risk is, if growth cannot return to double digits, a price/earnings de-rating is likely. Morgan Stanley maintains a Overweight rating at this point, noting the recent weakness in the share price reflects some of its concerns.

UBS concludes that the shape and risk profile of forward growth appears to be less attractive versus history yet the stock remains inexpensive relative to the past. The upside risks to the broker's forecasts relate to whether the company can sustain around 10% annual revenue growth in the dealer business through a combination of price and depth measures, and obtain growth in non-core domestic streams.

On the other hand, downside risk looms with heightened competition and a limited dealer profitability pool. All up, the broker considers the stock to be fairly valued after its rebound and maintains a Neutral rating.

Citi expects an acceleration in revenue growth in the core business and growth rates to be maintained in the longer term, driven by both volume and yield in the dealer business. In the international market the broker acknowledges long-term potential but does not believe this will make a meaningful contribution in the near term. Hence, Citi's Buy rating is based on the performance of the core domestic business.

Stratton Subdued

Macquarie was encouraged by the revenue trends, including the dealer category, where contributions were made from depth revenue, price increases and volumes. As expected, Stratton revenues were negatively affected by supplier issues. The broker expects a gradual re-basing as this business adjusts its operations and cost base to account for recent disruptions.

Stratton will probably face additional challenges, should the industry need to adjust its practices regarding insurance add-ons and/or flex commissions. Nevertheless, the broker envisages scope for better earnings momentum in the second half.

The first half reflected higher marketing spending which, partly a timing issue, is expected to taper off in the second half. Macquarie notes this is the last result that will be delivered by co-founder and CEO Greg Roebuck following his retirement. The broker does not expect any shift in strategy with the new CEO, Cameron McIntyre, who is the current chief operating officer.

Management remains positive on the differentiation that the Redbook Inspect service can provide. Margins will be inferior to the core business but the broker still expects the contribution to be positive and improve as the business scale increases.

Morgans maintains a Hold rating and notes, but for the problems at Stratton, underlying earnings would have increased almost 14%. Assuming Stratton does not get any worse in the second half, although unlikely to improve, there are reasonable prospects for high single digit growth in earnings per share from FY18 onwards, in the broker's opinion. Stratton Finance was affected severely by one of its main suppliers of loans falling foul of the corporate regulator, ASIC, and management has signalled that the second half will not be that much better.

Competition Increasing

This is one of the weakest half-years to date Morgans observes, as the core business chugged along nicely, albeit with elevated costs, while more recent add-ons such as automobile finance and Asian classifieds cut around $10m out of the headline result. The broker has a long-term positive view on the stock, as the company dominates online automotive advertising and is unlikely to be toppled by a new entrant, albeit major competitor Carsguide is being re-launched under a new owner, Cox, which has deep pockets.

History does not favour weak number two players in online classifieds, Morgans asserts, yet Cox is a huge company with a successful business in the US. Hence, caution prevails regarding the impact of competition on Carsales in FY18 and FY19.

Is The Business Riskier?

Ord Minnett expects the increase in the dealer lead fee and the strength in data & research will offset the ongoing challenges in Stratton in the second half and once again deliver a quality result, while the company invests the growth in emerging businesses and highly prospective international options.

The broker notes the acquisition of DeMotores rounds out the company's Latin American exposure and, combined with the Asian investments, calculates $1.10 in value embedded in the share price. Stripping this out this reveals a core FY18 price/earnings ratio of 18.6x. With the businesses at an early stage and with some development costs borne by the core business, the broker believes there is considerable potential for growth.

Despite the solid performance, Deutsche Bank is more cautious and lowers its forecasts to reflect lower earnings at Stratton and the macro conditions that are affecting Webmotors in Brazil. Webmotors moved to a lead-based model from July 2016 and, while first half dealer leads were up 41%, this failed to translate to a meaningful revenue uplift. Weak macro conditions in Brazil are having an impact, the broker observes.

Elsewhere, Shaw and Partners notes the company's investments in infant markets have attractive earnings potential. This includes Argentina, Mexico and Chile. Nevertheless, these are medium-term propositions, which the broker believes makes the stock a much riskier investment than it was. Lower margin businesses are taking a greater portion of earnings growth and this is a key risk for the future.

The broker has a target of $11.50, which incorporates a demanding multiple with increased earnings risk and lower earnings growth relative to the company of old. Shaw, not one of the eight stockbrokers monitored daily on the FNArena database, has a Hold rating.

Credit Suisse was particularly encouraged by the 10% growth in dealer revenue and expects the core domestic revenue growth to continue strongly. The broker does not believe the stock is expensive as it trades at the low end of its peer group range, retaining an Outperform rating.

The database shows five Buy ratings and three Hold. The consensus target is $12.05, suggesting 10.7% upside to the last share price. Targets range from $10.50 (UBS) to $13.20 (Macquarie).

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Material Matters: Oil, Nickel And Metals

A glance through the latest expert views and predictions about commodities. Macquarie eases oil and LNG price outlook; Philippines throws another spanner in nickel works; China's looming capacity reductions.

-Oil market likely to become over-supplied in 2018 -Spot LNG prices likely to struggle to rise -Indonesia the wild card as nickel deficit expectations ratchet higher -China's capacity reforms expected to ramp up this year

By Eva Brocklehurst

Oil And LNG

Macquarie's analysts have updated forecasts for oil and gas prices. They expect tighter balances in 2017 will lead to a return to surplus in 2018 and 2019. Brent is expected to average US$57/bbl, US$56/bbl and US$61/bbl in 2017, 2018 and 2019 respectively.

The broker suspects supply will be reduced by the cuts from OPEC, even assuming only 50% compliance from non-GCC members. The six GCC members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

This pricing stability has already allowed shale producers in the US to lock in hedges and capital. The broker calculates that as OPEC's cuts roll off, this will combine with US production to push the market into oversupply in 2018.

Macquarie lifts spot LNG forecasts for 2017 to around US$5.8/mmbtu from US$5/mmbtu to reflect a combination of market tightness and stronger demand. But this relief is short lived as the ripple effect of rising US oil production means greater gas volume must coincide with the completion of trains three and four at Sabine Pass and train one at Cove Point.

2017 will also mean the completion of the much-delayed LNG export facilities in Australia. With more supply entering the market the broker envisages spot LNG prices will struggle to be materially higher than US$5/MMBtu until the early 2020's.

In light of the reduced forecasts the broker believes those stocks at risk within the LNG market are those most exposed to contract re-negotiation. Lower oil and gas prices means reduced earnings across the board, and as a result Macquarie downgrades AWE Ltd ((AWE)) to Underperform.

The broker retains a preference for Oil Search ((OSH)) over Woodside Petroleum ((WPL)). The broker remains positive on Santos ((STO)), as it seeks to ramp up gas volumes from Roma into GLNG. Beach Energy ((BPT)) is expected to struggle to replace the decline within its PEL 91 and is the most exposed to oil of the stocks the broker covers.

Revisions to Macquarie's oil price outlook results in a 30 basis point reduction to Australian inflation forecasts. The broker now expects headline inflation to remain stuck below 2% until late 2018. A flatter petrol price outlook removes a headwind for discretionary spending in terms of consumers.

Outside of the energy sector, a lower oil price forecast should benefit energy input costs for companies, making budgets less strained. Lower oil prices will represent an avoidance of the transfer of income from oil consumers back to oil producers but non-oil energy export earnings could also be more modest, particular for LNG volumes, as the price is oil linked.

Nickel

The Philippines government has shocked the nickel market by announcing the suspension, or closure, of all mines it had previously suspended, as well as a vast bulk of mines into place under notice of suspension in October last year. The minister responsible has announced that the government is averse to any kind of mining operation in functional watersheds and said it was a mistake to have approved such mines in the past.

On Macquarie's calculations, the closures affect mines which produced around 165,000 tonnes of nickel in 2015. The decision is not final since all miners may appeal directly to the president. Nevertheless it goes against expectations that many of the mines would escape closure. At this stage the broker calculates up to -70,000 tonnes of nickel may not be available for export to Chinese nickel pig iron facilities.

The decision comes in the wake of the Indonesian government's move to allow a partial relaxation of its nickel ore export ban. It remains unclear how much Indonesia's ore quota will be and Macquarie suspects a deficit of -40,000 tonnes of nickel in 2017, and -50,000 tonnes per annum thereafter, may be on the low side.

Until there is more information from both countries the broker is reluctant to calculate a new supply/demand balance. However, the net loss in 2017 of around -70,000 tonnes of nickel, as a result of the Philippines announcement, could easily be offset by at least 20,000 tonnes of nickel from other sources.

After the reversal of the Indonesian ban on export ore Deutsche Bank retracted its expectations for a squeeze on the nickel price. While admitting its first half average price forecast of US$12,250/t and full year forecast of US$11,750/t may look optimistic, post the Philippines closures there could still be upside from today's spot prices.

The broker had expected miners in the Philippines would avoid closures as long as appropriate remediation plans were put in place. The latest news suggests that the shutdowns account for around 50% of the country's nickel ore output.

On a 2015 production basis, this would amount to around -200,000 tonnes but, given that many of the mines was suffering from grade decline, the broker estimates the loss is more like -175,000t of contained nickel. The broker agrees the tonnage of ore allowed out of Indonesia is still a matter of conjecture but assumes 10m tonnes of 1.4% grade, amounting to 90,000t of contained nickel.

The broker would expect upside risks to its export assumptions should prices rally but for now the net effect is seen removing 80-100,000 tonnes of nickel from the market and pushing up the 2017 deficit to -150,000t from -50,000t.

Metals China

China has emerged as a major producer of metals and now accounts for around 20% of global supply. Goldman Sachs believes that the government is determined to curtail capacity considerably and that the oversupply of China's commodities may be much more limited than widely perceived.

The country is ramping up its structural reform on the supply side by removing marginal capacity, amid reforms to increase industry concentration while restructuring zombie firms to prove quality and efficiency.

Aside from a continued focus on coal and steel, Goldman Sachs expects reforms to extend to cement and aluminium this year. If steel capacity curtailment overshoots - as it did with coal in 2016 - the broker envisages a risk the steel market may experience a shortage in the first half this year. Also the potential for aluminium capacity cuts should support aluminium prices.

Western miners are unable to pick up the slack as mining capital expenditure among the majors is at the lowest it has been in a decade and a lack of investment in new growth over the past three years has meant there is limited ability to flex volumes.

Goldman Sachs believes these factors should support commodity prices remaining elevated for longer, assuming demand remains intact. The broker cites a preference for Australian stocks Newcrest Mining ((NCM)) and South32 ((S32)) among its globally preferred mining stocks.

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Material Matters: Coal, Gold And Iron Ore

A glance through the latest expert views and predictions about commodities. China and coal; ASX gold sector; outlook for energy sector; iron ore prices.

-Re-introduction of China's 276 work-days rule may underpin coking coal -Rising oil price supports a better outlook for energy stocks: Deutsche Bank -More growth than investors allow for in Woodside: Morgan Stanley -Iron ore price likely to incentivise additional supply

By Eva Brocklehurst

Coal

The question of whether the Chinese government will re-impose the 276 work-days rule for Chinese coal mines is an important one for coking coal prices, Credit Suisse attests. Prime hard coking coal has fallen to around US$170/t, around US$35/t below Tangshan in price parity terms. Stronger steel production, as China enters its spring construction season, and the work-days rule being imposed at the end of March, are two factors that may help the price.

The thermal coal price is not yet in the government's target range, having hovered close to RMB600/t since the start of the year. For China to impose the 276 work days rule, the broker expects thermal coal would need to enter its targeted price range which is believed to be RMB500-570/t FOB.

Thermal coal is not yet abundant in China, with Credit Suisse noting stocks at the port in Guangzhou were depleted to 900,000 tonnes in the first week of February, the lowest level in the broker's eight years of recording the data.

Gold

The ASX gold sector has reported strong production in the December quarter, leading the way on cost improvements with 75% of miners, overall, beating Deutsche Bank's forecasts. The broker notes the sector has increased 12% in the last month, which compares with the US dollar gold price being up 4% and the Australian gold price being flat.

The best performing equities were St Barbara ((SBM)), Newcrest Mining ((NCM)) and Regis Resources ((RRL)). The broker expects the sector to be focused on organic growth and exploration over the next three months. Deutsche Bank updates its models following the December quarter production reports, downgrading Evolution Mining ((EVN)) and OceanaGold ((OGC)) to Hold and Regis Resources to Sell on valuation.

Energy

Deutsche Bank has become more constructive for the near-term outlook in Australian energy coverage, supported in its view by a much firmer and rising oil price. In 2017 the broker expects demand to outstrip supply on forecast, which underpins a forecast for US$55/bbl Brent oil for 2017, as excess inventory is a gradually depleted. The degree of adherence to OPEC's production cuts remains the key swing factor.

Longer term, new production is likely to be necessary from higher-cost regions and a price signal will be required for such projects to proceed. While spot LNG markets have recovered in recent months from stronger demand, the broker expects a medium-term oversupply as the build up in new LNG capacity accelerates.

The broker's top pick in the sector remain Oil Search ((OSH)) because of its high quality assets. Santos ((STO)) also features in the broker's preferred exposure, with its exposure to PNG LNG and strong leverage to a rising oil price. The broker also likes Caltex ((CTX)), which it believes is currently pricing in unrealistically low expectations.

Morgan Stanley believes there is more growth than investors allow for in Woodside Petroleum ((WPL)). The growth plans that are underway are likely to exceed expectations over time. The broker notes the company's low-cost and low-capex LNG assets have enabled it to re-position its portfolio over the past 12 months. These projects should drive production and cash flows from the beginning of the next decade. Production is set to grow to 96.1mmboe in 2018 and 100mmboe by 2019. This should lead to higher operational earnings (EBITDA).

The projects become key drivers of value over the next 12 months, in the broker's view, as the market is applying little value to them. Capital expenditure is expected to be stable, meaning free cash generation will improve. There is also spare debt capacity of over US$1bn in 2018, providing potential for capital management and this should become a focal point for investors in the latter half of this year.

Moreover, the broker believes the company's M&A strategy over 2016 was right and expects Woodside will focus on oil opportunities outside of Australia that are either producing or have near-term development potential. Morgan Stanley upgrades its valuation for Senegal, Scarborough, Myanmar and North West Shelf backfill. The broker has an Overweight rating and $40.00 target.

Iron Ore

Ord Minnett observes the drivers of the recent iron ore price rally to US$80/t appear to be a combination of Chinese demand, solid consumption in the rest of the world as China reduces steel exports, and relatively flat supply. The broker expects tight conditions to persist through the first half of FY17 but the price will eventually provide incentives for additional supply to come on line, and this could remove some of the current pricing tension.

Ord Minnett raises its 2017 forecast for iron ore to US$73/t but still expects a downward trend towards the year-end as supply grows. Overall, the broker expects major miners to add 71mt in 2017, with global demand growth of 43mt expected. While viewing the market as broadly balanced, the broker acknowledges a risk in the growth in non-traditional supply, with the incentive of higher prices.

Macquarie observes iron ore is the only steel-making ingredient for which prices are still holding up, as coking coal, manganese and steel scrap prices have all weakened from recent peaks. The broker expects prices will ease for iron ore now that the Chinese new year holidays are over, as supply is clearly abundant. Steel mills are expected to pressure iron ore sellers, despite the traditional post Chinese New Year pick up in steel output and demand.

Full year Chinese trade data shows total iron ore imports rose 7.5% in January year on year, while the broker estimates iron ore consumption rose by less than 1% last year. Indian iron ore exports also show the biggest response to higher prices, Macquarie observes, aided by the removal of low-grade export taxes and export bans last year.

While the Indian government has maintained export taxes of 30% on fines above a 58% iron grade in the February budget, the broker envisages India could still export 30m tonnes or more of iron ore at current prices.

Lithium Rising As Electric Vehicles Take Hold

By Sam Green, adviser at Options Education Centre, TradersCiricle

The New Year has started with an abundance of news from the Lithium industry, as a tangible shift in the mobile energy mix appears to be taking place.

Increasingly, stakeholders are expressing a view that electric motor vehicles will replace their internally combusting counterparts, with this trend likely to have major implications for the global economy over the next few decades.

In January, petroleum industry website, Gasbuddy, asked the provocative question, "Has US gasoline demand peaked?" which generated heated discussion across several economic news websites. The company estimated that US gasoline demand has topped out, and that ongoing demand for gasoline is in permanent decline. They blamed increasing oil prices, as well as the increasing prevalence (and declining cost) of electric vehicles as leading to the change.

This sentiment was echoed by the Imperial College London, in collaboration with the Carbon Tracker Initiative think tank, who estimated that 2 million barrels a day of oil demand could be replaced by electric vehicles by 2025. They furthered that such an outcome would be similar to the 10 percent loss of market share that caused the collapse of the U.S. coal mining industry. Indeed, even oil giant BP has also quietly admitted that electric vehicles could displace as much as 5 million barrels of oil demand over the next 20 years.

One of the big drivers of the uptake of electric vehicles has been the rapidly declining cost, with prices falling faster than the most optimistic of forecasts. If this trend continues, the price of electric vehicles will reach parity with internal combustion vehicles by 2020.

Leaders of the automakers Ford and Audi have also come out recently to express their view of the coming dominance of electrified vehicles, with the Ford CEO stating that "15 years from now, is that there are going to be more electrified offerings than there are internal combustion engines,"

Because of the growing prevalence of electric vehicles, consumers will increasingly be able to charge their batteries at retail gasoline outlets. Indeed, Shell, long known as a market leader in greener gasoline technologies, plans to leverage their existing service station infrastructure in the UK and the Netherlands to offer charging points for electric vehicles; with the first to be installed by the end of the year.

The revolution is not just happening in the private vehicle sector either. Tesla Motors has recently announced development of an electric truck called the Tesla-semi, which Tesla CEO Elon Musk states "will deliver a substantial reduction in the cost of cargo transport". Commercial vehicle fleets have traditionally shied away from electric vehicles, due to concerns over range and cost; but this latest announcement from Tesla would indicate that these shortcomings are rapidly being overcome through advances in technology.

With all the ground being made by electric vehicles, manufacturers are increasingly struggling to source electric vehicle batteries, and the lithium which they contain. According to Thomas Sedran, VW's head of group strategy, "The capacity is not there," "Nobody has the capacity."

Rich rewards already exist for those producing the lithium required for electric vehicle batteries, and this is only going to increase with the anticipated increase in demand for electric vehicles. In fact, Australian company Galaxy Resources ((GXY)) recently started lithium production from their Mt Caitlin facility, which sent shockwaves through their share price. Their stock rose from mid-30 cents per share, up to just below 70 cents per share, all within the space of a few weeks. This would be incredible performance for a microcap stock, but Galaxy is a billion dollar entity.

We have also seen some exiting new lithium explorers hitting capital markets over the recent period. Not least of which a company called Lithium Consolidated Minerals Exploration ((LI3)), which plans to explore an allotment of land next to the leading lithium production site in North America.

The wealth of the 20th Century was largely built on the back of the oil boom, which powered our means of transportation. In the 21st century, the means of transportation are becoming electrified, and the spoils are once again likely to go to those who power our technology.

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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 January 30 to Friday February 3, 2017 Total Upgrades: 16 Total Downgrades: 15 Net Ratings Breakdown: Buy 43.80%; Hold 42.15%; Sell 14.05%

Australian investors had a few nasty profit downgrades to digest ahead of the first financial reports of the season, and James Hardie on Friday missed market expectations. Add unexpected tightening from Chinese authorities and more mayhem in Washington and it has become all but clear: this year's February reporting season is ramping up under a macro cloud.

FNArena registered 16 upgrades and 15 downgrades in ratings for individual ASX-listed stocks for the week ending Friday, 3rd February 2017. There are still more Buy ratings than Neutral/Hold recommendations for all stocks covered by the eight stockbrokers in our database. Traditionally this has earmarked not-so-good times for the local stock market. This time around the major indices are being carried by a rather narrow group of reflation winners.

Amongst stocks to receive upgrades, Navitas was the stand-out with three upgrades post the release of its financial results. Sydney Airport, Woolworths, Transurban and Scentre Group were all upgraded too. A sign the market overall is reconsidering its positioning post the Trump rally?

On the othet side of the ledger, 15 stocks each received one downgrade during the week and amongst them were Ansell, GBST, Orocobre, Iluka Resources and Sonic Healthcare.

In further evidence investors are warming to the prospect of a Woolworths comeback in the local supermarket wars, Woolworths sits on top of the week's table for positive revisions to price targets; up 9%, at a distance followed by IOOF Holdings and Iluka Resources.

The table for negative adjustments is led by GBST, followed by Navitas and Tabcorp.

Orocobre enjoyed the largest increase to forecast profits during the week, seeing consensus jump by 277%. The likes of AWE Ltd, Mt Gibson and Fortescue Metals too enjoyed increases in excess of 50%, but couldn't match Orocobre's pace.

The negative side looks equally impressive with ERM Power topping the table (-1375%), followed by Iluka Resources (-291%), Perseus Mining and Aconex (-40% plus each).

Too early to draw any conclusions just yet as the February reporting season slowly accelerates its pace.

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 1/4/1

The company's share price has underperformed the market since it reached its all-time high back on August 1, 2016.

Ord Minnett believes the correction has been driven by a recognition of the difficulty in achieving realised cement price increases amid tepid underlying demand.

Both these dynamics are expected to improve in 2017. The broker upgrades to Hold from Lighten and raises the target to $4.90 from $4.60.

BT INVESTMENT MANAGEMENT LIMITED ((BTT)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/4/0

Credit Suisse suspects the departure of Gavin Rochussen will weigh on BT's capacity to maintain fund inflows at the same level of recent years. Target falls to $10.00 from $10.50 as a result. The broker remains cautious given fund flow and equity market volatility.

However BT's share price has fallen around -15% since December to a point at which Credit Suisse sees valuation support. BT consistently delivers superior funds flows to peers and is successfully executing on its global expansion, the broker notes. Upgrade to Neutral.

BRAMBLES LIMITED ((BXB)) Upgrade to Add from Hold by Morgans .B/H/S: 5/1/1

Brambles' recent first half trading update was a disappointment to Morgans, and the broker awaits new FY guidance at the company's result release. Earnings forecasts have been trimmed in the meantime.

But Morgans believes Brambles' longer term fundamentals remain solid, suggesting the recent pullback in price represents a buying opportunity. Target falls to $11.61 from $11.91. Upgrade to Add.

CHARTER HALL GROUP ((CHC)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/1/2

In a general update on the sector, Citi analysts observe investors are very much focused on global bond yields in order to recalibrate their strategies with regards to AREITs, but history shows, point out the analysts, cap rates are a more important factor to keep an eye on.

The cap rate is the ratio of Net Operating Income (NOI) to property asset value. Citi analysts suggest investors should watch for potential trend changes.

Charter Hall has been upgraded to Buy from Neutral. Price target gains 5c to $5.59. Estimates have been lifted ever so slightly.

NEWCREST MINING LIMITED ((NCM)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/2/3

December quarter gold production met Morgan Stanley's estimates.The broker considers the metrics are fair and the free cash flow supportive and that the stock can be a defensive exposure in periods of volatility.

The broker believes the operational issues are dissipating, while margins and scale are robust. Morgan Stanley upgrades to Equal-weight from Underweight. Target is raised to $22.00 from $21.75. Industry view: Attractive.

See also NCM downgrade.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/2/0

Morgan Stanley is adding the stock to its preferred list of miners. After applying updated commodity prices and operational data, Morgan Stanley's FY17 estimate for earnings per share is down -27%. Nevertheless, FY18 and FY19 are changed to be up 3% and down -8% respectively.

The broker notes the company is carrying a sizeable cash buffer and no bank debt. The FY17 dividend and yield are projected at 9.1c and 2.3% respectively, based on 25% pay-out of free cash flow per share.

Morgan Stanley upgrades to Overweight from Equal-weight. Target is $5.30. Industry view: Attractive.

NAVITAS LIMITED ((NVT)) Upgrade to Outperform from Neutral by Macquarie and Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Buy from Neutral by UBS .B/H/S: 2/3/0

Macquarie expects sustained earnings growth, with the risks for contract losses and regulation reduced. The broker transfers coverage to a new analyst.

The stock is upgraded to Outperform from Neutral, reflecting these expectations. The broker considers contract losses, which have been a significant concern for prospective investors, are significantly reduced following a successful run of renewals. Target is $5.25.

Campus closures and currency headwinds meant Navitas' result was a messy one, but in line with Credit Suisse at the headline. The broker expects a return to growth in the second half that will finally put the Macquarie Uni contract loss in the past.

Taking a conservative view, Credit Suisse has nevertheless lowered earnings forecasts and its target to $4.40 from $4.95. On recent share price weakness the broker upgrades to Neutral.

With the transition period from the loss of the Macquarie University contract largely completed, and the recent addition of another US college locked in, UBS believes the market can now focus on potential earnings growth and other attractive attributes.

UBS upgrades to Buy from Neutral. Target is reduced to $5.18 from $5.65. The company continues to expect FY17 EBITDA to be broadly in line with the prior year on a constant currency basis.

OIL SEARCH LIMITED ((OSH)) Upgrade to Neutral from Sell by Citi .B/H/S: 4/3/1

Citi analysts are of the view that exploration success at Muruk & Antelope changes the outlook for PNG expansion which has now become more feasible.

As such these latest results support 3 Train expansion including potential for reserve increases.

Target price lifts to $7.03 from $6.48. Upgrade to Neutral from Sell.

QUBE HOLDINGS LIMITED ((QUB)) Upgrade to Add from Hold by Morgans .B/H/S: 5/3/0

The Moorebank development project has reached financial closure which is significant event, Morgans suggests, triggering long term earnings growth potential for Qube. The broker believes revenue contracts have been awaiting final closure.

Morgans has upgraded earnings forecasts, also adjusting for the Patrick and ATT acquisitions and capital raising. Target rises to $2.63 from $2.53. On a potential total shareholder reward of 15%, the broker upgrades to Add.

SCENTRE GROUP ((SCG)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/2/1

In a general update on the sector, Citi analysts observe investors are very much focused on global bond yields in order to recalibrate their strategies with regards to AREITs, but history shows, point out the analysts, cap rates are a more important factor to keep an eye on.

The cap rate is the ratio of Net Operating Income (NOI) to property asset value. Citi analysts suggest investors should watch for potential trend changes.

Scentre Group has been upgraded to Neutral from Sell. Price target moves to $4.35 from $4.28.

SUNCORP GROUP LIMITED ((SUN)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 5/2/1

While the fundamentals are in place, valuations for the general insurance sector are approaching that of the broader market and Deutsche Bank takes up a neutral outlook on the sector.

The broker transfers coverage to another analyst and updates its thesis on the sector, highlighting a preference for Suncorp as it is trading at a 20% discount to Insurance Australia Group ((IAG)), despite operating in broadly similar product lines.

Rating is upgraded to Buy from Hold. Target is raised to $14.00 from $13.70.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Upgrade to Add from Hold by Morgans .B/H/S: 4/2/1

Two factors underpin Morgans' decision to upgrade to Add from Hold. First comes the share price slump. Then follows the assumption Sydney Airport will not participate in the development of a second airport at Badgerys Creek, at least not under the conditions proposed.

Morgans acknowledges the long term uncertainty about precise impact from a second airport in Sydney, but for now, growth and yield seem too attractive to ignore. Target remains unchanged at $7.04.

TRANSURBAN GROUP ((TCL)) Upgrade to Add from Hold by Morgans .B/H/S: 5/2/0

The rise in government bond rates has weighed heavily on Transurban's share price. Morgans has cut its target on more conservative assumptions, but the new target of $11.23, down from $12.00, suggests 10% upside from the current price.

Transurban's underlying business remains robust, Morgans suggests, and forecast dividend growth remains strong.

On a current total shareholder return forecast of 15%, the broker upgrades to Add.

WOOLWORTHS LIMITED ((WOW)) Upgrade to Buy from Sell by UBS .B/H/S: 3/2/2

It appears UBS has upgraded to Buy from Sell, raising the price target to $27.30 from $19.10.

Downgrade

ANSELL LIMITED ((ANN)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/6/1

The broker observes the company is leveraged to a potential uplift in economic conditions but believes this is now largely reflected in the share price, especially given the near doubling of latex costs.

Despite the benefit from the Nitritex acquisition, the broker is wary, noting Ansell could face challenges from US tax reform given its Asian-based manufacturing.

Rating is downgraded to Hold from Buy. Target is $25.

CARSALES.COM LIMITED ((CAR)) Downgrade to Hold from Add by Morgans .B/H/S: 5/3/0

The company has expanded its Latin American footprint with the purchase of the Demotores online classifieds businesses in Argentina, Colombia and Chile. While the deal a small, Morgans notes it reveals a broader continental strategy is emerging.

Separately, the broker adjusts earnings forecasts to include price rises implemented this month and higher advertising costs as the company responds to the arrival of Cox Enterprises as a competitor.

The broker believes the home competitive environment is about to get a lot tougher and, while retaining a positive long-term view on the stock, winds back its rating to Hold from Add. Target is reduced to $11.07 from $12.03.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Hold from Add by Morgans .B/H/S: 0/6/2

Morgans believes the bank sector is now fully valued following the post US election rally, however an easing in capital requirement expectations supports the broker's view dividends will remain robust.

CBA is downgraded to Hold. Target rises to $79.00 from $75.80.

CSR LIMITED ((CSR)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/2/2

Transport restrictions in China have led to tight supply for aluminium in recent months. As this unwinds in the first quarter of 2017, Ord Minnett expects the underlying commodity price to retrace.

In addition, a shift in the global supply/demand balance to an oversupplied position presents another risk. The broker downgrades to Lighten from Hold and raises the target to $3.80 from $3.75.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Downgrade to Hold from Add by Morgans .B/H/S: 3/2/0

Morgans adjusts first half forecasts to show 1% revenue growth and a -1% decline in costs, to deliver 7% growth in EBITDA.

The target lifts to $1.19 from $1.13, to reflect the changes, largely because of the broker's oil price outlook.

Morgans downgrades to Hold from Add as, at current prices, the potential shareholder return is around 5%.

GBST HOLDINGS LIMITED ((GBT)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/1/0

GBST has issued a profit warning ahead of its result, cutting FY17 earnings guidance to 33% below UBS' prior forecast. Project delays, deferred spending on major projects in the UK, and the weak GBP are all to blame.

While the risks are not new, the broker is concerned about the size of the downgrade. Improvement in FY18 is dependent on a recovery in services work and/or new contract wins. Elevated R&D costs will remain a significant drag over FY17, the broker notes.

UBS has cut earnings forecasts and lowered its target to $3.40 from $4.35. Downgrade to Neutral.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 0/5/1

December quarter production delivered in line with, or better than, guidance. Credit Suisse reduces FY17 revenue estimates by -3% and underlying EBITDA by -10%.

The broker assumes a modestly slower ramp up for Nova, given mine development rates in the December quarter fell short of internal targets.

With a potential relaxation of the ban on Indonesian nickel ore exports, the broker reduces the target to $4.00 from $4.50 and downgrades to Neutral from Outperform.

ILUKA RESOURCES LIMITED ((ILU)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/2/1

Ord Minnett observes feedstock price rises are taking longer than previously anticipated and the latest 2017 guidance highlights a slow start in Sierra Leone.

The stock screens relatively expensive compared with its peers at a 2017 enterprise value/operating earnings multiple. Ord Minnett cuts its rating to Lighten from Hold. Target is raised to $6.60 from $6.50.

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/4/1

The stock is up 20% against the Australian market since it reported FY16 results.

UBS believes this reflects stronger nitrogen fertiliser prices, positive sentiment around the US election and the potential impact on infrastructure-led explosives demand and the ongoing ramp up of the Louisiana project.

While the broker believes there is further upside to fertiliser prices, a large degree of success is now incorporated in the valuation and the rating is downgraded to Neutral from Buy. Target rises to $3.80 from $3.40.

NEWCREST MINING LIMITED ((NCM)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/2/3

Newcrest's Dec Q production and sales were largely in line with Macquarie's forecasts. FY17 production guidance has been maintained for all projects. Modest earnings upgrades follow on a solid performance. Target rises to $23 from $20.

But the stock has had a solid run since December, outperforming the market and both local and global gold mining peers, the broker notes. With little upside apparent from the target, Macquarie downgrades to Neutral.

See also NCM upgrade.

NIB HOLDINGS LIMITED ((NHF)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 2/4/1

As the share price has rallied, Ord Minnett downgrades to Accumulate from Buy. The main issues the broker envisages in the upcoming first half results are Australian resident health insurance margins, claims inflation and growth trends.

The margins were upgraded at the AGM largely on the back of more favourable claims environment but the company also increased its drawing rate inflation range. The broker awaits further clarity from the commentary on claims inflation trends. Target rises to $5.00 from $4.90.

OROCOBRE LIMITED ((ORE)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/2/0

Pricing in the December quarter was lower than Macquarie expected, and cash flow was negative. Production was at the bottom of the guidance range.

While the miss on pricing and sales was disappointing, it is the broader impact on funding and cash flow that drives the broker to downgrade to Neutral from Outperform. The target is reduced to $4.35 from $4.60.

OZ MINERALS LIMITED ((OZL)) Downgrade to Reduce from Hold by Morgans .B/H/S: 2/3/3

Morgans has updated its OZ valuation, applying increased copper price assumptions, pricing operational improvements at Prominent Hill and reducing the risk-weighting for Carrapateena. The result is a target price increase to $7.30 from $5.95.

This remain well shy of the current trading price. The broker believes the market has re-rated OZ by some 50% on global growth exuberance and a lack of other large, high margin copper exposures on the market. Downgrade to Reduce. The broker prefers Sandfire Resources ((SFR)) in the copper space.

PERSEUS MINING LIMITED ((PRU)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/2/1

As the disappointing news flow continues at Perseus, with the second production downgrade in two weeks, Citi analysts have downgraded to Sell/High Risk from Neutral/High Risk.

The analysts estimate another $30m external funding will be needed to complete the new mine at Sissingue for first production in Q1 2018. Target falls to 37c from 42c.

SONIC HEALTHCARE LIMITED ((SHL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/4/1

Ord Minnett finds the announcement of yet another acquisition in Germany "encouraging", but otherwise is worried about weak demand in Australia and the USA. On this basis, the recommendation is being pulled back to Hold from Accumulate.

In addition, the analysts point at the lack of progress on the hoped-for reform of collections centres in Australia and pending funding cuts in the USA. Incorporating new FX forecasts has triggered mild reductions to estimates. Price target falls to $23 from $24.30. The analysts see little room for upside surprise.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ADELAIDE BRIGHTON LIMITED Neutral Sell Ord Minnett 2 BRAMBLES LIMITED Buy Neutral Morgans 3 BT INVESTMENT MANAGEMENT LIMITED Neutral Sell Credit Suisse 4 CHARTER HALL GROUP Buy Neutral Citi 5 NAVITAS LIMITED Buy Sell Macquarie 6 NAVITAS LIMITED Buy Neutral UBS 7 NAVITAS LIMITED Neutral Sell Credit Suisse 8 NEWCREST MINING LIMITED Neutral Sell Morgan Stanley 9 NORTHERN STAR RESOURCES LTD Buy Neutral Morgan Stanley 10 OIL SEARCH LIMITED Neutral Sell Citi 11 QUBE HOLDINGS LIMITED Buy Neutral Morgans 12 SCENTRE GROUP Neutral Sell Citi 13 SUNCORP GROUP LIMITED Buy Neutral Deutsche Bank 14 SYDNEY AIRPORT HOLDINGS LIMITED Buy Neutral Morgans 15 TRANSURBAN GROUP Buy Neutral Morgans 16 WOOLWORTHS LIMITED Buy Sell UBS Downgrade 17 ANSELL LIMITED Neutral Buy Ord Minnett 18 CARSALES.COM LIMITED Neutral Buy Morgans 19 CLEANAWAY WASTE MANAGEMENT LIMITED Neutral Buy Morgans 20 COMMONWEALTH BANK OF AUSTRALIA Neutral Buy Morgans 21 CSR LIMITED Sell Neutral Ord Minnett 22 GBST HOLDINGS LIMITED Neutral Buy UBS 23 ILUKA RESOURCES LIMITED Sell Neutral Ord Minnett 24 INCITEC PIVOT LIMITED Neutral Buy UBS 25 INDEPENDENCE GROUP NL Neutral Buy Credit Suisse 26 NEWCREST MINING LIMITED Neutral Buy Macquarie 27 NIB HOLDINGS LIMITED Buy Buy Ord Minnett 28 OROCOBRE LIMITED Neutral Buy Macquarie 29 OZ MINERALS LIMITED Sell Neutral Morgans 30 PERSEUS MINING LIMITED Sell Neutral Citi 31 SONIC HEALTHCARE LIMITED Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 NVT NAVITAS LIMITED 40.0% -40.0% 80.0% 5 2 WOW WOOLWORTHS LIMITED 7.0% -36.0% 43.0% 7 3 SCG SCENTRE GROUP 25.0% 8.0% 17.0% 6 4 BXB BRAMBLES LIMITED 57.0% 43.0% 14.0% 7 5 SYD SYDNEY AIRPORT HOLDINGS LIMITED 43.0% 29.0% 14.0% 7 6 TCL TRANSURBAN GROUP 71.0% 57.0% 14.0% 7 7 MFG MAGELLAN FINANCIAL GROUP LIMITED 33.0% 20.0% 13.0% 6 8 SUN SUNCORP GROUP LIMITED 44.0% 31.0% 13.0% 8 9 QUB QUBE HOLDINGS LIMITED 63.0% 50.0% 13.0% 8 10 OSH OIL SEARCH LIMITED 31.0% 19.0% 12.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 EPW ERM POWER LIMITED -67.0% -33.0% -34.0% 3 2 GBT GBST HOLDINGS LIMITED 67.0% 100.0% -33.0% 3 3 IFL IOOF HOLDINGS LIMITED 20.0% 40.0% -20.0% 5 4 PRU PERSEUS MINING LIMITED 20.0% 40.0% -20.0% 5 5 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 50.0% 70.0% -20.0% 5 6 BPT BEACH ENERGY LIMITED -25.0% -8.0% -17.0% 6 7 CGF CHALLENGER LIMITED 6.0% 19.0% -13.0% 8 8 IPL INCITEC PIVOT LIMITED 25.0% 38.0% -13.0% 8 9 CAR CARSALES.COM LIMITED 63.0% 75.0% -12.0% 8 10 CBA COMMONWEALTH BANK OF AUSTRALIA -25.0% -13.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 WOW WOOLWORTHS LIMITED 24.306 22.277 9.11% 7 2 IFL IOOF HOLDINGS LIMITED 9.000 8.600 4.65% 5 3 ILU ILUKA RESOURCES LIMITED 7.221 6.921 4.33% 7 4 NHF NIB HOLDINGS LIMITED 4.704 4.584 2.62% 7 5 BPT BEACH ENERGY LIMITED 0.678 0.665 1.95% 6 6 IPL INCITEC PIVOT LIMITED 3.496 3.446 1.45% 8 7 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 1.112 1.100 1.09% 5 8 CGF CHALLENGER LIMITED 10.220 10.118 1.01% 8 9 MFG MAGELLAN FINANCIAL GROUP LIMITED 26.077 25.832 0.95% 6 10 SUN SUNCORP GROUP LIMITED 13.639 13.520 0.88% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 GBT GBST HOLDINGS LIMITED 3.853 4.690 -17.85% 3 2 NVT NAVITAS LIMITED 5.026 5.336 -5.81% 5 3 TAH TABCORP HOLDINGS LIMITED 4.650 4.823 -3.59% 5 4 PRU PERSEUS MINING LIMITED 0.568 0.584 -2.74% 5 5 CAR CARSALES.COM LIMITED 11.740 11.877 -1.15% 8 6 TTS TATTS GROUP LIMITED 4.391 4.423 -0.72% 7 7 CWN CROWN RESORTS LIMITED 12.538 12.616 -0.62% 6 8 BXB BRAMBLES LIMITED 11.790 11.833 -0.36% 7 9 LNK LINK ADMINISTRATION HOLDINGS LIMITED 8.406 8.413 -0.08% 5 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ORE OROCOBRE LIMITED 1.950 -1.100 277.27% 4 2 AWE AWE LIMITED -1.550 -3.617 57.15% 6 3 MGX MOUNT GIBSON IRON LIMITED 1.733 1.133 52.96% 3 4 FMG FORTESCUE METALS GROUP LTD 92.065 60.811 51.40% 8 5 NHC NEW HOPE CORPORATION LIMITED 14.923 12.323 21.10% 3 6 BHP BHP BILLITON LIMITED 187.015 165.321 13.12% 8 7 BPT BEACH ENERGY LIMITED 6.071 5.633 7.78% 6 8 ALL ARISTOCRAT LEISURE LIMITED 76.716 72.930 5.19% 6 9 MIN MINERAL RESOURCES LIMITED 77.840 75.040 3.73% 4 10 OGC OCEANAGOLD CORPORATION 30.277 29.375 3.07% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 EPW ERM

POWER LIMITED -2.550 0.200 -1375.00% 3 2 ILU ILUKA RESOURCES LIMITED -7.631 3.993 -291.11% 7 3 PRU PERSEUS MINING LIMITED -3.903 -2.742 -42.34% 5 4 ACX ACONEX LIMITED 3.612 6.145 -41.22% 6 5 GBT GBST HOLDINGS LIMITED 12.233 19.833 -38.32% 3 6 NST NORTHERN STAR RESOURCES LTD 30.978 38.504 -19.55% 5 7 TCL TRANSURBAN GROUP 22.312 26.753 -16.60% 7 8 SXY SENEX ENERGY LIMITED -12.817 -11.000 -16.52% 6 9 EVN EVOLUTION MINING LIMITED 16.923 19.474 -13.10% 7 10 AWC ALUMINA LIMITED 4.903 5.337 -8.13% 7 Technical limitations

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Uranium Week: Volume Picks Up

The uranium spot market appears to now be feeding on itself as stronger prices lead to increasing interest.

By Greg Peel

Due to an extended delay in restarting its reactor fleet – the fifth anniversary of Fukushima is next month – Tokyo Electric Power Company has cited force majeure in terminating its long term uranium supply contract with Canada's Cameco. Cameco will mount a legal challenge.

The termination offers up a risk that uranium otherwise destined for TEPCO inventories will now hit the market instead, weighing on prices. But the market has brushed aside such a risk, at least for now.

Momentum Is Up

Momentum has been building on 2017 in spot prices and last week saw that continue, on increasing volume.

Last week marked the end of January and industry consultant TradeTech reports twenty spot transactions were concluded over the month totalling 2.5mlbs U3O8 equivalent. TradeTech's spot price indicator rose US$4.25 over the month to US$24.50/lb.

On a week-on-week basis, the consultant's price indicator is up US$1.00 to US$25.50/lb at week's end. A further ten spot transactions were concluded in the first three days of February totalling 1.5mlbs U3O8 equivalent.

These volumes are a far cry from the tepid numbers reported as 2016 came to a close, when the spot price bottomed out at a twelve-year low US$17.75/lb. Since that time, the spot price has rebounded 44%. Intermediaries and speculators, who spent most of 2016 trying desperately to offload their positions, have been active in the mix this year alongside producers and actual end-users.

Demand From Asia

On the demand side of the equation, TradeTech notes there are 60 reactors currently under construction worldwide, two-thirds of which are in Asia. Asian nuclear programs are largely driven by the desire to reduce carbon emissions and improve air quality.

On the supply side, 2016 saw many a uranium producer curtail production through mine shutdowns, temporary or otherwise. The greatest supply-side impact has been delivered by Kazakhstan, in announcing a -10% cut to annual production.

In most cases, supply has been curtailed, not removed. The spot price rally underway is being supported by tight supply. Many operating mines are still burning cash at current pricing despite this year's rebound, but if the rebound continues it's only a matter of time before idled supply starts coming back on line. See: US shale oil.

There were three transactions concluded in the term uranium markets late last week, TradeTech reports, for reasonable volumes. As demand picks up and prices rise, the consultant has adjusted its end-month term price indicators accordingly.

The mid-term indicator has risen US$5.75 to US$27.75/lb. The long-term indicator has risen US$5.00 to US$35.00/lb.

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 February 2, 2017

Last week saw the ASX200 trade largely sideways in a range of 5600-5650.

It is not unsurprising for the market to go a bit quiet ahead of earnings season ramping up, but further incentive to do little on a macro level has been provided by a stalled Wall Street.

It is also typical for changes to short positions to be minimal ahead of earnings season. All of the up and down moves in the table below reflect bracket creep, with no move greater than one percentage point.

There is one exception however, at the top of the table.

Aconex shorts have fallen to 14.9% from 16.0%.

Weekly short positions as a percentage of market cap:

10%+

MYR 16.6 ACX 14.9 WSA 12.0 TFC 11.7 VOC 11.0 NEC 10.4 WOR 10.1

In: WOR

9.0-9.9%

MTS, SYR Out: WOR

8.0-8.9%

NWS, FLT, MND, MYX, HSO, NXT, ISD, BAL

In: MND, ISD

7.0-7.9%

EHE, DOW, RWC, ORE, MTR, BEN

Out: MND, ISD, MYO, AWC

6.0-6.9%

IVC, AWC, GTY, PRU, SGH, MYO, SRX, OFX, JHC, AAD, TGR, BGA, CSV, SEK

In: AWC, MYO, OFX, AAD, TGR

5.0-5.9%

RIO, IFL, CSR, GXL, IGO, PDN, A2M, MSB, OSH, VRT, GEM, CTD, WOW, BKL, AWE, KAR, IPH, AAC, CAB

In: VRT Out: OFX, AAD, TGR, ILU

Movers and Shakers

I noted last week that construction industry SaaS company Aconex ((ACX)) has been at the top of the table, and briefly most shorted stock on the market, for the past few weeks. After a solid run over early 2016 as investors jumped herd-like onto all things “cloud”, late 2016 saw increasing nervousness as the company struggled to deliver on expected revenues. The shorts began to build.

While Aconex has suffered a couple of sharp falls in recent months, none have been as sharp as last week’s spectacular -45% capitulation in one session, after the company issued the profit warning the shorters had been anticipating.

Yet it appears most shorters are in for the long haul. Despite the gift of a near halving in share price, Aconex shorts have only fallen 1.1ppt to 14.9% from 16.0%, leaving the stock still in second place behind Myer on 16.6%.

It may be that not all position changes had been reported to ASIC by that time, so we’ll keep an eye out again next week.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Telcos, Restructuring And Cobalt

Weekly Broker Wrap: Oz economy; Ord Minnett re-initiates on telecoms sector; positive data for Woolworths; increased numbers of companies restructuring; the year of cobalt.

-Core inflation expected to under-shoot Reserve Bank's targets -Structural changes in telecoms presenting opportunities -Successful restructuring could lead to outperformance -Cobalt demand growing while supply growth is stagnant

By Eva Brocklehurst

Oz Economics

Credit Suisse believes stagnation in the economy is the likely scenario in 2017, owing to weakness in business capital expenditure and fragility in residential investment. The delayed effects of macro prudential and exchange-rate tightening are expected to manifest in the current year. Nevertheless, with no incremental tightening effect visible to prevent a moderate recovery in 2018, the broker expects around 2.5% growth in that year.

Credit Suisse expects core inflation to under-shoot the Reserve Bank's targets. The trimmed mean of CPI inflation is expected to slow to 1.3% per annum by 2018. The broker does not believe there will be a sufficiently large, timely or sustained fiscal stimulus to prevent the central bank from cutting the cash rate further and forecasts the RBA to cut cash rates at least twice in 2017 and again in 2018.

Telecoms

Ord Minnett resumes coverage of the telecommunications sector, noting structural changes present opportunities. The broker believes the tailwinds in the mobile market are strong and assumes a three player market as its base case. Increasing data usage and mobile device proliferation should support growth in the industry.

In the NBN, margins are likely to continue coming under pressure for the incumbents, but this creates an opportunity to invest in operators such as Vocus Communications ((VOC)), for which growth is expected to accelerate over the next 4-5 years. The broker expects faster speeds and higher data limits to offset pressure on pricing. Ord Minnett initiates on Vocus with a Buy rating and $5.25 target.

Telstra ((TLS)) is rated Accumulate with a $5.45 target. Telstra is facing the strongest headwinds in the industry as the NBN is expected to reduce earnings by $2-3bn annually. The broker believes downside from the NBN is already priced in and a high dividend yield and modest valuation should provide support.

TPG Telecom ((TPM)), while being one of the more cost efficient operators in the industry, is expected to sustain compressed margins from NBN migration and new entrants potentially pressuring pricing and market share. Furthermore, its mobile ambitions in Australia and Singapore are uncertain. Ord Minnett initiates with a Hold rating and target of $6.65.

UBS observes a key feature of the results for Optus was an acceleration in net additions in mobile in the December quarter. The broker's question is whether the increased number of subscribers was driven by an acceleration in the market or a gain in market share.

Optus has stated it is winning incremental subscribers and share in regional Australia on back of its network investments. The company has also sustained increased uptake of its EPL mobile content services.

The broker notes the other aspect to the result was a significant step-up in the cost of sales in the consumer segment. The read-through for Telstra from the Optus result is difficult but the net additions for Optus appear to have accelerated and this suggests to UBS, at the very least, that Telstra's mobile share gains have plateaued.

Supermarkets

The first half result from Shopping Centres Australiasia ((SCP)) provides a positive data point for Woolworths ((WOW)) as that company's supermarkets occupy around 75% of the property group's portfolio. Of interest to Deutsche Bank is disclosure that supermarkets sales increased 2.0% year-on-year in November and 2.4%

year-on-year in December. Meanwhile, the data suggests Big W is still doing it tough.

The data is in line with Deutsche Bank's channel checks on suppliers, which signal that Woolworths experienced an improving sales trend over the December quarter. Industry feedback suggests Coles ((WES)) sales growth has slowed, so the recovery for Woolworths may be even more acute than what the numbers suggest.

Deutsche Bank currently forecasts second-quarter food like-for-like sales growth of 1.5% for Woolworths and expects improvement over the longer term as execution gets better.

Restructure

Credit Suisse observes an increase in the number of Australian companies that are restructuring. Many of the candidates are the types of stocks that previously performed well during earnings expansions and are low-valued. They are also under-earning and cyclical, the broker observes. Successful execution of the restructuring should be yet another reason why they may outperform.

In 1999 only 15% of the ASX 200 reported a restructuring expense while Credit Suisse notes, in 2016, more than 25% did. The broker observes that, over the last 20 years, the pace of restructuring accelerated after poor years for the equity market and slowed after buoyant years.

Around 50 companies are reporting a restructuring expense in 2016. The broker lists 17 restructuring candidates for 2017 and they trade on a median price/earnings ratio of 14, a distribution yield of 4.6% and a free cash flow yield of 7.1%.

The 17 trade at a discount to the market but are expected to be considerable growers of free cash flow. Unlike previous years this list is underweight commodity companies.

The dominant theme of the current restructuring is "post-acquisition cost synergies". The list includes ANZ Bank ((ANZ)), Aurizon ((AZJ)), Automotive Holdings ((AHG)), Boral ((BLD)), Crown Resorts ((CWN)), Computershare ((CPU)), Fairfax Media ((FXJ)), Henderson Group ((HGG)), IOOF ((IFL)), JB Hi-Fi ((JBH)), Metcash ((MTS)), Myer ((MYR)), Origin Energy ((ORG)), Speedcast ((SDA)), Treasury Wine Estate ((TWE)), Vocus Communications ((VOC)) and WPP AUNZ ((WPP)).

Cobalt

2017 may be the year when cobalt hits the spotlight. Macquarie observes prices have accelerated to levels last seen in 2011 and, with demand from the recovery in the portable electronic sector and supply growth stagnant, this price rise can be fundamentally justified.

China has almost no domestic supply and is highly reliant on the Democratic Republic of Congo for its cobalt. Moreover, the prioritisation of higher quality battery development by the Chinese government may open up the new energy vehicle market to greater cobalt penetration, the broker contends. There are still risks, both technological, in terms of demand, and geopolitical, in terms of supply.

Macquarie observes cobalt tetroxide prices in China have roughly doubled in RMB terms since mid-2016 which suggests battery demand has been improving. Part of this may be to do with a wider industrial recovery, as cobalt has always tended to benefit from a maturing of such recoveries, when the industrial consumer is feeling more confident.

Cobalt is distinct among peer metals in that roughly half of current consumption is in battery manufacture. While lithium is often thought of as the key battery material, this sector only accounts for around one third of total demand and may only reach cobalt's current levels on a 5-10 year view, Macquarie notes.

As in many other markets, cobalt has limited new supply coming on stream. Refined output in countries such as Australia, Russia and Zambia are well down on levels a decade ago.

The reliance on the DRC, a country where geopolitical risk is rising after a period of relative stability, is also dependent on the copper price, as much of the DRC cobalt supply comes as a co-product with copper.

With a steady down-trend in copper prices until October last year investment in the DRC was limited and certain existing assets sustained supply declines. DRC copper output has been stagnant for the past three years and 2017 is expected to continue this trend. Macquarie expects some growth in 2018-19.

The broker believes the fundamental outlook for cobalt is improving in 2017 and a sustained deficit and draw-down on stocks is expected through to the end of the decade.

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Less Buzz For Capilano Honey

First half results for Capilano Honey were subdued after years of strong earnings growth, as the company invests in new product.

-Stronger second half expected with greater contribution from manuka JV -Margin improvement expected in the shift to higher value honey -Yet, near-term growth likely to be constrained domestically

By Eva Brocklehurst

There was less buzz in Capilano Honey's ((CZZ)) first half, after years of strong earnings growth, as the company invests in new product. The result was clouded by a move to net pricing, which reduced rebates and overall revenue when compared to the previous corresponding half.

The company made a $2.1m profit on the sale of its bee-keeping operations. The company also incurred $1.3m in extra costs associated with the new honey product, Beeotic, a prebiotic honey. Still, initial sales of Beeotic to China helped boost overall sales to that region by around 87%.

The balance sheet was assisted by an equity raising and asset sales in the half and, in line with the board's policy of only paying annual dividends, no interim was declared.

Morgans expects a stronger second half because of the scaling of the Beeotic sales and a greater contribution from the joint venture in manuka honey. Because of lower sales and increased investment across the business, Morgans downgrades FY17 and FY18 net profit forecasts by -12.7% and -18.9% respectively.

The broker still expects solid earnings growth over the next few years because of the increasing demand from consumers for honey and the benefits from selling higher-margin honey products, as well as rising exports.

Morgans now values the stock at $18.95 a share, down from $23.50, using a blended valuation methodology and focusing on FY18 multiples. The broker applies a small discount to the stock, given it has a materially smaller market capitalisation with lower liquidity. The broker retains an Add rating.

Compared to peers, Morgans considers Capilano Honey is attractively priced. It is a household brand and a market leader in a high-margin, growth category. The broker also believes Capilano Honey warrants corporate appeal, noting the full price that Bega Cheese ((BGA)) is paying for Vegemite, a similarly well-known Australian brand.

Next Six Months Challenging

The first half result was marginally below Canaccord Genuity's expectations, characterised by greater competition in the domestic market and lower export sales. However, Canaccord Genuity believes longer term growth will be supported by the manuka joint venture with Comvita and by Beeotic.

Revenue growth was pleasing given the greater level of supply domestically, which also put more product in the hands of competitor Beechworth. Capilano Honey is envisaged maintaining its market share.

International sales were down 23%, affected by the exit from some low-margin industrial business. The company has plans to re-direct this product to branded sales, which the broker notes has been a successful strategy to shift the mix in the past. Margin improvement has been a factor in the continued shift in mix away from bulk products and the push into higher value honey.

Canaccord Genuity expects the next six months will be challenging from a growth point of view as domestic sales represent over 80% of revenue and competition is likely to increase. Longer term, the company is expected to benefit from its initiatives in export markets

The broker previously applied a premium to the stock but with near-term growth constrained, believes a market multiple is now more realistic. As the near-term outlook is benign the broker reduces its target to $17.23 from $20.22. Hold rating retained.

Forecasts for earnings per share in FY17 and FY18 are revised down -6% and -10% respectively. Should some of the growth initiatives materialise in FY18, the broker believes there is upside to its estimates, which are yet to include specific benefits from the joint venture with Comvita.

Canaccord Genuity (Australia) received fees as joint lead manager and underwriter to the entitlement offer from Capilano Honey in June 2016.

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ASX200: Upside Restored

By Craig Parker, asset manager, Moat Capital

Perhaps instead of looking at charts we should be watching the Trump twitter feed to get an idea of the direction of markets. This week was a slightly downward move with not a lot of action. With payroll reports coming out in the US overnight we will get a better idea of the direction. Perhaps the counter trend I mentioned a couple of weeks ago, is going to head down between the 5500 and 5600 level before resuming the overall uptrend. Our market is now getting closer to the 60-day moving average (blue line) and if it happens to break through this level I would be looking for support around the 200-day moving average (red line).

When viewing our market through the weekly chart we are still in counter trend mode and will likely be this way for the next week or so until an up range is confirmed. On the other hand, if investors take the payroll reports as good news [it was - Ed] then we will most likely head back up towards the 6000 level, lest further Trump geo political tensions. Definitely keep an eye on our 60-day moving average for a break. A lot will depend on the news out of the US tonight. Taking a quick look at the S&P 500 weekly chart you will notice some bearish divergence on the RSI indicator and the MACD indicator seems to be peaking. If the US market does happen to continue its advance it will be very overbought from a technical perspective and caution will be required in the coming months.

ASX200 daily

ASX200 weekly

S&P500 weekly

Authorised Representative Sentinel Private Wealth AFSL 344762

www.moatcapital.com.au

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Resources Carrying Most Growth Momentum

In This Week's Weekly Insights:

-Resources Carrying Most Growth Momentum -Temporarily Out Of Fashion: All-Weather Performers -Count Down To New Era For FNArena -Rudi On TV -Rudi On Tour

Resources Carrying Most Growth Momentum

By Rudi Filapek-Vandyck, Editor FNArena

The Australian share market has opened the new calendar year on the back foot.

The Trump-inspired rally has largely ran out of puff as the world's focus shifted from a potential new Reagan-esque policy regime to the more darker characteristics of the populist, self-indulgent, non-conformist, erratic personality that is now the Leader of the (Free) World. (Ahem).

Australian bank shares trading well above stockbrokers' price targets (see Stock Analysis) without a commensurate improvement in analysts' forecasts hasn't helped either, nor does the fact that Chinese authorities might be reining in excessive liquidity in their domestic economy.

Further weighing upon sentiment is most early corporate reports haven't been that flash -think GUD Holdings, James Hardie, Virtus Health- while a number of others surprised with an unexpected profit warning. Brambles ((BXB)) might not be everybody's favourite in today's share market, but it still is a Top20 member, and supposedly a more defensive and reliable option with low risk of a sudden negative shock announcement.

Combine Brambles with Aconex ((ACX)) and GBST ((GBT)) and we already have what might well be the early beginnings of potentially a negative narrative for the whole of February: are political uncertainty and risks in countries such as the UK and USA weighing upon corporate spending intentions?

Add worse than expected economic data (see the latest update on retail spending in Australia) and it probably should not surprise price action coming out of January and leading into the second week of February has been rather lethargic. The gusto and confidence from late 2016 have left the stage, or so it seems.

Positive surprises from CSL ((CSL)) and ResMed ((RMD)) have not been sufficient to offset the negatives.

Here and there strategists have started to mutter: better to reduce exposure to equities. Thus far, quantitative analysts at Credit Suisse have warned loudest. They see "heightened risk of an impending protracted market correction".

Best Profit Prospect In Years

The somewhat lackadaisical market sentiment leading into the February reporting season stands in sharp contrast with the hefty profit upgrades by analysts over the past four months. Depending on whose numbers we take as guidance, average profit growth (EPS) for the Australian share market this financial year increased over that brief period from a mere 6-7% to between 13-19%.

If these numbers still stand by the end of August, the Australian share market might well be about to experience its strongest year for profit growth post-GFC.

Note: a big chunk of this growth won't show up until the August reporting season, but even so the underlying trend is firmly upwards and by then the average might well be a lot higher.

The downside to all of this is that virtually all of the increases in forecasts have occurred in the resources sector and in the resources sector only. The banks, for example, have not enjoyed any noteworthy uplift in forecasts. Their risk profile has improved somewhat, predominantly because Basel regulations might be pushed further out or abandoned altogether.

According to some analysts, bank management teams might anticipate better margins for the second half, which would certainly please investors. It will also further fuel the emphasis on the second half, as will be the case for iSentia ((ISD)), for Vocus Communications ((VOC)) and for a large group of other companies that will be extra-scrutinised this month for any indications about what can reasonably be achieved between now and late June.

As per usual, the largest gains and losses will be for those companies whose financial report genuinely surprises. Which means most among us are unable to predict these events beforehand (it cannot be a "surprise" otherwise). Feedback from the local funds management industry is that many portfolios have been de-risked in recent weeks. Everybody wants to avoid holding the next Aconex when yet another negative surprise hits the ASX website.

This explains the rather erratic price action for many medium sized, high PE industrial stocks leading into February.

General Themes This February

It is likely the dominant question asked by investors this month will be: what are mining companies going to do with all that cash that is flowing in? It was only twelve months ago market speculation was focused on who might be next to go out of business. Today expectations are rife about which company might be handing back cash to shareholders.

Rio Tinto is widely speculated to potentially announce a $3bn share buy back this month, even though a conservative board might wait until August. Maybe a firm hint might do the trick, for now?

BHP Billiton is still carrying too much debt, but others might soon be in a similar position as is the cash luxury at Rio Tinto. Think South32, Whitehaven Coal ((WHC)), and others.

Another big change is a reversal of momentum among supermarkets. Analysts are warming towards the idea that Woolworths is taking back market momentum from Coles. Recent price action for Woolworths and Wesfarmers ((WES)) shares is reflecting this.

General momentum for retailers is, once again, murky at best. Expectations are that electronics sales continue to do well with potential for JB Hi-Fi ((JBH)) and Harvey Norman ((HVN)) to come out better than market expectation, but otherwise retail remains a sector filled with minefields, as has been the case for quite some time now. Profit warnings by the likes of OrotonGroup ((ORL)) and Shaver Shop ((SSG)), as well as unlisted apparel shops going into administration do not set a positive tone beforehand.

Former yield investor darlings Transurban ((TCL)) and Sydney Airport ((SYD)) are expected to release strong earnings reports. Too bad general sentiment remains against the sector on expectation of prolonged rallies in government bond yields later in the year.

Stocks mentioned as likely candidates to release a negative surprise include Automotive Holdings ((AHG)), CSG Ltd ((CSV)) and Flight Centre ((FLT)).

The Brokers' Picks

Every reporting season triggers confessions and predictions from stockbroking analysts about who is their sector favourite and who's seen as most likely to disappoint. This exercise always opens up some spectacular misses. Brambles pre-profit warning was Deutsche Bank's sector favourite while stockbroker Morgans not so long ago had Bellamy's ((BAL)) among its Conviction Buy ideas.

Yes, there was also a lot of conviction at Morgan Stanley behind the outlook for Aconex, but that has been extensively reported upon elsewhere.

In many unreported cases stockbroking analysts do get it right, and below are some of the snippets published recently.

Credit Suisse believes JB Hi-Fi is likely to outperform market expectations, as should Myer ((MYR)), while Flight Centre might not disappoint just yet given the heavy skew to H2 in this financial year's guidance.

Over at Morgan Stanley, strategists have updated their "Australia Sustainable Leaders Conviction List'" by removing ResMed post earnings surprise and subsequent share price response. No additions were made so the selection consists of: ASX Ltd ((ASX)), Westfield ((WFD)), AMP Ltd ((AMP)), Dexus Property ((DXS)), Insurance Australia Group ((IAG)), Investa Office Fund ((IOF)), Orora ((ORA)), Sonic Healthcare ((SHL)), Spark New Zealand ((SPK)), Sims Metal ((SGM)), Mirvac ((MGR)) and Henderson Group ((HGG)).

Deutsche Bank analysts are not too keen on Brexit exposures and prefer to remain cautious towards companies relying on consumer spending in Australia. They note for offshore-exposed industrials the tailwind of a weakening AUD is abating.

Deutsche Bank suspects a potential upside surprise from Amcor, Fletcher Building ((FBU)), Harvey Norman, JB Hi-Fi, QBE Insurance ((QBE)), Rio Tinto, Star Entertainment ((SGR)). Potential downside surprise might stem from REA Group ((REA)) and/or from WorleyParsons ((WOR)).

UBS is not expecting any fireworks from the general insurers but suggests companies could surprise with a better than anticipated outlook/guidance. A similar scenario is thought possible for Computershare ((CPU)). For both IOOF ((IFL)) and Perpetual ((PPT)) the risks are seen as to the downside.

UBS strategists much prefer international growth stories, preferably with US exposure, albeit selected consumer discretionary names are expected to perform strongly this month. They like Harvey Norman, Super Retail ((SUL)) and Costa Group ((CGC)).

The strategists added Boral ((BLD)), Computershare, Origin Energy ((ORG)) and Woolworths to their Model Portfolio, having removed Brambles, Caltex Australia ((CTX)), Healthscope ((HSP)) and Incitec Pivot ((IPL)).

The Top Ten of most Overweight positions held by the UBS Model Portfolio are: Aristocrat Leisure ((ALL)), BHP Billiton, BlueScope Steel ((BSL)), Boral, CSL, Harvey Norman, Lend Lease ((LLC)), Orora, ResMed and Stockland ((SGP)).

Stockbroker Morgans has now removed GBST from its High Conviction List. Still on the list are: Westpac ((WBC)), Orora, South32, ResMed and ALS Ltd ((ALQ)) from the Top100 and from outside the Top100 Evolution Mining ((EVN)), Corporate Travel ((CTD)), Speedcast ((SDA)), Kina Securities ((KSL)), Catapult Group ((CAT)) and Impedimed ((IPD)).

Shaw & Partners advocates a cautious ("neutral to underweight") balanced portfolio weighting towards the Australian share market. The stockbroker recently communicated to its clientele "The spectre of rising long term interest rates, potentially harmful trade policies emanating from Washington, event risk around reporting season as well as the cocktail of geopolitical risk from Brexit to the EU makes us nervous".

The recent model portfolio update saw the removal of both Telstra ((TLS)) and Westpac and the inclusion of QBE Insurance and Northern Star ((NST)).

FNArena is publishing daily updates on the impact of corporate results on stockbroker ratings, valuations and forecasts. See website.

Temporarily Out Of Fashion: All-Weather Performers

One year ago today, share market indices were tanking and it appeared a genuine prospect financial markets were repeating the 2008 experience. It had been reported the start to fresh calendar year 2016 was the worst ever on record and records kept go back more than one hundred years.

The experience from the FNArena/Vested Equities All-Weather Model Portfolio was nowhere near as bad. At that time, owning stocks outside financials and resources stocks proved a true blessing.

The double edged sword of investing in a small share market like is Australia's, is that one's portfolio does not have to imitate whatever is happening with the highly concentrated ASX200 or even the All Ordinaries. Hence twelve months ago we missed out on the gut wrenching moves to the downside that put the fear into so many investor hearts.

Twelve months later, the Model Portfolio still is not mimicking the major day-to-day moves that characterise Australia's key market indices. But this time we are not benefiting as such. This time we feel the neglect as investor focus has narrowed to a small group of stocks only, with little attention (if any) for anything outside miners, energy producers, engineers and contractors, and, yes, the banks.

To put it in simple parlance: it's a raging bull market for resources and for financials, but it's an annoying bear market for most of the rest in the market. This also happens to be the main message of my latest book, Who's Afraid Of The Big Bad Bear?, available via Amazon and other channels, but paying subscribers at FNArena receive a free copy as a bonus.

As I argue in the book, and as remains on display in the Australian share market every day, price action and investor attention show a lot more gusto when it comes to the likes of Rio Tinto ((RIO)), Fortescue Metals ((FMG)) and South32 ((S32)), even though prices have pulled back lately, in comparison with, say, CSL ((CSL)), Amcor ((AMC)) and Bapcor ((BAP)).

Not that there's anything wrong with the latter three. Profit growth should be healthy, as has been the case in years past, and the upcoming reporting season should provide more evidence of this. CSL already proved the doubters wrong with an upgrade to guidance last month. It was a Big Upgrade, mind you.

But right now the market narrative does not fit in with these solid, reliable All-Weather Performers. I could potentially write yet another book about the virtues of owning such stocks for the longer term, it won't change the fact that Australian and global investors, right now, are simply not interested.

Post CSL's positive market surprise, I spotted a twelve month price target of $138.50 for the stock, issued by CLSA who maintains the company's performance, as well as the shares remain poised to outperform market expectations. This is well possible, but market sentiment will have to change dramatically before CSL shares can even remotely think of rallying that high this year.

CSL's "disadvantage" in the present market context is that, even on CLSA's upgraded market expectations, the company is only projected to grow earnings per share (EPS) by 22% this financial year and by 14% in each of the two following years. Market consensus sits at 11% this year, followed by 17%. (see Stock Analysis).

Mining companies like BHP Billiton ((BHP)) and Rio Tinto are offering much higher growth, still at cheaper valuations, and with an in-built promise of more upgrades to follow because analysts still are not using today's spot prices in their modeling.

Understand this dynamic and thou shalt not find it difficult to see why investor focus is on BHP and not on CSL, on Rio Tinto and not on Amcor, and on Fortescue Metals and not on Bapcor.

It is not a rejection of high quality, high performing industrials in an absolute sense. It's a relative preference for the Champions of today, with little room left for anything else.

Note that on my observation, many stocks of the second category continue trading below the 200 moving average and in case of a short term rally, as occurred in December, share prices are rejected to the downside whenever they attempt to climb above the trend line.

Share prices for BHP, Rio Tinto and the likes are trading well above the 200MA. They could potentially experience a serious correction and they would still be on the right side of the demarcation line between being in a bull or bear market.

Such is the present set-up for Australian shares and it's anyone's guess as to how long exactly this extreme bifurcation in market dynamics can last. Today's market also forces investors to make up their mind: what kind of investor are you? What kind of investor do you want to be?

For instant gratification, there's probably none to be found short term among the CSLs, the Amcors or the Bapcors. But if my assessment is correct, and these companies continue doing what they've been doing for years, then investor interest will return, exact timing unknown.

I remain confident the key constituents of the All-Weather Model Portfolio still offer many more years of excellence, and of shareholder rewards, though the short term might not offer much at all, within the general context as is.

For more information about the FNArena/Vested Equities All-Weather Model Portfolio, send an email to info@fnarena.com

Also: if you are a paid subscriber, and you haven't received your copy of Who's Afraid Of The Big Bad Bear?, ask for your copy via the same address and we'll send it to you via email.

Count Down To New Era For FNArena

It's quite frankly impossible not to show any excitement when looking forward towards the one event that is going to change the future here at FNArena: the launch of the new website.

I have been talking and writing about it for quite a while but, assuming no unforeseen obstacles from left field occur this week, next weekend (Feb 11-12) should mark the death of the old website and the birth of the new one. Let the count down begin!

To all you loyal subscribers who have been with us for many, many years: prepare for something completely different.

It goes without saying, we think we are about to present a much better product and service, with more bells and whistles, better access, upgraded presentation, new tools and additions, but above anything, the new approach I've chosen is very different from the current style and set-up.

To assist you all with finding your way post the switch to the new website, here's a brief guide to the New FNArena:

-Firstly, the new website adapts to mobile phone and other devices smaller than your standard desktop pc. We've come up with some nifty adjustments to make sure it all fits and works, so you can now read FNArena content while on the bus, train, at the airport, near the beach, or wherever you want to stay in touch with the latest broker updates or Tweets from yours truly.

-We have significantly upgraded the search and research capabilities on the website. Make sure you put a few company codes in the improved Search Engine and check out FNArena Windows where more than 400 ASX-listed stocks are grouped together with peers and competitors in modern sector allocations (no more Amcor with Rio Tinto in the same Materials basket, etc).

-A dedicated page for research and updates on All-Weather Performers (only accessible for paid subscribers).

-One exclusive section for paid subscribers to download Special Reports and Bonus Publications, like my recent book "Who's Afraid Of The Big Bad Bear", as well as all Powerpoint slides from my presentations since 2008.

-Much clearer segmentation and presentation of daily news content. All news stories carry price charts of the listed stocks mentioned.

Of course, all your favourite items are still there; the Australian Broker Call Report, Stock Analysis, Rudi's Views, The Overnight Report,... They've all been upgraded and should be much easier to access, to use and to find. The same applies for add-ons including The Icarus Signal, R-Factor and FNArena Sentiment Indicator.

I have little doubt this new website is going to shock most among you: we have even more content than you thought we had. And it now comes in a much easier to digest format.

I hope your enthusiasm, once the new website is up and running, is able to match mine. Cannot wait to read your responses and feedback. Note: this is an important step for FNArena, but it is by no means the end of our path forward. By all means, if you have an idea for improvement, tell us. If you don't like some of our changes, we like to hear that too.

Info@fnarena.com

The count down starts now...

Rudi On TV

This week I shall appear twice on Sky Business on Thursday. First from 12.30-2.30pm and later again on Switzer TV, between 7-8pm.

On Friday I shall skype-link with Sky Business to discuss broker calls at around 11.10am.

Rudi On Tour

I am sending today's email from Perth where I shall present to local members of Australian Shareholders Association (ASA) and Australian Investors Association (AIA) on Tuesday around noon and from 7.30pm onwards, respectively.

(This story was written in Perth on Monday 6th February 2017. 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 Editor Direct on the website).

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-Who's Afraid Of The Big Bad Bear? Chronicles of 2016, a Veritable Year Extraordinaire

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